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2nd Quarter Market and Economic Update

July 12, 2023

"In investing, what is comfortable is rarely profitable." - Robert Arnott, Research Affiliates
"The markets do whatever they have to do to frustrate the most people." -An old Wall Street adage

Happy summer! Coming into this year, widespread pessimism concerning financial markets was the norm. The Bloomberg survey of 25 Wall Street strategists showed the consensus forecasting a negative return for stocks in 2023, for the first time since its inception in 1999. This was understandable considering that 2022 was one of the worst years ever for both equity and credit markets.

In spite of, or perhaps because of, this extreme pessimism, equity markets rallied smartly during the first half of the year. Clients and readers of my letters know that I always shy away from taking any forecast, including my own, very seriously. It is good to have a working thesis on what may happen, but the first half of 2023 should remind us that forecasting the future and investing solely in that forecast is a fool's errand. Another thing many know is that I tend to be a contrarian at heart. Thus, I took a more sanguine view of this year than most in my 2022 year-end letter. In that letter I said, "*For the first time in quite a while, I am seeing great companies trading at good-to-great prices*." Further, while saying that I had no idea where markets would go in 2023, I did state the following: "*I believe that 2023 will prove to be a better year for financial markets than many are predicting*." So, it looks like I did well with my outlook. Why not start taking my own forecast more seriously? Because I could still end up being very wrong; we've got half the year to go, including the traditionally weakest period of the year for markets (August through October). Also, as we saw again with the bank failures earlier this year, risk happens fast. As the old Wall Street adage above suggests, markets don't care what anyone thinks, least of all me. We will continue to focus our energy on finding good long-term investments, at hopefully good-to-great prices, while continuing to let our research partners help us to navigate the increasingly complex macro environment.

As the quote from Mr. Arnott says, being comfortable in your investment could be contrary to that investment being profitable. This is something I'm keenly watching for now: too much comfort and complacency on the part of investors. That was a major problem at the end of 2021. Coming into this year, the comfortable position was to have more cash on hand and less money in equities, particularly large-cap technology stocks, for they led the market lower in 2022. Well, guess what has performed best so far in 2023? You guessed it, large-cap technology. Last year's top performer was energy; this year, energy is one of the worst, posting a negative return through the first half of the year. Again, the market will do what it must to frustrate the most people. As Charlie Munger says, "*Investing is simple, but it isn't easy*."

One of the things which concerned me as the market advanced was the lack of participation across the equity spectrum. In other words, the breadth of the market was terrible through the end of May, as only three of eleven sectors were positive on the year. The equity market rally was being led by a small number of large-cap growth stocks. Thankfully, the market advance started to broaden in June as all eleven sectors were positive for the month. Equity markets are healthiest when participation is broad, so this has been a welcome development. As for the credit (bond) and commodity markets, they were mixed. Yields have stayed in a range, more or less, which led to positive returns from bonds, while commodities as a group struggled and ended the first half lower, with a couple of exceptions. That said, with rates where they are now, bonds may present an attractive option in certain circumstances, while supply shortages may provide the necessary environment for improved commodity performance. As always, we will look for opportunities.

In case you are wondering, I have absolutely no idea how the second half of this year will go for any asset class or the economy. Inflation has come down as most thought, but it does appear to be stickier in certain spots than many thought would be the case. Thus, while the Fed left rates unchanged at their last meeting, I wouldn't be surprised to see them raise rates at their upcoming meeting toward the end of this month. By all indications, a recession is still not imminent, which is one reason I was more sanguine as we started 2023. However, there are signs that the global economy is slowing. With China's growth easing, the aforementioned sticky inflation (services sector), and credit conditions tightening, the back half of this year could be more challenging. Then again, we will let our models and indicators guide our investment decisions.

If time permits, I will try to put out a special update later this summer to answer some broad financial and economic questions posed by clients. Meanwhile, please be on the lookout for a separate mailing, which details changes Pershing is making with regard to non-electronic communications.

I hope you and yours are healthy and enjoying a wonderful start to the summer. Please let us know if there is anything we can do for you. We're always here to help. From all of us at HFA, thank you for your trust, confidence, and loyalty. It is a joy and a privilege to work with you and your family.

Best wishes,

Harvey E. Hutchinson IV
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