Market Outlook
Second Quarter 2023

RPA
RETIREMENT PLAN ADVISORS
THE FUTURE IS BETTER THAN YOU THINK

MARKET SNAPSHOT

U.S. equity markets rallied strongly in the second quarter, but much of the market's gains this year have been concentrated in 6-7 mega-cap tech stocks.

The Federal Reserve opted not to hike interest rates at its June 14 meeting, the first time in the last 10 FOMC meetings that it did not hike interest rates.

We expect the Fed to remain hawkish with 1-2 more interest rate hikes this year, barring any unforeseen events or economic downturns.

We remain cautious, as a number of recessionary signals continue to flash red, and we prefer higher-quality stock and bond portfolios to cushion the potential impact of an economic slowdown.

Despite these concerns, the technical backdrop is favorable for equities and we certainly could continue to see strength, though we know not to chase performance.

Market Recap

Global equities continued to rally in the second quarter, led by surging U.S. mega-cap technology and growth stocks, particularly anything related to artificial intelligence (AI).

The S&P 500 index gained 6.6% in June and 8.7% in the second quarter, driving its year-to-date return to 16.9% overall. The technology-heavy Nasdaq Composite has driven the majority of returns in U.S. stocks, rising over 13% in the second quarter and 32% year to date.

Outside the U.S., stocks in Europe and emerging markets have also posted solid results. Developed international stocks (MSCI EAFE Index) rallied 4.6% in June, gaining 3% for the quarter and 11.7% YTD. Emerging-market stocks (MSCI EM Index) rose 3.8% in June, resulting in a 0.9% gain for the second quarter and a 4.9% return YTD.

Moving to the fixed-income markets, core bond returns (Bloomberg U.S. Aggregate Bond Index) were slightly negative for the quarter as interest rates slightly rose and prices fell. The benchmark 10-year Treasury yield ended the second quarter at 3.8%, up from 3.5% at the end of March. Riskier high-yield bonds (ICE BofA U.S. High Yield Index) gained 1.6% for the quarter and are up 5.4% YTD. Municipal bonds (Morningstar National Muni Bond Category) were generally flat on the quarter and up 2.3% YTD. Actively managed flexible/nontraditional bond funds (Morningstar Nontraditional Bond Category) gained around 2% and are up over 5% for the year.

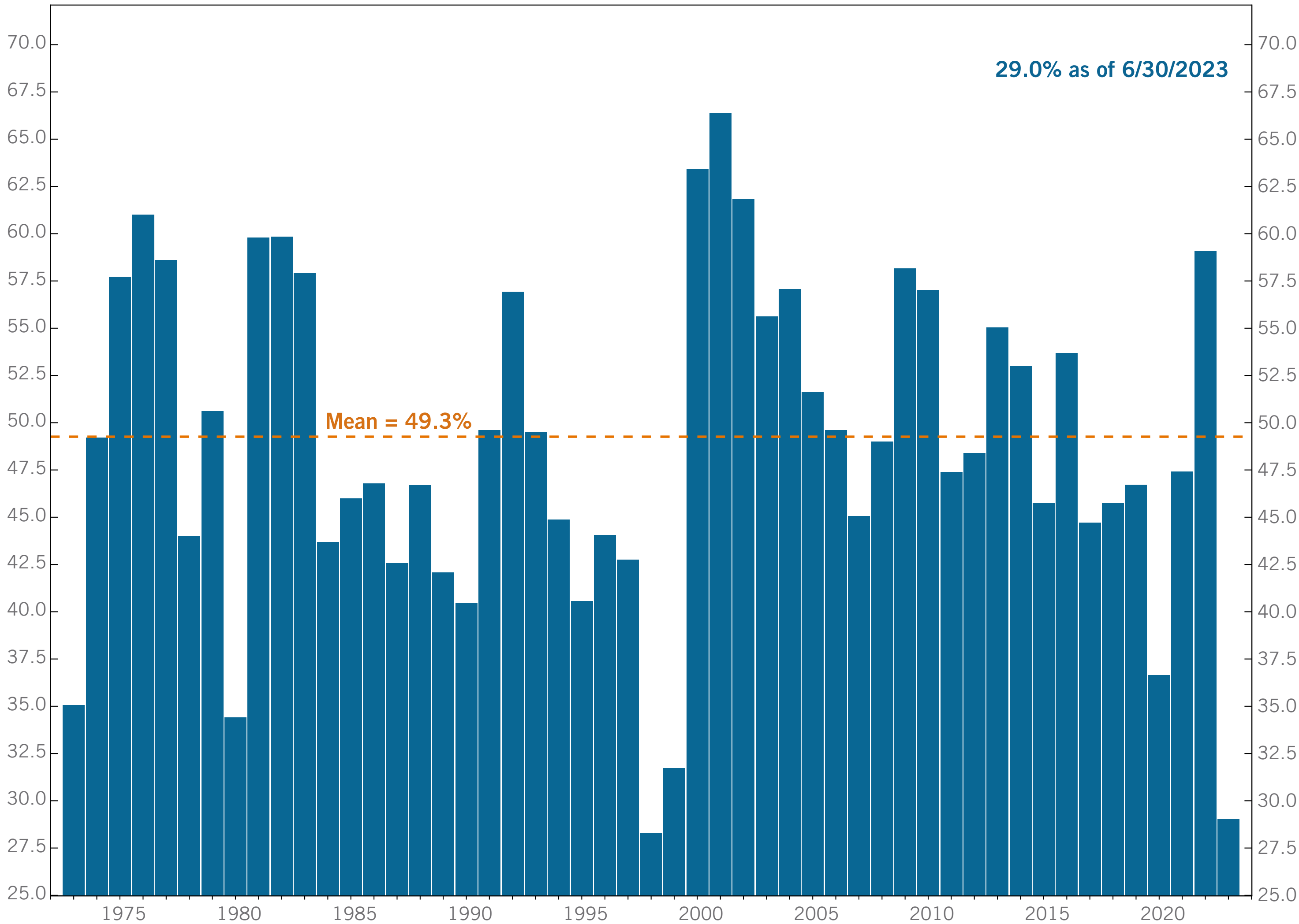
Finally, multi-alternative strategies (Morningstar Multistrategy Category) and managed futures (SG Trend Index) underperformed stocks but outperformed core bonds for the quarter. Trend-following managed futures had a strong rebound after a tough first quarter, gaining around 8%.

The Narrowest Stock Market in at Least 50 Years

The market-cap-weighted S&P 500 Index's rally this year has been one of the narrowest on record, with less than 28% of the index's constituents beating the overall index return. As shown in the Ned Davis Research (NDR) chart on the following page, in an average year approximately 49% of the index's 500 companies beat the overall index. (The only other year comparable to this year was 1998, as the tech/internet stock bubble was inflating. That didn't end well, but it took another 15 months before it started to burst.)

More granularly, with the sudden frenzy in all things AI, the average YTD return for Amazon, Google, Meta, Microsoft, Nvidia, and Tesla is 96%. The gains in these six mega-cap tech stocks are responsible for almost the entire S&P 500 return for the year. Moreover, the combined market cap of these six stocks plus Apple now comprises over 27% of the total index, the largest concentration in history for the top seven stocks.

The "Narrowest" Stock Market in at Least 50 Years:
Percentage of S&P 500 Stocks that Outperformed the S&P 500 over the Calendar Year



Mean excludes 2023 year-to-date value. Annual calculations use S&P 500 constituents as of calendar year end. 2023 year-to-date calculation uses S&P 500 constituents as of 6/30/2023. © 2023 NDR, Inc. Source: S&P Dow Jones Indices. Data as of 6/30/2023.

It remains to be seen whether this extremely narrow market rally resolves via the rest of the market catching up or the seven companies mentioned above "catching down," but improved market breadth would be a positive indicator for the market's continued bull run.

On a positive note, it appears the stock market rally is *potentially* broadening to other sectors and markets caps: the small-cap Russell 2000 index shot up 8.1% in June, while the large-cap Russell 1000 value index delivered similar gains of 6%.

Investment Outlook & Portfolio Positioning

The current macroeconomic data continue to send mixed signals. On the one hand, the U.S. economy has been more resilient than we (and many others) expected through the first half of the year. The economy has grown, albeit at a subpar rate. The labor market has remained very strong, supporting consumer spending, and headline inflation has dropped meaningfully thanks to a sharp decline in energy prices. On the other hand, key leading indicators of an impending recession are still flashing red, including a deeply inverted yield curve and tightening credit conditions, among others. Moreover, although the Federal Reserve paused its aggressive interest rate hiking campaign in June, core inflation (excluding food and energy) remains stubbornly high, with the Fed signaling it will resume rate hikes later this year, further raising the likelihood of a recession.

As we read the muddy economic tea leaves through our cloudy crystal ball, we maintain our view that a recession is the *most likely* outcome over the next few quarters. Historically, the odds are unfavorable for the economy avoiding a recession after the Fed has been aggressively tightening. And we have yet to see the full (lagged) impact of this cycle's monetary tightening on the real economy.

However, a near-term recession is not a certainty. Each cycle is somewhat different, and this one is considerably so due to the pandemic dislocations. Further, there have been three instances (out of 13) where the Fed tightening cycle ended without a recession. So a more benign near-term outcome is certainly possible, and the current growth and inflation trajectory is not inconsistent with that.

Just as the U.S. economy has been more resilient than expected in the face of aggressive Fed tightening this year, the U.S. stock market (S&P 500) has been as well—and then some—gaining nearly 17%. There are always multiple factors driving the markets, but we think the key drivers of this year's strength include the fact that the economy and corporate earnings have held up better than many expected, the markets' optimis, that the Fed will soon end its tightening cycle, and investor euphoria around artificial intelligence.

Specific to the last point, we'd argue that while it's likely AI will have a huge impact on society and the global economy, that doesn't necessarily mean the current AI stock frenzy is justified by these companies' underlying earnings fundamentals. It may be in some cases, but we also remember the tech/internet stock bubble in 1998-2000. The internet obviously has had huge economic impact over the past 25 years, but very few tech stocks were priced appropriately in early 2000.

As an example, a poster child for the current AI exuberance is Nvidia, a graphics chip maker used in AI applications. As of June 30, 2023, Nvidia stock is up over 200% this year, pushing its market cap over $1 trillion and into the top 10 largest constituents of the S&P 500. Nvidia has strong fundamental earnings growth potential, but its stock is currently trading at a trailing 12-month P/E ratio of 220x! (For comparison, the overall S&P 500 index currently has a P/E around 20x.)

Our view of the U.S. fixed-income market is slightly positive, as rising rates have resulted in attractive long-term total return opportunities within high-quality bonds.

For example, the yield on the core U.S. Aggregate Bond Index is currently around 4.7%. With inflation very likely to drop below 4%, core bonds are finally providing a positive real (after-inflation) yield. With a duration of about six years, the core bond index will generate strong price gains if interest rates fall during a recession, as we'd expect.

Closing Thoughts

While we believe a recessionary bear market is the most likely outcome over the next 12 months, there are reasons to believe it could be relatively moderate given the strength of the labor market, ample household savings, and solid corporate balance sheets.

As we extend our time horizon over the next five to 10 years, we see reason for optimism. Within the U.S. stock market, there are companies and sectors that are reasonably priced and offer attractive return potential. The fixed-income landscape is also attractive, thanks to higher yields and inefficiencies that can be exploited by skilled active managers.

As we look outside the U.S., we see a number of divergences in terms of the economic factors impacting various countries and regions. While a number of tailwinds to growth exist in areas such as Japan and India, other countries such as the U.K. and China are still grappling with high and sticky inflation. Valuations are more compelling outside the U.S., which could create longer-term opportunities, but we do expect to see divergent outcomes across countries and regions.

We're investors, not short-term market traders. Strong short-term market trends can trigger our emotions and make us want to act—either chasing (buying into) a rising market or fleeing from (selling) a falling one. That is not the path to successful long-term investment outcomes. In addition, we have exposure to disciplined trend-following strategies that complement our longer-term valuation-based tactical approach.

Successful investing requires a balance between offense and defense. Earning superior long-term returns requires one to take calculated risks when opportunities present themselves, and to exercise caution during periods of market exuberance. By maintaining a disciplined and balanced investment approach, we are well positioned to weather the inevitable market storms and capitalize on the opportunities that are sure to arise.

As always, thank you for your continued confidence and trust.

Best regards,

Retirement Plan Advisors

29 E. Madison St., Suite 500 | Chicago, IL 60602 | 312.701.1100

Market Indicators
Second Quarter 2023

RPA
RETIREMENT PLAN ADVISORS
THE FUTURE IS BETTER THAN YOU THINK

S&P Sectors

	QTR	YTD	1Y	5Y
S&P Technology Select Sector TR USD	15.44	40.44	38.27	21.65
S&P Financial Select Sector TR USD	5.33	-0.53	9.50	7.20
S&P Consumer Disc Select Sector TR USD	13.86	32.27	24.91	10.46
S&P Health Care Select Sector TR USD	2.95	-1.48	5.37	11.79
S&P Industrial Select Sector TR USD	6.49	10.19	25.16	10.52
S&P Cons Staples Select Sector TR USD	-0.02	0.71	5.54	10.62
S&P Energy Select Sector TR USD	-1.13	-5.45	18.08	6.62
S&P Utilities Select Sector TR USD	-2.53	-5.69	-3.68	8.24
S&P Real Estate Select Sector TR USD	1.81	3.79	-4.13	6.55
S&P Materials Select Sector TR USD	3.31	7.74	15.12	9.69
S&P Telecom Select Industry TR USD	-3.97	-4.27	0.73	2.73

Market Returns

	QTR	YTD	1Y	5Y	10Y
S&P 500	8.74	16.89	19.59	12.31	12.86
Russell Mid Cap	4.76	9.01	14.92	8.46	10.33
Russell 2000	5.21	8.09	12.31	4.21	8.26
MSCI EAFE	2.95	11.67	18.77	4.39	5.41
MSCI Emerging Markets	0.90	4.89	1.75	0.93	2.95
BBgBarc U.S. Agg Bond	-0.84	2.09	-0.94	0.77	1.52
High Yield	1.75	5.38	9.06	3.36	4.43

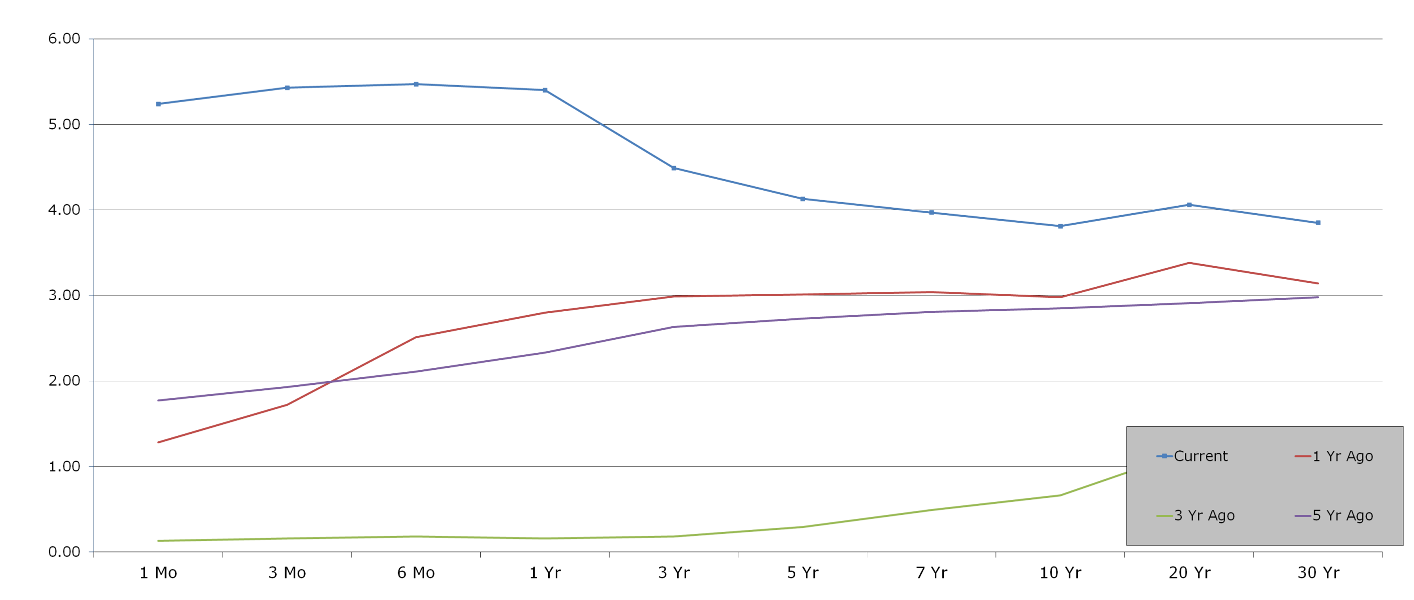
Value / Growth Returns

	YTD			Previous Calendar Year		
	Large	Mid	Small	Large	Mid	Small
Value	12.15	7.16	3.95	-5.22	-6.93	-12.73
Growth	21.25	10.44	7.02	-29.41	-18.96	-21.08

Index Characteristics

	LTM P/E	NTM P/E	Div Yld	Earn Yld
S&P 500	22.84	19.91	1.47	5.02%
Russell Mid Cap	16.94	16.80	1.50	5.95%
Russell 2000	11.50	13.28	1.51	7.53%
MSCI EAFE	13.96	13.38	2.18	7.47%
MSCI Emerging Markets	11.97	12.87	2.26	7.77%

Long-Term Outlook on Treasury Yield Curve



Source: Morningstar

29 E. Madison St., Suite 500 | Chicago, IL 60602 | 312.701.1100