DayMark
WEALTH PARTNERS

Market Commentary

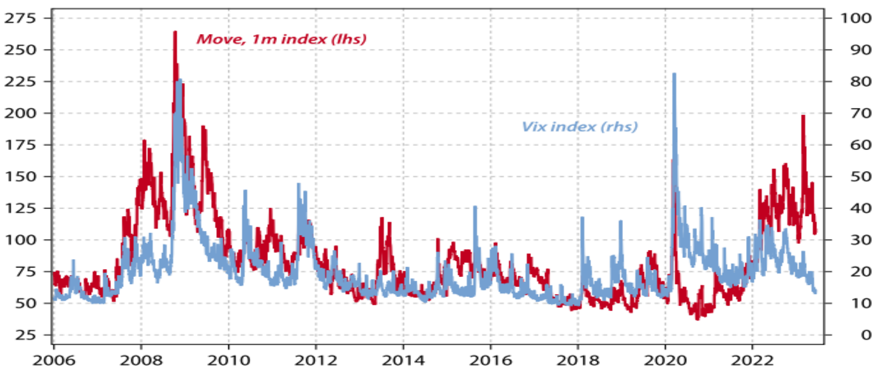
Glass Half Bull
Q3 2023

Recap of Q2 2023: US Officially in a Bull Market

US Stocks are officially confirmed to be in a Bull Market, with the S&P 500 rallying 20+% from the low on October 12th, 2022. As a reminder, stocks dropped -24% in the latest Bear Market that started on January 3rd, 2022 and lasted roughly 9 months. Recently, the S&P 500 has continued to post a series of "higher highs and higher lows", while trading above its 200-day moving average. The market's resilience has been impressive considering regional bank failures, fears of a US Recession, a disappointing China reopening, Debt Ceiling negotiations, and rising rates. As shown on the right, Bull Markets can last many years and typically are much longer than Bear Markets. Excluding the current Bull Market, the US has seen 14 different Bull Markets dating back to World War II – with a median return of 91%.

Volatility in the equity markets has remained surprisingly muted (as measured by the VIX). As a reminder, the Volatility Index (VIX) measures one-month expected volatility of the S&P 500 using the equity index options. The VIX index closed below 15 for the first time since February 2020, breaking a streak of 835 trading days! Meanwhile, the MOVE Index (which measures one-month implied volatility of US Treasury market) has remained elevated. This divergence between the VIX and MOVE is highly unusual. Bond market volatility could be contributed to the regional banking crisis or fears of a Government default, but these issues were either contained so far (Banking Crisis) or resolved (raising Debt Ceiling). Ultimately the Bond Market may be signaling concerns around inflation, further Fed tightening, and tight credit and lending conditions.

The divergence of equity and bond market volatility is highly unusual



History of S&P 500 Bull Markets (Post WWII)

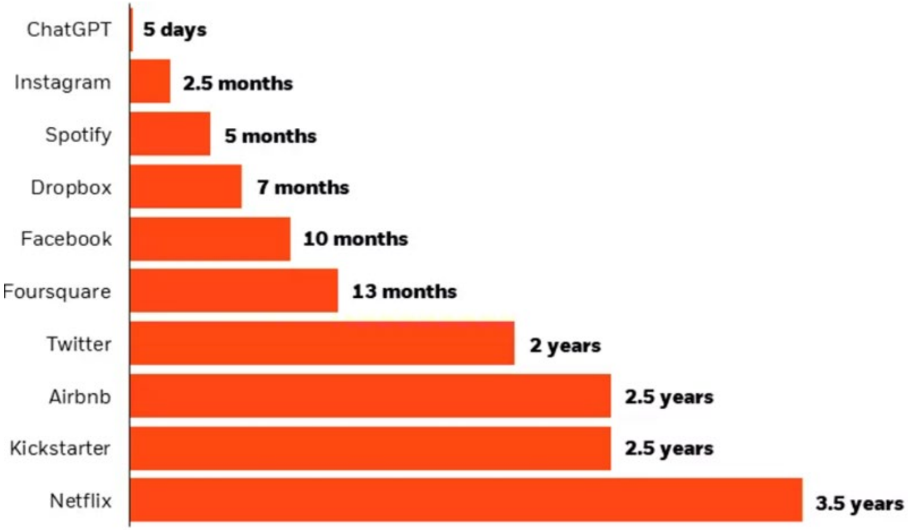
Start Date	End Date	Return	# of Days
5/19/1947	6/15/1948	23.9%	393
6/13/1949	8/2/1956	267.1%	2,607
10/22/1957	12/12/1961	86.4%	1,512
6/26/1962	2/9/1966	79.8%	1,324
10/7/1966	11/29/1968	48.0%	784
5/26/1970	1/11/1973	73.5%	961
10/3/1974	11/28/1980	125.6%	2,248
8/12/1982	8/25/1987	228.8%	1,839
12/4/1987	3/24/2000	582.1%	4,494
9/21/2001	1/4/2002	21.4%	105
7/23/2002	10/9/2007	96.2%	1,904
11/20/2008	1/6/2009	24.2%	47
3/9/2009	2/19/2020	400.5%	3,999
3/23/2020	1/3/2022	114.4%	651
10/12/2022	???	25.5%	261
Median		**91.3%**	**1,418**

Trust the Bull Market? Leadership Has Been Narrow…

Despite the Regional Banking Crisis, the Nasdaq continued to rally in Q2 and finished the first half of 2023 up 32.3%. The overall strength in Big Tech this year can be contributed to : 1) anticipation of a Fed "pause", 2) a flight to safety during the Banking Crisis, and 3) buzz around Artificial Intelligence. The introduction of ChatGPT in late-2022 opened investors eyes (and the entire world) to the potential of AI, particularly around productivity gains. ChatGPT was created by OpenAI and uses advanced language technology to create human-like responses, original ideas, and content. Once released, it reached one million users in just 5 days! This is faster than any other online application in history, including Instagram (2.5 months) and Facebook (10 months). The excitement propelled Growth stocks associated with AI, including Microsoft (who partnered with OpenAI) and Nvidia (whose GPU chips power AI).

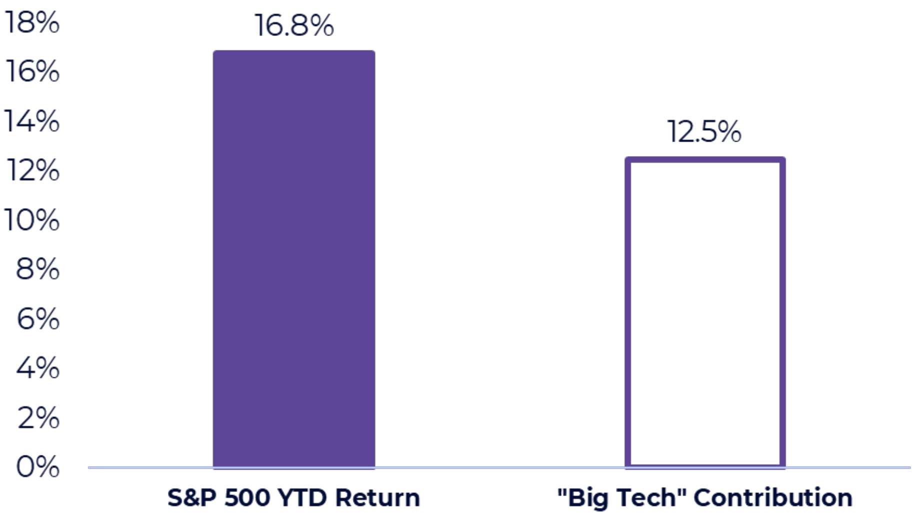
What has made this Bull Market so unique is the bulk of this year's S&P 500 returns have come from the seven largest Big Tech stocks (Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla, and Meta). In fact, these seven names accounted for roughly 75% of the S&P 500's YTD return (see below).

Online Applications: Amount of Time to Reach One Million Users



Source: BlackRock and Statista, with data from company announcements via Business Insider/LinkedIn, as of January 24, 2023. Kickstarted measured as one million backers. Airbnb measured as one million nights booked. Instagram measured as one million downloads.

YTD Returns: S&P 500 and Contribution from Big Tech



Source: Bespoke Invest
"Big Tech" Stocks: Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla, and Meta

Trust the Bull Market? The Rally is Broadening

Despite the narrow rally in the first five months of the year, we have seen bullish signs of the equity rally broadening in June beyond Growth names. For example, Large Growth surged 20.8% in the first five months of the year, while Large Value (-1.4%) and Small Caps (-0.1%) were negative. In June, Large Value (+6.6%) and Small Caps (+8.1%) both rallied. Most reassuring may be the June rally in sectors that are tied to either the strength of the consumer, such as Cons. Discretionary (+12.1%), or the health of the economy, such as Industrials (+11.3%). Meanwhile, more defensive sectors have underperformed in June, such as Consumer Staples (+3.2%) and Utilities (+1.6%).

Another positive note for equities - a strong first half historically leads to a positive equity returns for the remaining six months of a year. The chart to the right highlights calendar years where the S&P 500 was up more than 10% in the first half, and the corresponding returns in the second half. Of the 22 years that fit this criteria since WWII, the S&P 500 was positive in the second half of the year 18 different times, with median returns of 9.9%.

Source: Morningstar & Bloomberg

Asset Class	Jan-May 2023	June 2023	YTD
Large Cap	9.6%	6.6%	16.9%
Large Growth	20.8%	6.8%	29.0%
Large Value	(-1.4%)	6.6%	5.1%
Mid Cap	0.6%	8.3%	9.0%
Small Cap	(0.1%)	8.1%	8.1%
International Developed	6.8%	4.5%	11.7%
Emerging Markets	1.1%	3.8%	4.9%

Source: Morningstar & Bloomberg

First Half S&P 500 Returns >10% Bode Well for Second Half of Year

Year	First Half Returns	Second Half Returns
1954	17.7%	23.2%
1955	14.0%	10.8%
1958	13.1%	22.0%
1961	11.2%	10.7%
1967	12.8%	6.4%
1975	38.8%	(5.3%)
1976	15.6%	3.0%
1983	19.5%	(1.9%)
1985	14.7%	10.1%
1986	18.7%	(3.5%)
1987	25.5%	(18.7%)
1988	10.7%	1.5%
1989	14.5%	11.1%
1991	12.4%	12.4%
1995	18.6%	13.1%
1997	19.5%	9.6%
1998	16.8%	8.4%
1999	11.7%	7.0%
2003	10.8%	14.1%
2013	12.6%	15.1%
2019	17.3%	9.8%
2021	14.4%	10.9%
2023	16.9%	?
Median Second Half Return		**9.9%**
% of the Time Higher in Second Half		**81.8%**

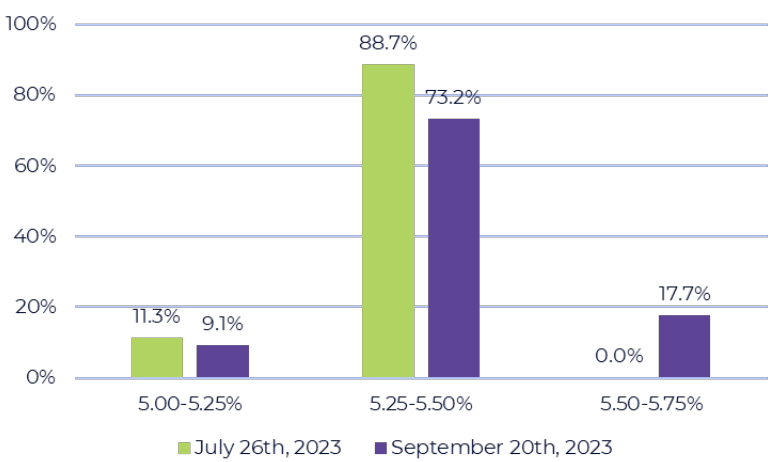
Source: Bespoke Invest & Bloomberg

Equities Historically Rally After the Last Fed Hike

As mentioned last quarter, equities historically have rallied after the last rate hike in a cycle. The Fed left rates unchanged in June for the first time since January 2022, after a streak of ten straight meetings with rate hikes. This is one of the longest streaks of consecutive rate hikes, with the record being 17 straight hikes in the early 2000s. Despite the “pause,” Fed officials all but indicated they expect 1 to 2 more rate hikes in 2023, with Fed Chair Powell noting the July meeting “will be live.” The reason for the temporary pause was due to the lagging effect on the economy when raising rates, and for Fed officials to monitor incoming data. Recently Powell has indicated policy “may not be restrictive enough.” If the Fed raises rates two more times, the Fed Funds Rate would reach a level of 5.50%-5.75%. According to the CME FedWatch Tool, the market is currently pricing in an 89% chance of a 25 basis point hike in July, but just an 18% chance the Fed will hike again in September (see below chart).

Despite projecting additional hikes, it appears the Fed is nearing the end of its rate hiking cycle. In looking at the past 30 years (going back to 1994), there have been five prior rate hiking cycles – including the current cycle. In the prior four cycles, equities rallied in the following 12 months after the last rate hike (except in 2000 during the Tech Bubble).

Fed Funds Rate Probabilities the Next Two Meetings



Source: CME FedWatch Tool, as of July 5th, 2023

S&P 500 Performance: One Year Before & After Last Rate Hike (%): 1994-2023

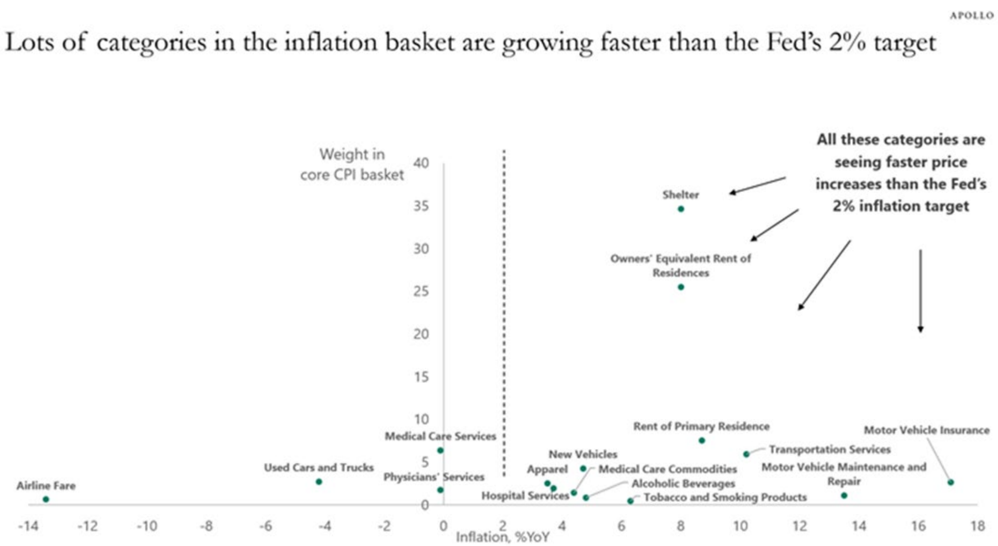
Source: Bespoke Investment Group and Morningstar

Remaining Forces Pressuring Inflation

CPI only rose 0.1% month-over-month in May, with the year-over-year figure dropping to 4.0%. Falling food prices and stable energy prices have contributed to the drop in CPI. Fears over oil shortages proved to be unfounded despite production cuts by OPEC+ (April) and Saudi Arabia (June). Despite CPI dropping from a high of 9.1% last June, Core CPI (which excludes food and energy) has remained stickier and caught the attention of the Fed. Last month, Core CPI rose 0.4% month-over-month and 5.3% year-over-year (from 5.4% the previous month). The Fed remains adamant that their Fed Funds Target is 2% and has signaled more demand destruction is needed to bring down CPI. One potential warning sign for Fed Officials is inflation re-accelerating, which the UK is currently experiencing.

Below we highlight the different components of Core CPI versus their year-over-year inflation rates. As shown, Shelter and Owners Equivalent Rent continue to exhibit the most upward pressure on inflation. New Home Sales recently climbed at the fastest pace in over a year and US Housing Starts soared over 21% in May. Motor Vehicle Repairs and Transportation Services have some of the highest inflation rates. In general, Services are less sensitive to interest rates and are still experiencing structural tailwinds after Covid.

Source: Bureau of Labor Statistics, Barron's, and Bloomberg



Data as of May 2023.
Source: Haver Analytics and Apollo Chief Economist

Other Factors Pressuring Inflation	
Labor Market	Remains far too tight, with the number of Job Openings over 10 Million and a ratio of 1.65 job openings/per unemployed person
Wage Inflation	A hot Labor Market leads to higher labor costs - Average hourly earnings (4.3%) now outpace US CPI (4.0%)
Household Savings	Households continue to spend excess savings from Covid
Fiscal Stimulus	Roughly $2 Trillion in government stimulus through the Infrastructure Investment & Jobs Act, the Inflation Reduction Act and the CHIPS Act

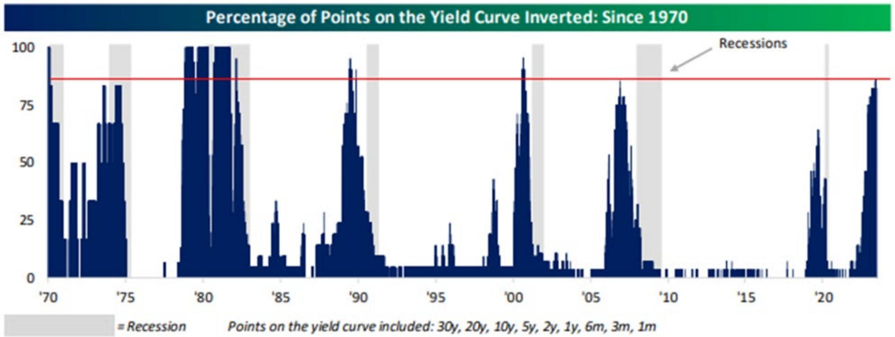
Source: Bureau of Labor Statistics, Barron's, and Bloomberg

The Bond Market Continues to Signal Warning Signs

Despite positivity in the equity markets, the bond market continues to tell a completely different story. Yield curves remain massively inverted and signal Recession fears. Normally longer-term yields are higher due to uncertainty over inflation and interest rates. Currently, however, over 80% of the yield curve is inverted as short-term yields surged over expectations of elevated rates. Since 1980, every time this number was over 80%, a Recession followed.

- **Why are Bond Markets so cautious?** There are many lingering concerns:
- **Tighter Lending Standards** as a result of the regional banking crisis and concerns around the availability of credit to small- and medium-sized businesses
- **Commercial Real Estate (CRE) market** due to the popularity of "work from home" and the fact the CRE market depends on loans from smaller banks.
- **Stickier inflation** and the Fed tipping the economy into a Recession through higher rates.
- **Worrisome Economic Data**, including eight straight months of the ISM Manufacturing data in contraction territory (<50.0). The latest reading (46.0) is the weakest level since May 2020

Every US Recession since the 1950s has been preceded by an inverted yield curve. The 10-year and 2-year yield curve is closely watched by investors and is at its most inverted level since the early 1980s. It is important to note there is usually a delay between the time of inversion and beginning of Recession. For example, following the inversion of the 10-year and 2-year yield curve, a Recession historically followed by as little as six months or as much as two years (since 1955). The current inversion began in July 2022.



Source: Bespoke Investment Group

Source: St. Louis Fed and Bloomberg

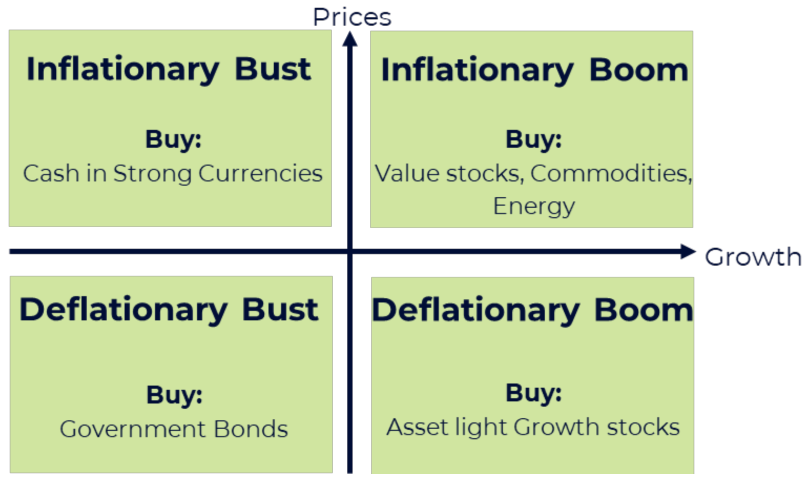
Investment Implications

1. **Our original forecast of "higher for longer" rates at the beginning of the year is panning out. The Fed's updated Dot Plot shows 1-2 more rate hike in 2023 and then holding rates steady into 2024.** The Fed's view is still consistent with an "Inflationary Boom" scenario, in which economic growth continues at a relatively brisk clip with inflation remaining above the Fed's target into 2024. The market however seems to be pricing in a "Deflationary Boom." Last quarter we favored the scenario where "banking stresses are successfully contained, the US economy avoids a near-term Recession, and the Fed doesn't move aggressively." We largely still agree with this view, even thought we expect 1-2 more rate hikes, starting in July.

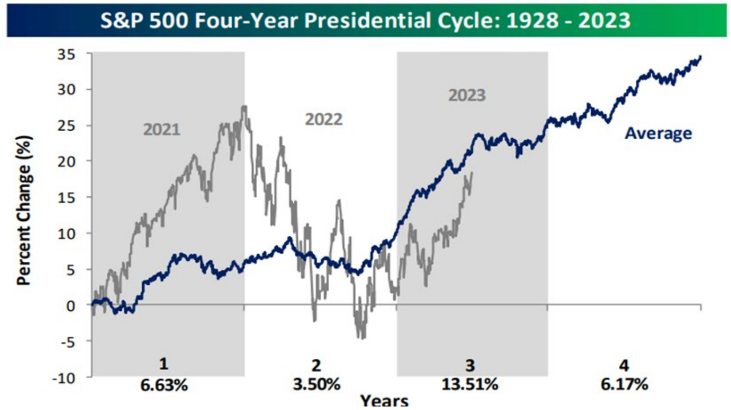
2. **Maintain positioning in high quality stocks.** We are still cautious on this market, given warnings in the Bond Market, a lack of volatility in the equity markets, and a run up in valuations (S&P 500 trades at roughly 19x). We believe investors should avoid complacency and monitor positions and sizes to avoid becoming overexposed to certain first half outperformers, such as Big Tech and Semis.

3. **Targeted Fiscal Stimulus Will Benefit Certain Industries:** $2 Trillion in government spending will support Infrastructure, including Energy Transformation and domestic manufacturing (i.e. Semi industry).

4. **There are powerful price and seasonality trends that cannot be ignored.** Bull Markets last much longer than Bear Markets, and we potentially could be in the early stages of a Bull market that officially started in October 2022. As stated earlier, a strong first half to a year (>10%) historically leads to strong second half returns. Finally, the 3rd year of a Presidential cycle has historically produced the strongest equity returns in a four year cycle. On the other hand, Year 2 of a Presidential cycle is the weakest for equity returns. The chart to the right highlights a composite of average S&P 500 returns by Presidential Year dating back to 1928 (Navy Line), versus President Biden's current election term (Grey Line).



Source: Bloomberg and Dynasty Financial Partners



Source: Bespoke Invest

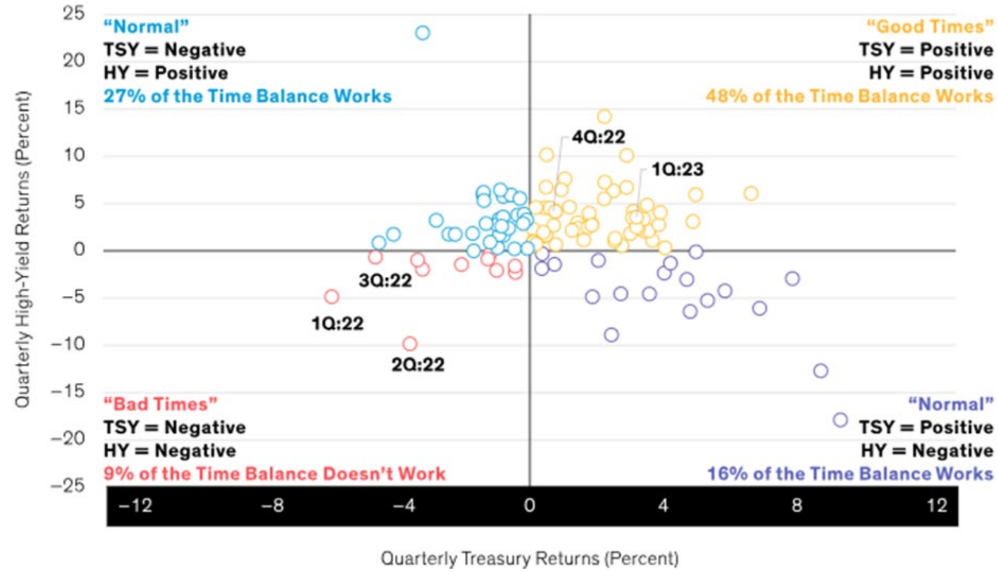
Investment Implications (continued)

1. **The US isn't the only Bull Market:** Maintain global diversification. Japan is in the third longest Bull Market in its history due to loose monetary policy, yield curve control, renewed foreign interest, and a more shareholder friendly approach by companies. India is another Bull Market and is one of the fastest growing countries in the world.

2. **US over Developed Europe:** The US is closer to the end of its rate hiking cycle than Europe, which is dealing with sticker inflation (and in some cases accelerating inflation). For example, the Bank of England announced a surprise 50 basis point hike after Core CPI rose at its fastest pace since 1992. It's possible the European Central Bank and Bank of England continue hiking rates beyond when the Fed pauses. Low Natural Gas prices also have benefited Europe in 2023, but prices rallied in June.

3. **Don't give up on Fixed Income:** and maintain a barbell approach between US Treasuries & Credit. 2022 was an extremely unusual year for fixed income, as US Treasuries and Credit delivered multiple quarters of negative returns together. Historically they move in different directions, as Government bonds tend to do well when the economy is slowing and inflation is cooling, while Credit typically outperforms in a growing economy.

Government Bonds, Credit Rarely Underperform at the Same Time



Historical analyses do not guarantee future results.

HY is represented by Bloomberg US Corporate High Yield. TSY is represented by Bloomberg US Treasury. An investor cannot invest directly in an index and its performance does not reflect the performance of any AB portfolio.

Reflects quarterly returns starting from April 1, 1993 to March 31, 2023. Numbers may not sum due to rounding.

Source: Bloomberg and AB

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