July 18, 2023
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Is This the Soft Landing?

TAM US Q2 2023 Review and Outlook Chartbook

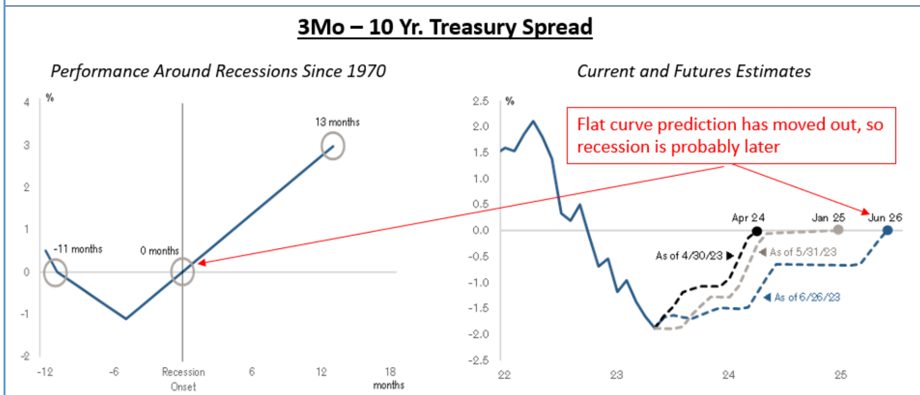
	2Q 2023	YTD	1 Year	3 Year*	5 Year*	7 Year*	10 Year*
S&P 500	8.74%	16.89%	19.59%	14.60%	12.30%	13.38%	12.86%
Russell 1000 Value	4.07%	5.12%	11.55%	14.30%	8.10%	8.94%	9.22%

* *Annualized Total Returns.*

Despite early year concerns of a hard landing, followed by some prominent bank failures in March and fears of a US debt default, the economy held together as inflationary pressures appear to be easing. "Soft landing" is defined by Investopedia, as a cyclical slowdown in economic growth that avoids recession. Thus far, we are meeting that definition. You don't have to search very hard to find an angry Market Strategist nowadays, because many have been betting on a recession while the economy and market have strengthened. **Another recession will happen someday, but markets have changed their expectations of when that should occur and are pushing it out much further**.

Investors worry about a recession because the yield curve is inverted (i.e., an unusual period when short term interest rates are higher than long term). The left chart points out that **since 1970, recessions have started AFTER those yields un-invert.** We still have a very inverted curve, but futures pricing (right chart) has **pushed out the expected un-inversion from early 2024 until mid-2026** based on recent pricing. A recession might not happen until more than 12 months from now.

No Recession Yet...They Occur AFTER Curves UN-Invert



Source: Credit Suisse

- Since 1970, recessions occur after the yield curve steepens and goes flat.
- Bond markets don't forecast that until 2026.
- Equity markets should broaden if investors start believing this.

Market leadership has been extremely narrow YTD, led by resurgence in the largest growth names that were shellacked last year. Recession fears and financial crisis worries prompted this as investors believe they were the only truly safe names. The largest 10 stocks in the S&P accounted for about 75% of the market gain thru mid-year. Most money managers did not match that, as they were not overexposed to those names. If the economy continues to avoid recession, **we believe the other 490 stocks in the S&P index as well as the Russell 1000 Value index should play a lot of catch up with the S&P 500**. A broader market advance would help most active managers against the index.

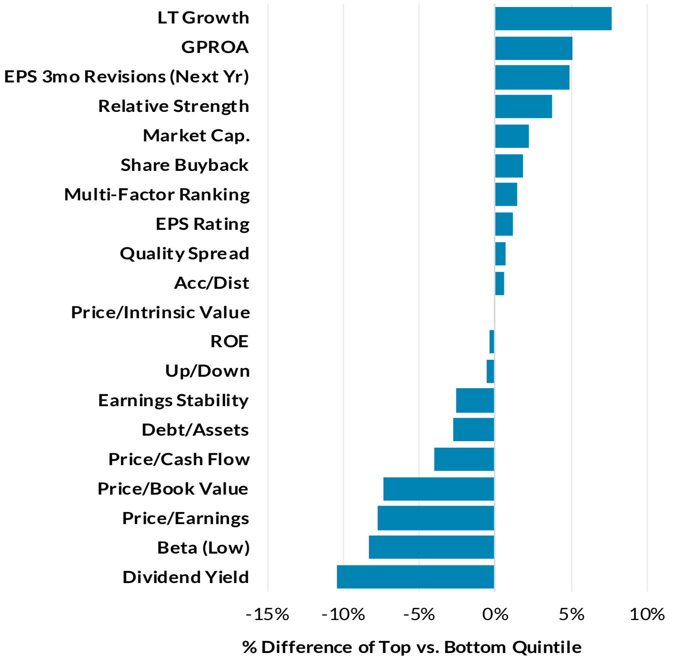
Strength in the labor market has been a key reason that investors feel better about the economy. There are many reasons for this, but a lack of workers, coupled with continued reopening in services (think revenge travel) and lack of layoffs in anything other than Tech have helped. This strength is causing some heartburn though, as wage gains have been higher than the Feds target for inflation. Despite the overall CPI normalizing, some core measures of inflation continue to run hot. **The Federal Reserve remains diligent, and they intend to keep rates high (and perhaps raise them a bit) until that core inflation is in line with their expectations.**

Many of our themes are continuing to play out. **Our overarching theme is that a new capital investment cycle is occurring** aimed at spending in the “old” economy. **The government is dabbling in industrial policy** and stimulating investment in Semiconductor Chip manufacturing and “Green” investments. Electric Vehicle production for US based automotive companies is benefitting from incentives and overall auto sales have risen to nearly 16 million units. It would be hard to forecast a recession without that declining. This stimulus has some pros and cons attached to it. The biggest con is that **it suggests federal deficits will remain high, and funding needs could crowd out private investment and cause even higher interest rates and interest expense for the Federal Government**. Also, re-shoring implies that companies (and politicians) are emphasizing security of supply over higher costs. This could lead to margin pressures. The pros should outweigh the cons over time. **Re-shoring leads to employment gains and a larger wage base.** US factories are the oldest they have been since World War II, so a period of reinvestment is needed and welcome**. New facilities should be more productive too, something that the new developments in Artificial Intelligence can probably provide a tailwind to.** Other areas of capital investment include known productivity enhancers like Airports, Roads and Bridges. We expect spending on development of new energy resources to see continued growth, both in green and traditional hydrocarbons, especially if recession fears get pushed out further. Lastly, the world is a more dangerous place than it had been since before the Iron Curtain fell. Governments worldwide are spending more on defense.

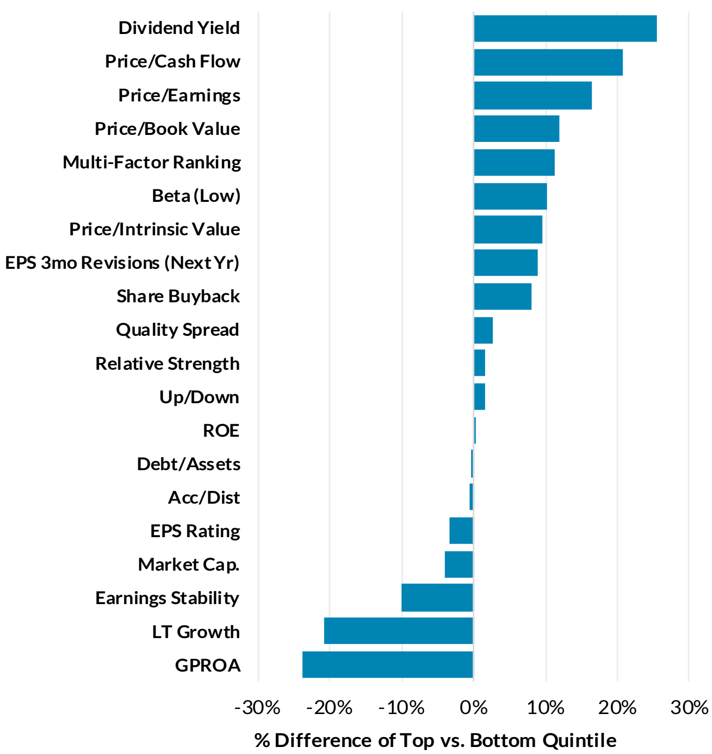
In all, **we cannot rule out a pause in the recent rally, but until a recession becomes a much nearer term worry, we believe equity markets are positioned to broaden out and act better**. No scenario is perfect, as there are signs of weaker consumer sales, purchasing managers indexes are weaker and commercial real estate is a concern. Still, the economy is holding up. Our signposts for a recession will be rising unemployment and a flatter yield curve among other things. **As investors gain comfort with the economic outlook our themes should regain traction and the market advance should broaden out to include many of the groups that have lagged thus far this year.**

Factor Analysis

S&P 500 Best-Worst Performers for Q2 23.



S&P 500 Best-Worst Performers for FY 2022.



- These charts illustrate the performance spread between the best 100 stocks versus the weakest 100 stocks in the S&P 500 for each factor listed for the most recent quarter as compared to the full year of 2022.

- Recent factor performance favored large cap growth, momentum and quality as seen in the top pane. The reversion trade from last years' drubbing of large cap growth, coupled with recession fears has led to this, at the expense of value factors.

- The recent factors represent a complete reversal of the factors that were leading at the end of 2022, presented in the bottom pane. Value led, and the higher multiple growth stocks were the laggards.

- We believe investors should feel better about the economic outlook over the second half of the year, which should result in the value factors seeing renewed interest.

Source: Bloomberg, William O'Neill + Co. and Todd Asset Management

Charts We Are Sharing with Our Clients

Most S&P YTD Gains Were Post Silicon Valley Bank

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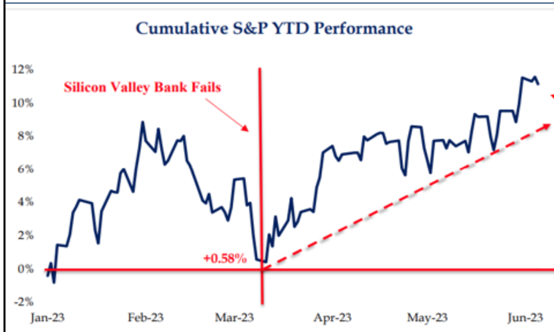
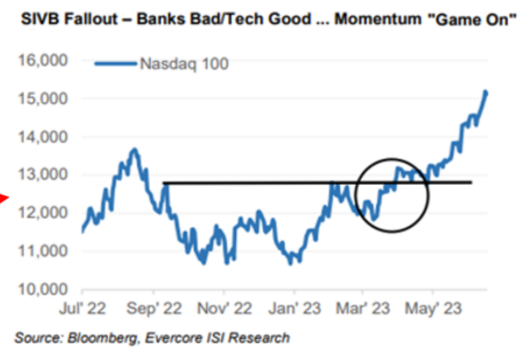


Source: Strategas

Investors decided the "coast was clear" after Silicon Valley Bank failed followed with a Debt Ceiling Bill. The S&P rallied dramatically.



Higher multiple growth stocks got the biggest boost as the Fed and treasury flooded the system with cash.

Magnificent 7 drove US H1 returns, Europe was More "Normal"

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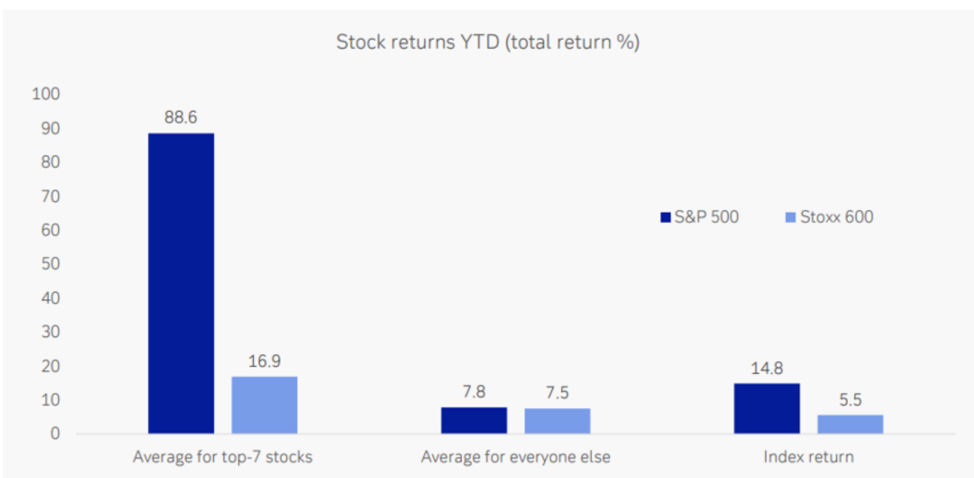

Source: Deutsche Bank

Largest S&P Stocks are Under-Earning their Index Weight

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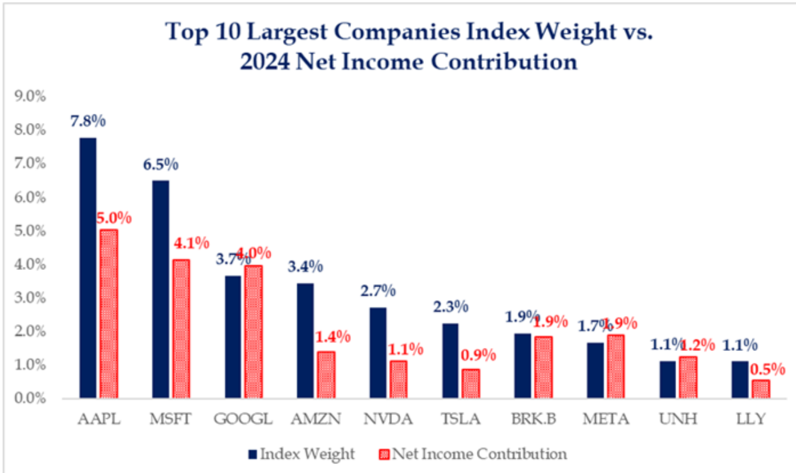

Source: Strategas

Investors know about the index weight concentration in the 10 largest S&P stocks. For their 32% share of S&P Market Cap, they only earn 22% of the index profits.

Auto Sales Continue Recovery- Not Recessionary

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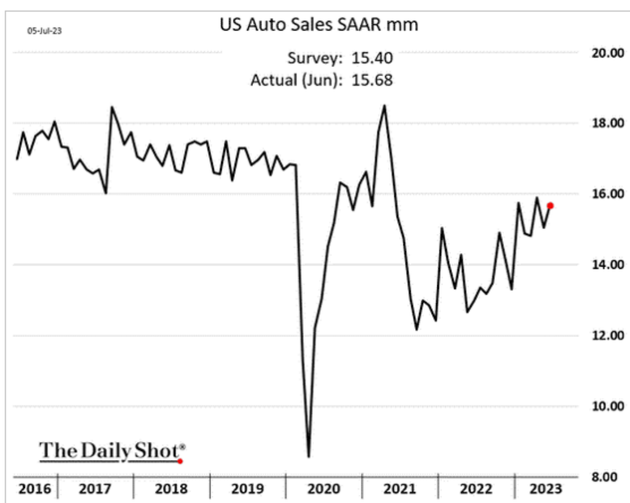

Recessions usually do not start with strength here. Demand for Electrics is still small, so those subsidies/availability probably add to this demand.

A Mixed Blessing- The Fed Wants Unemployment to Rise

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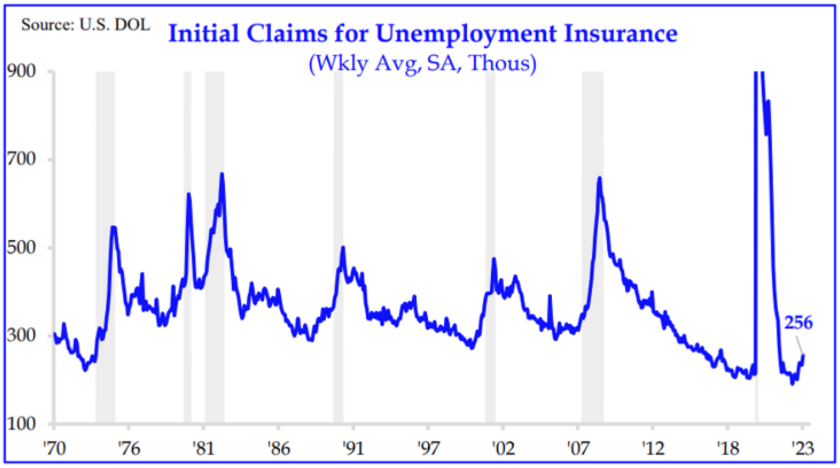

Source: Strategas

We all want low unemployment, well most of us at least. The Fed worries inflation will remain higher until unemployment rises. Rates probably stay higher for longer.

CPI is Encouraging- Inflation is Declining

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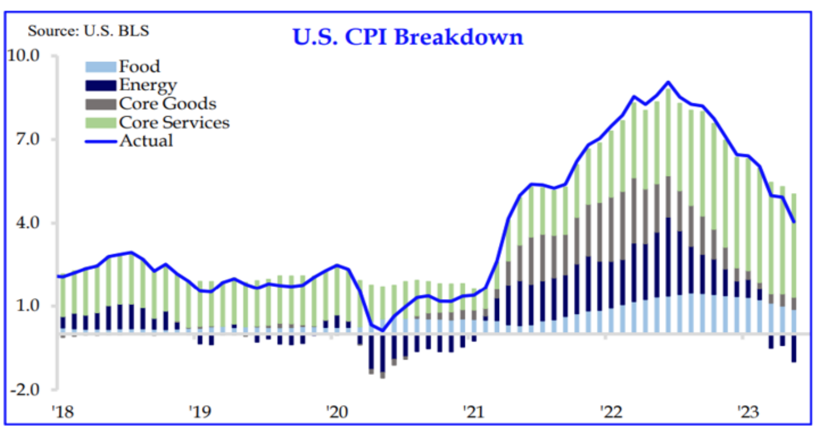

Source: Strategas

Inflation is decisively easing. Energy prices are declining , while goods and food price increases have abated. Services remains stubbornly high.

Central Banks are Selling Bonds, Pressuring Rates Higher

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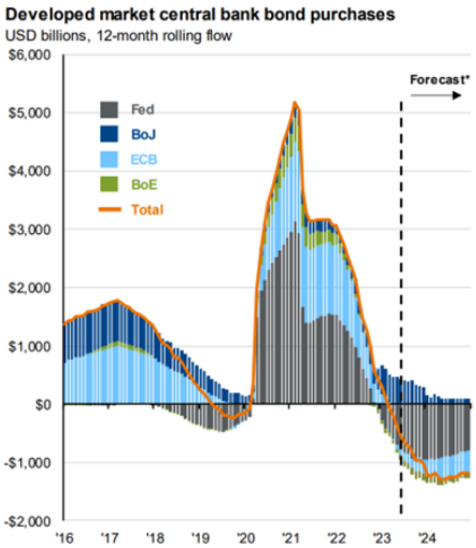

Source: JP Morgan

- **<u>Central Banks are slated to sell trillions of dollars in bonds</u>** over the next few years. This should pressure rates higher.
- Additionally, **<u>a capital cycle is unfolding.</u>** Increased funding needs for government spending, infrastructure, reshoring, green energy, commodities investment and defense spending are **<u>likely to contribute to structurally higher rates as well.</u>**
- All of these contribute to the **<u>new regime</u>** thesis we believe markets are in.

Commentary may contain subjective judgements and assumptions subject to change without notice. Commentary is based on information as of the date of this presentation. There can be no assurance that developments will transpire as forecast.

Real 10 Yr. Yields are Rising Again Should Pressure Higher Multiple Stocks

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Source: Strategas

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Energy: A Checkback like 2003?

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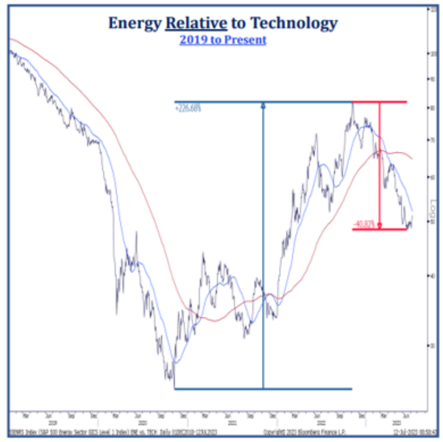

Source: Strategas

Energy stocks have suffered over the past year as commodity prices declined. Relative to the old (and new) technology leadership, the energy sector has checked back just like it did in 02-03. A large recovery followed from 03 to 06.

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Dollar Breaking Down Should Support Commodities

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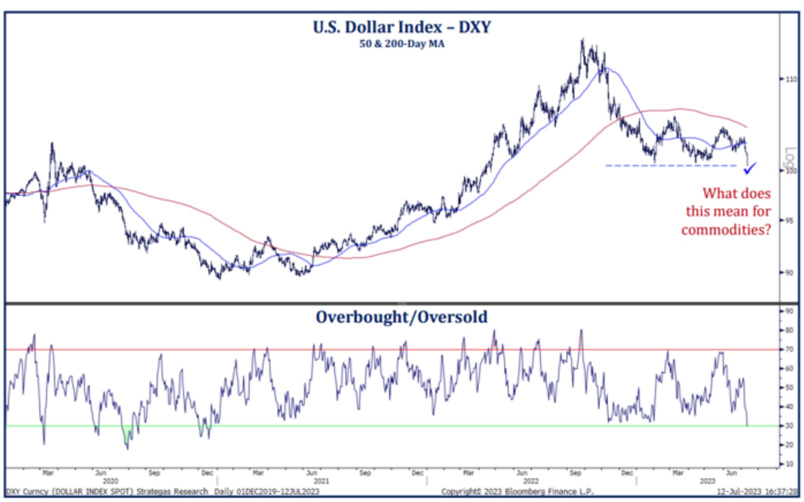

Source: Strategas

The dollar declined as economic prospects have brightened and the Fed is almost finished tightening. A weaker dollar should lead to higher commodity prices.

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Summary

We've never seen the consensus call for a recession before, so to hear most of Wall Streets best and brightest do so earlier this year was a little unnerving. Consensus calls are often wrong though. It appears this one was as well. Maybe it was only premature, and there is a recession sometime much later. In any event, it appears the economy is in soft landing territory now. For as long as that is the case, we believe we can be constructive on the stock market. More importantly, the market can broaden out and sustain a healthier balance in the leadership. The narrow leadership of the last six months should give way for a period where more stocks can perform well … if we avoid a recession. We think that is constructive for many of our secular trends and will be keeping you abreast of that in future reports.

As always, if you need any additional information, please feel free to contact any of us.

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Jack Holden CFA
Shaun Siers, CFA

07/18/2023
S&P 500 – 4,555
Russell 1000 Value –1,578

Refer to the following page for more information on the commentary presented. This is pertinent to this letter and should not be reproduced or duplicated without this disclosure.

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S&P 500 Index is a widely recognized index of market activity based on the aggregate performance of a selected portfolio of publicly traded common stocks. The performance data was supplied by Standard & Poor's. It is included to indicate the effect of general market conditions.

Russell 1000 Value Index is a widely recognized index of market activity based on the aggregate performance of common stocks from the Russell 1000 Index, with lower price-to-book ratios and lower forecasted growth values. The performance data was supplied by Frank Russell Trust Company.