Market Perspectives

June 2023

KEY HIGHLIGHTS

- Performance — The bear goes into hibernation and a new bull emerges?
- Market breadth remains narrow but broadens a bit
- Inflation continued to decline, and a Fed pause
- M2 is falling fast
- All quiet on the banking front for now and a look ahead

PERFORMANCE

June was a strong month for stocks. From a technical perspective, the bear market went into hibernation, and a new bull market emerged indicated by the S&P 500 rising 20% from the October 2022 bear market low.

June capped off a stellar first half of 2023 yet was littered with fear and uncertainty stoked by high inflation, rising rates, an inverted yield curve, bank failures, debt ceiling saga and continued geopolitical tensions. Remarkably, markets shrugged off those fears and surged to the upside. As of June 30th, all major indices are up year-to-date with the tech heavy Nasdaq leading the charge with a staggering 32.32% gain (best start to the first half since 1983) followed by the S&P 500 and the Developed International index with gains of 16.89% and 12.13% respectively. While the Russell 2000 lagged through May, the U.S. small cap index got in on the action in June with a strong return of 8.13%. At the end of May, the small cap index was in negative territory for 2023. The S&P 500 and Nasdaq powered ahead in June as well with gains of well over 6% each. While positive for the year, the Bloomberg Aggregate Bond Index declined by 0.36% for the month due to hawkish Fed commentary and a rise in yields, marking consecutive monthly losses. However, we now view yields for long-term investors as quite attractive. High quality private debt should continue its winning ways as well.

The "Magnificent Seven" comprised of Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla and Meta have accounted for approximately 75% of the S&P 500 gain.

MARKET BREADTH REMAINS NARROW

Market breadth refers to the number of stocks that are participating in a given move of an index. As noted last month, market breadth remains narrow with U.S. mega-cap companies generating most of the market returns. In fact, the "Magnificent Seven" comprised of Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla and Meta have accounted for approximately 75% of the S&P 500 gain and the top 30 stocks by market capitalization accounted for over 95% of the index's

Index	MTD	QTD	YTD	1 Year	2022
S&P 500	6.61	8.74	16.89	18.34	-18.11
Dow Jones Industrial Average	4.68	3.97	4.93	13.04	-6.86
Russell 2000	8.13	5.21	8.09	11.01	-20.44
NASDAQ Composite	6.65	13.05	32.32	25.02	-32.54
Europe, Australia, & Far East (EAFE)	4.58	3.22	12.13	20.31	-14.01
MSCI Emerging Markets	3.89	1.04	5.10	3.01	-19.74
Bloomberg Barclays U.S. Aggregate Bond	-0.36	-0.84	2.09	-1.53	-13.01

As of 6.30.23; Returns in percent

gain. This narrow breadth was a prominent talking point for bearish investors, but history has shown narrow leadership has not been a harbinger of market weakness. Breadth did broaden in June with small and mid-cap stocks rebounding and outpacing their mega and large cap counterparts for the month. A continuation of this broadening would be a positive sign for the market, but it is not unreasonable to expect the largest companies to become even larger. In June, Nvidia joined the $1T club and Apple exceeded the $3T mark driven in large part by optimism and secular growth trends surrounding artificial intelligence (AI).

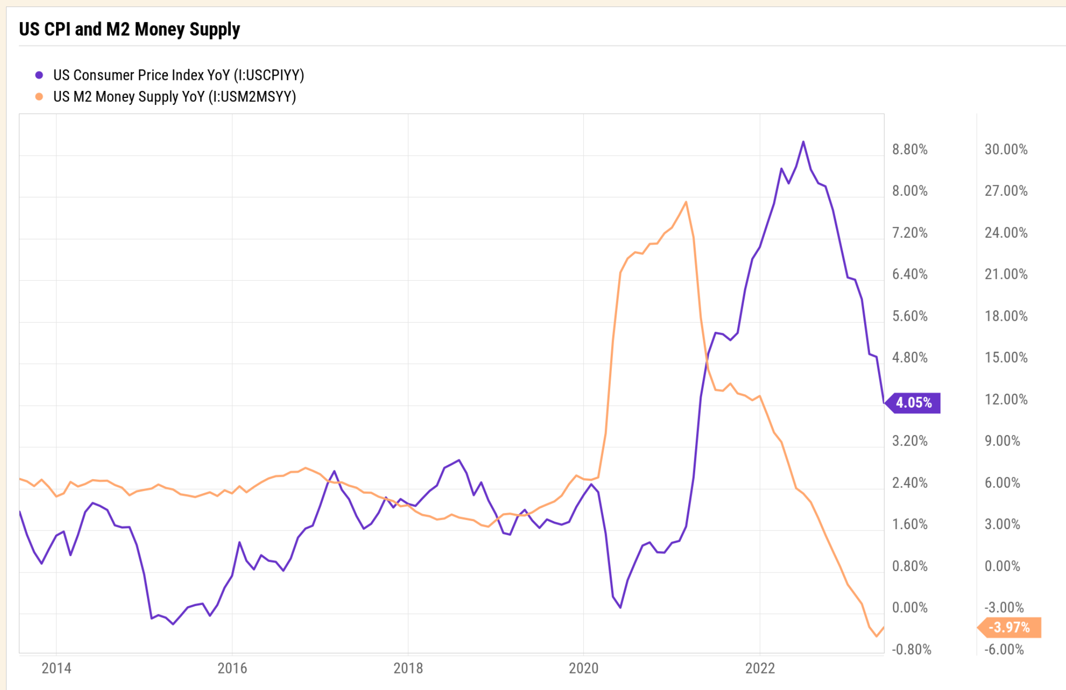
INFLATION DECLINED AND A FED PAUSE

The widely followed Consumer Price Index (CPI) was reported for May on June 13th and fell to 4.0%, down measurably from the peak of 9.1% in June 2022. Prices in the manufacturing sector have now fallen into contraction territory and services prices are easing as well but not as quickly. Given these positive developments on inflation coupled with the known lagged effect of policy tightening, the Fed unanimously felt it prudent to hit the pause button on rate hikes on June 14th, ending the streak of 10 consecutive hikes. The streak began in March of 2022 and has brought the Federal funds target range to 5% to 5.25% from 0% to 0.25% in the past 15 months. This has been the most aggressive monetary tightening seen since the early 1980s. Holding steady will allow the Fed to assess key labor market and inflation data prior to the next FOMC meeting on July 25-26th. June CPI will be released on July 12th and will have major implications on the Fed's decision. The current expectation is for two more rate hikes of 0.25% this year after the June pause. As recently as March, the expectation was for cuts of 1.00% before year end; we expect none. Recession fears have eased somewhat, although the full impact of this tightening cycle will likely be felt over the next 12 to 18 months. Uncertainties remain.

During the early days of the COVID-19 pandemic, M2 rocketed higher as the Fed unleashed massive amounts of liquidity into the economy to stave off a full-blown economic collapse.

M2 IS FALLING FAST

There are ample headlines of inflation, interest rates, and earnings but little is mentioned of M2. What is M2 and why is it important? If one searches for M2 online, the first result is likely to be the BMW M2 coupe. Financially speaking, M2 is the Federal Reserve's estimate of the money supply in aggregate including currency and coins held by the public, checking accounts, savings accounts, retail money-market funds and short-term savings vehicles. Insights into economic activity, health of financial markets and inflation pressures can be gleaned from M2. During the early days of the COVID-19 pandemic, M2 rocketed higher as the Fed unleashed massive amounts of liquidity into the economy to stave off



Source: YCHARTS

a full-blown economic collapse. It worked, but there are consequences to such actions. Most notably was the spike in inflation that followed the rise in M2, albeit with a considerable lag, which can be seen in the chart above. M2 year over year growth peaked in February of 2021 and inflation measured by CPI peaked in June of 2022. As M2 accelerated at the fastest pace in history, inflation followed. However, the money circulating in the economy has been falling fast on a year-over -year basis and so too has inflation but not to the Fed's 2% target. As excess cash reserves are diminished, we will continue to monitor M2 and the labor market which are tethered to consumer spending (approximately 70% of GDP), credit card debt and delinquencies to help inform our portfolio positioning.

ALL QUIET ON THE BANKING FRONT AND A LOOK AHEAD

Earlier this year, customers of regional banks rushed to move deposits to larger institutions after the implosion of Silicon Valley Bank, Signature Bank and First Republic Bank. Deposits are the lifeblood of banks and though outflows from these smaller lenders have stabilized, credit conditions have tightened which if persistent can slow economic activity. Just last week, the Federal Reserve Board released results of its annual bank stress test, which this year measures the resilience of 23 large banks to a severe recession and the continued ability to lend. All 23 passed. We will soon learn more on the stability of the banking industry when several large banks (JP Morgan, Citigroup, Wells Fargo, Bank of America, etc.) report earnings beginning in mid-July.

July is a busy month with a CPI release on July 12th, FOMC meeting concluding on July 26th and the beginning of a new earnings season. Earnings growth for the second quarter is expected to decline by 6.5%. We would not be surprised if the market took a little breather to digest the recent gains. For stocks to continue their upward trajectory in the second half of 2023, earnings will need to clear another low hurdle just as they did in the first quarter. Traction in cost cutting measures and the AI tailwind could provide just that and not just for the mega cap names.

Turtle Creek Wealth Advisors, LLC ("Turtle Creek") offers investment advisory services and is registered with the U.S. Securities and Exchange Commission ("SEC"). SEC registration does not constitute an endorsement of the advisory firm by any regulatory authority, nor does it indicate that the advisory firm has attained a particular level of skill or ability. All content available in this commentary is general in nature, not directed or tailored to any particular person, and is for informational purposes only. Neither this commentary nor any of its content is offered as investment advice and should not be deemed as investment advice or a recommendation to purchase or sell any specific security. The information contained herein reflects the opinions and projections of Turtle Creek as of the date hereof, which are subject to change without notice at any time. Turtle Creek does not represent that any opinion or projection will be realized. The information contained herein has been obtained from sources considered reliable, but neither Turtle Creek nor any of its advisers, officers, managers, or affiliates represents that the information presented in this commentary is accurate, current, or complete, and such information is subject to change without notice. The information contained [in this commentary does not purport to be a complete description of the securities, markets, or developments referred to in this material. Any performance information must be considered in conjunction with applicable disclosures. Past performance is not a guarantee of future results. Neither this commentary nor its contents should be construed as legal, tax, or other advice. Individuals are urged to consult with their own tax or legal advisors before entering into any advisory contract. Any investment is subject to risks, including the possible loss of principal. Individual investor's results will vary. Investing involves risk, and you may incur a profit or loss, including the entire loss of investment, regardless of the strategy selected. Sources: FactSet, Yardeni Research, Barrons, YCHARTS, Bespoke, FRED