MARKET UPDATE

Fiduciary Financial Group

EXECUTIVE SUMMARY

The results of the first half of 2023 suggest that the overwhelming consensus among market participants is that interest rates will fall materially in the near-term. This is reflected in the recent outperformance of more interest-rate sensitive growth stocks (vs. value stocks), the inverted yield curve, and the remarkably resilient domestic real estate market. We believe that investing under this assumption of 'near-term rate declines' exposes investors to significant risk of loss in stocks, bonds, AND real estate. Rather, we feel focusing on strategies that would outperform in a "rates staying elevated for longer" climate is more prudent, especially because the market doesn't appear to be pricing in any material probability of this happening. This strategy is characterized by (a) an overweight to value stocks, (b) stock hedging strategies, (c) mitigating credit and duration risk in bonds, and (d) overemphasizing liquidity to leave room for more opportunistic investments in asset classes that will face distress if rates do not drop imminently as the market currently anticipates.

STOCK INVESTMENTS

Asset Class Snapshot	6/30/23
Asset Class	YTD Return
U.S. Stock	16.17%
Global Stock Ex U.S.	9.47%
U.S. Real Estate	4.04%
U.S. Bond	2.09%
Global Bond	1.43%

Region Snapshot	6/30/23
Region	YTD Return
Latin America Stock	18.52%
U.S. Stock	16.17%
Europe Stock	13.59%
Global Stock Ex U.S.	9.47%
Asia Pacific Stock	6.17%
Emerging Markets	4.89%

Equity Style Snapshot			6/30/23
YTD	Value	Blend	Growth
Large	2.53%	17.29%	33.26%
Mid	3.46%	8.80%	14.97%
Small	5.26%	9.19%	14.82%

Sector Snapshot	6/30/23
Sector	YTD Return
Technology	40.32%
Comm. Services	36.20%
Consumer Cyclical	32.14%
Industrials	10.16%
Materials	7.67%
Real Estate	3.77%
Consumer Defensive	0.68%
Financials	-0.50%
Health Care	-1.52%
Energy	-5.41%
Utilities	-5.74%

S&P 500 Sector Weights*	6/28/23
Sector	Weight
Technology	28.83%
Health Care	13.47%
Financials	11.87%
Consumer Cyclical	10.85%
Comm. Services	8.51%
Industrials	8.34%
Consumer Defensive	6.67%
Energy	4.11%
Utilities	2.58%
Real Estate	2.50%
Materials	2.26%

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BOND INVESTMENTS & INTEREST RATES

Name	As of	Latest**	1 Month Ago	1 Mo. % Change	1 Year Ago	1 Year % Change	Freq.
Key Interest Rates							
1 Month Treasury	6/30/23	5.24%	5.31%	-1.3%	1.28%	309.4%	Daily
2 Year Treasury	6/30/23	4.87%	4.46%	9.2%	2.92%	66.8%	Daily
10 Year Treasury	6/30/23	3.81%	3.69%	3.3%	2.98%	27.9%	Daily
30 Year Mortgage	6/29/23	6.71%	6.57%	2.1%	5.81%	15.5%	Weekly
US Corporate AAA	6/29/23	4.73%	4.68%	1.1%	3.88%	21.9%	Daily
US Corporate BBB	6/29/23	5.86%	5.90%	-0.7%	5.13%	14.2%	Daily
US Corporate CCC	6/29/23	14.00%	14.85%	-5.7%	14.83%	-5.6%	Daily
Effective Federal Funds	6/29/23	5.07%	5.08%	-0.2%	1.58%	220.9%	Daily

US ECONOMIC INDICATORS

Name	As of	Latest**	1 Month Ago	1 Mo. % Change	1 Year Ago	1 Year % Change	Freq.
U.S. Economy							
Consumer Sentiment	6/30/23	64.40	63.50	1.4%	50.00	28.8%	Monthly
Unemployment Rate	5/31/23	3.70%	3.40%	8.8%	3.60%	2.8%	Monthly
Inflation Rate	5/31/23	4.05%	4.93%	-17.9%	8.58%	-52.8%	Monthly
Manufacturing PMI	6/30/23	46.00	47.10	-2.3%	53.00	-13.2%	Monthly
Non Manufacturing PMI	5/31/23	50.30	51.90	-3.1%	55.90	-10.0%	Monthly
Retail Sales	5/31/23	598,576	596,523	0.3%	594,233	0.7%	Monthly
Building Permits	5/31/23	1,491	1,417	5.2%	1,708	-12.7%	Monthly

2023 Mid-Year Review

Stocks

- The experience for stock investors this calendar year has been the total inverse of 2022.
    - Just as we saw extreme losses in growth stocks last year, we've seen extreme recoveries in this asset class for 2023. The NASDAQ was down > 30% for the full calendar year of 2022 and is up >30% so far in 2023.
    - Similarly, we saw only mild losses in 2022 in value stocks. Thus far in 2023, these equities are up only modestly in the low-to-mid single digits.
    - Technology, consumer cyclical, & communication services stocks were the top sector performers in the first half 2023. These were the bottom three performing sectors in 2022.
    - Foreign stocks have performed well, although low-single-digit returns in mainland Asia stocks (AAXJ up 2.55%) offset mid-teens returns in Europe & Latin America such that US markets outperformed the diversified foreign market index (16.17% vs. 9.47% respectively).
- Valuations on market-cap weighted US stock index funds such as the S&P 500 are elevated as these indices are heavily weighted in the largest and most expensive companies. Smaller companies and value stocks trade closer to average valuations.

Bonds

- After the worst returns posted in 50+ years in 2022, bonds look to be stabilizing.
    - The US Aggregate Bond index is up 2.09% for the first 6 months of 2023.
    - The 2-year treasury yield is now greater than the earnings yield on the S&P 500 (more on that later).
    - Although stabilized in 2023, the 20+ year treasury bond index ETF "TLT" remains 40% off the highs hit in mid-2020. These embedded losses in long treasury bonds remain a significant risk for banks & insurance companies (the largest holders of these bonds), particularly if liquidity gets strained from events such as rapid declines in bank deposits (Mar'23) or large natural disasters causing spikes in insurance claims.
- The incremental yield earned on "junk bonds" vs. Treasury yields, as measured by the US High Yield BB Option-Adjusted spread, remains low (2.69%) compared to longer-term averages (3.57%).

Precious Metals, Real Estate, & Commodities

- After a near 13% run-up to start the year, Gold prices have cooled since the debt ceiling was raised, resulting in a full 6-month return of just 5.43% as of 6/30/2023.
- Although variable at the local level, the median existing home price for May 2023 dropped just 3% from May'22 despite a 15% increase in the cost of a 30 year fixed rate mortgage (6.71% in Jun'23 vs 5.81% Jun'22). Rental vacancies remained below 70 year averages at 6.4%.[i] The result of low inventories, low vacancy rates, & high borrowing costs has led to the lowest housing affordability levels in 40+ years.
- Despite China easing COVID lock-downs, crude oil prices have declined ~13% YTD. Copper prices have also been falling for months. The trend of decline in demand for productive commodities, like oil & copper, are common leading indicators for a recession.

Economics

- US unemployment has held steady, near 50-year lows, currently measuring at 3.70%. That said, wage growth has stagnated [ii], likely caused by distortions in higher lay-off rates in the high paying tech sector vs. ongoing hiring in the lower paying services sectors.
- The treasury yield curve remains steeply inverted, with the 10 year yield paying just 3.81% vs. 4.87% on the 2-year. Historically, these inversions have preceded recessions.
- After an 8% spike in 2022, the ICE US Dollar index is flat for 2023.
- Inflation dropped to 4.1% in May'23, thanks largely to the decline in energy prices, which is 10% of the influence on headline CPI. The figures are still well above the 2% FED inflation target, which is why the FED governors continue suggesting more rate hikes are coming in the back half of 2023.

MARKET UPDATE

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2023 2nd Half Outlook

Stocks

- US hedged equity positions look attractive given:
  - Demand for put options being remarkably low (and thus price for protection being low). For a proxy of relative pricing on puts (protective options) vs. calls (speculative options), you can reference the CNN Fear & Green Index's 5-day put/call option ratio.
  - Leading economic indicators suggest recession risk is as elevated as it's been since 2007. [iii]
  - Most respectable metrics for valuing the S&P 500 continue to raise alarms.[iv]
- We continue to favor increased weightings to international stocks. This is based on:
  - More attractive valuations relative to US stocks. The price-to-earnings discount for the MSCI All Country Ex-US Index ("ACWI") vs. the S&P 500 is right near 20 year highs. At the same time, the spread in dividend yields on the ACWI index is also pushing near 20 year highs.[v] [**Chart Page #1 in Appendix**]
  - The IMF global GDP growth projections are superior to the US.[vi]
  - Most of the world's largest money managers including: Vanguard[vii], BlackRock[viii], Fidelity[ix], JP Morgan[x], and BNY Mellon[xi] maintain higher forward return estimates on Foreign vs. US stock market indexes in their long-run capital market assumptions.
- We believe US Large Growth stocks are overbought and overvalued, especially in this interest rate environment. Through June 5, 2023, 11.09% of the 11.31% of the S&P 500's return has come from the top 10 companies[xii].
- Overall, we are underweight equities given the negative risk premium as measured by the difference between the 2-year treasury yield and the S&P 500 earnings yield. [**Chart Page #2 in Appendix**]

Bonds

- We continue to favor treasury bonds or municipal bonds with durations < 5 years over all other bonds given:
  - Increased trading liquidity vs. other bond types
  - An inverted yield curve which makes longer-duration bonds more risky [**Chart Page #3 in Appendix**]
  - Low credit spreads on junk-rated bonds [**Chart Page #4 in Appendix**]
  - Advantageous tax treatment, particularly for those living in high state tax jurisdictions.

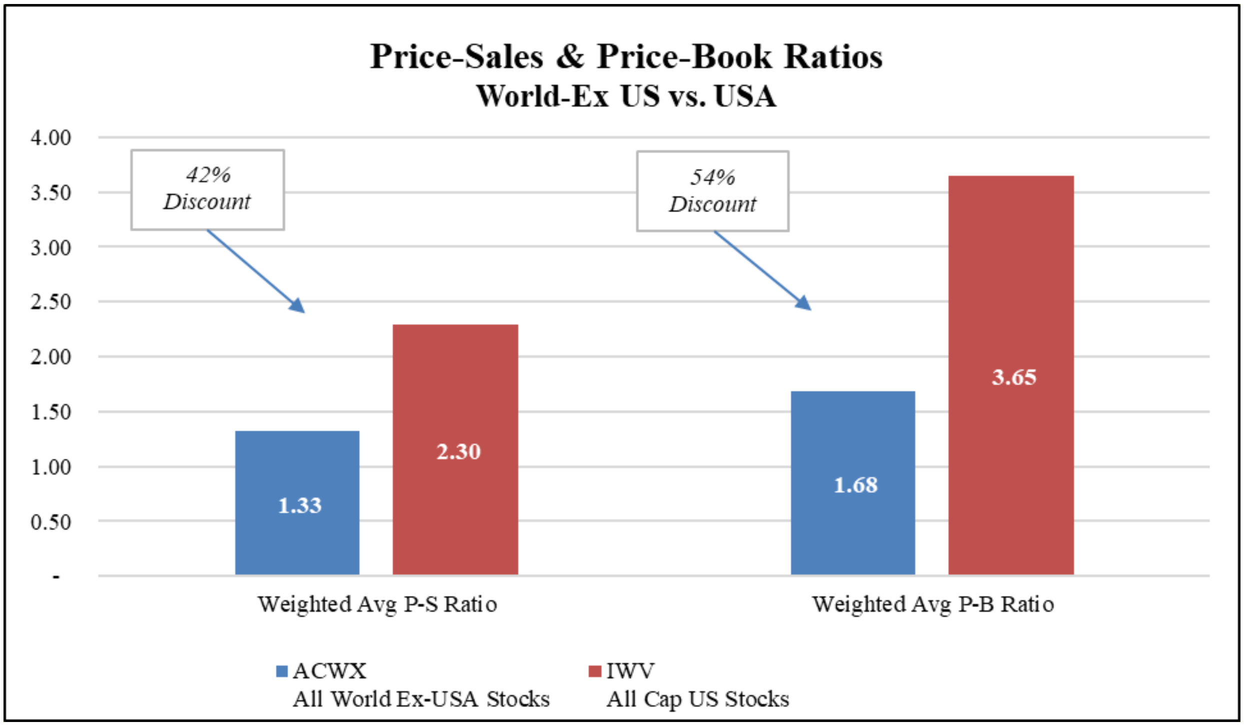
Real Estate

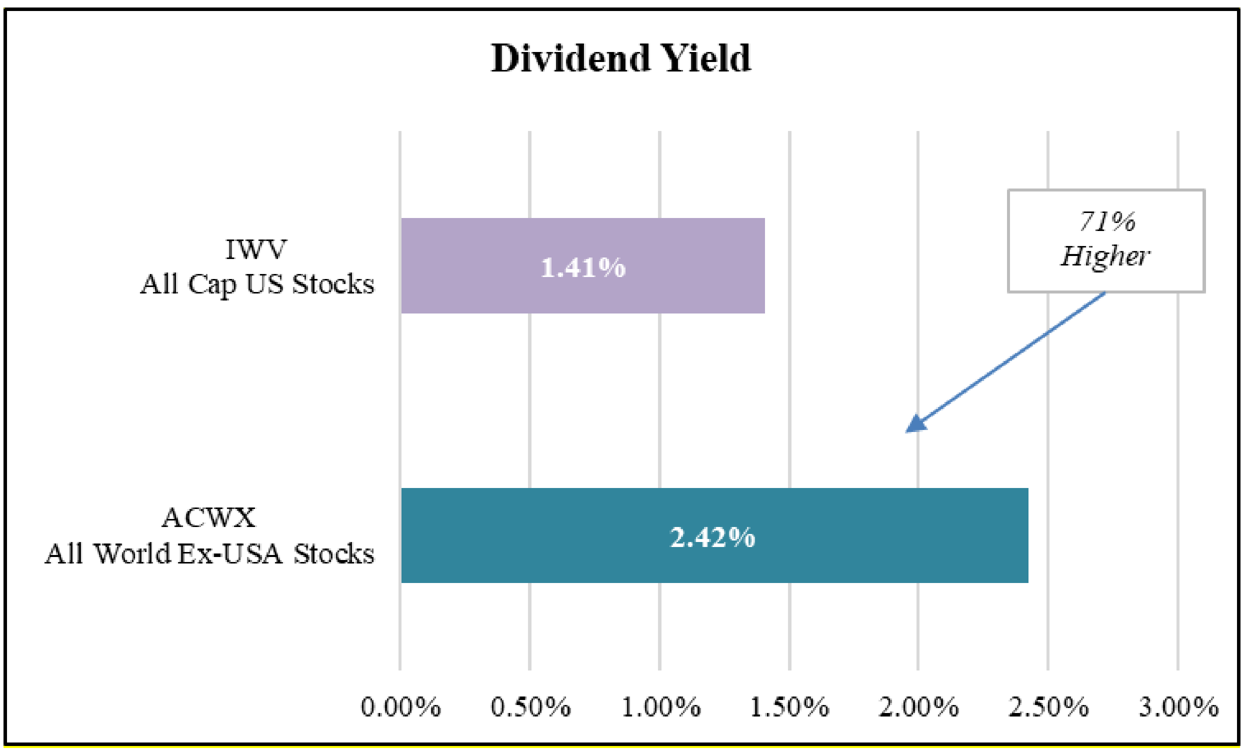
- We caution investors on making new investments in institutional real estate funds this summer. We anticipate further price declines across most sectors in the next 30 months with $1.5 Trillion in commercial real estate loans maturing before year-end 2025[xiii]. The combination of the regional banking sector's financial insecurity stemming from declines in deposits, coupled with jumps in commercial loan defaults should result in a spike in distressed sales of retail and office properties. The most well-capitalized and conservatively invested institutional real estate funds will likely be presented with a generational buying opportunity.
- Direct investment in residential real estate is a different story. While low affordability adversely impacts the demand side of pricing, 40-year low inventories coupled with high construction costs will likely insulate existing residential real estate prices in major markets from declining too significantly. That said, investment decisions should not be made under the assumption that mortgage rates will decline in the near-term. This is anything but guaranteed and investments should be assessed on their merits with current financing rates.
- Properly vetted Qualified Opportunity Zone funds (QOZ) still remain an option to make real estate investments with very attractive tax advantages**.**

Economics

- We anticipate that many of the adverse economic impacts spurred by the fastest rate hiking cycle in FED history will take time to play out. Bank failures started in March of 2023, and that turmoil has at least temporarily subsided, but more "brand name" business failures will likely occur as the FED continues raising rates. Investors should appreciate "lag"… that is, the delay between (a) rates rising and (b) economic conditions worsening + asset prices falling.

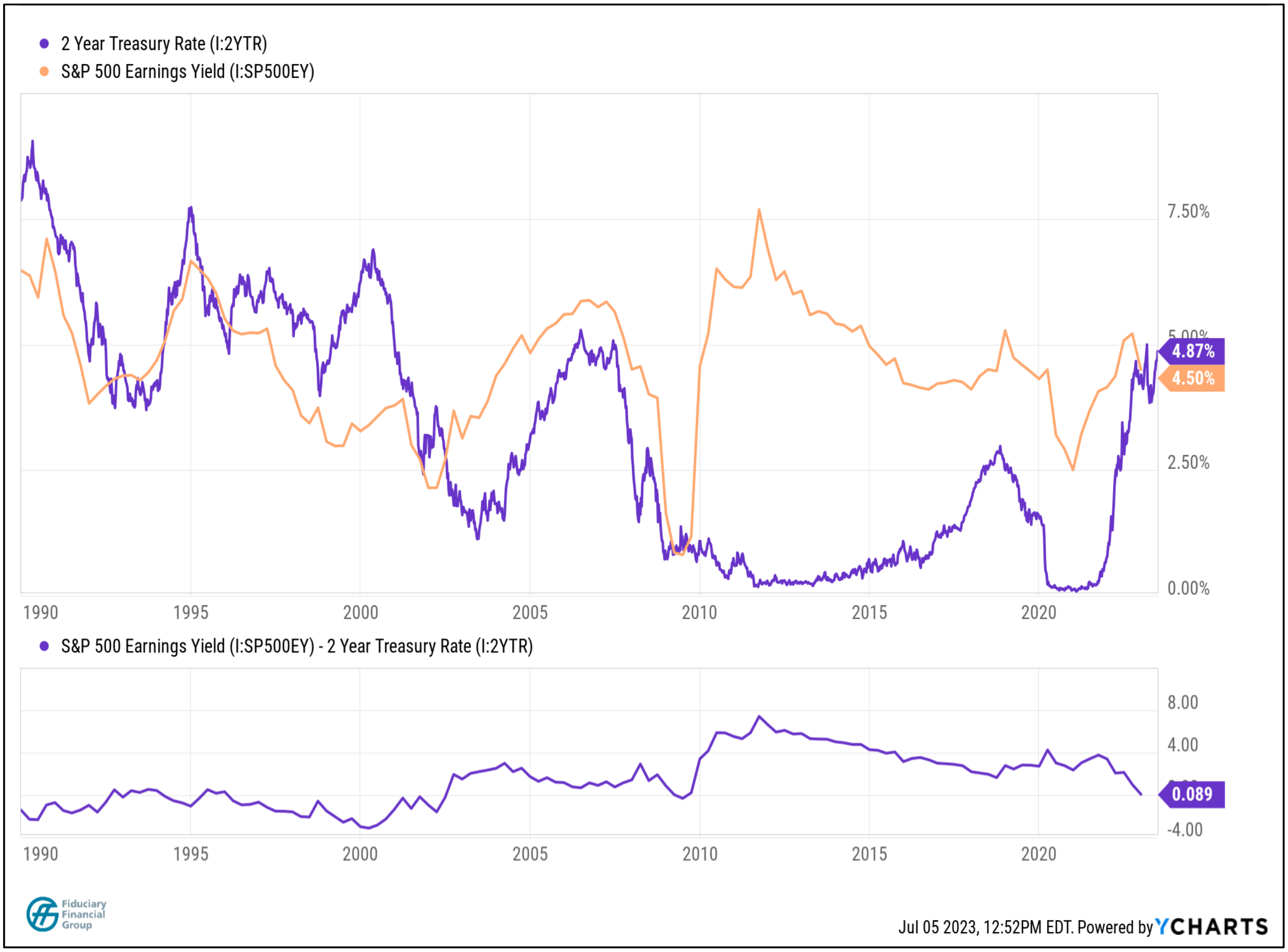
Chart #1 – US vs. Foreign Valuations on Stocks





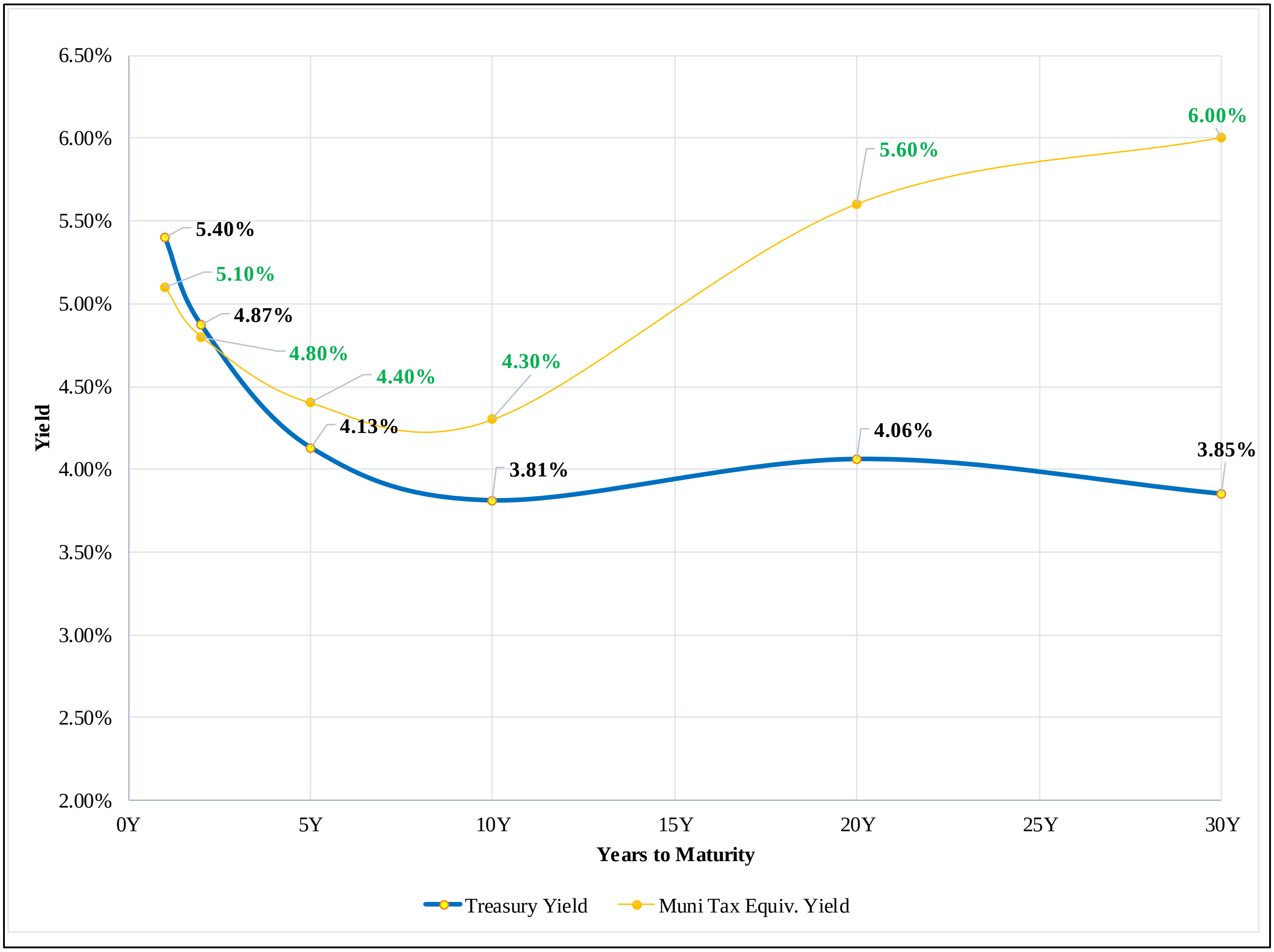
APPENDIX

Chart #2 - Equity Risk Premium – S&P 500 Earnings Yield vs. 2 Year Treasury Yields



APPENDIX

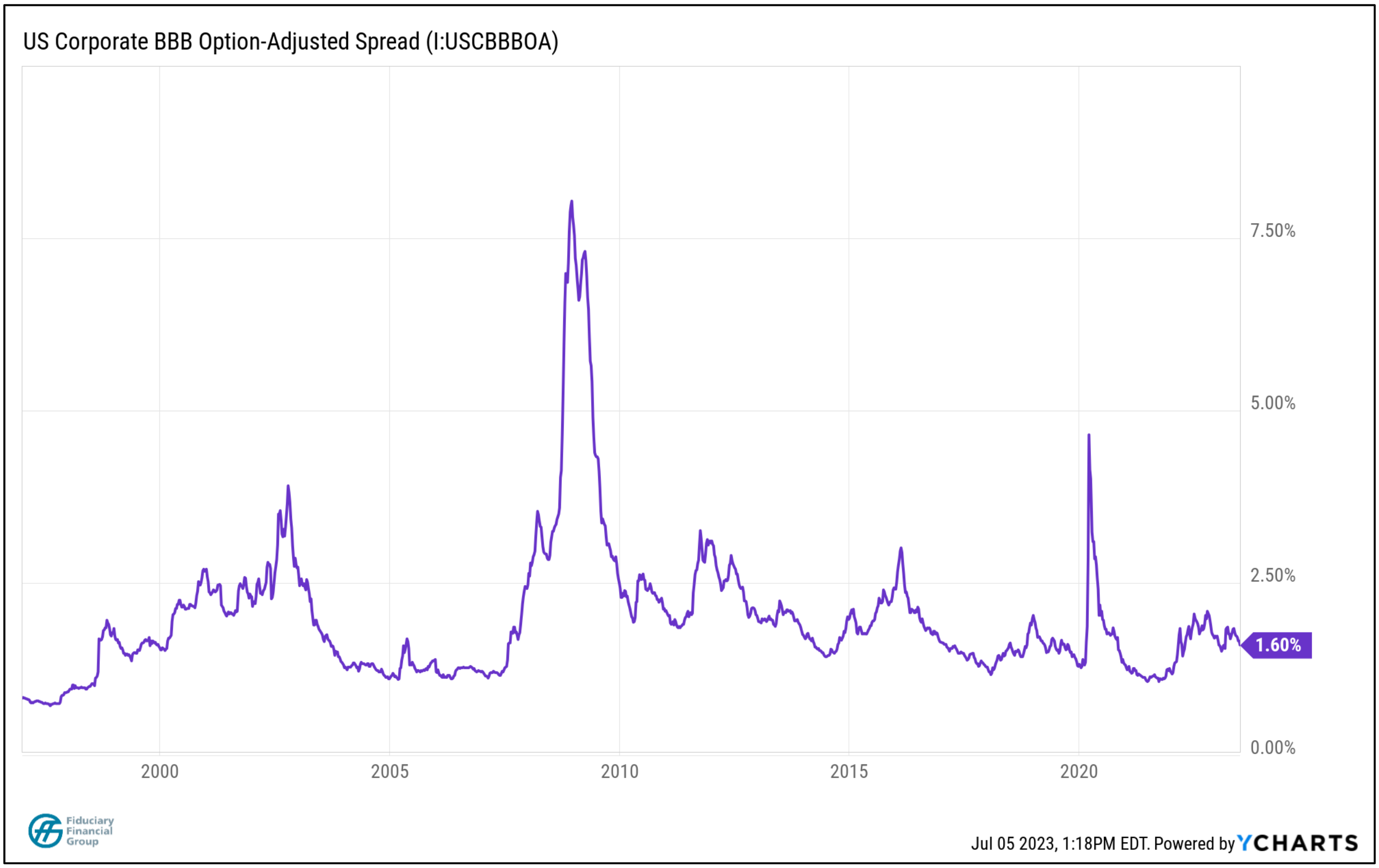
Chart #3 -US Treasury vs. AAA Muni Tax-Equivalent Yield Curve as of 6/30/2023



Muni Disclosures

- After-tax equivalent yields computed using highest FED tax rates
- Muni yields along the curve vary state to state, with higher tax states such as CA generally producing lower yields
- We generally only recommend buying muni bonds that can be held to maturity due to less attractive pricing typically received for selling these bonds before maturity.

Chart #4 -High Yield BB-Rated Bond Spreads



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***Special Note –** Data not specifically cited is pulled from FFG's YCharts terminal subscription*

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