SC Capital Advisors Investor Insights

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2nd Quarter 2023

2023 2nd Quarter in Review & Outlook

"Forecasts are difficult to make—particularly those about the future." —Burton G. Malkiel

Markets defy expectations

Stocks continued to defy Wall Street consensus expectations in the 2nd quarter as the rally in equities continued, boosted by cooling inflation, the prospect of a shift in monetary policy, and enthusiasm over Artificial Intelligence (AI). After a year in which 94% of global asset classes finished 2022 with negative total returns and many equity asset classes down 20 percent or more, investors continued to see value in stocks in the second quarter with the U.S. bond market taking a breather.

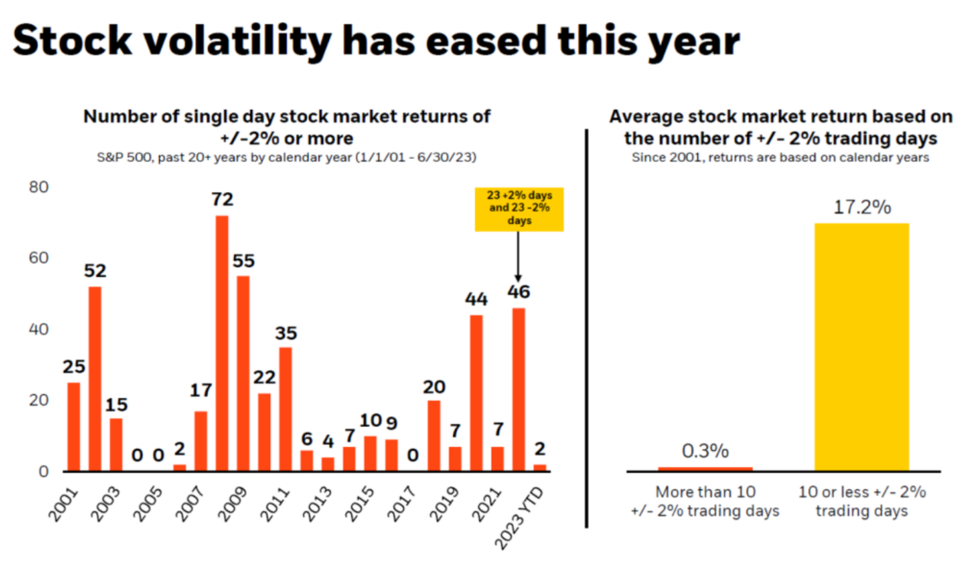
Asset Class Returns 2023 (06-30-2023)

	US Large	US Mid	US Small	REITs	Intl Large	Intl Small	Em Mkts	Bonds
Q1	7.5%	3.8%	2.7%	1.6%	8.5%	4.9%	4.0%	3.0%
Q2	8.6%	4.9%	5.2%	2.4%	3.0%	0.6%	0.9%	-0.8%
2023	16.7%	8.8%	8.1%	4.0%	11.7%	5.5%	4.9%	2.1%

Indexes: US Large, Russell 1000; US Mid, S&P MidCap 400; US Small, Russell 2000; REITS, DJ US Real Estate; Intl Large, MSCI EAFE; US Small, MSCI EAFE SMall Cap; EM, MSCI Emerging Markets; S&P GSCI TR; Bonds, Bloomberg US Agg Bond. Source: Morningstar.

Growth stocks, among the worst performers in 2022, reversed course and posted the best returns in Q2 with the Nasdaq Composite index gaining 12.8 percent. The S&P 500 was up 8.2 percent for the quarter with the Dow Jones Industrial Average posted a gain of 3.4 percent, according to Morningstar. The quarter did not escape without some volatility, driven by a drawn-out political battle over raising the debt ceiling.

Despite nervousness over recession expectations, however, investors should be sleeping a bit better this year as overall volatility has dropped significantly, according to Blackrock. 2022 saw 46 trading days where the stock market was up or down by 2% or more. This was the largest number of +or- 2% trading days since 2009. There have only been 2 such trading days thus far in 2023 through June 30.



Source: Morningstar as of 6/30/23. Stock market represented by the S&P 500 Index. Past performance does not guarantee or indicate future results. Index performance is for illustrative purposes only. You cannot invest directly in the index.

Strong equity returns are often associated with low volatility environments, according to Blackrock. They looked at any calendar year in which there were 10 or less 2% trading days since 2001. The average return was 17% for U.S. stocks in those calendar years of 10 or less +or- 2% trading days. There were no negative calendar year returns among that mix. Calendar year returns were flat on average when volatility exceeded 10 +or- 2% trading days since 2001.

Inflation breaks

The June inflation report released on July 12 showed that year-over-year inflation remained on a downward path, although inflation may not be falling as fast as the Federal Reserve board prefers. The Fed has currently paused further monetary policy tightening. According to Morningstar, in only 2 cycles of monetary tightening in the past 35 years has the Fed paused and then resumed raising interest rates. The Fed had not paused and resumed rate hikes in the past 3 monetary policy tightening cycles. Many Fed watchers expect one more quarter point rate hike.

Corporate earnings reports supported market strength in the 2nd quarter. With 99 percent of the companies comprising the S&P 500 reporting, 78 percent reported a positive earnings surprise, while 75 percent reported a revenue surprise. The earnings beat percentage was the best performance relative to Wall Street estimates since the fourth quarter of 2021, according to Factset.

The second quarter brought in a renewed focus on AI and the significant potential in productivity increases in the years to come. However, it also resulted in a market rally that was unusually concentrated and driven by a relatively few stocks that Morningstar dubbed the "Magnificent 7." These seven stock drove 75% of the 13.2% gain in the Morningstar U.S. Market index return through June 26th. Four of these companies are in our Core Equity portfolio.

Magnificent Seven Responsible for Almost Three-Quarters of Market Gains

- Stock market rally unusually concentrated
- Attribution analysis of the Morningstar US Market Index: only 7 stocks account for almost ¾ of total market return this year
- Excitement surrounding AI, specifically natural language processing tools
- But now, mostly fully valued

Magnificent Seven Responsible for Almost Three-Quarters of Market Gains

Name/Ticker	Index Weighting (%)	YTD Return (%)	YTD Contribution to Index Return (%)
Apple AAPL	6.05	43.01	2.27
Microsoft MSFT	5.34	37.66	1.83
Nvidia NVDA	1.68	178.11	1.75
Amazon.com AMZN	2.36	51.58	1.05
Meta Platforms META	1.16	131.40	0.96
Alphabet GOOGL	3.00	34.13	0.92
Tesla TSLA	1.26	95.69	0.86

Source: Morningstar. Data as of June 26, 2023. For Illustrative Purposes Only.

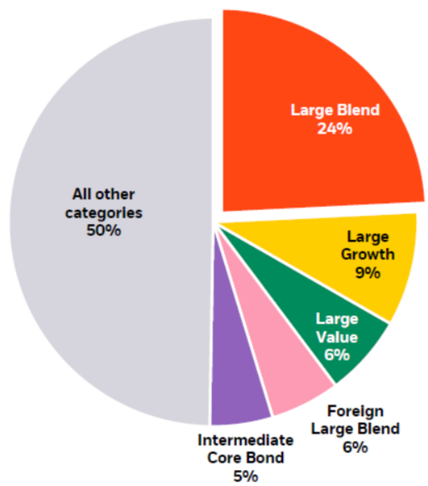
According to Morningstar, sectors that were the most undervalued last year have outperformed this year: Communications, 31.8%; Consumer Cyclicals, 25.4%; and Technology, 37.2%. Overvalued sectors at the end of last year have struggled: Energy, -8.4%; Utilities, -5.5%; and Healthcare, -2%. The Financial sector was also down 1.7% having absorbed the regional bank fallout. We think financial stocks have bottomed out.

Overweight to growth

With the recent runup in the market, large cap indices, especially the S&P 500 and Russell 1000, are very overweight growth. The S&P 500 is now tilted 41% to growth-oriented stock versus 23% value style box. The large cap blend category is almost a quarter of all assets in mutual funds and exchange-traded funds. The next largest category is 9%. Even these Core or blend funds and ETFs have become more heavily titled towards riskier growth stocks.

Enormous U.S. large cap core fund exposure overweight to growth

Percent of assets all mutual funds and ETFs
($23.9 Tr as of 5/31/23, top 5 categories)



Style exposure by U.S. large cap exposures
(as of 5/31/23)

	Value exposure	Core exposure	Growth exposure
S&P 500	23%	36%	41%
Growth index	6%	28%	66%
Value index	44%	44%	12%
Large core active funds	23%	39%	35%

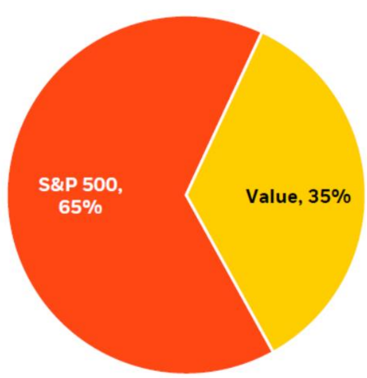
Source: Morningstar as of 6/30/23. Stock market represented by the S&P 500 Index, all fund categories represented by their respective Morningstar category,. Growth index represented by the Russell 1000 growth index, Value index by the Russell 1000 value index. **Past performance does not guarantee or indicate future results.** Index performance is for illustrative purposes only. You cannot invest directly in the index.

The graphic below shows just how much you would have to shift an S&P 500 portfolio toward value just to become style neutral, according to Blackrock. We could certainly see volatility in growth-oriented stocks going forward if mutual funds and ETFs re-balance away from growth sectors simultaneously.

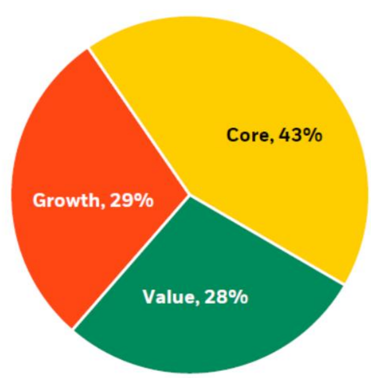
BALANCING GROWTH AND VALUE

The large cap indices are overweight growth, what it takes to get back to style neutral

By selling 35% S&P 500 and buying large value...



Your actual style exposures are skewed toward growth and core due to index overweights

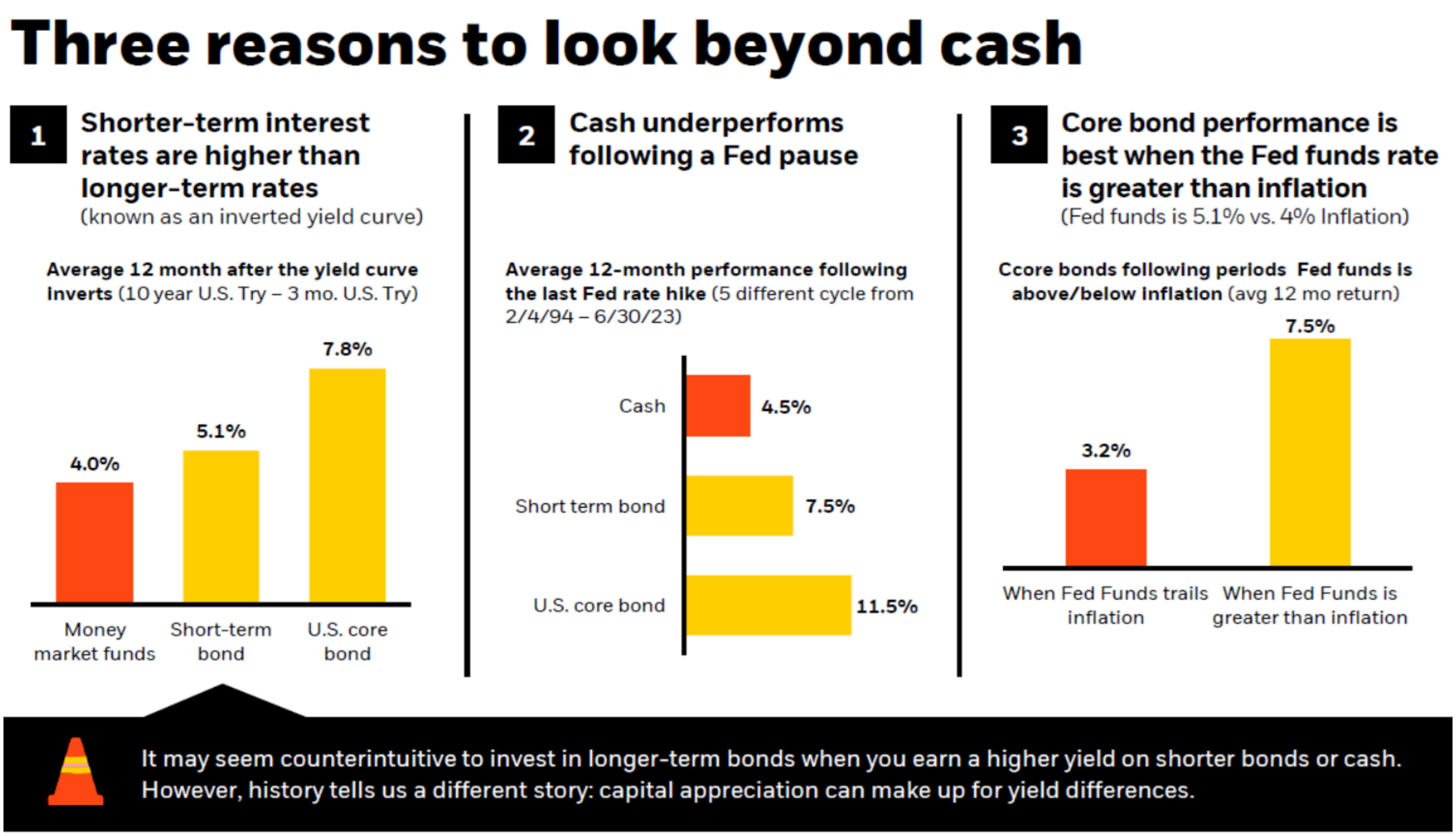


Worried about downside risk in your portfolio? Consider adding defensive stocks that are less sensitive to market fluctuations. We prefer quality companies with strong balance sheets, high cash flows, and low leverage.

Source: Morningstar as of 5/31/23. Stock market represented by the S&P 500 Index. **Past performance does not guarantee or indicate future results.** Index performance is for illustrative purposes only. You cannot invest directly in the index.

Although we still think there are plenty of attractively priced investment opportunities in Core individual equities, we began trimming over- and fairly-valued positions last quarter and are seeing less attractive ideas in Technology, Cyclicals, and other growth sectors. Referencing our ETF returns chart on the next page, it has been a terrific year for our largest ETF holding, the VanEck Morningstar Wide Moat Focus ETF which was up 22.9% in the first half of the year. We use this ETF to represent Core Equity in our smaller all-ETF portfolios. We use similar quality and price screening factors in managing Core Equity for larger portfolios.

Finally, maturities of a year or less are considered a "cash" asset class, and short-term yields are as attractive as they have been in a long time. Treasury bills and notes are providing excellent yields for short term spending liabilities. However, for long term portfolios it makes sense to extend duration or average maturities after interest rates have risen, and we have done so in our fixed income portfolios. Per Blackrock, three conditions are currently present: 1) The yield curve is inverted (short term rates higher than long term), 2) the Fed has paused Monetary tightening, 3) The current Fed Funds rate is higher than inflation. Historically, when these conditions exist longer term bonds have always outperformed cash returns.



Source: Morningstar as of 6/30/23. U.S. stocks are represented by the S&P 500 TR Index and U.S. bonds are represented by the Bloomberg U.S. Agg Bond TR Index, short term bonds by the Morningstar short term bond category average., money market funds by the Morningstar U.S. money market fund category average. **Past performance does not guarantee or indicate future results.** Index performance is for illustrative purposes only. You cannot invest directly in the index.

Please let us know if you have any questions. We look forward to talking with you soon.

—Dana L. Crosby, CFA, CFP®

ETF Returns

For the period ending 6-30-2023

Name	Ticker	YTD	1 Month	3 Months	12 Months	3 Year	5 Year	10 Year
U.S. Large Cap								
iShares Russell 1000	IWB	16.54	6.70	8.51	19.16	13.95	11.76	12.45
iShares Edge MSCI USA Momentum Factor	MTUM	-0.16	6.88	4.16	8.28	4.56	7.04	12.30
iShares Edge MSCI USA Quality Factor	QUAL	19.06	6.43	9.03	22.54	13.64	11.82	-
PowerShares S&P 500 Low Volatility ETF	SPLV	-0.57	4.05	1.24	3.61	10.28	8.05	9.66
Vanguard High Dividend Yield ETF	VYM	-0.47	5.52	1.38	7.67	13.92	8.44	9.91
VanEck Vectors Morningstar Wide Moat	**MOAT**	**22.92**	**6.59**	**8.07**	**26.77**	**16.65**	**14.44**	**14.09**
U.S. Mid Cap								
SPDR® S&P MidCap 400 ETF	MDY	8.80	9.16	4.81	17.45	15.25	7.58	9.99
PowerShares S&P MidCap Low Volatil ETF	XMLV	-1.96	5.13	-0.58	3.17	9.66	4.08	9.02
PowerShares DWA Momentum ETF	PDP	14.40	9.53	6.81	19.90	6.63	8.21	10.35
PowerShares High Yld Eq Div Achiev™ ETF	PEY	-5.12	5.53	-2.45	-2.36	14.78	6.20	10.21
U.S Small Cap								
iShares Russell 2000	IWM	8.09	8.06	5.26	12.38	10.73	4.11	8.27
PowerShares S&P SmallCap Low Volatil ETF	XSLV	-9.65	2.88	-5.50	-8.07	7.80	-1.30	6.41
REITs								
iShares US Real Estate	IYR	3.86	5.73	2.41	-3.06	5.74	4.26	6.16
International Large Cap								
iShares MSCI EAFE	EFA	12.49	4.49	3.25	18.63	9.13	4.58	5.39
iShares Edge MSCI Intl Momentum Factor	IMTM	9.13	5.57	4.10	13.68	5.26	5.09	-
PowerShares DWA Developed Mkts Mom ETF	PIZ	12.58	5.01	2.49	13.07	4.91	3.49	5.44
iShares Edge MSCI Intl Quality Factor	IQLT	11.44	3.99	2.25	17.75	9.22	6.84	-
PowerShares S&P Intl Dev Quality ETF	IDHQ	11.54	4.90	3.33	17.02	6.14	4.72	6.78
iShares Edge MSCI Min Vol EAFE	EFAV	8.24	2.18	1.74	9.55	3.07	1.71	4.69
iShares International Select Dividend	IDV	0.44	3.17	-1.56	4.51	8.03	2.37	3.69
International Small Cap								
iShares MSCI EAFE Small-Cap	SCZ	6.21	3.09	0.80	9.89	5.77	1.43	6.15
WisdomTree International SmallCp Div ETF	DLS	5.81	3.30	-0.40	7.12	6.58	0.02	4.86
Emerging Markets								
iShares MSCI Emerging Markets	EEM	5.20	4.40	1.04	0.94	1.69	0.39	2.39
PowerShares S&P Em Mkts Low Volatil ETF	EELV	3.76	1.77	2.12	4.53	10.48	3.62	1.91
PowerShares DWA Emerging Markets Mom	PIE	7.58	4.05	2.93	3.92	4.09	1.21	2.28

Data source: Morningstar

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