

## MARKET COMMENTARY - 2Q 2023



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## 2Q 2023 Market Returns

The stock market had a strong 2<sup>nd</sup> quarter based on better-than-expected economic data, U.S. debt ceiling resolution and a modest reduction in the inflation metrics.

Asset Class	Index	QTD	YTD	1 Year	3 years	5 Years
Global Equity	MSCI ACWI	6.2%	13.9%	16.5%	11.0%	8.1%
US Large Cap	S&P 500	8.7%	16.9%	19.6%	14.6%	12.3%
US Large Cap Growth	Russell 1000 Growth	12.8%	29.0%	27.1%	13.7%	15.1%
US Large Cap Value	Russell 1000 Value	4.1%	5.1%	11.5%	14.3%	8.1%
US Small Cap	Russell 2000	5.2%	8.1%	12.3%	10.8%	4.2%
International	MSCI EAFE	3.0%	11.7%	18.8%	8.9%	4.4%
Emerging Markets	MSCI Emerging	0.9%	4.9%	1.7%	2.3%	0.9%
Commodities	S&P Global Natural Resources	-3.9%	-3.8%	7.9%	17.7%	5.3%
Real Estate	CRSP US REIT	1.7%	3.4%	-4.0%	5.9%	4.4%
Muni Bonds	Bloomberg Municipal Bond	-0.1%	2.7%	3.2%	-0.6%	1.8%
Taxable Bonds	Bloomberg Aggregate Bond	-0.8%	2.1%	-0.9%	-4.0%	0.8%
High Yield Bonds	Bloomberg High Yield Bond	1.7%	5.4%	9.1%	3.1%	3.4%

Global equities returned 6.2%, driven by positive market sentiment and the excitement about the potential economic benefits from the adoption of artificial intelligence (AI). The largest contributor to equity market returns came from a small subset of technology stocks recently coined “The Magnificent Seven.”

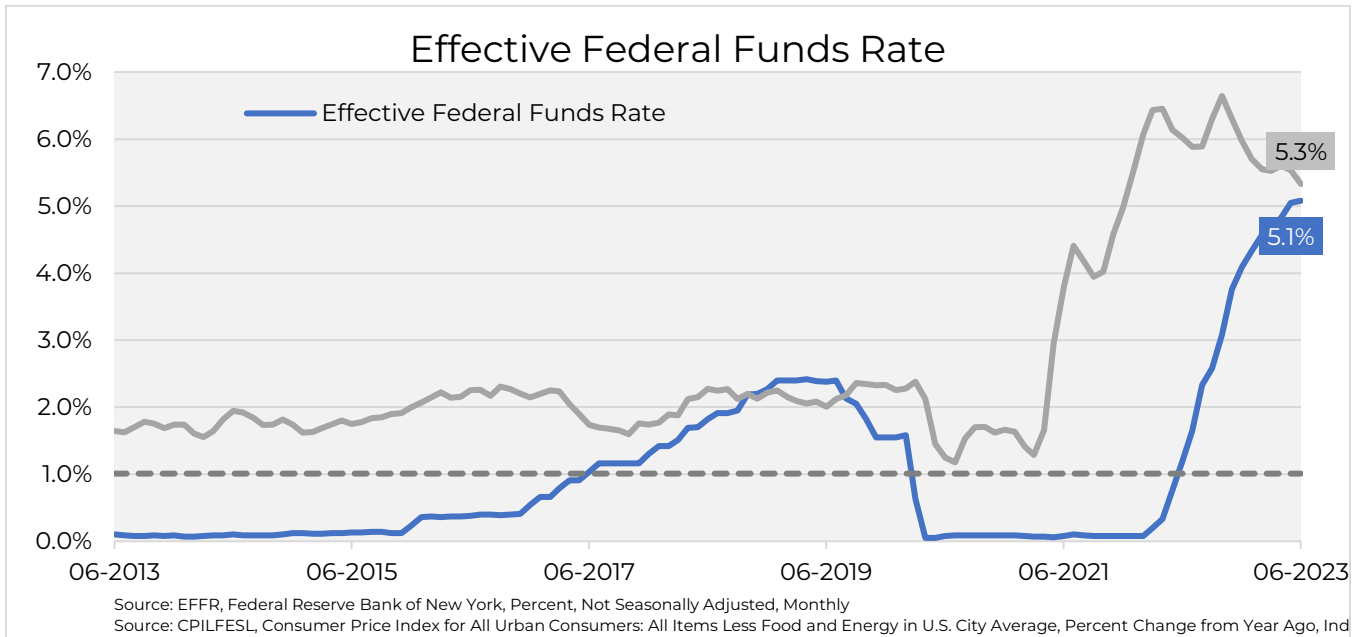
The core bond market returns were mixed during the quarter on concerns over prolonged higher interest rates. Bond yields moved higher, as the 10-year Treasury bond increased by 0.17%, while the corporate bond expected return premium over treasuries fell slightly due to lower market volatility.

Halfway through 2023, we have higher interest rates, steady employment, and modestly reduced inflation. The higher rates, driven by Fed policy, have not had the expected negative impact on employment, consumer spending and Core PCE inflation. The Fed’s long-term target for the Core PCE inflation level is 2.0%, which Chairman Powell recently stated is most likely unachievable for several years.

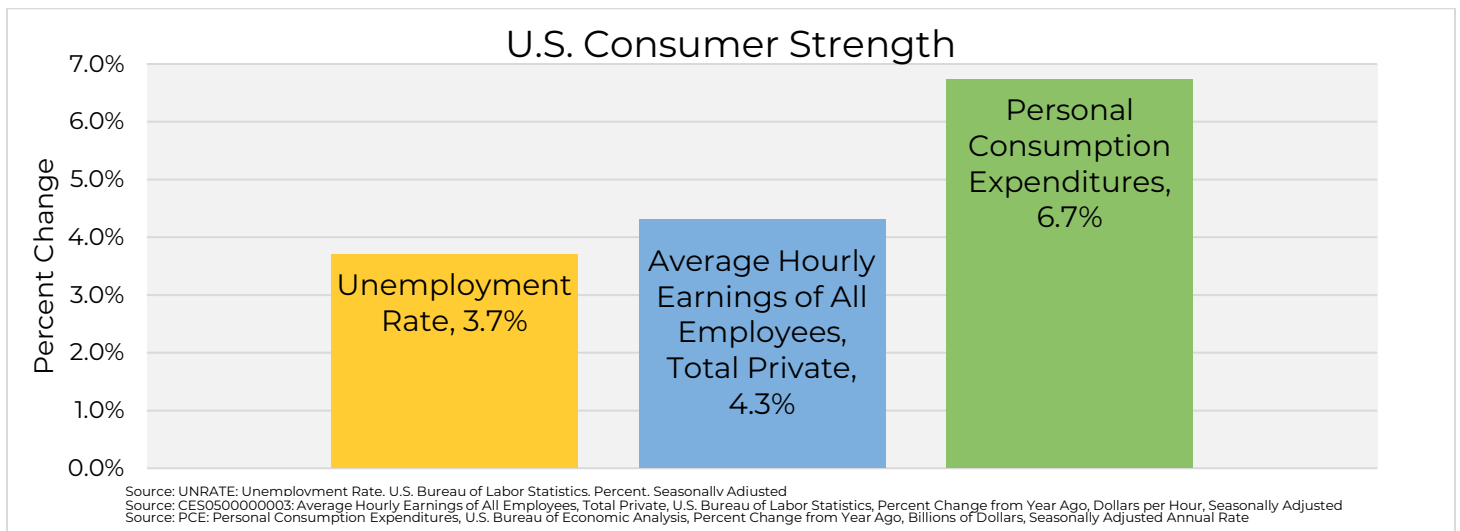
Indicator	Metric	Last	1Y Ago	3Y Ago	5Y Ago
Yield	10 Year US Treasury	3.81%	2.67%	0.55%	2.96%
Fed Funds Rate	Effective Fed Funds	5.07%	2.32%	0.10%	1.91%
Unemployment	US Unemployment	3.6%	3.5%	10.2%	3.8%
Inflation	Core CPI	6.0%	8.5%	1.0%	2.9%
Inflation	Core PCE	4.6%	4.7%	1.1%	2.1%

## The Federal Reserve Pauses But Remains Hawkish

The Fed Funds rate is currently at 5.07%, the highest reading since 2007. The Fed hit the pause button on the Fed Funds rate increases on June 14th after raising the rate 10 consecutive times from March 2022 to May 2023. Overall consumer inflation fell to its lowest level since late 2021. The Fed's long-term goal is to achieve a Fed Funds rate that is 0.5% higher than Core PCE: ex-Food and Energy inflation.

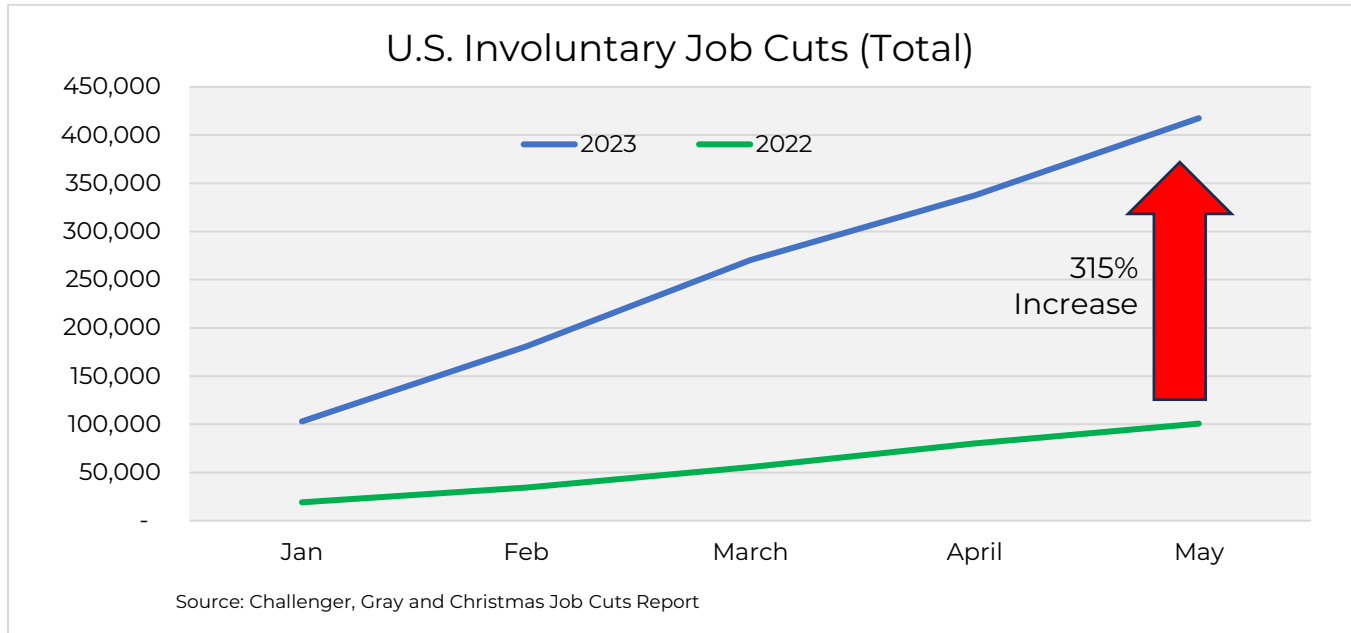


The Fed was quick to point out that this pause would be temporary as they are factoring in further hikes to slow the economy, specifically the strength in the job market, wage growth and consumer spending, which all remain strong. Chairman Powell stated that the Fed has “a long way to go” in his monetary policy testimony to Congress in June. The “dot plot” that summarizes the Fed committee members’ outlook indicates two additional 0.25% increases in 2023. Investors hoping for a Fed rate cut this year were taken aback by Fed chair Powell’s comment that rate cuts are a “couple years out.” The market is most recently pricing in an 87% chance that the Fed will hike in July by 0.25%.

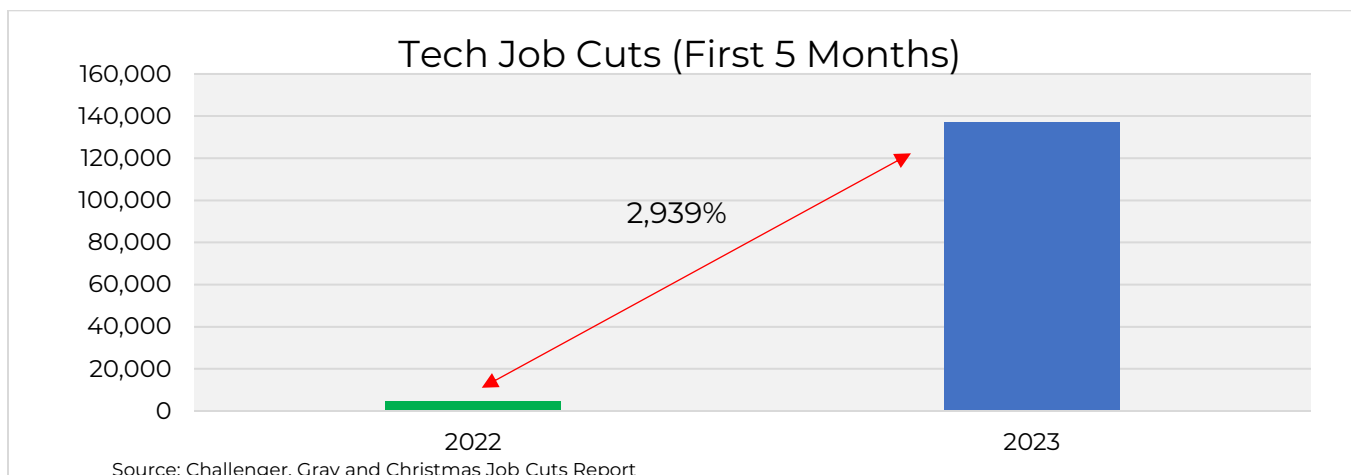


## Job Cuts: U.S. Corporations Focus on Profitability

Corporations have shifted focus from growth to profitability to combat the impacts of higher inflation and borrowing rates. These tactics tend to benefit companies in the short term but usually end up hurting future earnings and revenues. Part of the focus on profitability has come in the form of involuntary layoffs, which are up over 315% when comparing the first 5 months of 2023 to 2022. These layoffs tend to take several months to flow into the unemployment statistics due to severance packages and delay in filing for unemployment benefits.

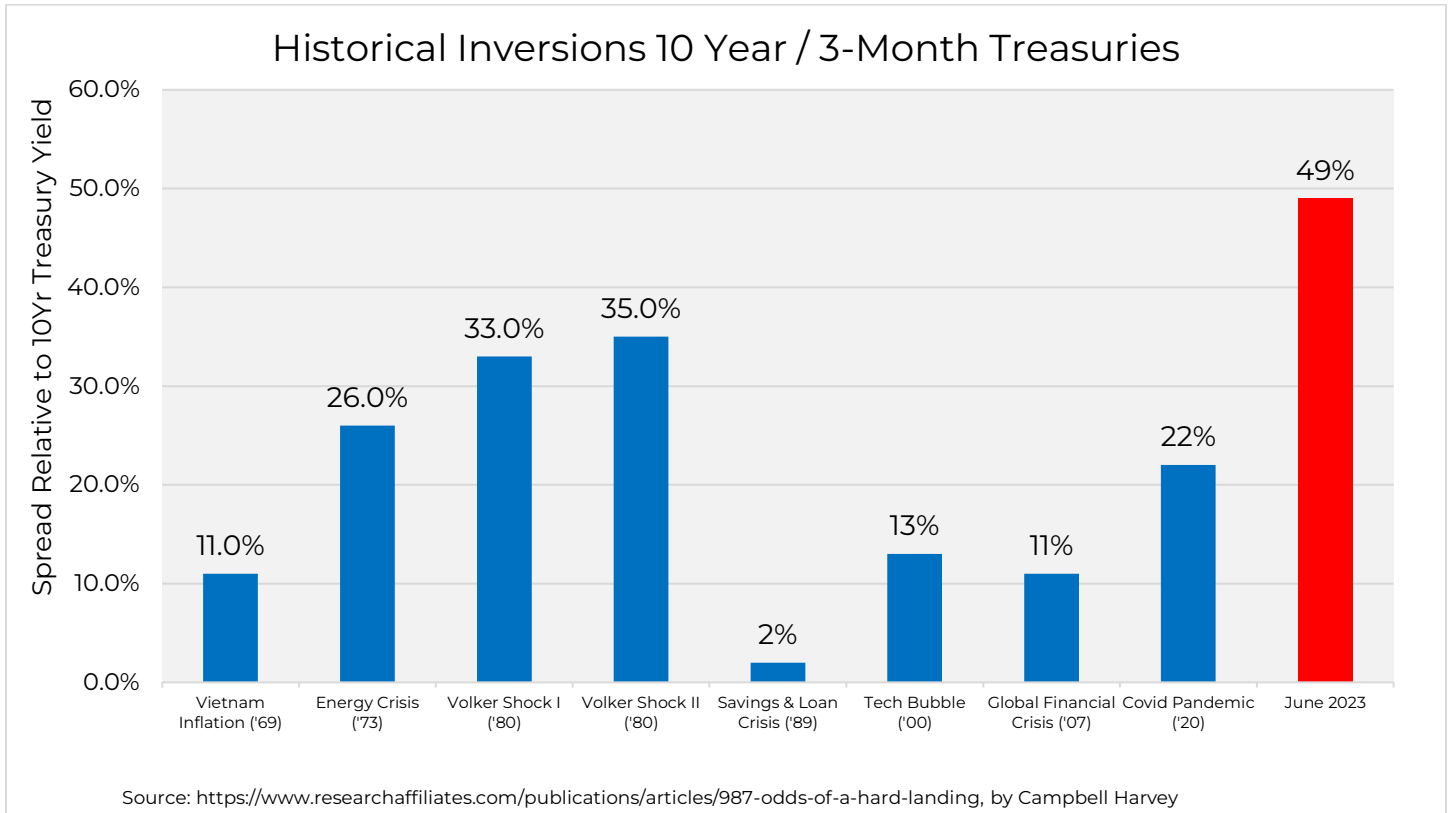


The largest contributor to the job cuts has come from an unlikely source. The technology sector has had an almost 3000% increase in job cuts in the first 5 months of 2023 compared to the first 5 months of 2022. The Tech industry accounts for 8% of the U.S. workforce but has contributed to 33% of the 2023 layoffs. Tech companies' investment in technology products and services has slowed dramatically in the last year as a major shift in focus discussed in earnings calls from growth to cost cutting, profitability and margins. For example, during a recent earnings call, Mark Zuckerberg used the word "efficiency" almost 100 times.

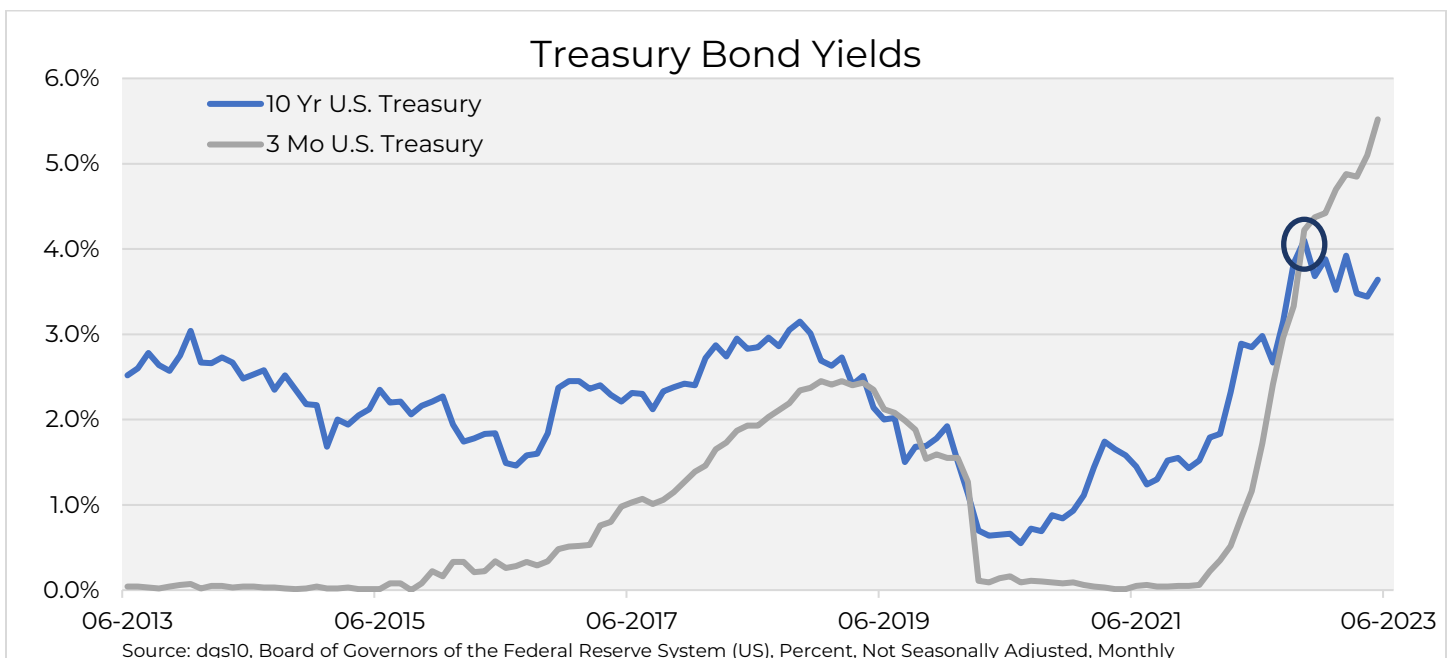


## Reason for Concern: Inverted Yield Curve

The Fed hawkish actions have caused an inversion in the yield curve. As outlined in the chart below, the 10-year yield relative to 3-month yields is at the greatest inversion going back to 1969. A recession has followed every inverted yield curve since the 1980s. The average time between the inverted curve and the subsequent recession being 12-24 months.

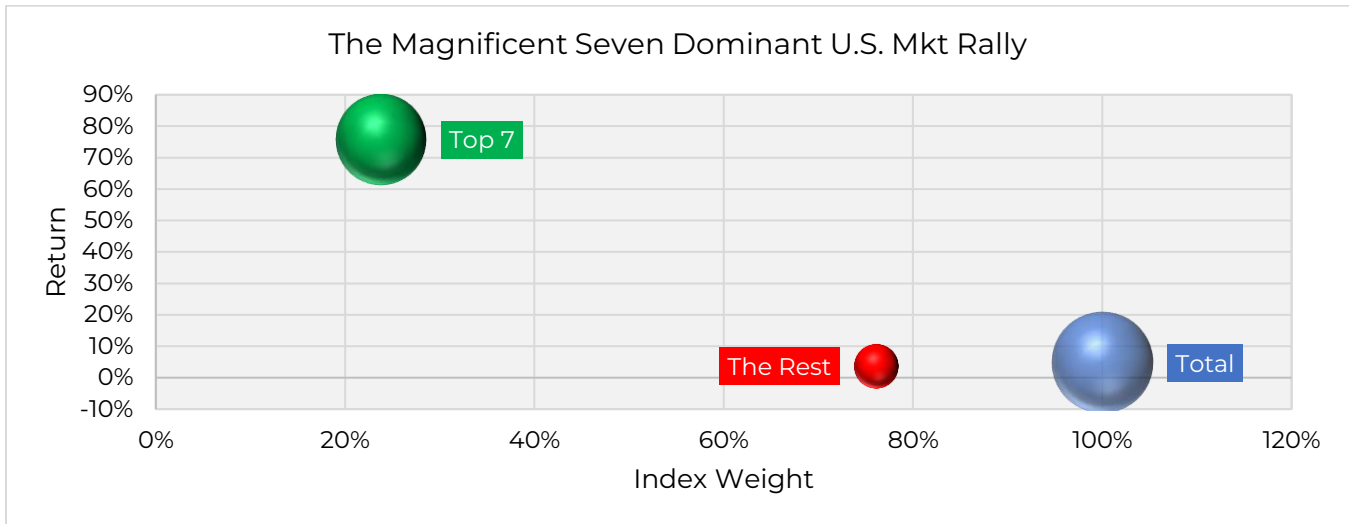


In the current Fed hiking cycle, the 3-month treasury yield moved higher than the 10-year treasury yield back in October 2022 (about 9 months ago).



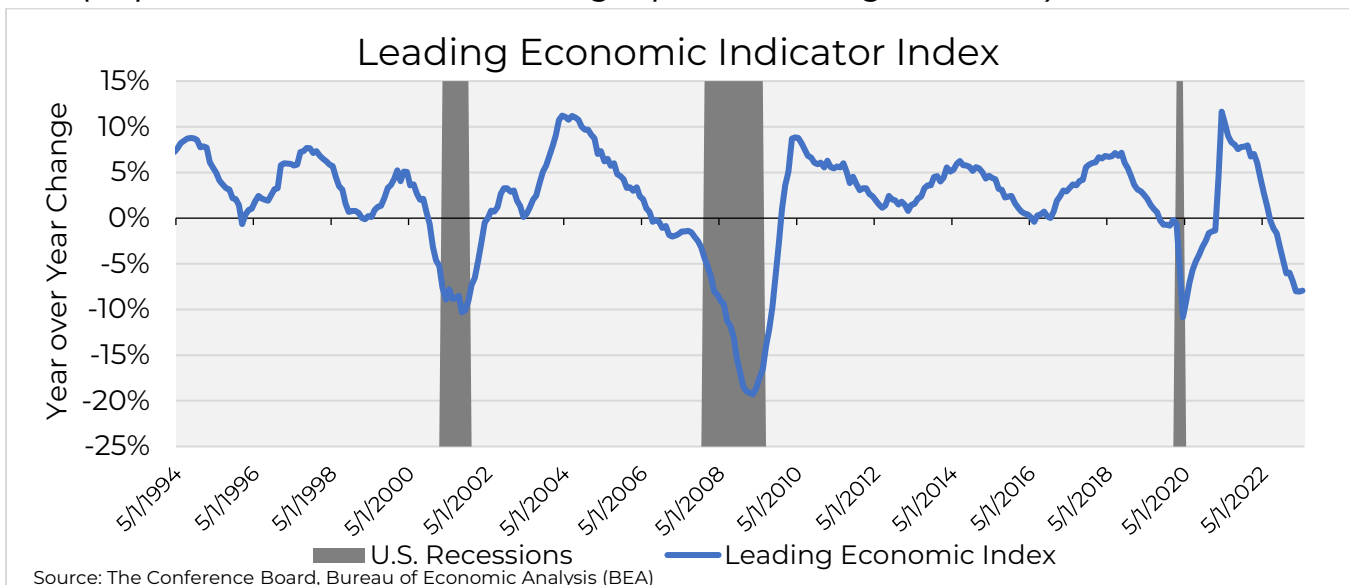
## Narrow Equity Rally: The Magnificent Seven

The Magnificent Seven stocks (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla), which represents less than 25% of the S&P 500, have returned on average 75% for the first 6 months of 2023. These strong performers are responsible for 80% of the S&P 500 return this year. In contrast, the remaining 490+ stocks in the S&P 500 have returned on average ~4% and over 40% of the stocks in the S&P 500 index have posted negative returns in 2023.



## Macro-Economic Environment Slowdown

The Fed's policy of rate increases over the past 15 months has only modestly reduced inflation pressures, but we are seeing evidence of increased economic weakness. The Conference Board U.S. Leading Economic Indicators Index (LEI), which contains 10 key data points, provides an early indication of significant turning points in the business cycle and where the economy is heading in the near term. The index has declined in each of the last fourteen months and has deteriorated more rapidly in the last 6 months. The US LEI continues to signal a recession within the next 12 months (<https://www.conference-board.org/topics/us-leading-indicators>).



## GSIS 2023 Allocation Positioning

The GSIS model allocation is structured to protect assets while allowing for long-term growth.

- The **Private Credit** portfolios were positive during the quarter, outperforming core bonds. The portfolios benefitted from the floating rate component through higher base rates resulting in higher income payments. Should the Fed continue to raise the Fed funds rate in 2023, the base rates will move higher resulting in even higher income payments.
- **Private Real Assets** had their first negative quarter since 1Q 2020 due to higher cap rates (real estate price decline) and interest rate hedge losses, which was a significant positive contributor in 2022 and remains a positive contributor since implementation. The investments continue to pay 4.5%+ in annual income as cash flow growth year over year at 9%, exceeding inflation. The portfolios continue to focus on the high-quality residential and industrial parts of real estate. The allocation to data centers has increased in 2023.
- The **Private Equity** strategies continue to perform well as a group. The majority of the portfolio is allocated to higher quality growth and buy-out portfolio companies. The investment managers in the secondary space have been focused on providing liquidity to sellers at discount prices in the current environment. The portfolios are underperforming public equities which is expected in a strong bull market but are still outperforming public equities over longer time horizons with much less price volatility.
- Within **Core Public Fixed Income**, most bond indices generated flat to slightly negative returns due to the overall rise in yields. The 10-year U.S. Treasury rate rose by 0.17% during the quarter. We continue to maintain a short-duration tilt relative to the broad market as has been our position since the Fed turned hawkish in early 2022. Short-duration bonds outperformed longer-duration bonds during the quarter.
- In **Global Public Equities**, U.S. large cap equities were the best performer in the quarter, once again led by a narrow subset of large cap growth stocks.

Our active strategic allocation continues to dampen volatility in client portfolios while capturing the majority of the market rallies.

Thank you for your Trust and Confidence.



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