MV CAPITAL MANAGEMENT

Weekly Market Flash

A Pretty Resilient First Half for US Equities

June 30, 2023

Well, here we are already, halfway through the 2023 marathon. It's the time of year when we go back, re-read the opinions we shared with you in our annual outlook in January, see what we got right and wrong, and adjust our outlook based on what we know now. As Yogi Berra said, it's hard to predict things, especially when it's about the future. In our commentary this week we will take a close look at US equities. Next week 's focus will be on the bond market, and following that we will consider the case of non-US developed and international equities.

After the Fall, the Stabilization

Equity markets hit a bottom in October 2022, with the S&P 500 retreating about 25 percent from the record high set at the beginning of that year. As we surveyed the landscape at the beginning of 2023, one of the things we paid attention to was the historical pattern of stock market pullbacks in conjunction with a cyclical recession. The 25 percent drawdown in 2022 was pretty well within the range of such events in the past (we emphasize here that we are talking about traditional business cycle recessions, not events driven more by financial crises (e.g. the 2000 tech meltdown and the 2008 financial crisis) than by the attendant recessions. We opined in our annual outlook that the first half of 2023 might be volatile, but that equities should stabilize at some point and offer upside potential.

The stabilization came sooner than we might have thought; ironically, it came on the heels of an unanticipated development – the collapse of several prominent financial institutions including Silicon Valley Bank and Swiss behemoth Credit Suisse. The unrest in the banking sector could have been one of those crisis events that would test the resilience of the October '22 lows. Instead, once it became clear that the troubles were more localized rather than a system-wide contagion, conditions settled down. As we write this article on Friday morning, the S&P 500 is up in simple price terms by more than 15 percent from its beginning of the year level, and a scant eight percent off that January 2022 high point. Meanwhile the VIX index that serves as a measure of market volatility is trading at its lowest (i.e., least volatile) level since before the Covid-19 pandemic.

AI Optimism Outlasts Recession Pessimism

The biggest complaint many investors have had about US equities in the first half of the year relates to the very narrow breadth of the rally, a topic we have covered on several occasions in our weekly commentaries. Seven mega-cap stocks did the lion's share of heavy lifting, and the common thread tying them together was artificial intelligence. Generative AI is a core growth driver for a handful of firms including Microsoft, Nvidia, Amazon, Alphabet (Google) and Meta (Facebook). The frenzy around this theme followed the public unveiling of chatGPT, a generative AI platform that performs some fairly amazing (and sometimes bizarre) feats of responding to human queries, late last year. As we noted in our commentary of May 26 the five companies mentioned above plus Apple and Tesla, collectively accounting for around 28 percent of the S&P 500, accounted for some 85 percent of the S&P 500's year to date gain as of that writing.

While the AI frenzy was going on, though, a not inconsiderable chorus of skeptics noted that the overall economic picture was a concern. Indeed, one of the core themes in our January outlook was the likelihood

of a US recession at some point in 2023. Those who were skeptical about the AI-driven euphoria of the past several months pointed to the vulnerability of the market to a broad-based downturn once the small coterie of mega-caps had run their course. Other parts of the market like cyclicals, financials and small caps could be particularly vulnerable to a notable economic downturn.

More Room to Run?

That argument may have some reasonably compelling historical precedents. But the economy is showing quite a bit more resilience than one might have thought it would, a year and a half into the most severe monetary tightening program conducted by the Federal Reserve since the draconian shocks of the Volcker Fed in 1979-81. The jobs market has surprised to the upside month in and month out. Unemployment claims, while higher than they were a year ago, have not supplied evidence of widespread layoffs beyond a few concentrated sectors. Consumer spending, the engine of US economic growth, has stayed firm. In fact, just this week first quarter real GDP growth was revised upward largely due to better than previously estimated results for consumer spending.

We will talk more about the recession question in our piece next week on the bond market, where a persistently inverted yield curve has been screaming “recession” for many months now. For purposes of US equities, though, we do not think the potential for an imminent recession is likely to weigh heavily on stocks as we head into the third quarter. The early signs of an equity asset class rotation that we talked about in our commentary last week continue; for example, the Russell 2000 small cap index, an underperformer for most of the year so far, has actually outperformed the tech-dominated Nasdaq for the month of June. We think there could be some more room to run, with broader participation than we have seen so far. There are always risks to consider, of course. But the equity market has done a pretty good job so far this year of climbing the fabled wall of worry.

Masood Vojdani
President & CEO

Katrina Lamb, CFA
Head of Investment Strategy & Research

Investment Advisory Services offered through MV Capital Management, Inc., a Registered Investment Advisor. MV Financial Group, Inc. and MV Capital Management, Inc. are independently owned and operated.

Supplemental disclosure item: MV Financial maintains an active portfolio position in shares of Alphabet, Apple, Microsoft and Nvidia, mentioned in this commentary.

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by MV Capital Management, Inc.), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from MV Capital Management, Inc. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. MV Capital Management, Inc. is neither a law firm nor a certified public accounting firm and no portion of the newsletter content should be construed as legal or accounting advice. A copy of the MV Capital Management, Inc.’s current written disclosure statement discussing our advisory services and fees is available for review upon request.