Second Quarter 2023 Market Commentary

The Economy

Last Thursday, the Commerce Department delivered some good news about the state of the US economy. It sharply upgraded its assessment of first quarter growth from 1.3% to 2.0%. It still represents a significant economic slowdown from the prior two quarters, as the Federal Reserve's efforts to tame inflation through a series of ten consecutive interest rate increases have impacted growth.

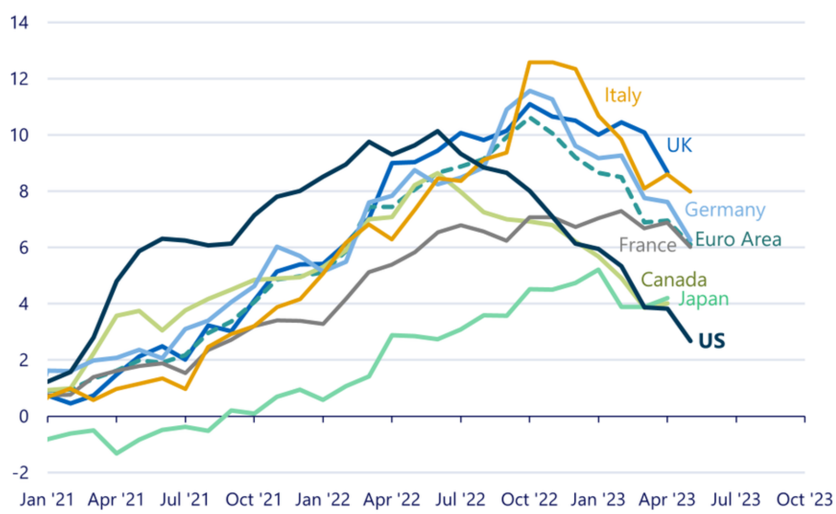
The report's details on GDP (gross domestic product - the total output of goods and services) revealed why the economy has managed to avoid falling into a recession. Consumer spending - which comprises about 70% of the US economy - continued to rise. The 4.2% annual rate for Q1 2023 was the most since the second quarter of 2021.

For the second quarter, it's assumed that the economy's growth has slowed more, while still remaining positive. A recent survey of economists showed a projected growth rate for Q2 of about 1%.

By way of comparison, the US currently has the highest growth and lowest inflation of the G7 nations.

Figure 1. Harmonized Headline HICP Inflation in the G7

All items, HICP basis (Year-on-year percent)



Council of Economic Advisers

Sources: Eurostat, ONS, BLS, Statistics Canada, MEI, CEA analysis.

Note: Euro Area: HICP; UK: CPI; US: R-HICP-U; Canada: CPI ex. Mortgage Interest, Replacement Cost, & Property Taxes; Japan: CPI ex. Imputed Rent.

As of June 20, 2023 at 6:00pm.

Springwater WEALTH MANAGEMENT

Inflation & Interest Rates

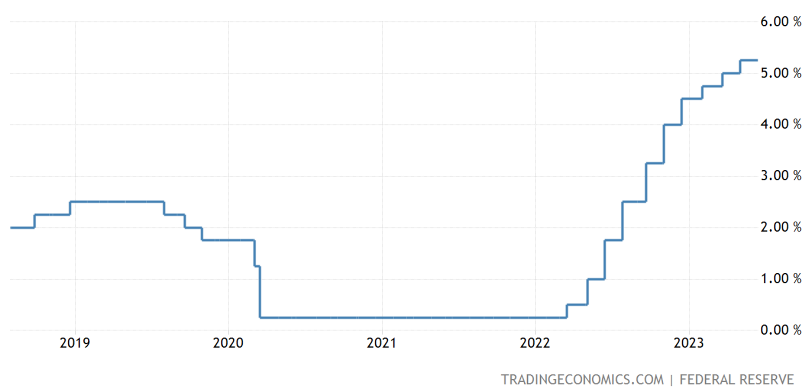
At a conference in Sintra, Portugal the leaders of the Federal Reserve, the European Central Bank and the Bank of England stated that additional interest rate increases may be required to bring inflation down to a target rate of 2%. This despite warnings from some economists that further rate hikes could trigger a global economic recession or even a financial crisis.

Fed Chair Jay Powell said that, while current monetary policy is restrictive, it may not be restrictive enough and it perhaps hasn't been restrictive for long enough.

Investors expect the central banks to raise rates at least once or twice more in the coming months, as economic growth has remained surprisingly resilient, labor markets are relatively tight, and wages continue to rise.

As we've noted before, the Fed has raised its benchmark interest rate - the Fed Funds rate - ten times since March 2022 in its effort to tackle inflation, which reached 9.1% last year but has since slowed to 4%.

The chart below shows the changes in the Fed Funds rate over the past five years.



Source: Trading Economics

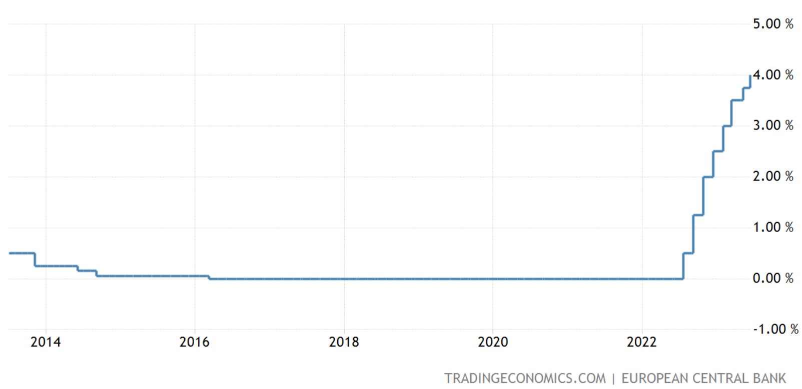
The markets are still anticipating that the Fed will succeed in getting inflation down close to its long-term target of 2% per year, with the 10-year breakeven inflation rate hovering around 2.2% for several months.

Source: [Federal Reserve]

Inflation has also been falling in the Eurozone but, as in the US, the labor-intensive services sector hasn't seen inflation soften as quickly as that for goods and housing.

Eurozone inflation is currently running at about 6.1%, and at 8.7% in the UK, compared to the aforementioned 4% in the US.

The chart below shows the EU equivalent of the US Fed Funds rate over the past decade.



Source: [Trading Economics]

Mortgage Rates

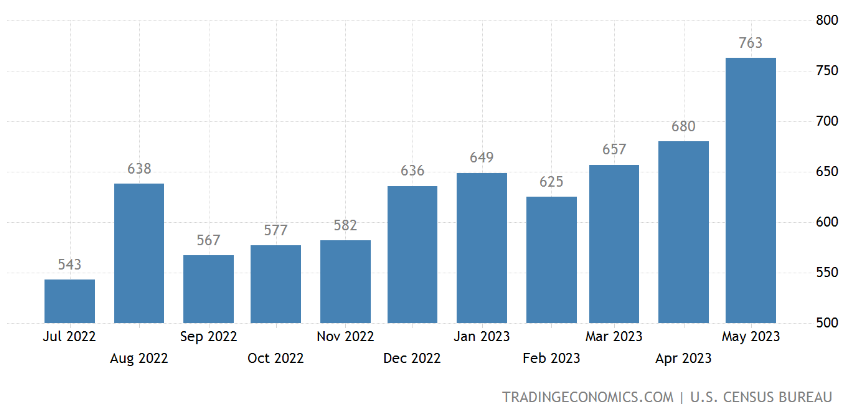
The average rate for a 30-year fixed rate mortgage rose slightly on Friday to 6.71%. This reversed three consecutive weekly decreases. A year ago, the benchmark loan rate was at 5.7%. Loan rates have fluctuated between 6% and 7% over the past six months, and it appears that buyers have adjusted to this new rate environment.

The chart below shows the benchmark fixed mortgage rate over the past five years.

Source: [Trading Economics]

The Housing Market

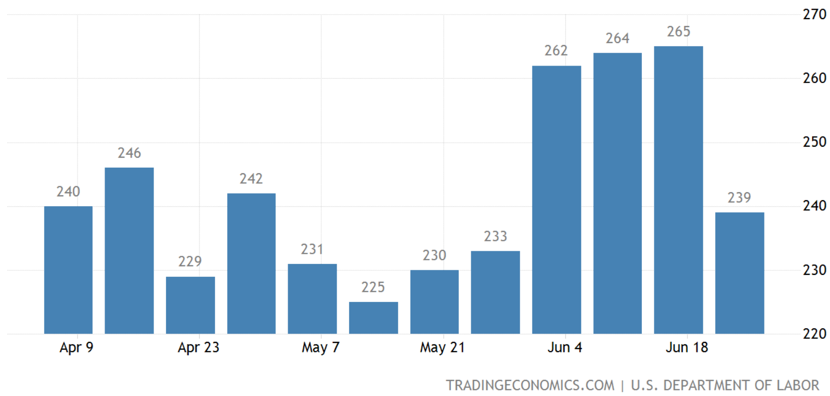
New home sales are at their highest level in more than a year.



Source: [Trading Economics]

The Labor Market

The number of Americans filing for unemployment benefits fell to 239,000 for the week ended June 24. This figure represented a drop of 26,000 from the prior week, the sharpest decrease since October 2021, and was well below the market's expectation of 265,000. The four-week moving average, which removes week-to-week volatility, rose by 1,500 to 257,550.



Source: [Trading Economics](#)

The Markets

US Stocks

Stocks rallied on the last trading day of the second quarter, responding to news about softening inflation and providing hope that additional interest rate increases may not be required.

Notably, Apple rose 2.3% for the day, and became the first company to be valued at more than $3 trillion.

The benchmark S&P 500 index - a proxy for large US companies - closed up 1.2% on Friday. Over the past month the index is up 6.4%, and over the past year it's up 16.3%.

The chart below shows the performance of the S&P 500 index over the past year.

Source: [Trading Economics]

The tech-heavy Nasdaq closed up 1.6% on Friday. Over the past month the index is up 6.4%, and over the past year it's up 30.9%.

The chart below shows the performance of the Nasdaq index over the past year.

Source: [Trading Economics]

International Stocks

The Stoxx 600 index - a proxy for large European companies - closed up 1.2% on Friday. Over the past month the index is up 2.3%, and over the past year it's up 13.5%.

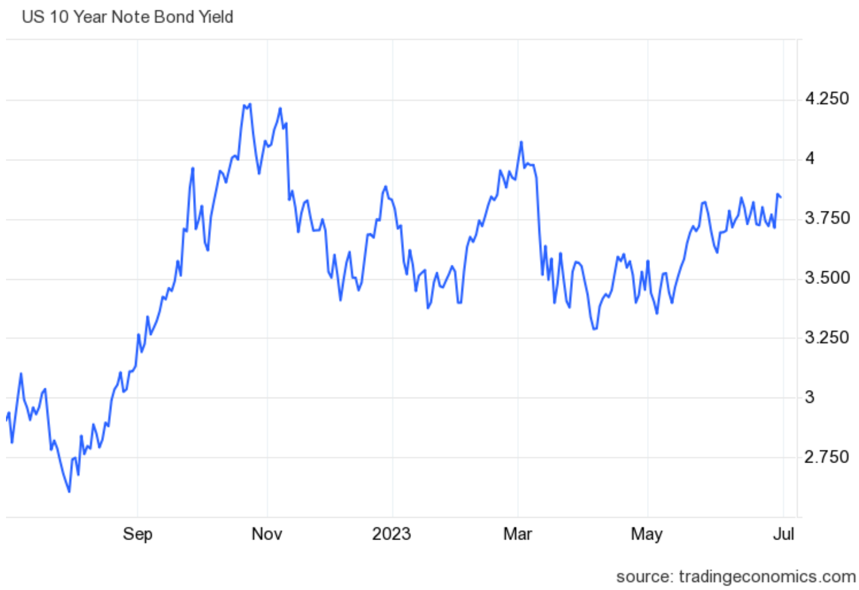
The chart below shows the performance of the Stoxx 600 index over the past year.

Source: [Trading Economics]

The Bond Market

The yield on the benchmark US 10-year Treasury note closed at below 3.85% on Friday, down from an over three-month high of 3.89% reached earlier in the week. Economic data showing a slowdown in the Fed's preferred measure of inflation suggested price pressures are easing due to the Fed's aggressive series of consecutive interest rate increases.

The chart below shows the yield on the benchmark US Treasury note over the past year.



Source: [Trading Economics]

Oil

Prices for the benchmark West Texas Intermediate futures contract closed at about $70 per barrel on Friday, as tightening global supplies offset concerns about softening demand. Saudi Arabia plans to reduce output in Q3, supporting the broader OPEC+ agreement to limit supplies until 2024.

The chart below shows the performance of the WTI contract over the past year.

Source: [Trading Economics]

Gasoline

Prices for gasoline futures contracts fell to about $2.50 per gallon on Friday, the lowest in two weeks. US domestic stockpiles rose more than expected, while demand increased only slightly. Prices remain well below the record levels of $4.00 per gallon seen in the summer of 2022.

Source: [Trading Economics]

A Giant in Finance Passes

Harry Markowitz, a Nobel laureate economist and one of the pioneers of modern investment theory, died last month at age 95.

Markowitz was one of the first academics to introduce abstract mathematical concepts - with structure and rigor - to investment decision-making. He is responsible for [Modern Portfolio Theory].

Before Markowitz published his seminal work "Portfolio Selection" in 1952, investing experts assumed that the best strategy was simply to select shares in companies that were thought to have the best prospects. His groundbreaking research was based on the relationship between risk and reward. He showed that the risk in any portfolio is less dependent on the riskiness of its component stocks and other assets, and more on how they relate to one another. It was the first time that the benefits of diversification had been codified and quantified, using advanced mathematics to calculate correlations and variations from the mean.

Andrew Lo, a professor at MIT, said, "Everyone knew about diversification - not putting all your eggs in one basket. But Markowitz told us more than that. He told us how many eggs we should put in the different baskets, and how to diversify in a systematic way."

Today, almost all modern professional investing is built on this type of quantitative analysis, with a focus on optimization and concepts of risk management that likely would not without Markowitz's insights.

Protecting Yourself from Financial Scams

Virtually every major financial institution - from custodians like Charles Schwab and Fidelity, to banks like Wells Fargo, Bank of America, and JP Morgan Chase - is highlighting the risks to consumers and investors from financial scams. Schwab, for example, even makes a brochure available online.

With the explosion in popularity of electronic communication and social media in recent years, "phishing" and "smishing" scams have become increasingly common.

This short article describes phishing in some detail: Trend Micro: What is Phishing?

This short article describes smishing in some detail: Trend Micro: What is Smishing?

In addition to common-sense recommendations like not clicking on links in texts or emails from unknown senders, most cybersecurity experts will recommend using a password manager to protect online access to your personal information and accounts.

And while some of you may have heard about the well-publicized hack of LastPass in late 2022, you shouldn't lose faith in password managers altogether. If you look online, you'll see that - in no particular order - 1Password, Bitwarden, NordPass and Dashlane - all come highly recommended.

Think of password managers like virtual safe deposit boxes. They hold your "valuables", in this case usually online credentials, in a section of the vault only accessible to you by a master password or a security key.

The password manager will automatically generate very complex passwords for websites that you visit regularly. It will also have an auto-fill feature that make it convenient to log in to any website without needing to remember those complex passwords, and it can keep your credit card information accessible for convenient online purchases, if you wish.

The mechanics of keeping those passwords safe differs slightly from provider to provider. Generally, you have a lengthy, complex "master password" that safeguards the rest of your information. In some cases, you might also get a "security key" to enter when you log in to new devices. This security key is a random string of letters, numbers and symbols that the company will send you when you register your account. Only you know this key, and because it's stored locally on your device or printed out on paper, it's more difficult for hackers to obtain.

Your master password should be long - ideally at least 20 characters. It should contain a mix of letters, numbers and symbols. It should avoid common words or phrases. And it should be easy for you to remember and to type into your manager when necessary (most managers will ask you to re-enter your master password periodically).

So, for example, "Ilovepoppyseedcupcakes" isn't complex enough. But, "1H@t3Muff1nsbutLuvc00ki3$" is considerably stronger.

If you suspect your accounts or financial information have been hacked, or your identity stolen, you should immediately contact the FBI and the FTC. You may also want to contact the credit bureaus to have your accounts frozen, to prevent unauthorized access. And you can use the free tool at USA.gov for additional guidance.

Benchmark Returns

For comparative purposes, the S&P 500 index (a proxy for large US stocks) rose 16.3% for the twelve months to June 30, and gained 8.3% in the second quarter.

The Russell 2000 (a proxy for small US stocks) rose 12.3% for the twelve months to June 30, and gained 5.2% in the second quarter.

The Wilshire 5000 index (a proxy for the broad US stock market) rose 19.0% for the twelve months to June 30, and gained 8.4% in the second quarter.

The MCSI EAFE index (a proxy for large international stocks) rose 15.5% for the twelve months to June 30, and 1.9% in the second quarter, as measured in USD. Because the USD strengthened slightly during the quarter versus the EUR, the picture was different when measured in the local currency, with the index gaining 10.6% for the 12 months to June 30, and rising 1.4% for the second quarter.

Finally, the MSCI Emerging Markets index fell -1.1% for the twelve months to June 30, and was basically flat in the second quarter.

In the fixed income segment, the Bloomberg Barclays US Aggregate Bond Index returned 0.6% for the twelve months to June 30, as rapidly rising interest rates pushed down bond prices.

Looking Forward

With the good news that US inflation seems to be trending down even as the economy manages to grow, the likelihood of an economic "soft landing" seems more possible.

Finally, we remind you that Springwater's investment philosophy is based on decades of robust, peer-reviewed academic research. One of the principles of that philosophy is that, over time, investors can expect to generate higher returns if they tilt their portfolio's equity allocation toward small stocks (the "size" factor) and value stocks (the "value" factor). The important caveat is that these tilts don't consistently deliver higher returns, day in and day out, just as stocks don't always out-perform bonds and cash.

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For those of you that are not already doing so, we encourage you to follow us on Twitter (at @SpringwaterWM), Facebook (at https://facebook.com/SpringwaterWealth/), and/or Instagram (at springwaterwealth). We're conscious of the "information overload" that everyone faces these days, and by using social media we can share with you our thoughts, observations and ideas in the least intrusive manner possible.

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Important Disclosure Information

as legal or accounting advice. A copy of the Springwater's current written disclosure Brochure discussing our advisory services and fees continues to remain available upon request.