POWER
WEALTH MANAGEMENT

# QUARTERLY MARKET UPDATE

PLAN WITH PURPOSE.
INVEST WITH CONFIDENCE.

2023

# Nicholas Coppola *MBA®, CFA®*

For those of you who have not yet had the pleasure of meeting Nick Coppola, we would like to take this opportunity to formally introduce him.

Nick is the Chief Investment Officer at Power Wealth Management. Nick has spent the better part of two decades in the investment business, in fixed income and derivative trading, institutional equity research, and most recently, as Senior Portfolio Manager overseeing nearly a billion dollars in assets.

Throughout his career, Nick has developed several beliefs that are foundational to his investment approach. These beliefs align with Power Wealth Management's core investment principles.

## Investment Principles

- We believe clients should understand and be compensated for the financial risks they take.
- We believe portfolio diversification is an active process that requires more than just traditional stocks and bonds.
- We believe a tax-sensitive approach is key to enhancing real returns.
- We believe each client's portfolio should be customized to best help them achieve their financial goals.

# July 2023

*"There's an excitable dog on a very long leash in New York City, darting randomly in every direction. The dog's owner is walking from Columbus Circle, through Central Park, to the Metropolitan Museum. At any one moment, there is no predicting which way the pooch will lurch.But in the long run, you know he's heading northeast at an average speed of three miles per hour. What is astonishing is that almost all of the dog watchers, big and small, seem to have their eye on the dog, and not the owner."*

*-Ralph Wanger, former manager of the Columbia Acorn Fund*


The complex backdrop we face halfway through 2023 calls for active management and decision-making. We are diligently evaluating the most compelling long-term opportunities for the allocation of capital while managing risk. As always, we caution that in the short-run markets are inherently volatile, and our clients' financial outcomes are logically more related to longer-term financial performance, as well as appropriate financial planning. Consistent with the PWM investment philosophy, we invest our clients' hard-earned capital with a focus on the long-term, but maintain flexibility to act opportunistically, and change course as new information arises.

# 2023 First Half Market Performance, Key Drivers & Outlook

The first half of 2023 has been remarkable, with domestic stocks up ~16%, despite a number of concerns, including a mini-banking crisis precipitating the collapse of Silicon Valley Bank, Signature Bank, and First Republic Bank, congressional brinksmanship over the federal debt ceiling, and continued rate hikes as the Federal Reserve Board battled persistent inflation. **See Figure 1.**

**Figure 1. Market Performance, Total Returns**

| | Q2'23 | 1H'23 |
|---|---|---|
| **Equities** | | |
| US Total Market[1] | 8.4% | 16.2% |
| International Developed[2] | 4.6% | 12.0% |
| Emerging Markets[3] | 1.4% | 3.9% |
| **Fixed Income** | | |
| Aggregate[4] | -0.8% | 2.0% |

*1. S&P Total Market Index, 2. FTSE Developed ex US Index, 3. FTSE Emerging Index, 4. Bloomberg US Aggregate Index*

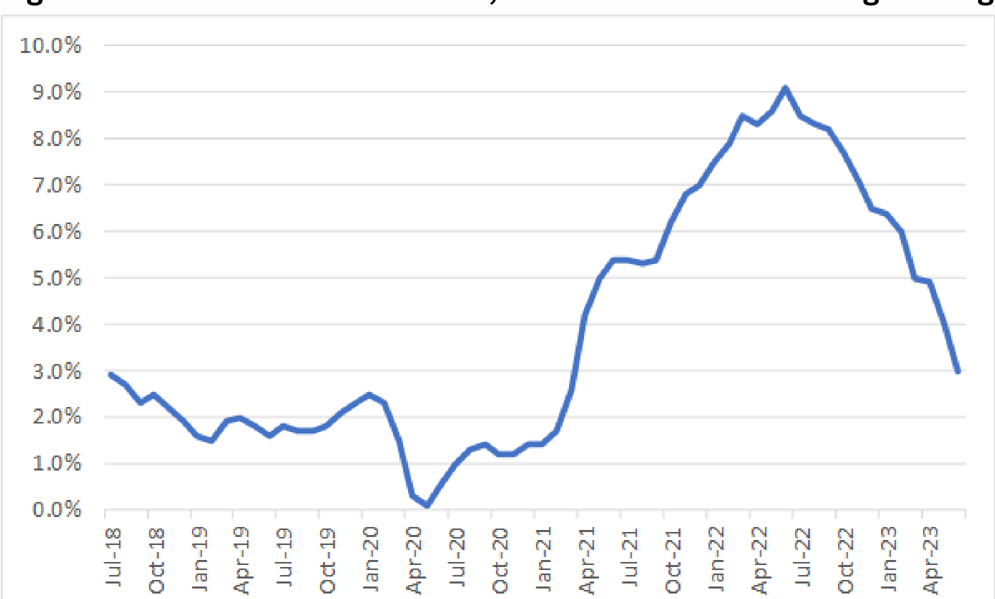
So why did the market rise in a period with so much turmoil? Time and again, investors' worst fears failed to materialize. The 'banking crisis' appears to have been small and contained by a swift federal government response to guarantee deposits. The threat of a government default was averted with the passage of a debt ceiling bill, and rate hikes have yet to push the economy into recession. Going forward, we are proceeding with cautious optimism.

# U.S. Economic Trends

Despite these reassuring developments, we continue to keep an eye on a number of lingering concerns. Currently, the yield curve is inverted, meaning long-term treasury yields are lower than short-term treasury yields, a signal that has historically preceded recession. Additionally, the Federal Reserve only started raising rates in March 2022, and the impact on the economy occurs on a lagged basis. As a result, the dampening effect of higher interest rates has yet to fully play out. On the other hand, the labor market is still strong with new jobs added each month, and analysts who have been forecasting a recession continue to ‘kick the can down the road,’ pushing back the timeline of their predictions.

Encouragingly, the Fed has been successful in starting to rein in inflation, though admittedly, there is still more work to be done. The U.S. Consumer Price Index shows inflation peaking at about ~9% in June 2022 and trending down to ~3% one year later. **See Figure 2.** Related to this, we believe we’re reaching the end of the Fed’s rate hiking cycle, and investors will soon be breathing a collective sigh of relief. Note that the Fed’s ‘dot plot’ expects two more 25 basis point increases during the remainder of the year, followed by rate cuts in 2024 and 2025.

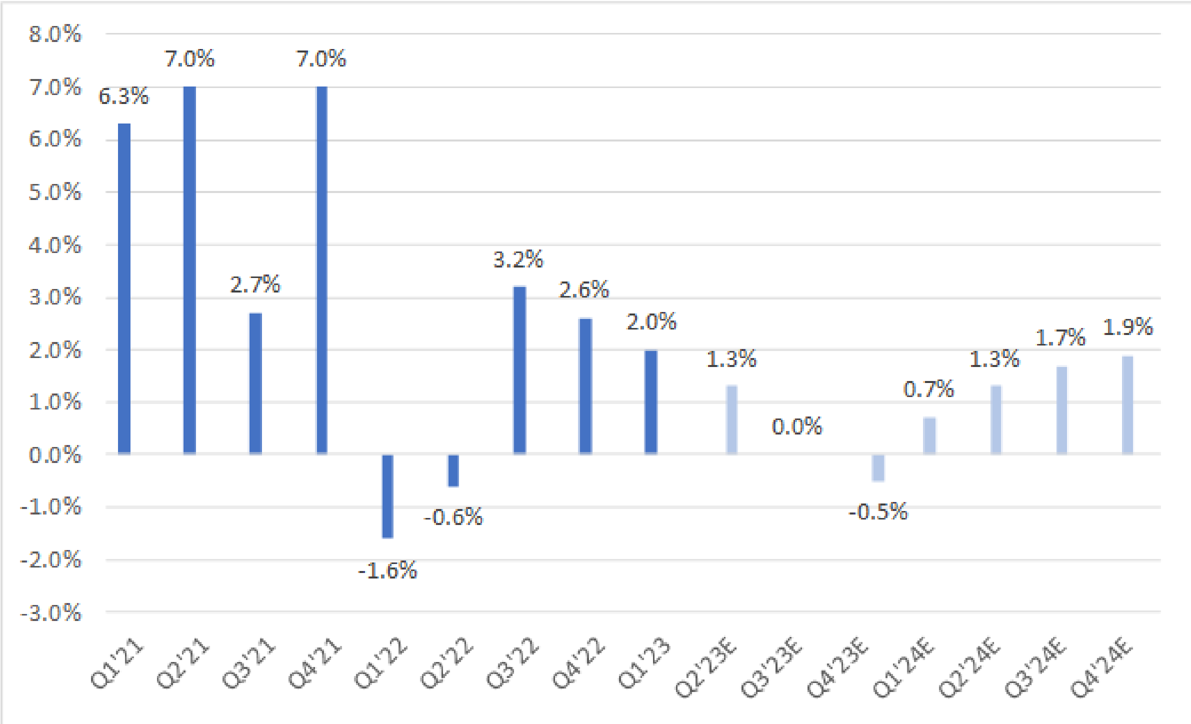
**Figure 2. US Consumer Price Index, Year-Over-Year Percentage Change**




*Source: Bloomberg*

Consensus expectations for U.S. GDP, adjusted for inflation, call for a mild contraction in late 2023 before rebounding to more normalized levels of growth. **See Figure 3.** Because consumption makes up nearly 70% of the national GDP, as the state of the consumer goes, so goes the economy to a large extent. We're encouraged that employment has remained resilient thus far, since folks with jobs are more apt to spend. A tight job market has also led to strong wage growth. However, we also caution that the excess savings accumulated over the course of the COVID pandemic are quickly being depleted, which can dampen spending.

**Figure 3. US Real GDP, Quarter-Over-Quarter, Seasonally Adjusted & Annualized**

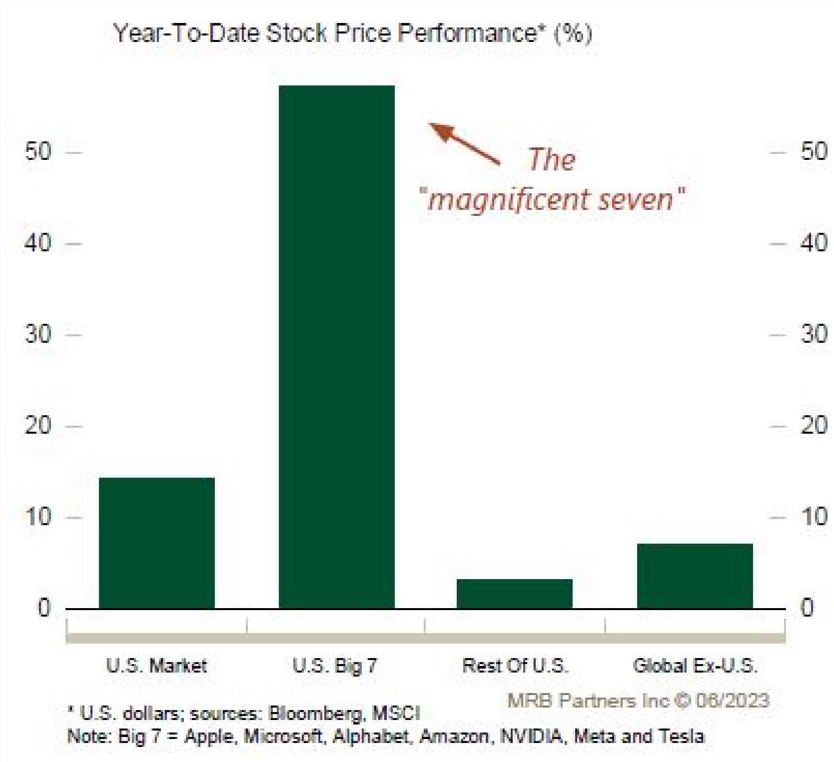



*Source: Bloomberg*

# Domestic Stock Market

As the old saying goes, “the stock market is not the economy”. The market mechanism incorporates future expectations into stock prices. Because of this, we often see the stock market seemingly decoupled from the economy. And, while economic indicators may, at times, point towards an economic recession, stock prices have often already been discounted to reflect these expectations. Consequently, although we have identified a number of headwinds for the economy, we believe domestic stocks appear to be reasonably priced, particularly when excluding mega-cap technology companies, which have appreciated substantially this year, in large part due to enthusiasm surrounding breakthroughs in artificial intelligence. Related to this, the market has seen narrow leadership—stellar performance in a few large stocks has led to much of the run-up in the broader market. In our view, gains need to be more broadly dispersed to sustainably move higher. There is a significant performance gap between the ‘Big 7’ (Apple, Microsoft, Alphabet, Amazon, NVIDIA, Meta, and Tesla) and other equities this year. **See Figure 4.** Excluding these seven stocks, United States equities underperformed foreign markets.

**Figure 4. Seven Stocks Driving the U.S.**




*Source: The Macro Research Board*

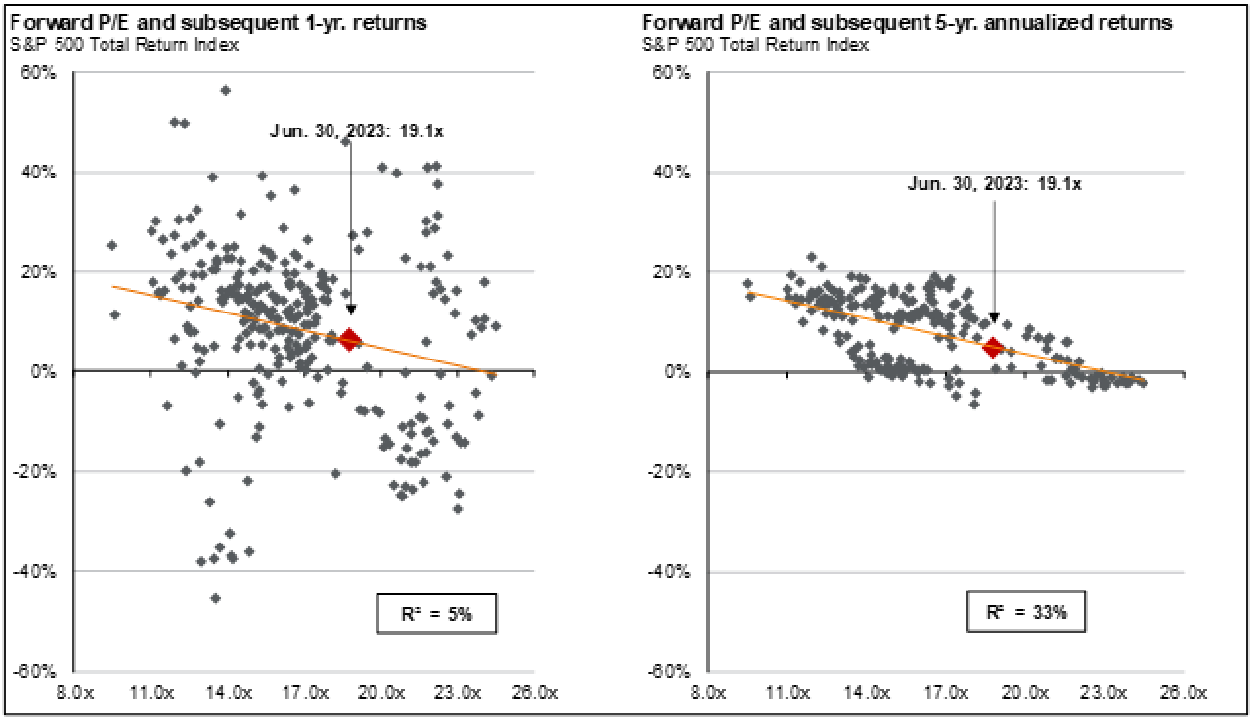
The United States stock market has likewise become unusually top-heavy. The top 10 stocks in the S&P 500 by market capitalization make up nearly one-third of the index. **See Figure 5.** These top 10 stocks are significantly more expensive than the rest of the market, measured by price relative to the earnings they generate. As a result, we're working to identify opportunities to rebalance portfolios by diversifying beyond concentration in the largest names.

**Figure 5. S&P 500 Index Concentration, Valuation & Earnings**


Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
The top 10 S&P 500 companies are based on the 10 largest index constituents at the beginning of each month. As of 5/31/2023, the top 10 companies in the ind were AAPL (7.5%), MSFT (7.0%), AMZN (3.1%), NVDA (2.7%), GOOGL (2.1%), GOOG (1.8%), Meta (1.7%), BRK.B (1.7%), TLSA (1.6%), UNH (1.3%) and XOM (1.2%). Tl remaining stocks represent the rest of the 494 companies in the S&P 500.
*Guide to the Markets – U.S.* Data are as of June 30, 2023.

Of course, valuation of equities over a short-time horizon (e.g., one year) tends to be a poor predictor of performance. Over longer-time horizons (e.g., five years), valuation is an increasingly better predictor of equity returns. **See Figure 6.** All in, we view the current valuation backdrop as constructive for US equities over a multi-year period. We think this longer-term view is akin to focusing on the 'dog walker' rather than the 'dog'.

**Figure 6. S&P 500 Index Concentration, Valuation & Earnings**

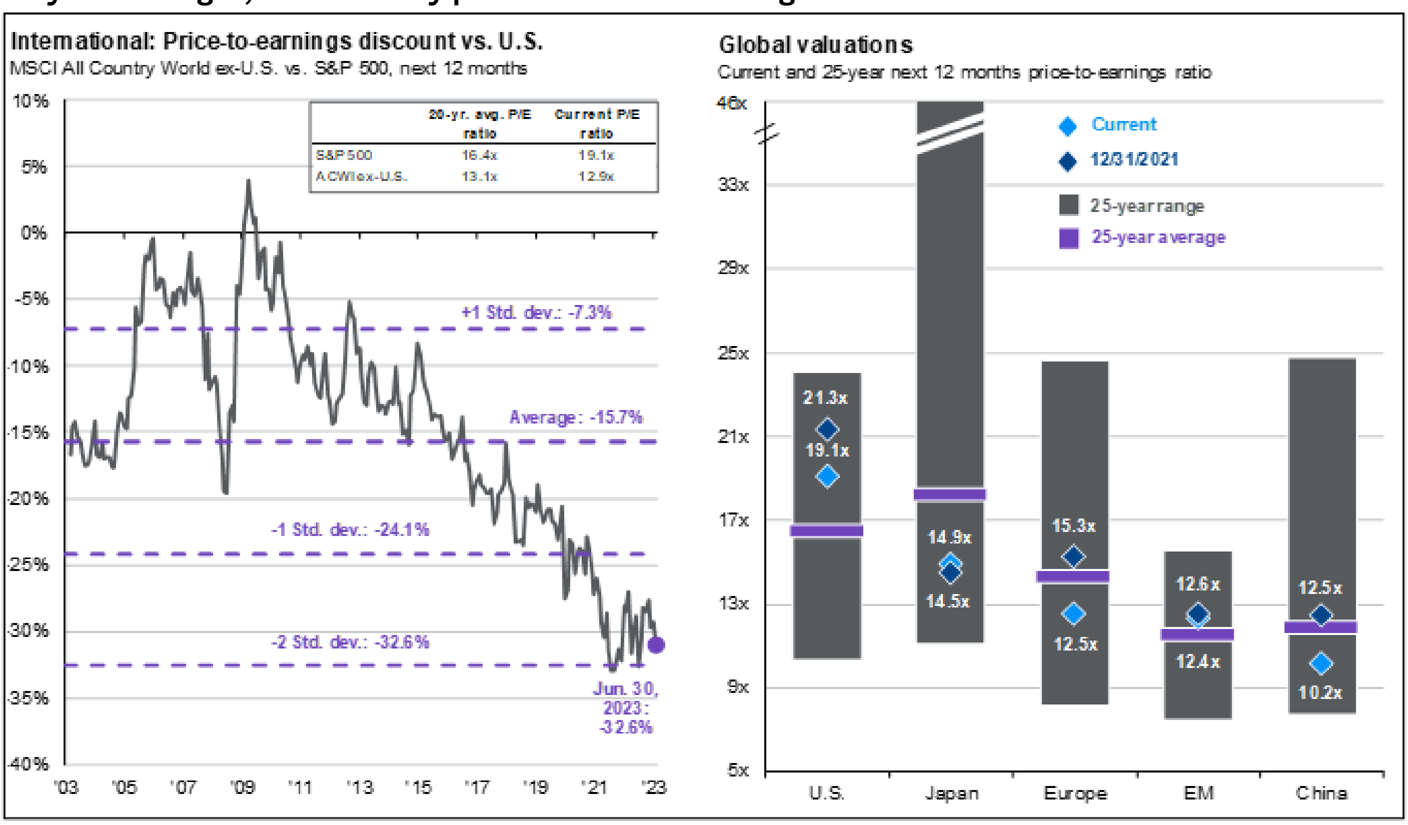



Source: FactSet, Refinitiv Datastream, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Returns are 12-month and 60-month annualized total returns, measured monthly, beginning 5/31/1998. $R^2$ represents the percent of total variation in total returns that can be explained by forward price-to-earnings ratios. Price-to-earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since February 1998 and by FactSet since January 2022.
*Guide to the Markets – U.S.* Data are as of June 30, 2023.

# International Stocks

International stocks look meaningfully cheaper than domestic stocks, both on an absolute basis and relative to their own histories, including Japan, Europe, emerging markets and China. **See Figure 7.** Our portfolios continue to be overweight in domestic equities, partly due to a home-country bias, more shareholder-friendly management teams, and a more robust technology sector with a faster pace of innovation. Nonetheless, we are incrementally more interested in overseas opportunities. International markets tend to be more value-oriented than growth-oriented, which makes them more attractive during periods of higher interest rates, barring a severe recession.

**Figure 7. International Equity Valuations relative to the United States and current valuations vs. 25-year averages, measured by price relative to earnings.**



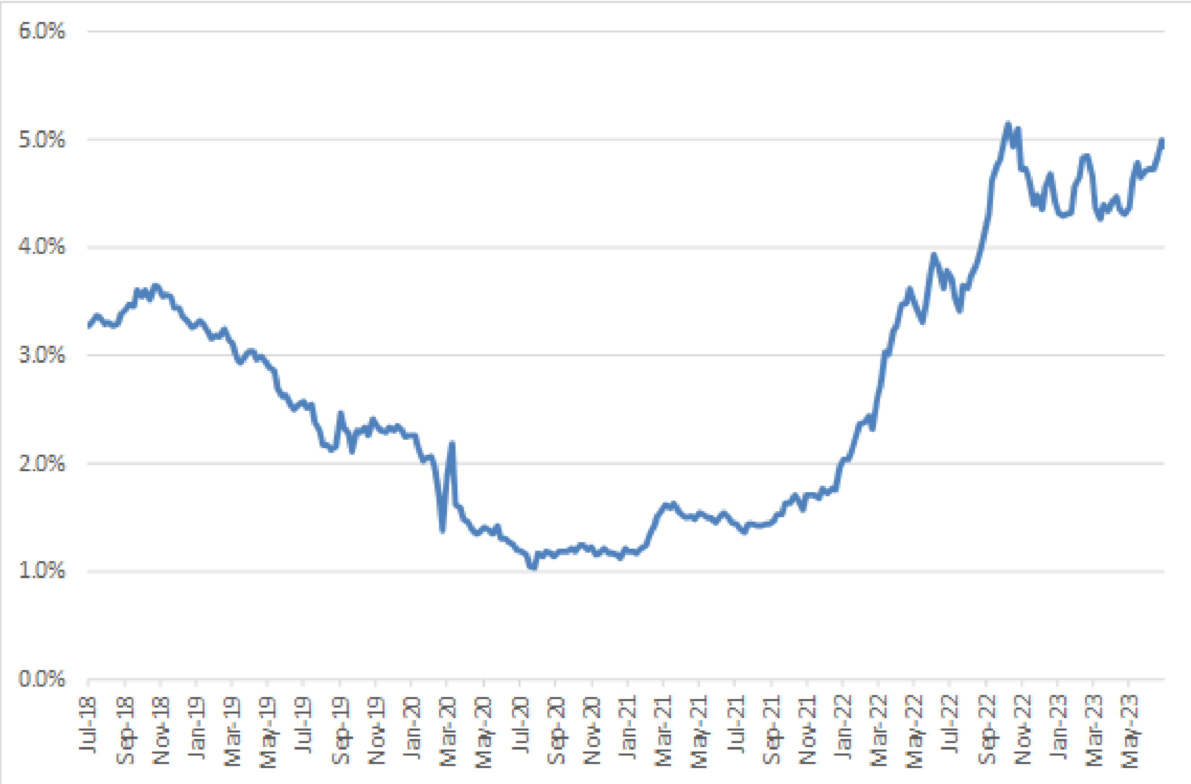

Source: FactSet, MSCI, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Next 12 months consensus estimates are based on pro-forma earnings and are in U.S. dollars. MSCI Europe includes the eurozone as well as countries not in the currency bloc, such as Norway, Sweden, Switzerland and the UK (which collectively make up 44% of the overall index). The purple lines for EM and China show 20-year averages due to a lack of available data. Past performance is not a reliable indicator of current and future results.
*Guide to the Markets – U.S.* Data are as of June 30, 2023.

# Fixed Income

Fixed Income has been getting more attractive and is once again providing 'income' as interest rates have moved higher. Bloomberg's broad index of investment grade bond yields in the United States has risen over the past couple of years. **See Figure 8.** Considering these higher yields and the possibility of interest rate cuts in 2024, we are more likely to move into longer-term bonds to take advantage of current rates. Although real rates of return are currently quite low because of inflation, we expect that inflation will continue to abate and eventually plateau. Thus, locking in bond yields may generate attractive real returns over the longer-term.

We would also point out that prior to the Federal Reserve's series of rate increases, the ability of fixed-income investments to act as a 'ballast' against volatility in equity markets was severely diminished. Theoretically, with bond yields near zero, as the equity market sold off, yields could not fall further, and thus bond prices could not rise. This is no longer the case. Going forward in a higher-rate environment, fixed income should play an increasing role in well-diversified client portfolios. Given lingering concerns regarding the economy, we are also more focused on higher-quality bonds with less credit risk, which should perform better in the event of an economic downturn.

**Figure 8. US Aggregate Yield to Worst**




*Source: Bloomberg*

# Conclusion


As always, we will continue to invest on your behalf, consistent with the PWM investment philosophy and a focus on long-term returns. As the end of the Fed's series of interest rate hikes approaches, we are working to rebalance portfolios and identify new opportunities for growth. We consider it a privilege to help our valued clients reach their financial goals. Thank you for your continued trust and, as always, we remain available to address any questions or concerns.

Sincerely,

**Power Wealth Management**