Tillotson Kenefick

Private Wealth Management of Wells Fargo Advisors

Under the Weather

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Inflation is coming down and the Federal Reserve may be close to finishing their campaign of raising interest rates at the fastest pace in US history. This is a major catalyst for the recent appreciation we have seen in the major market indices like the NASDAQ and S&P500. Portfolios are positive YTD as we officially ended the bear market in June (defined by a 20% rise from the low point of 3500) by rallying above 4,300 on the S&P led largely by the technology sector. Until last month, 5 of the largest technology stocks were responsible for ~80% of the move in the index. The breadth of the market has improved since June with Materials, Industrials, and Consumer Discretionary stocks all rallying over 5%. This increased participation both improves performance and indicates a healthier market.

The fixation on AI stocks has been all consuming this quarter. Media attention, general enthusiasm, and acceptance of the importance of this technology was at a faster pace than cryptocurrency and dotcom stocks. As an example, there has been ~50% appreciation YTD in 5 of the aforementioned largest technology stocks. AI will undoubtedly bring corporate efficiencies and change the way industry does business. The speed at which this new technology can be implemented and benefit companies' bottom-line will continue to unfold.

Interest Rates are high…relatively speaking. The 10-year treasury has basically yielded less than 4% for over 15 years and less than 3% for over 12 years. Today money market funds are yielding more than ~5%, but the 10-year treasury has been averaging ~3.8% this year, illustrating that short term interest rates are substantially higher than longer term interest rates, which is not normal or healthy. Historically, this has been indicative of an upcoming recession.

The number of houses available for sale is at record low levels, which keeps prices elevated. There are less than ~1.5mm houses for sale in the USA right now and more than half of those homes require ~$125,000 of income to purchase. Interestingly, Americans are not widely able to capitalize on the substantial appreciation and equity in their homes because the cost of purchasing a new home, even a less expensive home, will require a substantially higher monthly payment.

As an example, a $300,000 mortgage last summer at ~3%, would cost ~$1,275 per month in principal and interest (P & I). This summer, the same mortgage at ~6.75% will cost ~$1,975 per month in P & I. That is a $700 delta and 54% increase in monthly expenses. Essentially, even if you want to move, you can't find a house, but if you do, you are going to pay more for it in both price per square foot and monthly payment.

We highlight housing and interest rates as a means of illustrating that there are reasons to be optimistic but cautious. Manufacturing is likely in a recession, but travel and leisure are booming. You likely have a lot of appreciation in your home and a fabulous mortgage.

As you have heard us expound many times, the stock market movement is a leading indicator and the economic data is historical and therefore by definition, a lagging indicator. Last year the market was terrible, and the economy was strong. This year, the economic data indicates slowing growth, yet the market is appreciating. This bifurcation in direction is temporary as the stock market begins to price in lower inflation and higher unemployment. These are long term catalysts for earnings growth but short-term negatives.

Developed International stock indices have outperformed the U.S. year to date and commodities have been mixed performers with agriculture outperforming industrials. We expect the summer to be volatile as data confirms or refutes the soft economic landing and the end to rate hikes that is currently consensus thinking.

Here's the good news: technically we are no longer in a bear market which took 18 months to happen. More good news is that while a recession may be happening under the surface or in our near future, it is likely to be mild. Earnings growth is good and pointing toward a 2024 economic recovery. The market will not stand still waiting for the economic data to confirm the all-clear. It will move ahead in the direction of the most likely outcome, which is unfolding in real time with portfolio gains. So, while the economy may have a cold, the market is getting dressed for work.

Marcia C. Tillotson
Managing Director-Investments

Joy M. Kenefick
Managing Director-Investments

*Keeping in mind index returns are not fund returns. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results. All investing involves some degree of risk, whether it is associated with market volatility, purchasing power or a specific security, including the possible loss of principal. Stocks offer long-term growth potential but may fluctuate more and provide less current income than other investments. The report herein is not a complete analysis of every material fact in respect to any company, industry or security. The opinions expressed here reflect the judgment of the author as of the date of the report and are subject to change without notice. Any market prices are only indications of market values and are subject to change. The material has been prepared or is distributed solely for information purposes and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy. Additional information is available upon request.

1. 2023 Midyear Outlook, Wells Fargo Investment Institute, June 2023
2. Investment Strategy. Wells Fargo Investment Institute, June 20, 2023
3. Market Commentary, Wells Fargo Investment Institute, June 22, 2023
4. Market Monitor, Goldman Sachs Asset Management Strategic Advisory Solutions June 16, 2023
5. Market Monitor, Goldman Sachs Asset Management Strategic Advisory Solutions June 23, 2023
6. Morning Outlook: Today’s Market News, Wells Fargo Investment Institute, June 12, 2023
7. Morning Outlook: Today’s Market News, Wells Fargo Investment Institute, June 13, 2023
8. Morning Outlook: Today’s Market News, Wells Fargo Investment Institute, June 22, 2023
9. State of the Markets, Wells Fargo Wealth & Investment Management, June 20, 2023

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