DANN ASSET ADVISORS, LLC

Second Quarter 2023 Update

July 10, 2023

2Q23 Highlights

- U.S. stocks have another strong quarter, again led by large cap technology companies
- Results are more mixed across the rest of the market; international stocks rise modestly
- Employment and the economy continue to be stronger than expected
- Bonds decline as Fed signals additional rate increases and inflation remains above targeted levels

The table below summarizes the performance of some key indices during the second quarter and year to date:

Market Performance		
Index	% Ch. 2Q23	% Ch. YTD
S&P 500	8.7	16.9
Russell Mid Cap	4.8	9.0
Russell 2000 (small cap)	5.2	8.1
MSCI All Country World ex US	2.4	9.5
US Aggregate Bond	(0.8)	2.1
Liquid High Yield	1.2	4.9

Source: Morningstar, iShares

Equities. With a second consecutive strong quarter the S&P 500 index of large-company U.S. stocks registered a 16.9% return for the first half of 2023 – an outcome few were predicting at the beginning of the year. Technology (broadly defined) continued to lead the market higher, seemingly fueled by expectations that products/services related to artificial intelligence will accelerate tech growth. A belief that the financial strength of the large cap tech companies would provide some downside protection if the economy and stocks weakened may also have helped during the quarter.

It's worth noting that the S&P 500 is a capitalization-weighted index, meaning that the companies with the largest stock market values have a disproportionate impact on the index's return. For example, what happens with Apple, the largest weighting at 7.7%, dwarfs the impact of News Corp., the smallest at 0.1%[(1)]. At June 30, Tesla plus the six tech companies in the top 10 of the S&P 500 accounted for just under 28% of the index's value, and the first half gain of these stocks ranged from 36% for Alphabet to almost 190% for Nvidia. In contrast, an equal weighted index of the S&P 500 (Apple weighted the same as News Corp.) gained only 7.0%[(2)] over the first half, illustrating the outsized impact of large cap tech on the market's first-half results.

Another dichotomy over the first half was the performance of growth vs. value. The Russell 1000 Growth index (large-company growth stocks) returned 29.0% over the first half compared with only 5.1% for the Russell 1000 Value index. Small company stocks were extremely volatile, rising nearly 14% into early February, declining 14% into May, having one of their best five day stretches in early June[(3)], and then retreating into quarter end with only an 8.1% return. International stocks (with a substantially smaller tech exposure) also trailed the S&P 500.

Fixed income. Yields rose during the quarter as inflation continued stronger than expected and markets seemed to conclude that the regional banking issues of March wouldn't cause a recession. Further, the Fed indicated in June that it was likely to continue raising rates based on their belief that inflation remains too high. Reacting to Fed guidance, the two-year treasury yield rose from 4.06% at March 31 to 4.88% at quarter end. The 10-year yield rose a more modest 33 basis points (a basis point is 1/100th of a percent), from 3.49% to 3.82%.

When shorter term rates are higher than longer term rates, the yield curve is said to be inverted. In the current cycle, the curve began inverting last summer, and the June 30 inversion of 106 basis points between the yield on two- and 10-year treasuries is close to the most extreme it's been since the early 1980s[(4)]. Other points along the curve are similarly inverted[(5)]. A recent Bespoke Investment Group report noted that in previous periods with similar durations and magnitudes of inversion the economy was either in or on the precipice of recession[(6)].

Market sectors[(7)]. The three best performing sectors during the quarter were technology (+15%), consumer discretionary (12%, Amazon and Tesla account for 37% of ETF value), and communications (+10%, Alphabet and Meta 41%). These same three groups were the year-to-date best performers, with gains of 40% for technology and 30% for the other two. Through June 29, these sectors accounted for 97% of the S&P 500's year-to-date gain, meaning the eight other main industry groups in aggregate added only 3%[(8)].

The three worst sectors during the quarter were utilities (-3%), energy (flat), and consumer staples (+1%). For the year to date, utilities declined the most (6%), followed by energy at 5% and both financials and healthcare with just under 1% declines. It's worth noting that these four groups also are among the highest dividend paying sectors in the S&P 500, with the result that the first half of 2023 was also a relatively poor period for dividend focused strategies. In essence, first-half 2023 was the mirror image of all of 2022, with what worked best last year faring worst in 2023, and vice versa.

Portfolio Positioning

We made no significant changes to clients' fixed income portfolios during the quarter, with most portfolios remaining 90% or more in investment grade mutual funds and 70% or more in short duration (which we define as three years or less) funds. On the equities side, we invested cash raised in the first quarter into already-held investments as we became more optimistic about the market's nearer term outlook. Most clients ended the quarter close to fully invested for the equity portions of their accounts.

(1) June 30, 2023, weightings of iShares Core S&P 500 ETF.
(2) Based on Invesco S&P 500 Equal Weight ETF.
(3) The Bespoke Report, Bespoke Investment Group, June 9, 2023.
(4) The Bespoke Report, Bespoke Investment Group, June 23, 2023.
(5) Ibid.
(6) Ibid.
(7) Market sector performance numbers based on Vanguard sector ETFs.
(8) The Bespoke Report, Bespoke Investment Group, June 30, 2023.

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