WestStar
Wealth Management

Wealth Watch

For Managed Portfolios

2023 Q2 Review & Q3 Outlook

Summer In the City

The United States—particularly the Southwest—is experiencing a historic heatwave. At the time of this writing it is expected that 70% of all Americans will see temperatures above 90 degrees, many southwestern cities are experiencing record numbers of consecutive triple-digit temperature days, and rainfall is well below historical averages. As we endure these sweltering summer temperatures, an associated soundtrack of songs celebrating the season springs to mind. Foremost in thought are the lyrics to "Summer In the City" by the Lovin' Spoonful which lament the weather being "hotter than a match head." In this spirit, various summer-themed songs will set the tone for our review of economic and market conditions in this edition of the Wealth Watch.

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Your wealth, well managed.

What You Need To Know:

- The first half of 2023 has enjoyed outstanding market performance
- WestStar's proactive tactical strategy positioning proved prescient
- Inflation has declined by 2/3rds over the past year and in June was 3%
- The Fed justified in its plan for smaller, less frequent hikes, with a 0.25% hike expected in July
- Recession unlikely in 2023; if one occurs in 2024 it may be mild
- Market performance has tracked closely to expectations in 2023; may flatten later in the year
- Maintain your long-term investment strategy for best chance of meeting goals and objectives

Asset Class Index Performance* Year-to-Date As of June 30, 2023

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- US Large Cap Stocks 16.9%
- International Developed Market Stocks 11.67%
- US Small Cap Stocks 8.09%
- High Yield Bonds 5.38%
- International Emerging Market Stocks 4.89%
- Alternative Investments 2.6%
- Money Market (Cash) 2.33%
- US Investment-Grade Bonds 2.09%
- Real Estate 1.58%
- International Bonds 0.83%
- Commodities -7.79%

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Q2 Market Performance: *"Hot Fun in the Summertime"*

"End of Spring and here she comes back" are the lyrics introducing Sly and the Family Stone's classic summer anthem "Hot Fun in the Summertime." The next line is particularly applicable to stock market performance in the second quarter, singing, "high, high, high, high there!" Stocks continued their 2023 rally and enjoyed one the best first-halves in history, the best since 2019, the second-best this century, and the 12th best since 1926. The tremendous results posted by stocks were reflective of investors shifting back to a "risk-on" mentality, with stocks outpacing bonds, growth stocks eclipsing value stocks by a full 24 percentage points, high yield bonds surpassing investment-grade, and as evidenced by gold declining by -2.4% in Q2. Even T-bills experienced their best first half in 23 years!

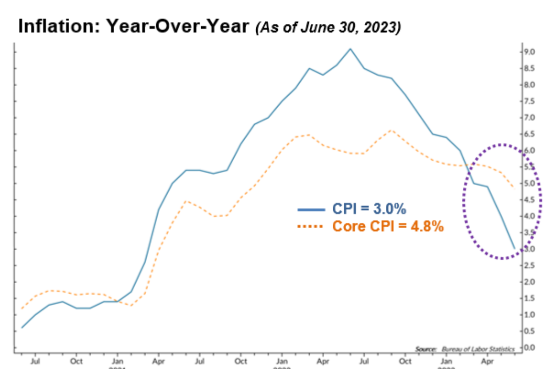
This outstanding market resilience caught many by surprise, as the year began with Crowd Sentiment in the midst of its second-longest streak of extreme pessimism on record and the Bloomberg Survey of 25 Wall Street strategists showing a negative S&P 500 target for the first time in its quarter-century history. WestStar did not share in this pessimism, however, and our tactical strategy was positioned accordingly.

Tactical Strategy: *"Walking on Sunshine"*

The ability to distinguish data from emotion is of the utmost importance in successful investing, with circumspect analysis and rigorous research being the primary influence of action. As discussed in the last issue of the Wealth Watch, despite prevailing pessimism, our examination of economic and market factors led to our implementing a strategy wherein we emphasized stocks, neutral-weighted bonds, and deemphasized both real assets and alternative investments early in the year. In light of the aforementioned market results in the first half of 2023 it is clear that our clients have benefited as a result of our proactive tactical maneuvering, having accurately emphasized areas of opportunity and deemphasized areas of risk. To quote the feel-good sing-along song by Katrina and the Waves, we're "walking on sunshine, and don't it feel good!" Further compounding this emotion is the fact that inflation has declined precipitously over the past year which may mean the Fed is nearly finished in its tightening cycle.

Inflation: *"Summer Breeze"*

The main driver of market and economic action in recent history has been overly-hot inflation. Many remember the pain at the pump when buying gas or the period of time when eggs were seemingly worth their weight in gold. We noted in January, however, that the data indicated inflation had peaked in June of 2022 and would decline to the 3% range by the summer of 2023. Right on cue, the July 12th announcement of June's year-over-year 3% inflation reading hearkened to Seals and Crofts' "Summer Breeze" and its lyrics, "sweet days of summer, the jasmine's in bloom, July is dressed up and playing her tune." June's decline in inflation was the slowest pace since 2021 and the twelfth straight month of cooling as shown in the chart below. Most promising is that all major core consumer inflation components made downward progress, indicating broad-based improvement. Furthermore, producer prices also slowed, suggesting inflation will continue to melt in the near term. This supports the Fed's plan for smaller, less frequent hikes. We expect a 0.25% hike in July which, depending on future inflation readings, may very well be the final hike of the cycle.



Source: Ned Davis Research

*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Developed: MSCI EAFE Index; Int'l Emerging: MSCI Emerging Markets Index; US Inv-Grade Bonds: Bloomberg Aggregate Index; Int'l Bonds: Bloomberg Global Aggregate ex-USD Index; High Yield: Bloomberg US Corporate High Yield Index; Cash: BofA Merrill Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodities: Bloomberg Commodity Index; Alternatives: Wilshire Liquid Alternatives Index

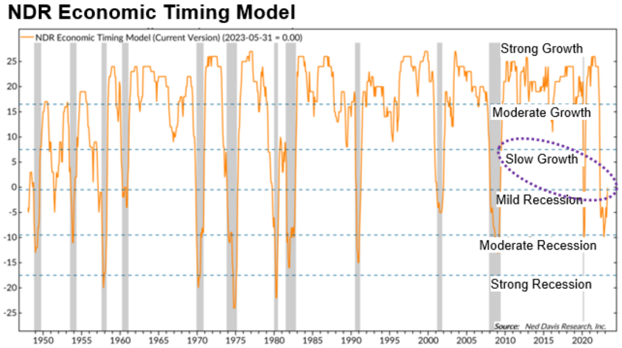
Potential Recession?: *"Summer of '69"*

Fed Tightening Cycles and Recessions

Cycle Starts	Cycle Ends	Recession Start	Months: Cycle Start to Recession	Months: Cycle End to Recession	Months: Cycle End to 1st Rate Cut	Months: Recession Start to 1st Rate Cut
Jul-1963	Dec-1965	None	--	--	16	--
Nov-1967	Apr-1969	Dec-1969	25	8	19	11
Jan-1973	Apr-1974	Nov-1973	10	-5	8	13
Aug-1977	Feb-1980	Jan-1980	29	-1	3	4
Sep-1980	May-1981	Jul-1981	10	2	6	4
Sep-1987	Feb-1989	Jul-1990	34	17	4	-11
Feb-1994	Feb-1995	None	--	--	5	--
Jun-1999	May-2000	Mar-2001	21	10	8	-2
Jun-2004	Jun-2006	Dec-2007	42	18	15	-3
Dec-2015	Dec-2018	None	--	--	7	--
		Median	**25**	**8**	**7.5**	**4**

Source: Ned Davis Research

NDR Economic Timing Model



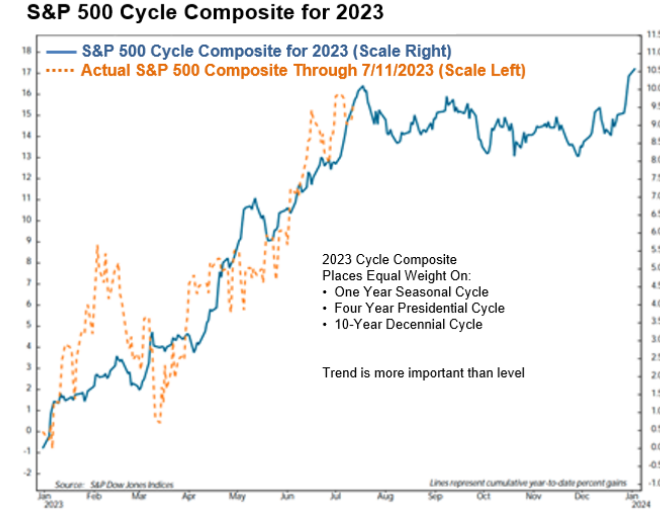
In January of this year a JP Morgan analyst noted that recent stock market performance and economic activity were in close concordance with that of the year 1969—a year during which a recession began and which naturally brings to mind the classic Bryan Adams rock song "Summer of '69." Contrary to said analyst's assessment, however, the stock market did not continue 2022's decline nor has a recession materialized. If we examine the last 10 Fed tightening cycles (table at left) we find that three did not have a recession. While seven did, recession did not materialize for a median of two years after the Fed hikes began and 8 months from the final hike. This would suggest that if a recession were to occur, it may not be until March of 2024. The same historical perspective would suggest the Fed's first rate cut might be expected to occur next summer.

That said, just how likely is a recession at this time? The chart at left reflects 27 different economic indicators combined, the monthly reading of which implies the likelihood of recession and the magnitude thereof. Currently this gauge has shown recent improvement and would indicate a low likelihood of recession. Though unlikely, if the aforementioned analyst's 1969 prediction did come to fruition, the good news is that year's recession was relatively mild. As Bryan Adams sang, however, "ain't no use in complainin' when you got a job to do."

Market Outlook: *"Good Vibrations"*

We have noted in past editions that while history may not repeat itself it often does rhyme. Accordingly, we can glean perspective by noting that stock market seasonality and multi-year cycles have patterns that tend to behave similarly over time. The blue line in the chart at right considers the historical one year, ten year, and Presidential term patterns to project 2023's stock market performance. Interestingly, we see via the orange dotted line that, while a bit volatile, the market has actually performed very closely to the rally this historical pattern predicted. This brings to mind the song "Good Vibrations," as no summer-themed commentary would be complete without a Beach Boys reference. We do acknowledge, however, that this analysis would suggest the market flattens in the latter part of the year. A tactical maneuver to reduce stock exposure to "neutral-weight" may therefore be warranted in the coming months, though additional data will determine if and when one is actually implemented.

S&P 500 Cycle Composite for 2023



Source: Ned Davis Research

Long-Term Strategy: *"Here Comes the Sun"*

Following the aggressive interest rate hikes, persistent inflation, and ensuing abysmal markets of 2022, it is no wonder pessimism abounded in early 2023. In their song "Here Comes the Sun" The Beatles sang, "it's been a long, cold, lonely winter;" but as it applies to what has actually transpired this year the song later notes quite fittingly, "I feel that ice is slowly melting" and "the smile's returning to their faces." Economic conditions are on much firmer footing midyear with positive economic growth, low unemployment, wage growth exceeding inflation, and robust market performance. A growing number of economists now believe inflation can be tamed while avoiding recession entirely. Regardless of prevailing conditions, the most effective means to attaining one's investment objectives is to adhere to a prudently-devised long term strategy. We will continue to monitor developments and proactively reposition our clients' portfolios as warranted.

WestStar
Wealth Management

The Team You Can Trust.

As true fiduciaries, our focus isn't on selling products to our clients. Instead, we focus on providing personalized service and real financial solutions.

Our team of wealth management professionals has the valuable depth of expertise you need to navigate life's events.

From retirement planning and investment management to trust services and estate settlement, we can help you devise the most effective plan to meet your financial goals.

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