SHAW Investment Management of RAYMOND JAMES®

Quarterly Update – June 30, 2023

This year has been a pleasant surprise to investors as markets have performed well despite high interest rates, inflation, and a brief banking crisis. The second quarter appears to be a signal from market participants that we may actually have a "soft landing" scenario as inflation fell, earnings were better than expected, employment data was strong, and the emergence of new artificial intelligence (AI) functionality across the technology sector got investors interested in growth stocks again.

In the 2nd quarter of 2023, most stock indices showed improvement while bonds took a small step backwards. Large cap US stocks outperformed small and midcap stocks as the S&P500 rose +8.7%. Growth stocks rallied again this quarter as the NASDAQ gained over 12% led by the big tech stocks. International stocks posted a modest 3% return as the US dollar weakened. Bonds (the Barclay's Aggregate Bond Index) and dividend paying stocks were the laggers as both posted slightly negative returns.

Here are the returns of the major asset classes at the end of the 2nd quarter 2023:

Asset Class	Index	2nd Q	YTD	1yr	3yr*	5yr*
US Large Cap Stocks	S&P500	8.74%	16.89%	19.59%	14.60%	12.30%
US Mid Cap Stocks	Russell Midcap	4.76%	9.01%	14.92%	12.50%	8.45%
US Small Cap Stocks	Russell 2000	5.21%	8.09%	12.31%	10.82%	4.21%
Dow Jones Industrial Avg	DJIA	3.97%	4.94%	14.23%	12.30%	9.58%
US Dividend Paying Stocks	DJ Select Dividend	-2.54%	-4.32%	0.47%	16.41%	7.20%
NASDAQ	NASDAQ	12.81%	31.73%	25.02%	11.08%	12.91%
Int'l Developed Mkt Stocks	MSCI EAFE	2.95%	11.67%	18.77%	8.93%	4.39%
Int'l Emerging Mkt Stocks	MSCI EM	0.90%	4.89%	1.75%	2.32%	0.93%
US Bonds	Bar Aggregate Bond	-0.84%	2.09%	-0.94%	-3.96%	0.77%

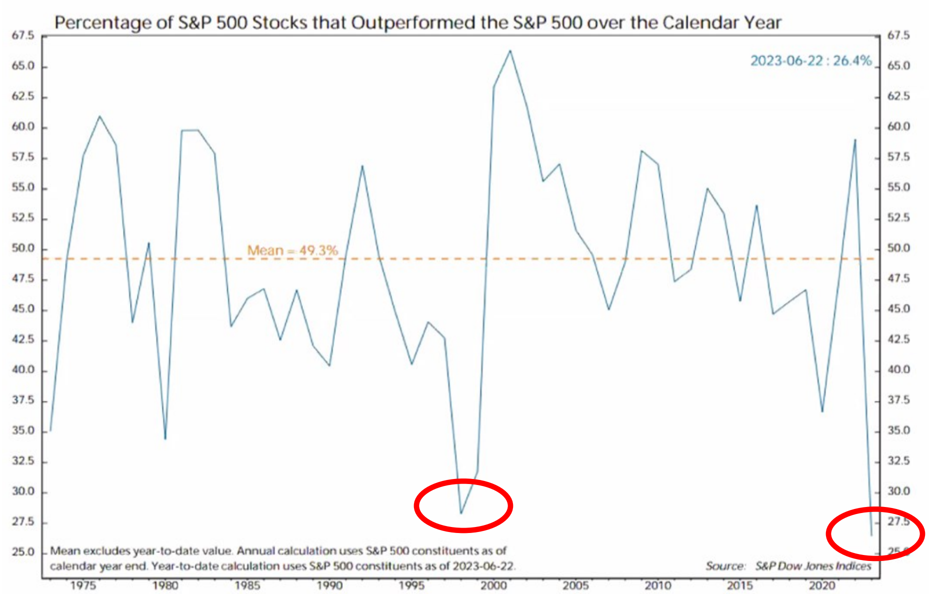
YTD = Year to Date *return is annualized [1]

We are still working our way though this FED rate hiking cycle which typically creates long and variable lags on the economy. We expect the FED is not completely finished raising rates but it seems they are slowing the frequency and amount of the rate hikes as they progress. The market is forecasting 2 more 0.25% increases before the end of the year. Meanwhile, we are getting mixed signals from the economy as a number of indicators point to economic slowdown (FED action, inverted yield curve, tight lending, weakness in new orders, declining index of leading indicators, etc.) while others (like labor, wages, disposable income) are holding up well. As the FED has locked in on their mission to get inflation under control over the last 15 months, the market has slowly adjusted to the new investment environment of higher interest rates, higher core inflation rate, and slightly slower growth than we have seen in the US over the last decade.

[1] Source: Raymond James Client Center Reporting

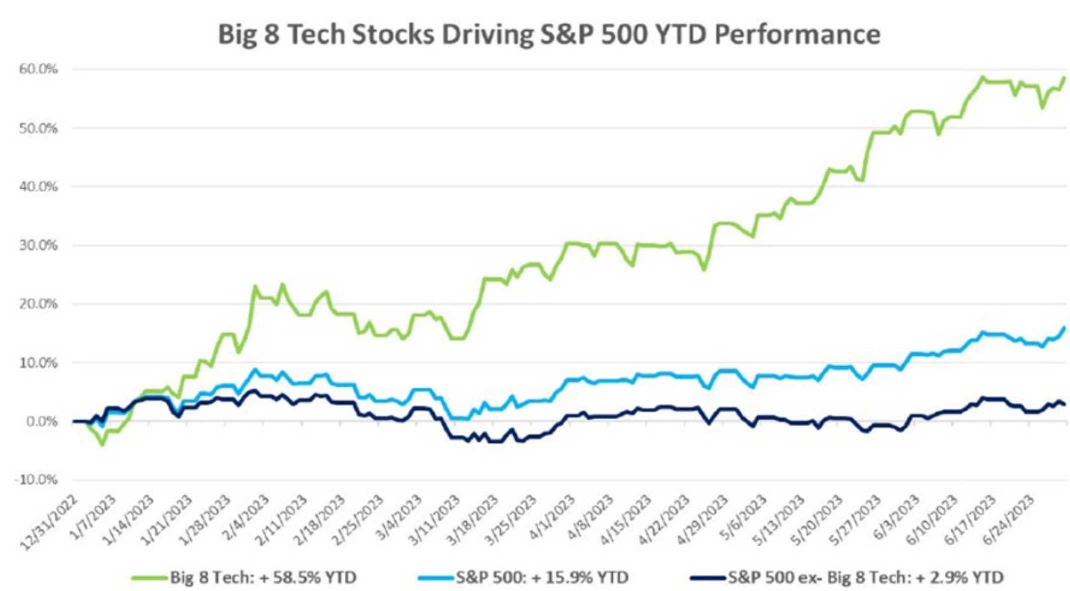
As we mentioned earlier, the market has progressed this year primarily driven by a few mega cap growth stocks. Many of these companies advanced after announcements regarding new AI functionality and its impact on future growth. While we welcome any positive move in the market, we worry that the majority of stocks are not participating as much as we would like to see. As of June 22nd, only 26% of the stocks in the S&P500 were outperforming the index. That is the fewest number of outperforming stocks relative to the S&P500 since 1970. The last time we witnessed a few stocks carry the performance of the market was during the tech bubble of the late 1990s.

The chart at the bottom of the page shows the performance difference in the S&P500 when you include and exclude the 8 largest tech stocks from the index. The green line represents the strong performance of the 8 largest tech stocks. The blue line show the S&P500 up about 16% for the year (including those eight stocks). The dark blue line tracks a hypothetical return of the S&P if those eight stocks were removed from the index.



[2]

The S&P500 ex-Big 8 Tech follows the remaining 492 stocks and is only up 2.9% year to date. That's the lack of breadth that still has us cautious about the market. We expect to be more constructive on the market if the breadth improves.



[3]

[2] Source: Ned Davis Research, "Quarterly Update - 2q 2023" p.2
[3] Source: Federated Advisory Services, "Orlando's Outlook" p.5

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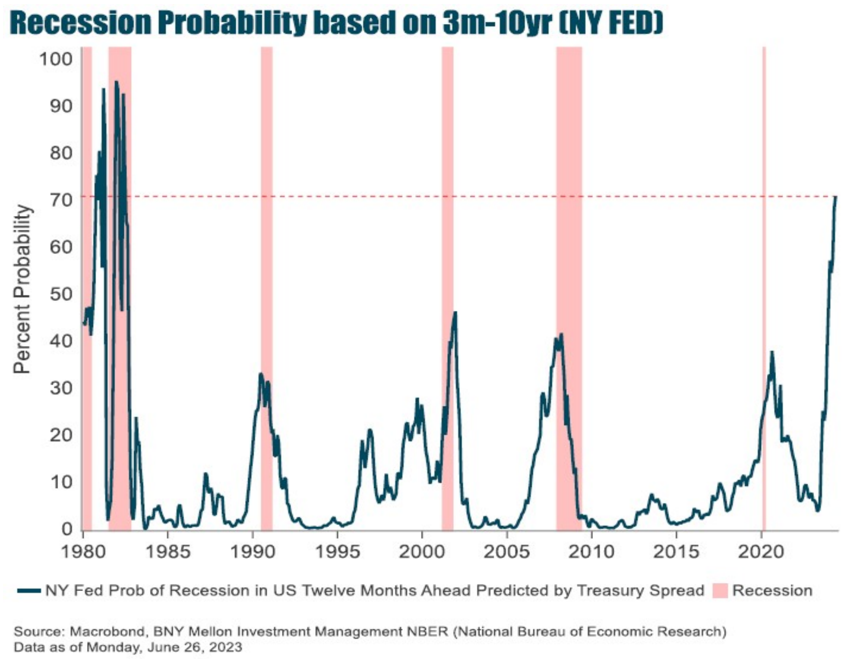
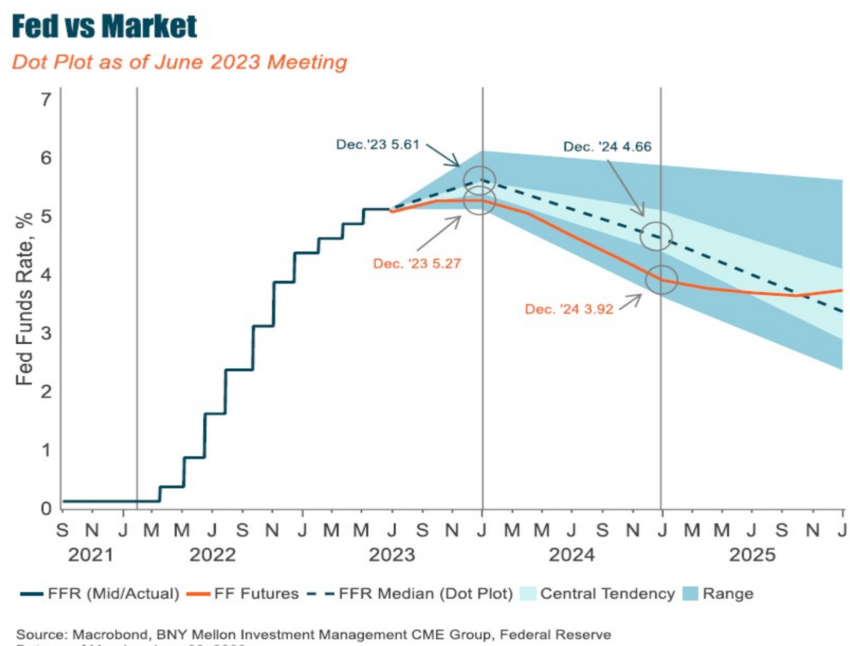
We continue to believe tight monetary policy, falling money supply, an inverted yield curve, and tighter bank lending standards sets the stage for slower economic growth in the US. However, the market is a forward looking instrument and many are re-evaluating and increasing the probability that an economic slowdown turns out to be mild and we get a “soft landing”. We completely understand this position given the extraordinary amount of savings by US consumers since 2020, the wealth effect of improved stock and housing markets, and a resilient labor market. However, as we investigate the FED’s actions throughout this cycle, we still tend to believe that the rate increases (and the increases yet to come in 2023) will slow the economy meaningfully over the next year.



[4]

The chart to the right shows the probability of recession over the next 12 months based on treasury spreads according to the NY Fed. It is very rare to see recession indicators this strong. In fact, we have not seen it since the mid-1980s. This is not a conclusive outcome, but it does add to the data that makes us cautious about the markets.



[5]

We are also watching the expectations for the fed funds rate going forward. The FED raised rates significantly over the last 15 months in order to fight inflation. Now the market is expecting there will be cuts in 2024 and 2025. We believe there are two reasons the Fed may cut rates: 1. The economy slows more than planned and we fall into a recession. 2. Inflation drops below the 2% target. We do not think inflation will fall that far, so this is another data point that makes us think there is a higher than normal probability of recession.

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[4] Source: BNY Mellon Investment Management, “Vantage Point Chartbook - June 2023” p. 8

[5] Source: BNY Mellon Investment Management, “Vantage Point Chartbook - June 2023” p. 9

We believe the market is fairly valued at this point given the risks, but it can continue to grind higher if the economy absorbs the impact of high rates better than we expect. We think it is prudent to stay invested in equities but maintain proper diversification. We suggest trimming some big winners with extended valuations and rebalance into areas that have more favorable valuations.

We think corporate bonds, municipal bonds, and money market funds offer a compelling risk/reward opportunity. Many corporate bonds are yielding in the 5%-6% range and money market funds are paying in the 4.5%-5% range. We continue to like dividend paying stocks, dividend growers, and US midcap stocks as they have better valuations relative to large cap stocks.

We anticipate more volatility the second half of the year as investor sentiment changes and investors weigh the evidence on the direction of the economy. As always, we thank you for the trust you place in our team. Please reach out to us with any questions.

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