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2nd Quarter 2023 Moreno Dye Cervantes
Wealth Management Group of Wells Fargo Advisors Quarterly Newsletter

The 2nd Quarter of 2023 was surprisingly strong given the uncertainty around how many more rate hikes the Federal Reserve is planning. It should be noted that the strongest performance has come from a small number of stocks within the tech sector and is very reminiscent of 2021. The rally would feel better if it captured a broader scope of the equity market. As you can see from the performance recap listed below, the best performance has been from the two most technology heavy indices: the NASDAQ and Russell 1000 Growth.

	2023 2nd Quarter	2023 Year-to-Date
Dow Jones Industrial Average	4.0%	4.9%
Russell 1000 Growth Index	12.8%	29.0%
Russell 1000 Value Index	4.1%	5.1%
NASDAQ Composite Index	13.0%	32.3%
S&P Mid Cap 400 Index	4.4%	7.9%
S&P Small Cap 600 Index	2.9%	5.1%
MSCI EAFE – International Index	3.2%	12.1%
Bloomberg Barclays US AGG Bond	-0.8%	2.1%

*Wells Fargo Advisors Monthly Major Index Returns

The Federal Reserve's interest rate policy continues to be the main driver of financial market performance. In the 2nd Quarter, the equity market gained on the expectation that the FED is close to the end of their interest rate hiking cycle. They chose to not raise rates for the first time in 14 months at their June meeting but maintained a hawkish stance indicating that they could raise interest rates at future meetings. They also indicated that they may leave interest rates at these levels for longer than the financial markets are currently anticipating. We tend to believe what the bond market is forecasting in that the FED is close to the end of the rising rate cycle, especially as more and more evidence show that the economy is becoming challenged.

Therefore, we remain cautious over the near-term. It appears that the financial markets are a little too optimistic that the FED is going to be successful at either managing a "soft landing" or inducing a very mild recession, while also being able to bring the inflation rate down towards their two percent target rate. We undoubtedly agree that the economy has been much more resilient than expected in the face of the fastest rise in interest rates in over forty years, but we are also keenly aware that the FED's interest rate policy will have a lagging effect on economic productivity. History suggests that it takes anywhere from 6-18 months for each move in interest rates to be felt in the economy, which means that most of the FED's interest rate hikes have yet to fully penetrate, and this is the primary reason we remain cautious moving into the second half of 2023.

In our opinion, the biggest impediment to economic growth over the near-term will be credit conditions. More specifically, our concern is persistently tight credit conditions. Any loans that need to be refinanced in the next

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twelve months or have floating terms are going to need to be refinanced at much less favorable rates. We are also seeing a decline in leading economic indicators, a slowdown in manufacturing, economic weakness globally and a decline in the money supply. Employment strength has been an outlier and the primary reason that the economy has remained resilient, which ironically is allowing the FED to remain more hawkish towards additional interest rate hikes.

On the bright side, inflation has continued to decline on a year-over-year basis. The current inflation rate is approximately 4% and has gone down each of the last twelve months. Much of the reduction has been a significant decline in energy and commodity prices when compared to the first half of 2022. The FED has mentioned keeping rates higher for longer because they believe that the core inflation rate, which excludes food and energy, has not declined as quickly due to stubbornly high shelter costs. So, when examining core inflation, we can see why the Federal Reserve will likely need to keep interest rates elevated until we see a reduction in rents and home prices.

Our expectation for the second half of 2023 is that inflation will continue to decline, albeit at a slower pace, and eventually drop below the percentage of wage growth. This will create an environment where consumer purchasing power will grow and allow for economic expansion. As concerns around additional interest rate hikes fade, the financial markets will be able to focus on economic growth in a higher interest rate, lower inflation environment. Understanding that the financial markets may be the best leading indicators of future economic growth, we expect that P/E multiples will expand well in advance of actual corporate earnings recovery.

Over the near-term, we remain overweight both higher quality stocks and bonds. We have proactively started to extend bond duration as it appears the FED is closer to being done raising interest rates and with additional economic slowing anticipated. We have also slightly increased exposure to international stocks and bonds due to their attractiveness when considering valuations and the decline in the US dollar this year. As the year progresses, we have a strong desire to remain flexible in an effort to allow for additional adjustments for the long-term success of your investments.

As we look further ahead, we foresee upside participation across all equity classes once the short-term economic challenges show signs of subsiding. Some signs of economic catalysts could come in the form of the FED softening their tone towards interest rates, easing credit conditions, or expanding consumer spending. As the financial markets begin to anticipate that the economy has slowed enough for the FED to begin potentially lowering interest rates, that would be the time to expand into more mid and small cap stocks as well as lower quality, higher yielding bonds. We guess this is why investing is as much of an art as it is a science!

It is hard to believe that the year is already half over. We consider ourselves exceedingly fortunate to have such wonderful clients and cannot thank you enough for the continued referrals of your family and friends. As usual, please do not hesitate to reach out if you have any questions, concerns, compliments, or an interest in meeting either virtually or in-person. We look forward to speaking with you soon and hope that you have a wonderful summer with some well-deserved vacations!

Sincerely,

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Managing Director – Investments

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The Dow Jones Industrial Average is a price-weighted index of 30 "blue-chip" industrial U.S. stocks.
The S&P 500/Barra Growth Index is an unmanaged capitalization-weighted index stocks in the Standard & Poor's 500 index having the highest price to book ratios. The Index consists of approximately half of the S&P 500 on a market capitalization basis.
The S&P 500/Barra Value Index is an unmanaged, market-capitalization-weighted index of the stocks in the Standard & Poor's 500 Index having the lowest price to book ratios. The index consists of approximately half of the S&P 500 on a market capitalization basis.
The NASDAQ Composite Index measures the market value of all domestic and foreign common stocks, representing a wide array of more than 5,000 companies, listed on the NASDAQ Stock Market.
The S&P Midcap 400 Index is a capitalization-weighted index measuring the performance of the mid-range sector of the U.S. stock market, and represents approximately 7% of the total market value of U.S. equities. Companies in the Index fall between the S&P 500 Index and the S&P Small Cap 600 Index in size: between $1-4 billion.
The S&P Small Cap 600 Index consists of 600 domestic stocks chosen for market size, liquidity (bid-asked spread, ownership, share turnover and number of no trade days) and industry group representation. It is a market value-weighted index (stock price times the number of shares outstanding), with each stock's weight in the index proportionate to its market value.
The MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada.
Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.