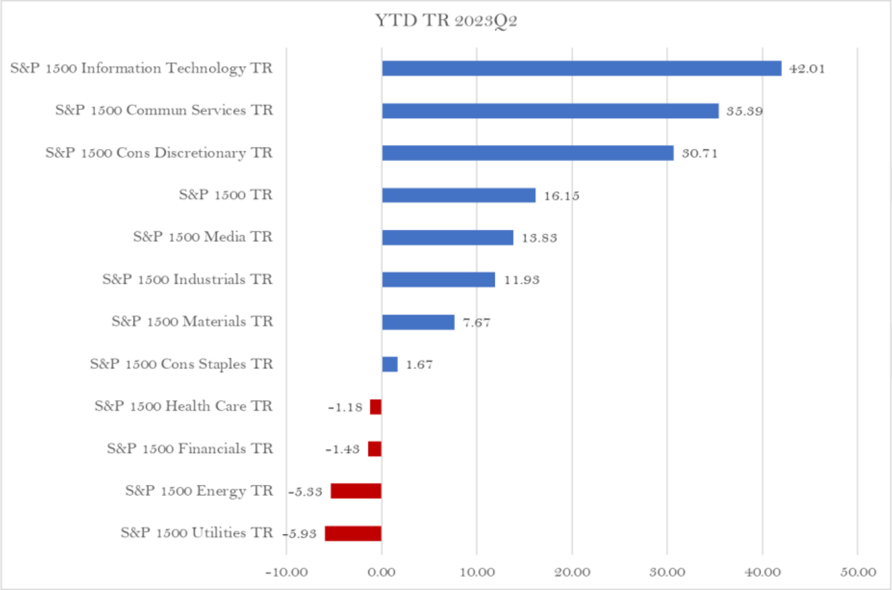
2023 Q2 Commentary: Clear as Mud

- The second quarter data continue to support every market narrative – more noise and few clear signals.
- The stock market extended its first quarter advance, and the S&P 500 Index in June entered a new bull market (20% above the 2022 low). With the excitement of ChatGPT and the promise of AI, the AI infrastructure stocks have led market advances. For example, NVIDIA, a dominant supplier of artificial intelligence hardware and software company has seen its stock up over 280% YTD. The stock market is focused on economic resilience.
- The common wisdom of stocks, being the longest duration asset (investors look to earnings in the future), is that they tend to underperform in a rising inflation adjusted (real) interest rate environment, in a similar manner as long dated bonds. This has not been the case. For example, at the end of May, The S&P 500 was up 16.89% during the 1st 6 months of 2023. The 5 stocks that are responsible for the vast majority of the stock market's 2023 gains are Apple (up 36% this year), Microsoft (37%), Alphabet (39%), Amazon (44%), and NVIDIA (159%). The rest of the markets have not fully participated in this bull market. One explanation is that, in a "slow or slowing" economy, investors look to technology to provide future revenue and profit. This forward looking or "looking through the near term" mentality tends to favor growth style investing. The expectation is for stocks to hold up or even expand their earnings and escape an economic contraction. June has seen some broadening market participation.
- The stock market is signaling that a hopeful time is ahead, and revenue, and thus earnings, remain positive and growing.
- Investors are willing to pay a higher multiple for every dollar of (projected) future earnings – a multiple expansion – which is not a sign of an economic slowdown (but a symptom of lower return choices and a low interest rate environment).
- Stock investors are all about making money based on the future.



2023 Q2 Commentary: Clear as Mud

- For the stock market, investors are hoping for the "immaculate disinflation" inside the wrapper of a soft landing as the likely outcome. Hawkish monetary policies are effective in falling inflation. With better financial conditions, economic expansion continues, and we are maintaining a historically low unemployment rate.
- On the other hand, the U.S. treasury interest rate yield curve is and has been telling a very different story. On July 6th 2022, the 2 year/10-year U.S. treasury interest rate spread turned negative and remains negative today. Historically, this has been a signal for an impending economic contraction or recession where short-term rates (e.g., 2-year) are higher to significantly higher than long-term bond rates (e.g., 10-year).
- The first interest rate increase was in March 2021, and historically, the long and variable lag is 12- to 18-months to impact the general economy. The full impact this time may be further delayed due to the massive fiscal and monetary stimuli injected into the economy. The massive fiscal transfer during the past three years ($5 trillion) muted the initial impact of tightening financial conditions (rate hikes and Quantitative Tightening) and the ramp up pace of rate hikes from 25bp per meeting to four 75bp hikes until June 2022 (12-months ago).
- The fact that long-term rates are lower can be attributable to the market expecting (1) a sustained disinflation trend towards the 2% target, and thus the FOMC no longer needing to keep rates high and sooner or later will cut rates, and/or (2) a further economic slowdown towards contraction that leads the FOMC to cut interest rates to stimulate the economy.
- Chair Powell has consistently and repeatedly affirmed that rates will remain elevated for a longer period of time to combat inflation and to anchor inflation expectation at 2%. Thus, there are three scenarios in which the FOMC would cut rates sooner: (1) a severe recession, (2) core inflation is convincingly reaching the 2% target level, and (3) a substantial shock to financial stability. Currently, there are no indications that any one of these conditions are present.
- The bond market is focused on higher inflation and higher interest rates now with a slowing and maybe even contracting economy that further brings inflation back to its 2% target and thus leads the FOMC to cutting rates back to neutral. This is good for bonds. The Fed Fund neutral rate (R*) is likely to be 0.5% to 1% real (inflation adjusted rate). If inflation is 2.5%, the R* is likely in the range of 3% to 3.5%.
- Bond investors are all about not losing money or protecting their downside.

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Long & Variable Lag – now only feeling ~1/5 of the impact

Source: FOMC, Experiential Wealth

Unweighted 1/5

Lower Range	Mar-22	May-22	Jun-22	Jul-22	Sep-22	Nov-22	Dec-22	Feb-23	Mar-23
Rate Hikes	**0.25%**	**0.50%**	**0.75%**	**0.75%**	**0.75%**	**0.75%**	**0.50%**	**0.25%**	**0.25%**
Mar-22	0.25%								
Apr-22	0.25%								
May-22	0.25%	0.50%							
Jun-22	0.25%	0.50%	0.75%						
Jul-22	0.25%	0.50%	0.75%	0.75%					
Aug-22	0.25%	0.50%	0.75%	0.75%					
Sep-22	0.25%	0.50%	0.75%	0.75%	0.75%				
Oct-22	0.25%	0.50%	0.75%	0.75%	0.75%				
Nov-22	0.25%	0.50%	0.75%	0.75%	0.75%	0.75%			
Dec-22	0.25%	0.50%	0.75%	0.75%	0.75%	0.75%	0.50%		
Jan-23	0.25%	0.50%	0.75%	0.75%	0.75%	0.75%	0.50%		
Feb-23	**0.25%**	0.50%	0.75%	0.75%	0.75%	0.75%	0.50%	0.25%	
Mar-23	**0.25%**	0.50%	0.75%	0.75%	0.75%	0.75%	0.50%	0.25%	0.25%
Apr-23	**0.25%**	**0.50%**	0.75%	0.75%	0.75%	0.75%	0.50%	0.25%	0.25%
May-23	**0.25%**	**0.50%**	**0.75%**	0.75%	0.75%	0.75%	0.50%	0.25%	0.25%
Jun-23	**0.25%**	**0.50%**	**0.75%**	**0.75%**	0.75%	0.75%	0.50%	0.25%	0.25%
Jul-23	**0.25%**	**0.50%**	**0.75%**	**0.75%**	0.75%	0.75%	0.50%	0.25%	0.25%
Aug-23	**0.25%**	**0.50%**	**0.75%**	**0.75%**	**0.75%**	0.75%	0.50%	0.25%	0.25%
Sep-23	0.25%	**0.50%**	**0.75%**	**0.75%**	**0.75%**	0.75%	0.50%	0.25%	0.25%
Oct-23	0.25%	**0.50%**	**0.75%**	**0.75%**	**0.75%**	**0.75%**	0.50%	0.25%	0.25%
Nov-23	0.25%	0.50%	**0.75%**	**0.75%**	**0.75%**	**0.75%**	**0.50%**	0.25%	0.25%
Dec-23	0.25%	0.50%	0.75%	**0.75%**	**0.75%**	**0.75%**	**0.50%**	0.25%	0.25%
Jan-24	0.25%	0.50%	0.75%	0.75%	**0.75%**	**0.75%**	**0.50%**	**0.25%**	0.25%
Feb-24	0.25%	0.50%	0.75%	0.75%	**0.75%**	**0.75%**	**0.50%**	**0.25%**	**0.25%**
Mar-24	0.25%	0.50%	0.75%	0.75%	0.75%	**0.75%**	**0.50%**	**0.25%**	**0.25%**
Apr-24	0.25%	0.50%	0.75%	0.75%	0.75%	**0.75%**	**0.50%**	**0.25%**	**0.25%**
May-24	0.25%	0.50%	0.75%	0.75%	0.75%	0.75%	**0.50%**	**0.25%**	**0.25%**
Jun-24	0.25%	0.50%	0.75%	0.75%	0.75%	0.75%	0.50%	**0.25%**	**0.25%**
Jul-24	0.25%	0.50%	0.75%	0.75%	0.75%	0.75%	0.50%	**0.25%**	**0.25%**
Aug-24	0.25%	0.50%	0.75%	0.75%	0.75%	0.75%	0.50%	0.25%	**0.25%**

The FOMC began its rate hike in March 2022 when the Fed Fund's rate was at 0%-0.25%. Since then, the FOMC raised interest rates 8 times for a cumulative rate hike of 4.75%, bringing the Fed Fund's rate to the range of 5%-5.25%. According to the St Louis Federal Reserve[1], "it can take changes in interest rates some time to affect the macroeconomy (the lag is long), and that time can differ unpredictably across episodes (the lag is variable). While asset prices respond quickly, the prices of goods and services (which are reflected in inflation) and real economic activity (which is reflected in employment and output) have longer and more variably lagged responses." There is even variability in opinion about the amount of variability in these lags. Atlanta Fed President Raphael Bostic wrote in November 2022 that "a large body of research tells us it can take 18-months to two years or more for tighter monetary policy to materially affect inflation." In contrast, in a January 2023 speech at the Council on Foreign Relations, Federal Reserve Gov. Christopher Waller stated his view that, "more recently, lags tend to be nine to 12-months." (The left graph: Each box highlights the 12th to the 18th month after each rate hike as the period range where the impact should be felt by the general economy. As of June 2023, we are only at the beginning of the full impact on the economy.)

[1] https://www.stlouisfed.org/publications/regional-economist/2023/may/examining-long-variable-lags-monetary-policy

Place Your Bets

Medium Term (18 to 24 months)

1. Immaculate Disinflation — No Landing

GDP	1.8% to 2%
Core Inflation	1.8% to 2.5%
Employment	Sub-4%
Fed Fund Rate	2% to 3%

2. Stagflation (Low Growth & High Inflation) — Soft Landing

GDP	0% to 1.5%
Core Inflation	3% to 3.5%
Employment	Sub 5%
Fed Fund Rate	3.5% to 4%

3. Recession (Economic Contraction) — Hard Landing

GDP	Sub 1%
Core Inflation	2% to 2.5%
Employment	> 4.5%
Fed Fund Rate	2% to 3%

2023Q2 Stocks & Bonds Performance in USD & 60/40

Index in US$ (as of 06-30-2023)	TR 2023 Q2	Total Trail 6 Mo	TR 2022	TR Trail 3 Yr Annlzd
DJ Industrial Average NR USD	3.80	4.59	-7.44	11.62
S&P 500 TR	8.74	16.89	-18.11	14.60
S&P 500 Growth TR USD	10.59	21.25	-29.41	11.80
S&P 500 Value TR USD	6.64	12.15	-5.22	16.79
Russell Mid Cap TR USD	4.76	9.01	-17.32	12.50
Russell Mid Cap Growth TR USD	6.23	15.94	-26.72	7.63
Russell Mid Cap Value TR USD	3.86	5.23	-12.03	15.04
Russell 2000 TR USD	5.21	8.09	-20.44	10.82
Russell 2000 Growth TR USD	7.05	13.55	-26.36	6.10
Russell 2000 Value TR USD	3.18	2.50	-14.48	15.43
NASDAQ 100 TR USD	15.39	39.35	-32.38	15.23

Index in US$ (as of 06-30-2023)	TR 2023 Q2	Total Trail 6 Mo	TR 2022	TR Trail 3 Yr Annlzd
Bloomberg US Agg Bond TR USD	-0.84	2.09	-13.01	-3.96
Bloomberg US Corp IG + HY TR USD	0.05	3.57	-14.91	-2.26
Bloomberg Municipal TR USD	-0.10	2.67	-8.53	-0.58
Bloomberg High Yield Corporate TR USD	1.75	5.38	-11.19	3.13
Bloomberg Global Aggregate TR USD	-1.53	1.43	-16.25	-4.96
JPM EMBI Global Diversified TR USD	2.19	4.09	-17.78	-3.10
JPM GBI-EM Global CompTR Local Currency	2.34	4.16	-1.84	1.76

US 60/40 Portfolio US$ (as of 06-30-2023)	TR 2023 Q2	Total Trail 6 Mo	TR 2022	TR Trail 3 Yr Annlzd
S&P 500 TR	8.74	16.89	-18.11	14.60
Bloomberg US Agg Bond TR USD	-0.84	2.09	-13.01	-3.96
Total Index Return (no fee)	4.91	10.97	-16.07	7.17
Global 60/40 Portfolio US$ (as of 06-30-2023)	**TR 2023 Q2**	**Total Trail 6 Mo**	**TR 2022**	**TR Trail 3 Yr Annlzd**
MSCI ACWI All Cap GR USD	6.01	13.47	-18.04	11.46
Bloomberg Global Aggregate TR USD	-1.53	1.43	-16.25	-4.96
Total Index Return (no fee)	2.99	8.66	-17.32	4.89

Index in US$ (as of 06-30-2023)	TR 2023 Q2	Total Trail 6 Mo	TR 2022	TR Trail 3 Yr Annlzd
S&P 1500 Information Technology TR	16.93	42.01	-27.91	19.92
S&P 1500 Cons Discretionary TR	13.30	30.71	-35.70	9.89
S&P 1500 Commun Services TR	12.69	35.39	-39.66	7.11
S&P 1500 TR	8.39	16.15	-17.78	14.67
S&P 1500 Industrials TR	7.34	11.93	-6.43	18.74
S&P 1500 Media TR	5.17	13.83	-30.54	1.78
S&P 1500 Financials TR	4.77	-1.43	-10.15	15.34
S&P 1500 Health Care TR	3.00	-1.18	-3.31	11.20
S&P 1500 Materials TR	2.68	7.67	-10.78	16.93
S&P 1500 Cons Staples TR	0.59	1.67	-0.74	12.05
S&P 1500 Energy TR	-0.41	-5.33	63.77	35.65
S&P 1500 Utilities TR	-2.88	-5.93	1.37	8.20

Index in US$ (as of 06-30-2023)	TR 2023 Q2	Total Trail 6 Mo	TR 2022	TR Trail 3 Yr Annlzd
MSCI ACWI ex USA All Cap GR USD	2.55	9.36	-16.24	7.84
MSCI EAFE GR USD	3.22	12.13	-14.01	9.48
MSCI Europe GR USD	3.13	14.21	-14.53	11.36
MSCI AC ASEAN GR USD	-4.53	-1.70	-4.09	2.86
MSCI EM GR USD	1.04	5.10	-19.74	2.72
MSCI Frontier Emerging Market GR USD	2.18	4.76	-17.84	3.37
MSCI Australia GR USD	0.31	3.13	-5.13	10.67
MSCI Brazil GR USD	20.81	17.07	14.61	13.79
MSCI Canada GR USD	3.91	8.64	-12.17	13.70
MSCI China GR USD	-9.65	-5.39	-21.80	-10.13
MSCI France GR USD	3.80	19.05	-12.67	15.83
MSCI Germany GR USD	3.52	18.83	-21.62	6.04
MSCI Hong Kong GR USD	-5.05	-7.32	-4.71	-0.17
MSCI India GR USD	12.36	5.30	-7.49	19.84
MSCI Italy GR USD	8.91	25.11	-13.42	16.05
MSCI Japan GR USD	6.45	13.24	-16.31	6.09
MSCI Korea GR USD	4.52	14.61	-28.94	5.46
MSCI Mexico GR USD	5.75	27.32	-1.64	28.32
MSCI UK All Cap GR USD	2.08	7.97	-10.16	11.11

Source: Morningstar Direct, Experiential Wealth 06-30-2023

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Chair Powell says Not A Skip - June 14 Prepared Remarks[1]

- "We have raised our policy interest rate by 5 percentage points and have continued to reduce our securities holdings at a brisk pace. We have covered a lot of ground, and the full effects of our tightening have yet to be felt." (*long and variable lag*)
- "The economy is facing headwinds from tighter credit conditions for households and businesses, which are likely to weigh on economic activity, hiring, and inflation. The extent of these effects remains uncertain… decided to leave our policy interest rate unchanged and to continue to reduce our securities holdings." (*taking a breath – a skip and not a pause*)
- "Recent indicators suggest that economic activity has continued to expand at a modest pace…the labor market remains very tight… unemployment rate moved up but remained low, and …inflation remains well above our longer-run 2 percent goal, with…inflation pressures continue to run high and the process of getting inflation back down to 2 percent has a long way to go." (*supporting a hawkish stance*)
- "We are highly attentive to the risks that high inflation poses to both sides of our mandate, and we are strongly committed to returning inflation to our 2 percent objective." *(a strong resolve to fight inflation)*
- "We will continue to make our decisions meeting by meeting, based on the totality of incoming data and their implications for the outlook for economic activity and inflation as well as the balance of risks." (*can't commit when to stop hiking*)
- "Nearly all Committee participants view it as likely that some further rate increases will be appropriate this year to bring inflation down to 2 percent over time." (*hiking cycle is not over*)

[1] https://www.federalreserve.gov/monetarypolicy/fomcpresconf20230614.htm

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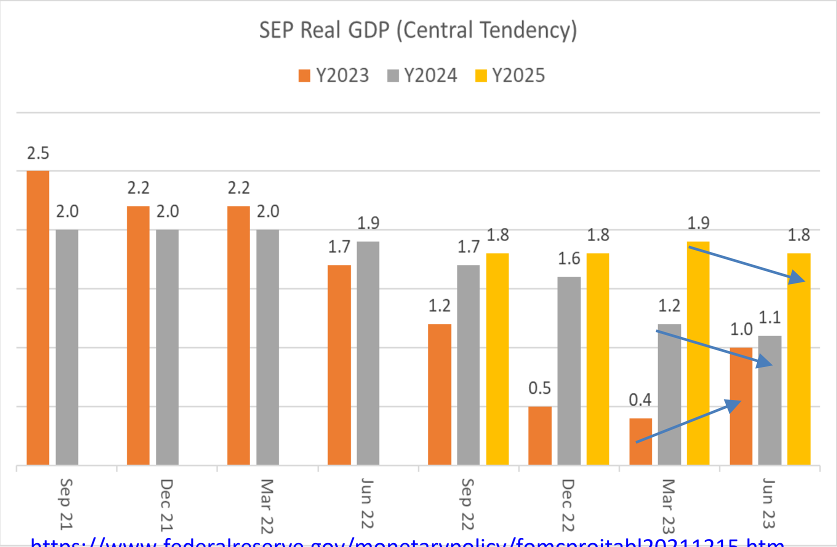
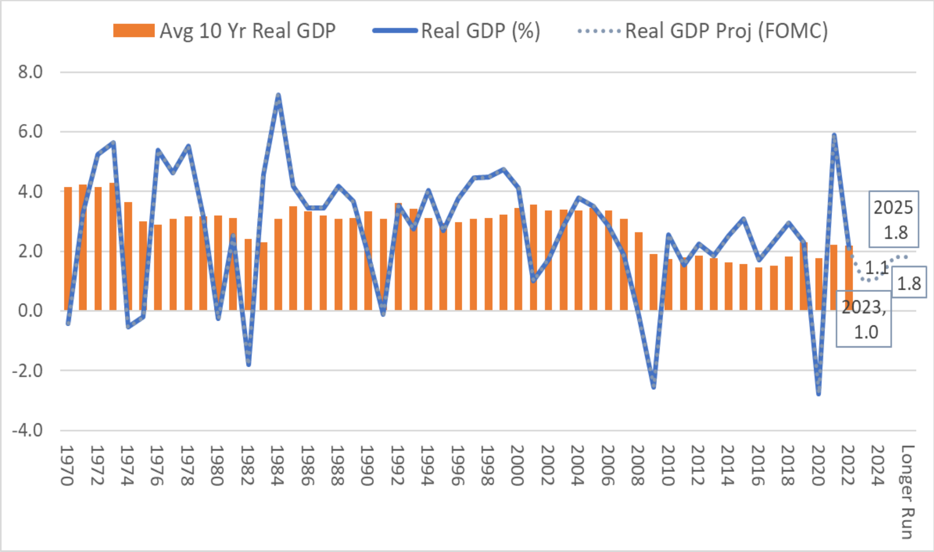
Summary of Economic Projections (SEP) – GDP 06-2023



https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20211215.htm



Source: FRED, FOMC SEP, Experiential Wealth

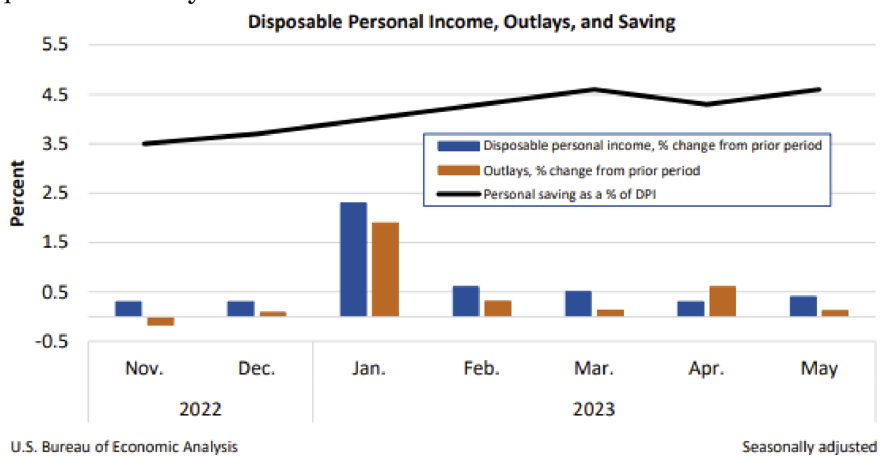
At its June meeting, the Federal Open Market Committee (FOMC) released its quarterly Summary of Economic Projections (SEP). FOMC participants submit their projections of the most likely outcomes for real gross domestic product (GDP) growth. Participant projections are based on information available at the time of the meeting together with their assessment of appropriate monetary policy and assumptions about other factors likely to affect economic outcomes. Historically, SEP projections are more instructive in terms of directionality rather than the actual projections.

The SEP should NOT be relied upon as the official position of the FOMC. It is a collection of individual indications about the future. The SEP has revised upward its 2023 economic growth projection. This is a recognition of an economy with continuing moderate expansion.

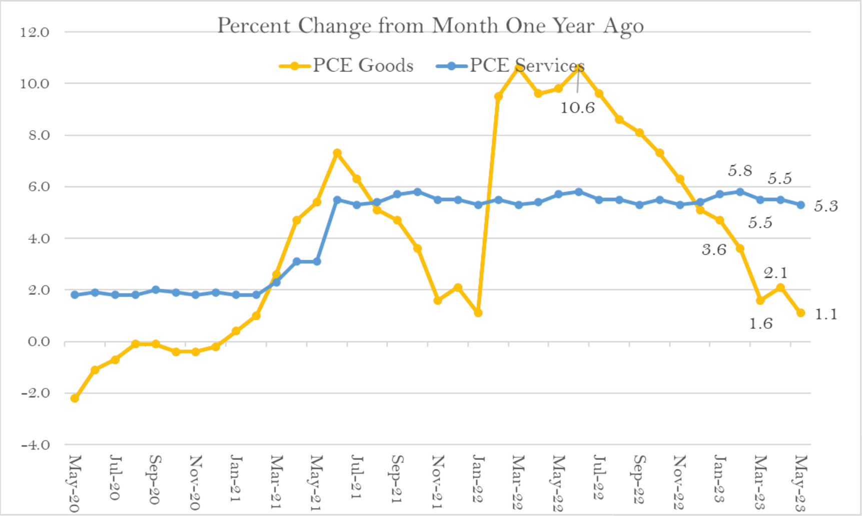
According to the June 2023 SEP, the central tendency average estimate for real GDP has revised up from **0.4% in March's meeting to 1.0% in May's meeting** for 2023 and **dropped 0.1% projection** for both 2024 and 2025. This suggests that the FOMC's central tendency is for continuing economic expansion (although weak) in 2023 but revising down for both 2024 and 2025 (i.e., economic slowdown to begin after the end of this year). These projections were submitted by FOMC members prior to the decision to "skip" and possibly raise rates in the following two meetings. The additional rate hikes could further constrain economic growth next year and cause more bank troubles this year (financial stability issue).

The U.S. Economy – GDP –Slowly Transitioning

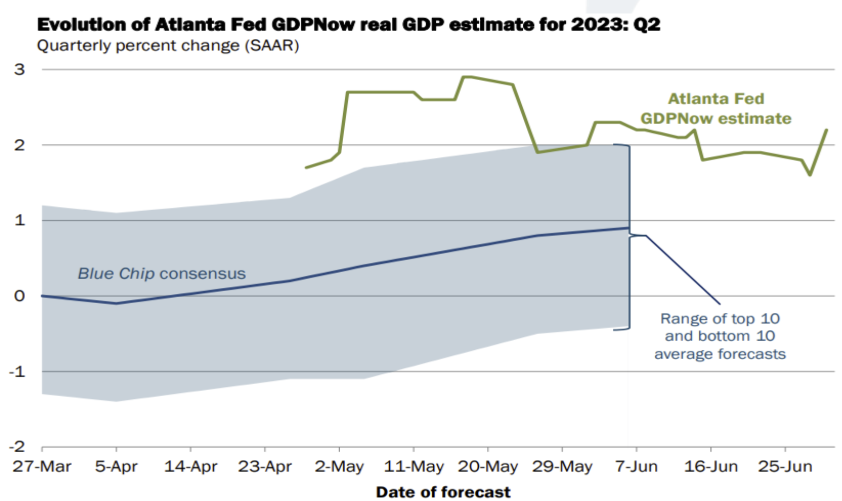
According to the BEA, personal consumption expenditure (PCE) for durable goods has shown some rebound, while PCE for services has trended down slightly in February. In the meantime, personal savings has continued to move higher as personal income has notched down from January along with personal outlay.



Personal income increased $91.2 billion (+0.4% at a monthly rate) in May. Disposable personal income - personal income less personal current taxes - increased $86.7 billion (+0.4%). Personal Outlays - the sum of personal consumption expenditures, personal interest payments, and personal current transfer payments—increased $22.7 billion (+0.1%), and consumer spending increased $18.9 billion (+0.1%). Personal saving was $910.3 billion, and the personal saving rate - personal saving as a percentage of disposable personal income - was 4.6% in May. These are signs that consumers are still earning and spending while saving more. May PCE data shows that activities for goods continue to come down while services remain elevated.



Source: BEA, Experiential Wealth
https://www.bea.gov/data/income-saving/personal-income

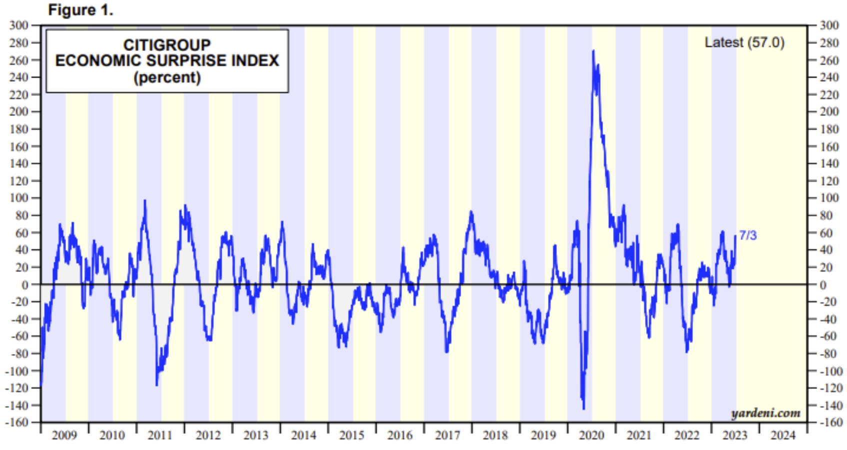


Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*
Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

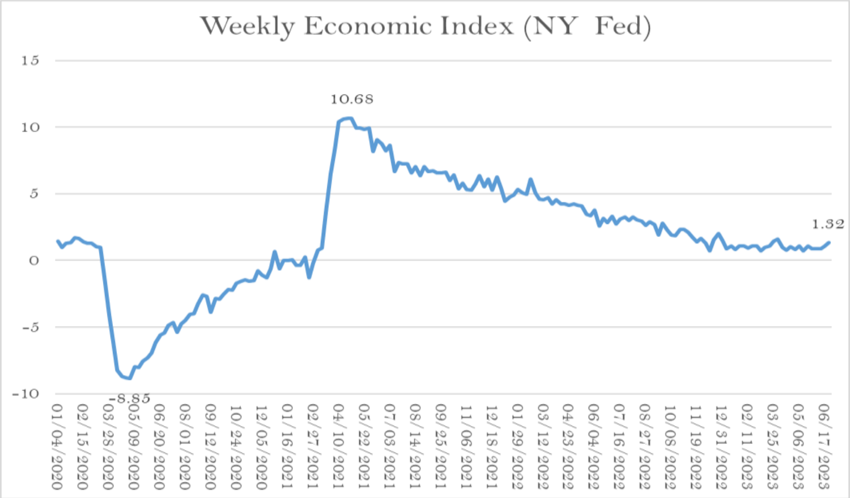
https://www.atlantafed.org/cqer/research/gdpnow (06-30-2023)

High Frequency Economic Data

Citigroup Economic Surprise Index



Note: Blue shaded areas are first half of each year.
Source: Citigroup.
https://www.yardeni.com/pub/citigroup.pdf



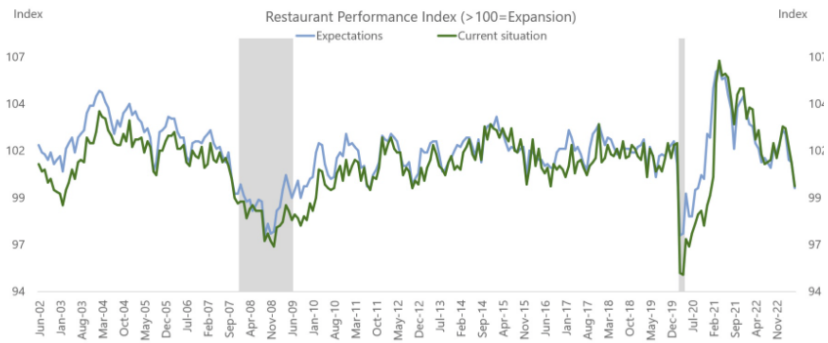
Source: Authors' calculations based on data from Haver Analytics, Redbook Research, Rasmussen Reports, the Association of American Railroads, and Booth Financial Consulting.
https://www.newyorkfed.org/research/policy/weekly-economic-index#/interactive

Citi's Economic Surprise Index, which measures the degree to which economic data is either beating or missing expectations, continued to positively improve in the second quarter.

New York Fed's Weekly Economic Index shows ten daily and weekly indicators of real economic activity. The increase in the week of June 24th is due to rises in steel production, tax withholding, and electricity output, and a decrease in initial unemployment insurance claims, which more than offset falls in retail sales, consumer confidence, railroad traffic, and fuel sales.
The fourth quarter BLS Employment Cost Index shows private industry wages along with government wages are both decelerating. This is a welcome sign for the Fed since slowing wage growth slows demand growth which leads to disinflation.

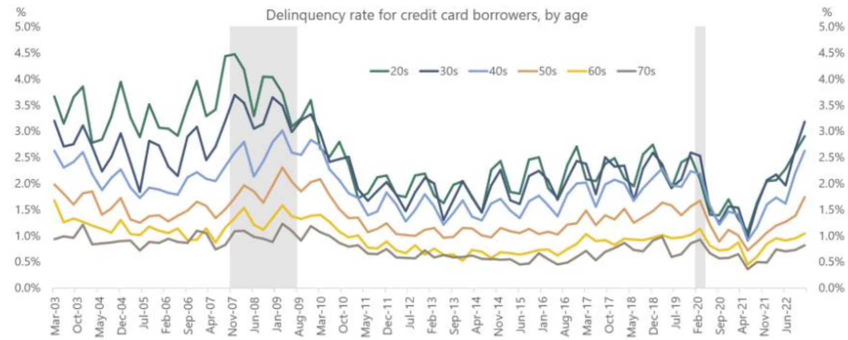
Covid Fiscal Stimulus Money is Likely Ending

Restaurant performance slowing quite rapidly in recent months



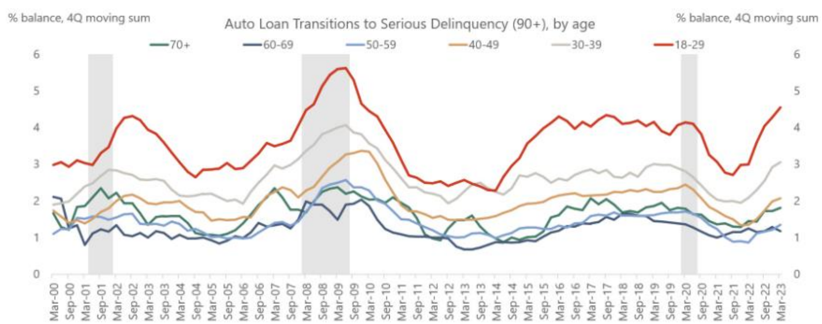
Source: National Restaurant Association, Haver, Apollo Chief Economist

Credit card delinquency rates at 2008 levels



Source: New York Fed Consumer Credit Panel / Equifax, Apollo Chief Economist

Auto loan transitions to serious delinquency approaching 2008 levels



Source: FRBNY Consumer Credit Panel, Equifax, Haver Analytics, Apollo Chief Economist

Weekly data shows that consumer spending is slowing down

Source: Redbook, Haver Analytics, Apollo Chief Economist

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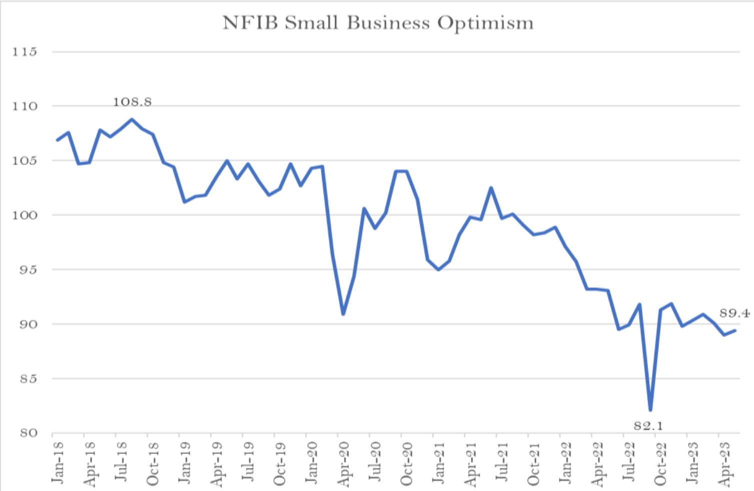
National Federation of Independent Business (NFIB)



The NFIB Small Business Optimism Index increased 0.4 points in May to 89.4, which is the 17th consecutive month below the 49-year average of 98. The last time the Index was at or above the average was in December 2021. Small business owners expecting better business conditions over the next six months declined one point from April to a net negative 50%. 25% of owners reported that inflation was their single most important problem in operating their business, up two points from last month, followed by labor quality at 24%.

https://www.nfib.com/surveys/small-business-economic-trends/

SMALL BUSINESS OPTIMISM INDEX COMPONENTS

Index Component	Seasonally Adjusted Level	Change from Last Month	Contribution to Index Change
Plans to Increase Employment	19%	2	*
Plans to Make Capital Outlays	25%	6	*
Plans to Increase Inventories	-2%	3	*
Expect Economy to Improve	-50%	-1	*
Expect Real Sales Higher	-21%	-2	*
Current Inventory (too low)	-3%	2	*
Current Job Openings	44%	-1	*
Expected Credit Conditions	-10%	-2	*
Now a Good Time to Expand	3%	0	*
Earnings Trends	-26%	-3	*
Total Change		4	

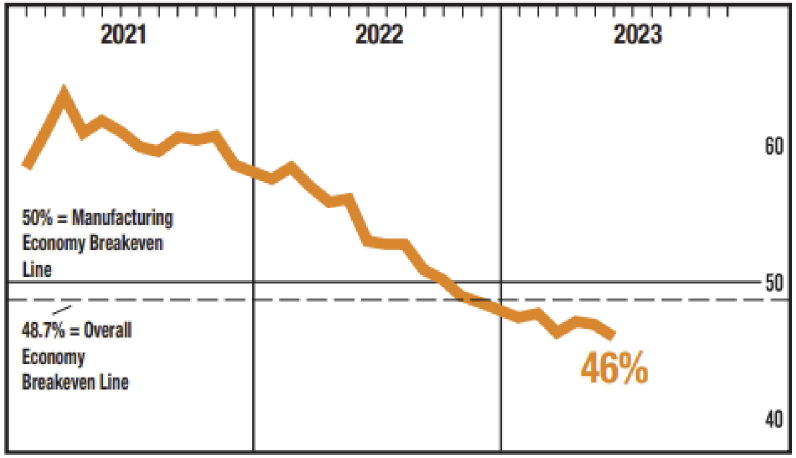
Based on a Survey of Small and Independent Business Owners

Key findings include:

- 44% of owners reported job openings that were hard to fill, down one point from April and remaining historically very high.
- The net percent of owners raising average selling prices decreased one point to a net 32% (seasonally adjusted), still an inflationary level but trending down.
- The net percent of owners who expect real sales to be higher deteriorated 2% from April to a net negative 21%.

Continuing Manufacturing Sector Contraction

ISM Manufacturing PMI Index
> 50 is expansionary



INDEX	Jun Index	May Index	% Point Change	Direction	Rate of Change	Trend* (months)
Manufacturing PMI®	46.0	46.9	-0.9	Contracting	Faster	8
New Orders	45.6	42.6	+3.0	Contracting	Slower	10
Production	46.7	51.1	-4.4	Contracting	From Growing	1
Employment	48.1	51.4	-3.3	Contracting	From Growing	1
Supplier Deliveries	45.7	43.5	+2.2	Faster	Slower	9
Inventories	44.0	45.8	-1.8	Contracting	Faster	4
Customers' Inventories	46.2	51.4	-5.2	Too Low	From Too High	1
Prices	41.8	44.2	-2.4	Decreasing	Faster	2
Backlog of Orders	38.7	37.5	+1.2	Contracting	Slower	9
New Export Orders	47.3	50.0	-2.7	Contracting	From Unchanged	1
Imports	49.3	47.3	+2.0	Contracting	Slower	8
Overall Economy				**Contracting**	**Faster**	**7**
Manufacturing Sector				**Contracting**	**Faster**	**8**

*Number of months moving in current direction. Manufacturing ISM® *Report On Business*® data has been seasonally adjusted for the New Orders, Production, Employment and Inventories indexes.

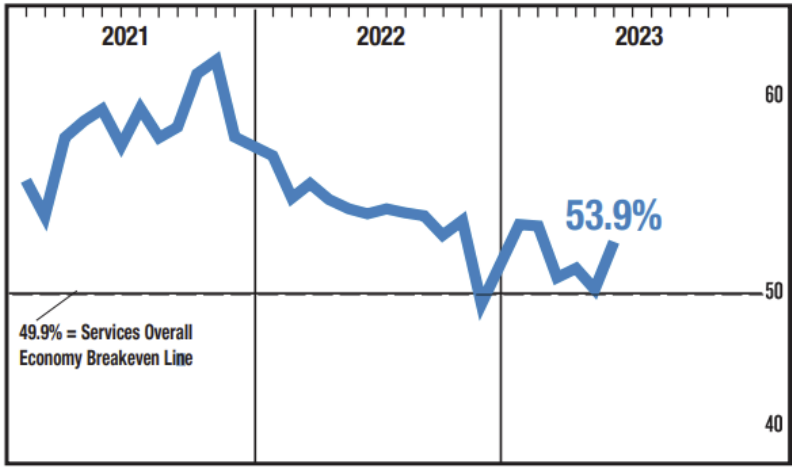
https://www.ismworld.org/globalassets/pub/research-and-surveys/rob/pmi/rob202307pmi.pdf

The U.S. manufacturing sector contracted in June, as the Manufacturing PMI® registered 46%, 0.9% lower than the reading of 46.9% recorded in May. This is the eighth month of contraction and a continuation of a downward trend that began in June 2022. That trend is reflected in the Manufacturing PMI's 12-month average falling to 48.8%. Of the five subindexes that directly factor into the Manufacturing PMI, none are in growth territory. Of the six biggest manufacturing industries, only one (Transportation Equipment) registered growth in June.

Economic activity in the manufacturing sector contracted in June for the eighth consecutive month following a 28-month period of growth based on surveys of the nation's supply executives in the latest Manufacturing ISM Report On Business. The four manufacturing industries that reported growth in June are: Printing & Related Support Activities; Nonmetallic Mineral Products; Primary Metals; and Transportation Equipment

But, Service Sector Still Expanding

ISM Services PMI Index
> 50 is expansionary

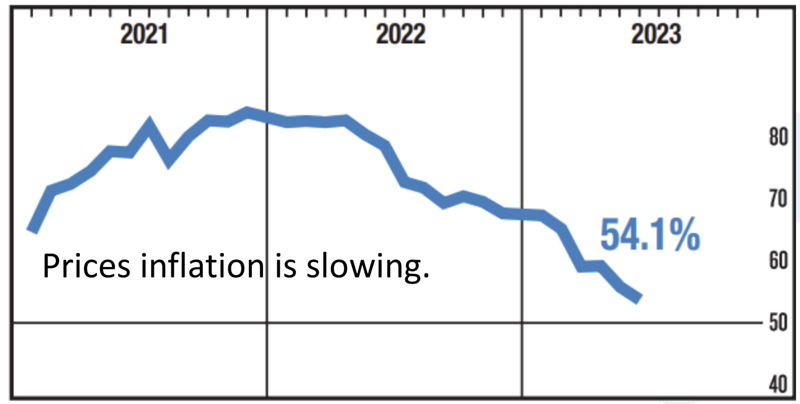


INDEX	Jun Index	May Index	% Point Change	Direction	Rate of Change	Trend* (months)
Services PMI®	53.9	50.3	+3.6	Growing	Faster	6
Business Activity	59.2	51.5	+7.7	Growing	Faster	37
New Orders	55.5	52.9	+2.6	Growing	Faster	6
Employment	53.1	49.2	+3.9	Growing	From Contracting	1
Supplier Deliveries	47.6	47.7	-0.1	Faster	Faster	5
Inventories	55.9	58.3	-2.4	Growing	Slower	2
Prices	54.1	56.2	-2.1	Increasing	Slower	73
Backlog of Orders	43.9	40.9	+3.0	Contracting	Slower	4
New Export Orders	61.5	59.0	+2.5	Growing	Faster	3
Imports	54.6	50.0	+4.6	Growing	From Unchanged	1
Inventory Sentiment	54.0	61.0	-7.0	Too High	Slower	2
Overall Economy				**Growing**	**Faster**	**6**
Services Sector				**Growing**	**Faster**	**6**

*Number of months moving in current direction. Services ISM® *Report On Business®* data has been seasonally adjusted for the Business Activity, New Orders, Employment and Prices indexes.

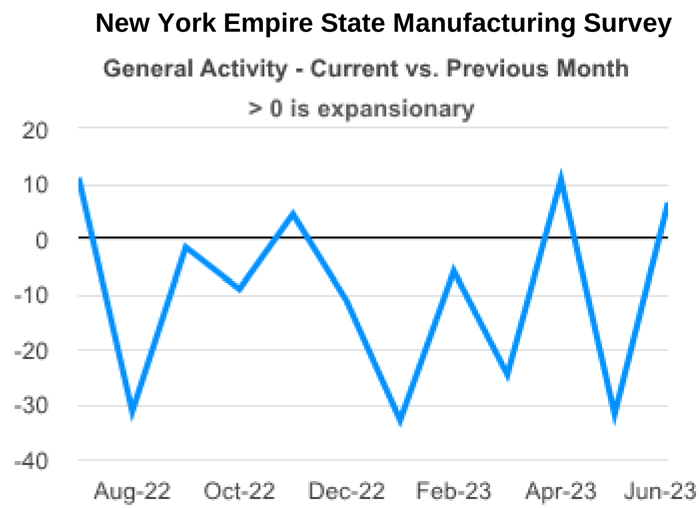
https://www.ismworld.org/globalassets/pub/research-and-surveys/rob/nmi/rob202307svcs.pdf

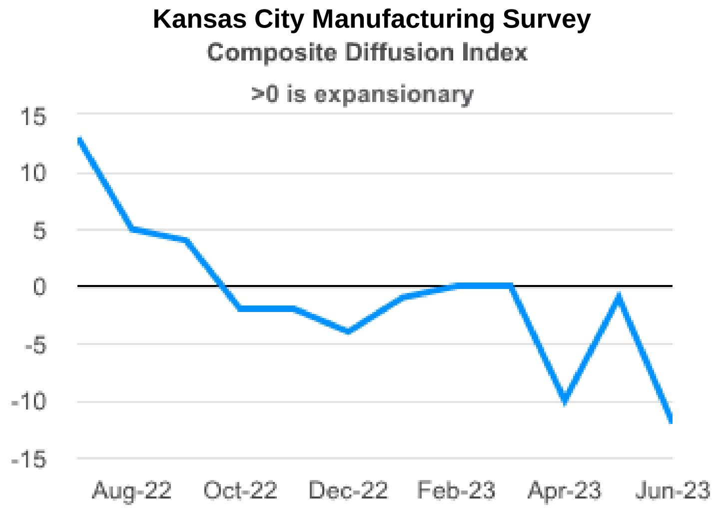
In June, the Services PMI® registered 53.9%, a 3.6% increase compared to the May reading of 50.3%. Therefore, the June Services PMI indicates the overall economy is growing for the sixth consecutive month after one month of contraction in December. A reading above 50% indicates the services sector economy is generally expanding; below 50 percent indicates it is generally contracting.

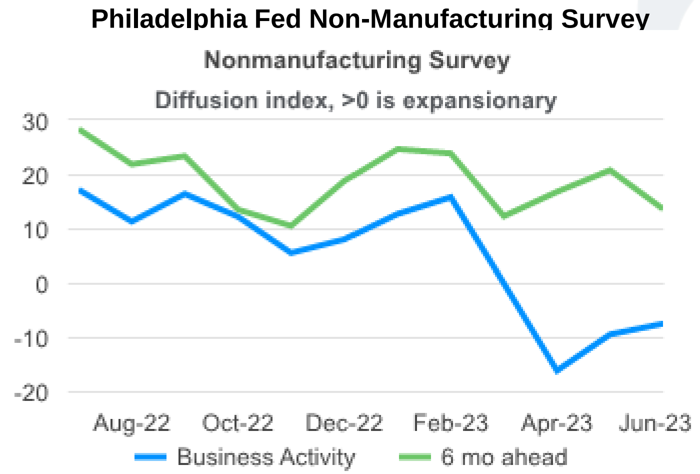


Prices paid by service organizations for materials and services increased in June for the 73rd consecutive month, with the index registering 54.1%. Twelve service industries reported an increase in prices paid during the month of June, in the following order: Public Administration; Finance & Insurance; Construction; Arts, Entertainment & Recreation; Management of Companies & Support Services; Health Care & Social Assistance; Utilities; Information; Other Services; Educational Services; Wholesale Trade; and Professional, Scientific & Technical Services.

Signs of Economic Slowdown



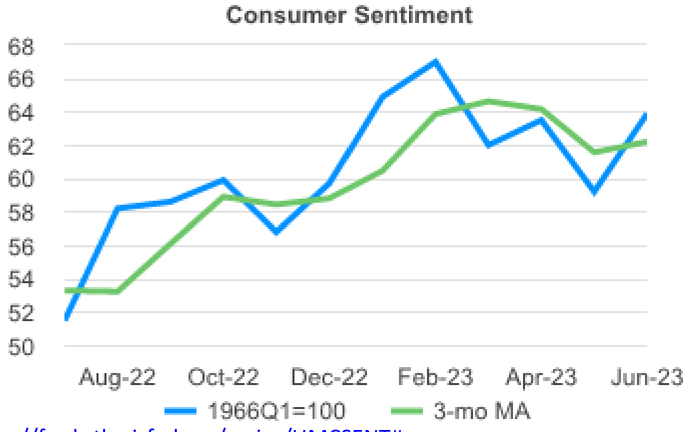




Source: Moody's economics

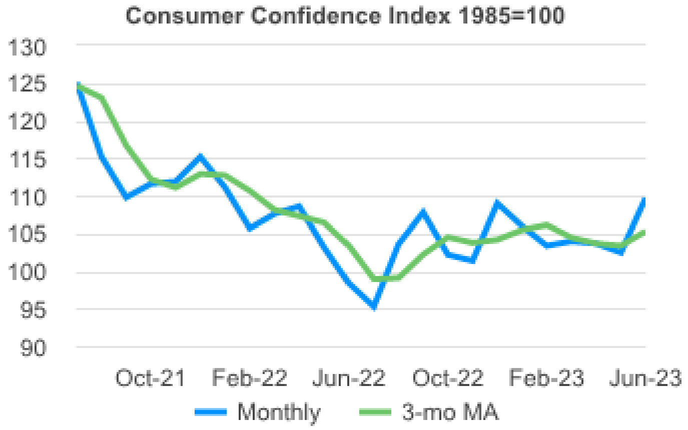
Consumer Sentiments … Improving However

UMich Consumer Sentiment
06-2023



https://fred.stlouisfed.org/series/UMCSENT#

Conference Board Consumer Confidence Survey
06-27-2023



Despite its gain in June, the University of Michigan consumer sentiment index remains stuck in deeply recessionary territory as household finances remain under pressure. While up from its record low set in June 2022, the index remains below where it started the year, coming in at 64.4 in June according to the final report, above the preliminary 63.9 and May's 59.2 but barely above April's 63.5. The change from May was led by the expectations component, which rose 6.1%. The current conditions component improved 4.1%. Inflation expectations fell sharply but remain elevated. Median 12-month inflation expectations dropped from 4.2% to 3.3%. Five-year expectations dipped to 3% from 3.1% last month.

https://www.conference-board.org/topics/consumer-confidence

U.S. consumer confidence improved much more than expected in June, according to the Conference Board. Its index increased from an upwardly revised 102.5 (previously 102.3) to 109.7 in June, an even-stronger increase than the consensus had anticipated. The top-line increase was driven by an improvement in consumers' near-term outlooks for income, business and job market conditions, as well as their more favorable assessment of current business and labor market conditions. Despite the recent increase in initial jobless claims, consumers are pointing to stronger labor market conditions than in May.

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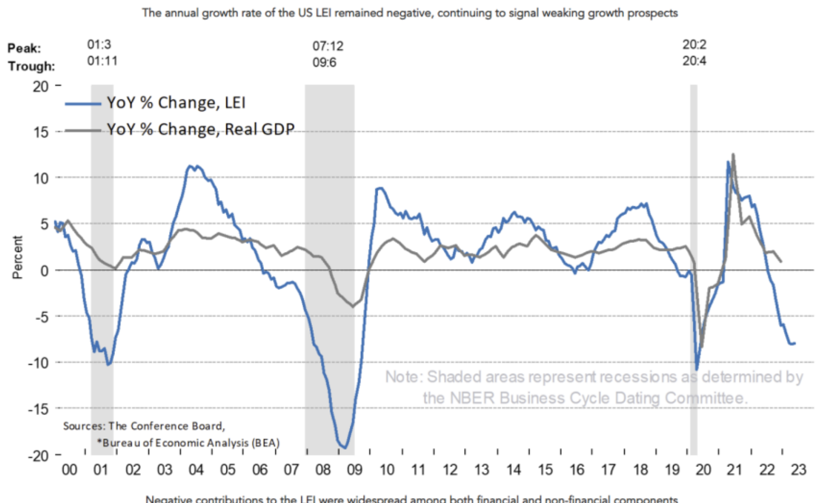
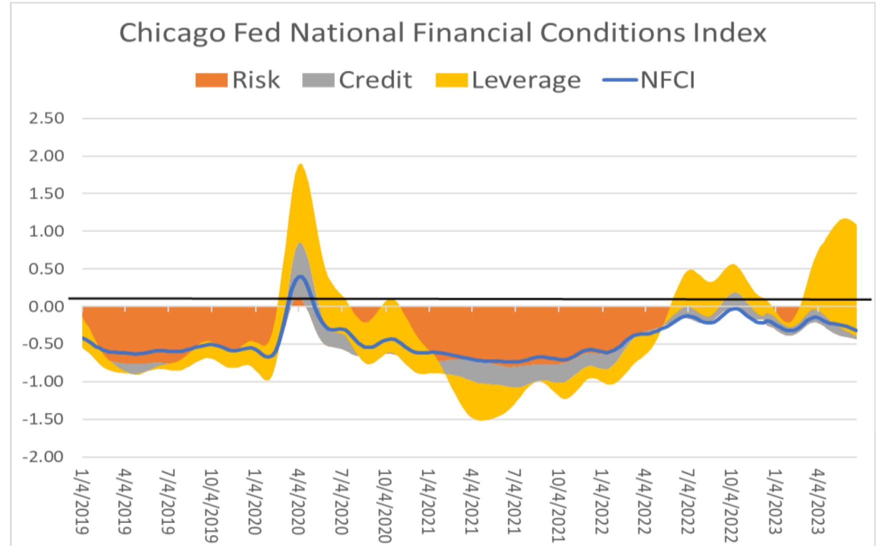
Leading Indicators and Financial Stress – a mixed bag

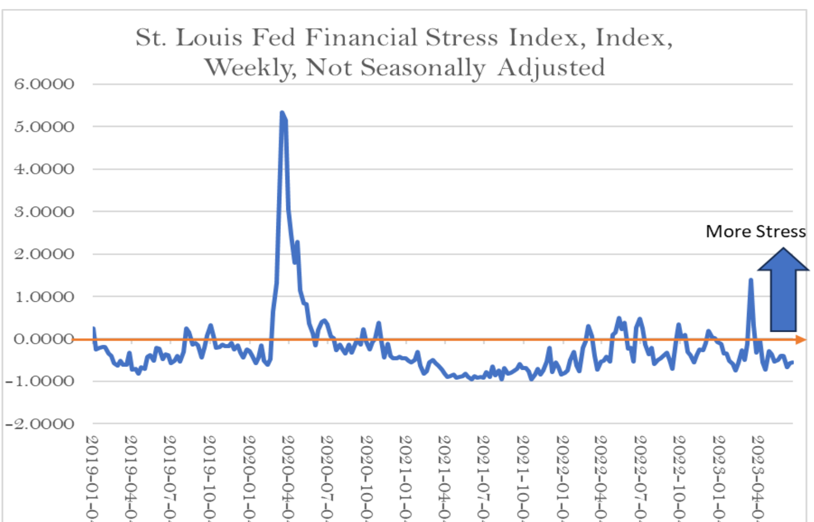
Conference Board Leading Indicator



Source: https://www.conference-board.org/topics/us-leading-indicators, Experiential Wealth



Source: https://www.chicagofed.org/publications/nfci/index, Experiential Wealth



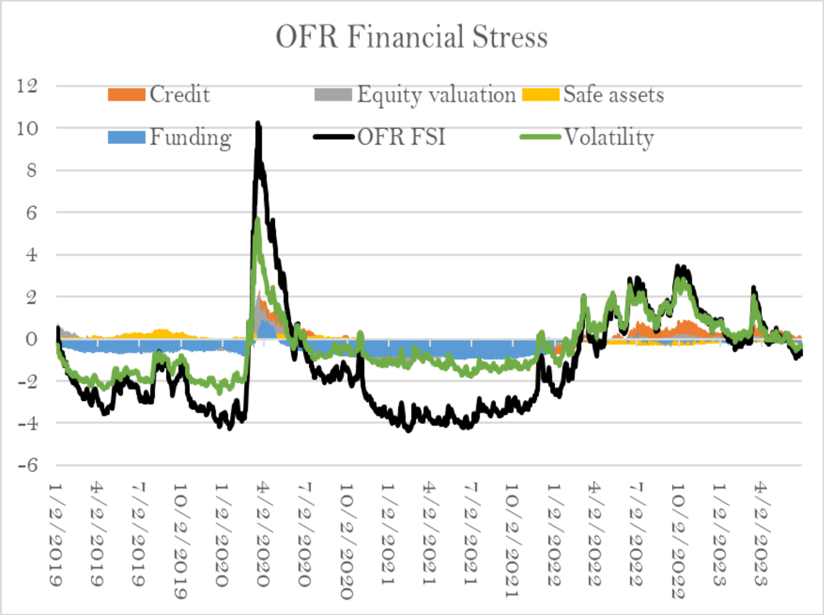
Source: https://fred.stlouisfed.org/series/STLFSI4, Experiential Wealth

The Conference Board Leading Economic Index (LEI) provides an early indication of significant turning points in the business cycle and where the economy is heading in the near term. The LEI for the U.S. declined by 0.7% in May 2023 to 106.7 (2016=100), following a decline of 0.6% in April. The LEI is down 4.3% over the six-month period between November 2022 and May 2023—a steeper rate of decline than its 3.8% contraction over the previous six months from May to November 2022.

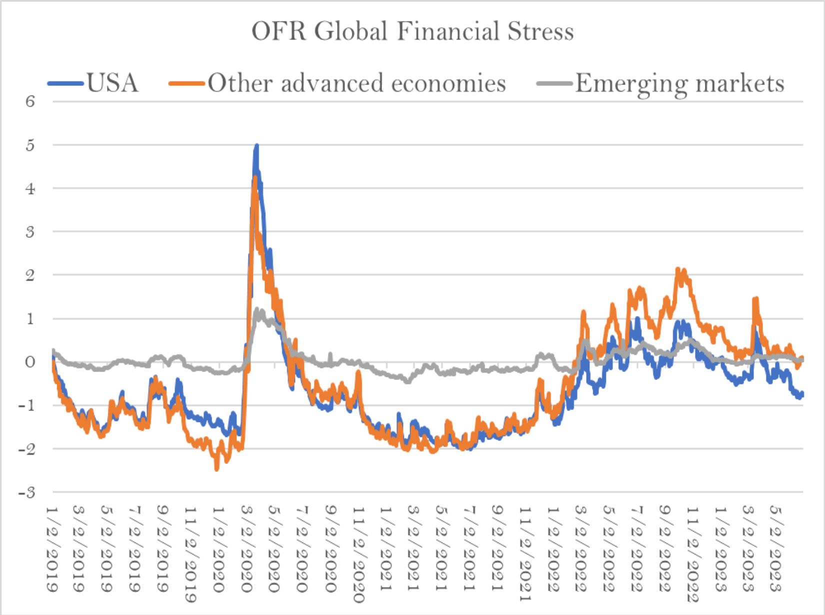
The St. Louis Federal Reserve Bank's Financial Stress Index measures the degree of financial stress in the markets and is constructed from 18 weekly data series: 7 interest rate series, 6 yield spreads and 5 other indicators. Each of these variables captures some aspect of financial stress. Accordingly, as the level of financial stress in the economy changes, the data series are likely to move together. The Index continue to show below-average financial market stress.

The Chicago Fed's National Financial Conditions Index (NFCI) provides a comprehensive weekly update on U.S. financial conditions in money markets, debt and equity markets, and the traditional and "shadow" banking systems. For the week ending June 23, the NFCI ticked down to –0.32. Risk indicators contributed –0.17, credit indicators contributed –0.11, and leverage indicators contributed –0.04. The index suggests financial conditions continued to loosen.

Financial Stress – still accommodative



FSI, Experiential Wealth



FSI, Experiential Wealth

https://www.financialresearch.gov/financial-stress-index/#ae

The OFR Financial Stress Index (OFR FSI) is a daily market-based snapshot of stress in global financial markets. It is constructed from 33 financial market variables, such as yield spreads, valuation measures, and interest rates. The OFR FSI is positive when stress levels are above average, and negative when stress levels are below average. The OFR FSI incorporates five categories of indicators: **credit, equity valuation, funding, safe assets** and **volatility**.

After a short spike due to the banking debacle in March, overall financial stress in the U.S. has continued to come down.

The FSI also shows stress contributions by three regions: United States, other advanced economies, and emerging markets.

Other advanced economies: Variables measuring stress from advanced economies other than the United States, including primarily the eurozone and Japan

Emerging markets: Variables measuring stress from emerging markets

After a brief spike during the banking debacle, overall global financial stress is coming down, with the U.S. recovering the best.

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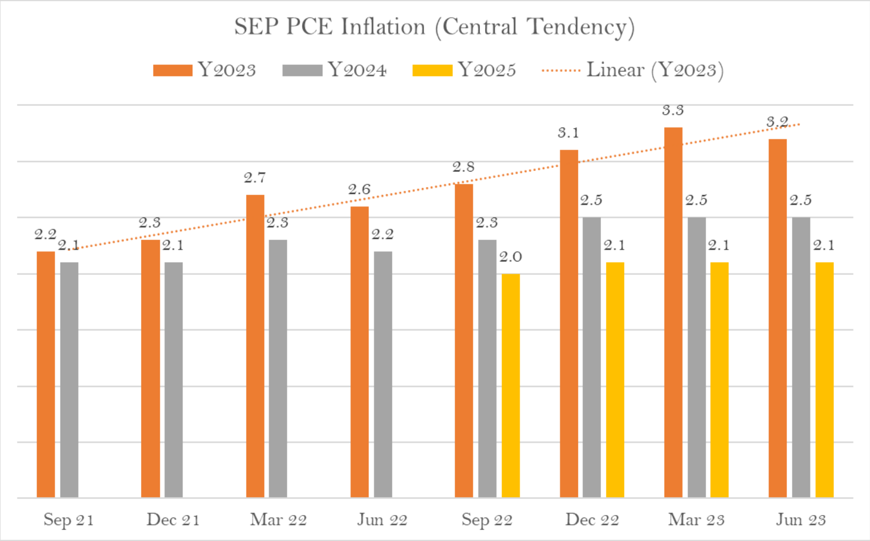
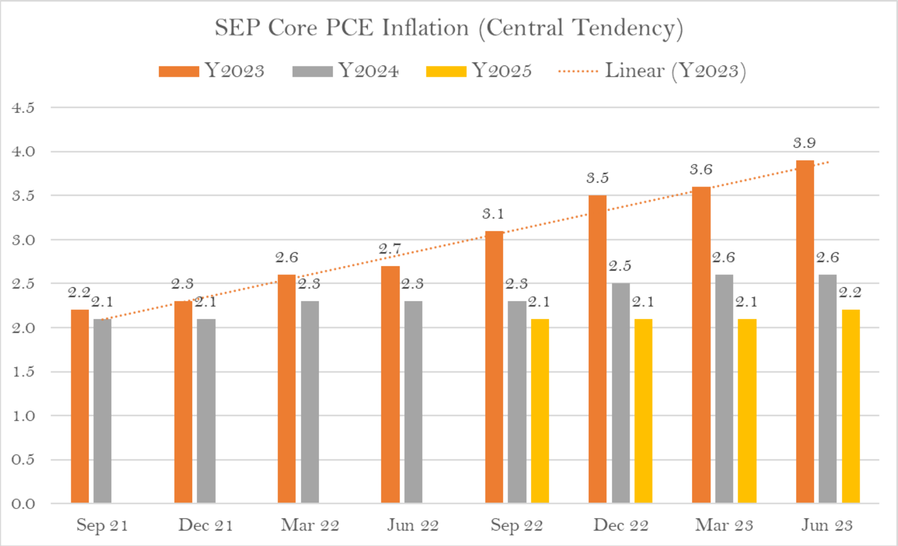
Summary of Economic Projections – Inflation (Core PCE)



FOMC, Experiential Wealth

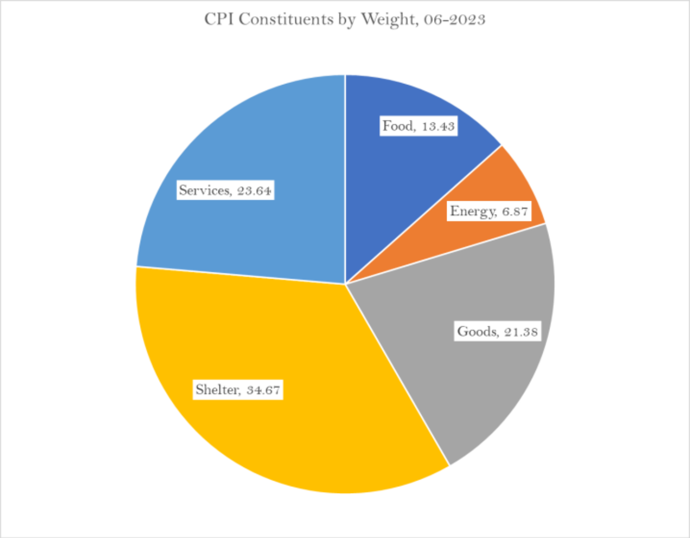


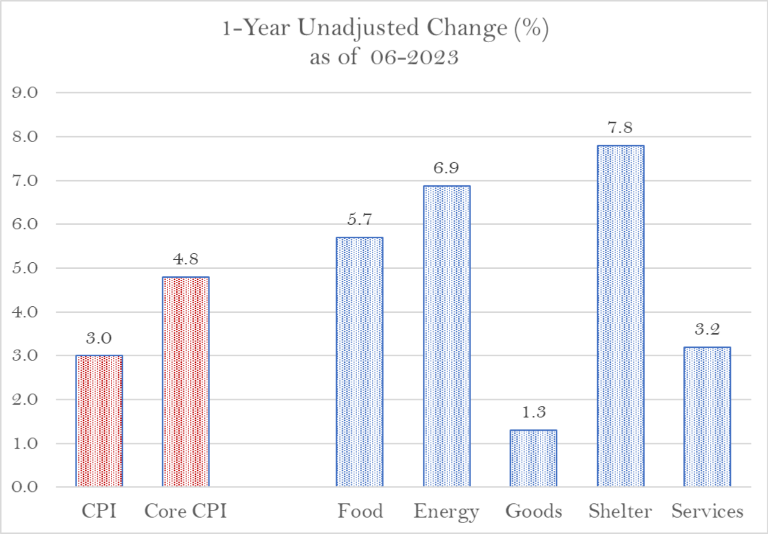
FOMC, Experiential Wealth

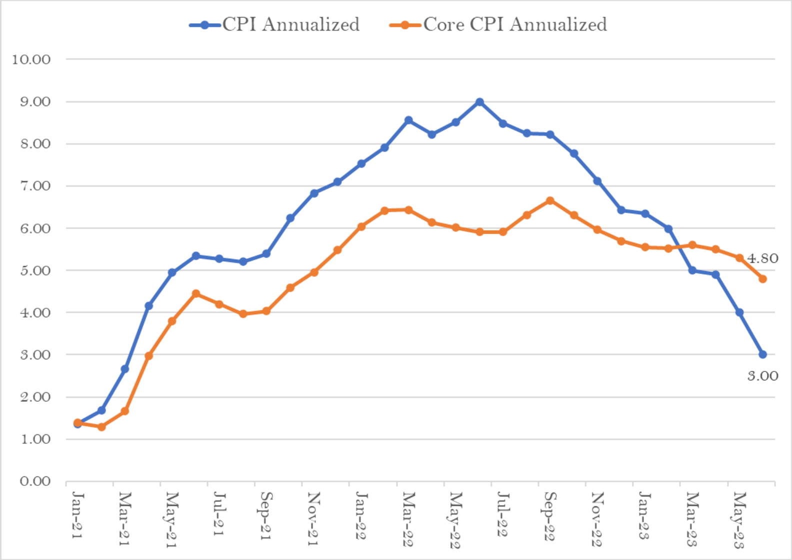
In the latest SEP, the central tendency average member continues to expect PCE inflation to move higher for 2023. Since September 2021's projection until March 2023's, the projection has consistently edged higher each quarter. In June, the projection has come down by 0.1%. For 2023, the projected annual PCE moved down to 3.2%. At the same time, the projection for 2024 remains at 2.5% and for 2025 at 2.1%

At the same time, projections for Core PCE (ex-food and energy) inflation continue to move higher. In June, it was 0.3% higher than the March projection at 3.6%. The Core PCE has moved up to 3.9% in June for 2023. This suggests that the FOMC members are expecting headline inflation (PCE) to come down at a faster pace than the all-important core PCE for 2023. This means that inflation remains sticky even though food, energy and goods prices continue to recover from the Covid shock. The Fed does not project reaching its 2% inflation target until the end of 2025.

Headline Inflation – CPI and Core CPI - Disinflation



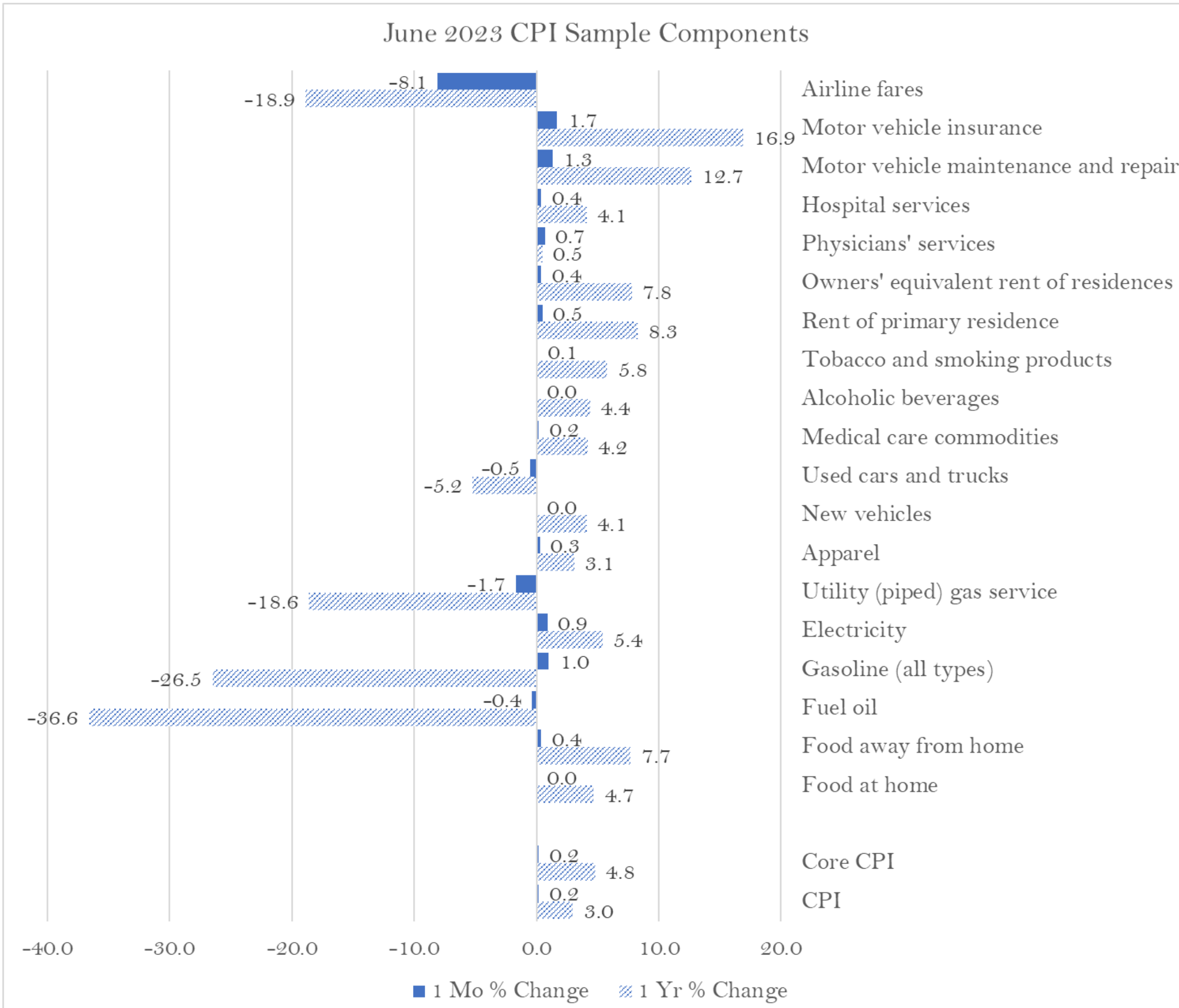




The Consumer Price Index for All Urban Consumers (CPI-U) rose 0.2% in June on a seasonally adjusted basis, after increasing 0.1% in May. Over the last 12 months, the all items index increased 3.0% before seasonal adjustment. The index for shelter was the largest contributor to the monthly all items increase, accounting for over 70% of the increase, with the index for motor vehicle insurance also contributing. The food index increased 0.1% in June after increasing 0.2% the previous month. The index for food at home was unchanged over the month while the index for food away from home rose 0.4% in June. The energy index rose 0.6% in June as the major energy component indexes were mixed.

Although core inflation is still more than twice the 2% FOMC target, the trend is definitely pointing to disinflation.

Energy is the largest drag on inflation



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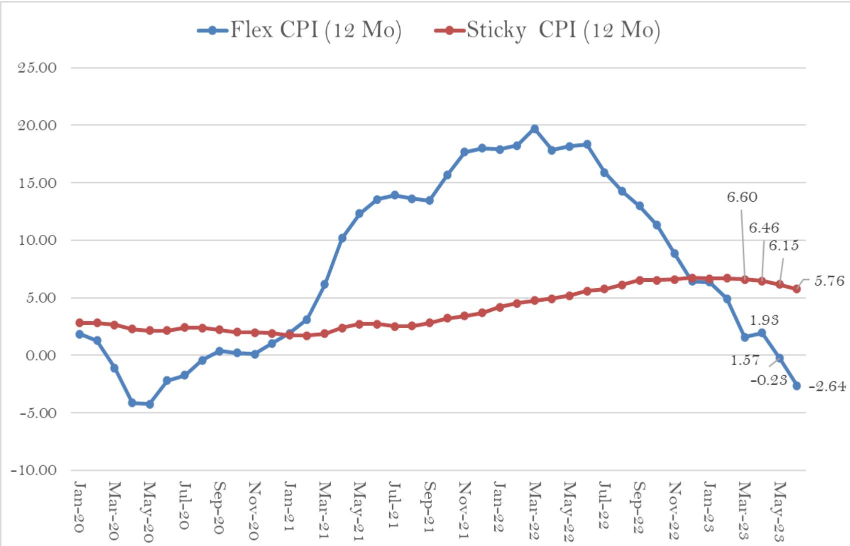
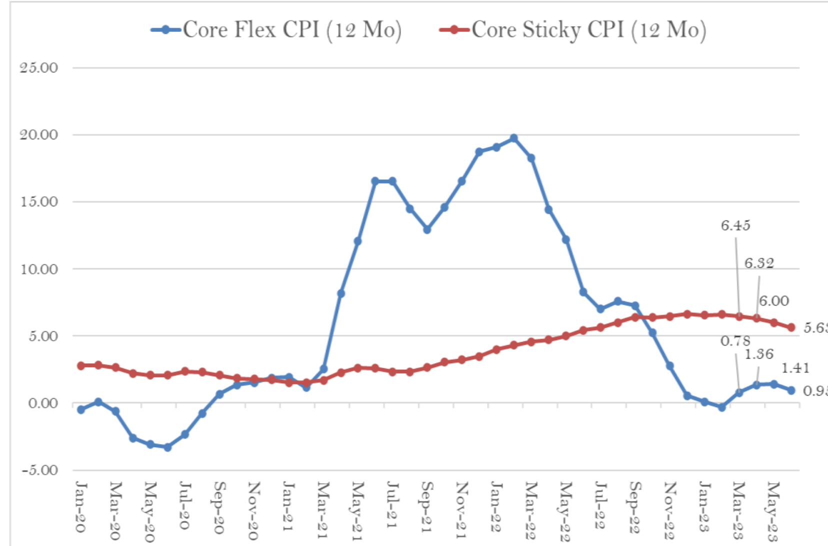
CPI – Flex and Sticky (06-2023) – Disinflation is happening



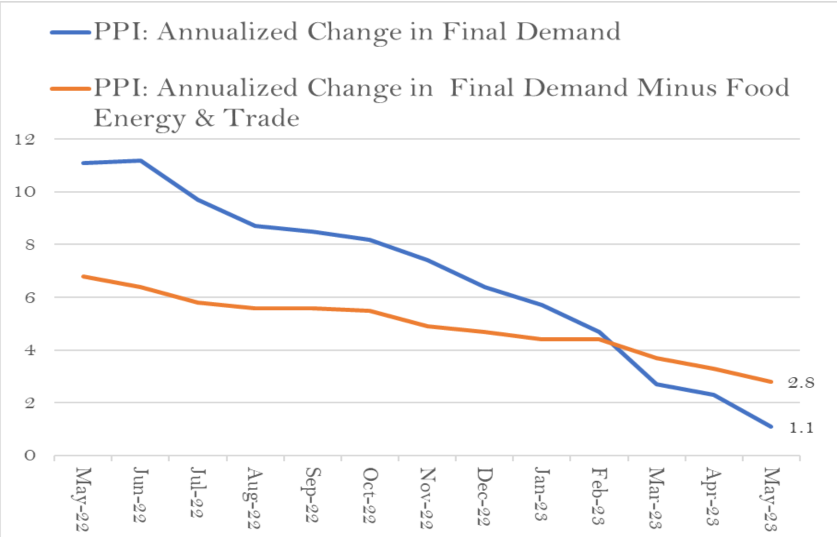


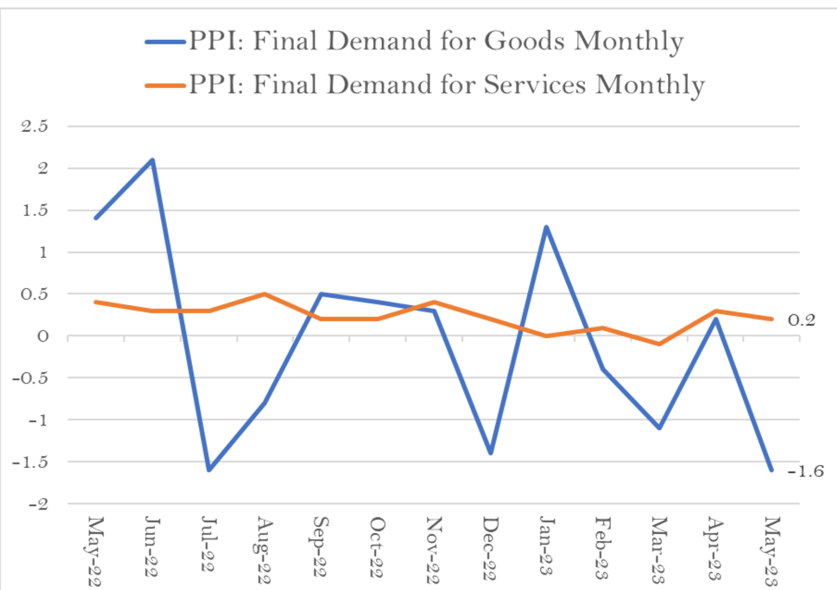
Source: https://www.atlantafed.org/research/inflationproject/stickyprice, Experiential Wealth

The Atlanta Federal Reserve use the published components of the CPI to compute two subindexes, a **sticky-price composite** of the CPI and a **flexible-price** CPI. The evidence indicates that the flexible-price measure is, in fact, much more responsive to changes in the economic environment— slack—while the sticky-price variant appears to be more forward looking. Price setters understand that it will be costly to change prices; they will want their price decisions to account for inflation over the periods between their infrequent price changes. The Atlanta Fed divides the published components of the monthly CPI (45 categories derived from the raw price data) into their "sticky-price" and "flexible-price" aggregates.

Flex and sticky are further divided into core and non-core. Core excludes energy and food prices. Historically, flexible-price and flexible core price CPI have shown much more volatility than the alternative sticky-price and sticky price core measures. Although imperfect, separating CPI categories into these two measures and further separating core categories from non-core provides a view of future inflation (i.e., removing the more volatile priced categories from the CPI). As of June, the sticky-price CPI increased 2.9% (on an annualized basis), following a 4.1% increase in May. On a year-over-year basis, the series is up 5.8%. The more refined division into Core Flex CPI moved 0.93% as of June, while the Core Sticky moved 5.63%. These are all signs of inflation slowing.

Producer Price Index (PPI)

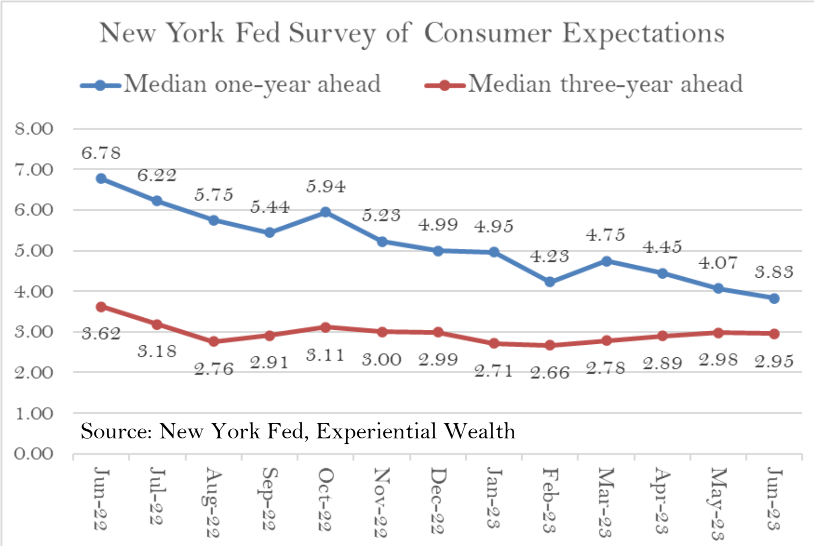


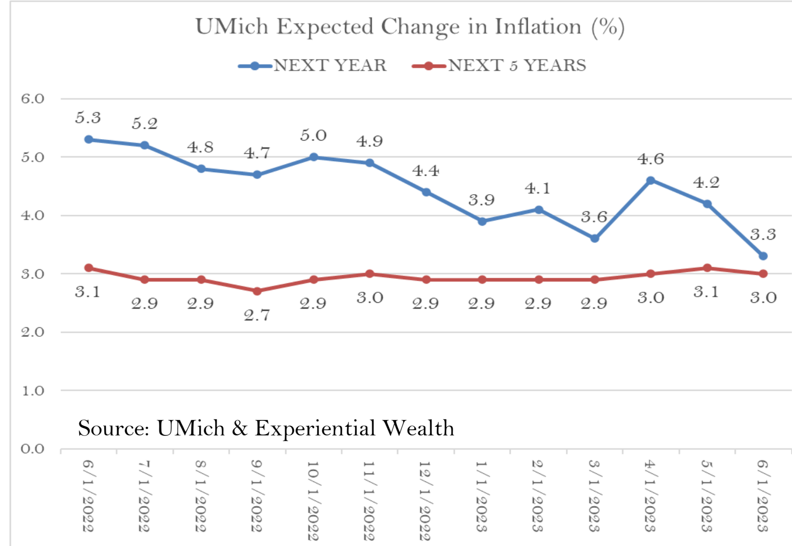


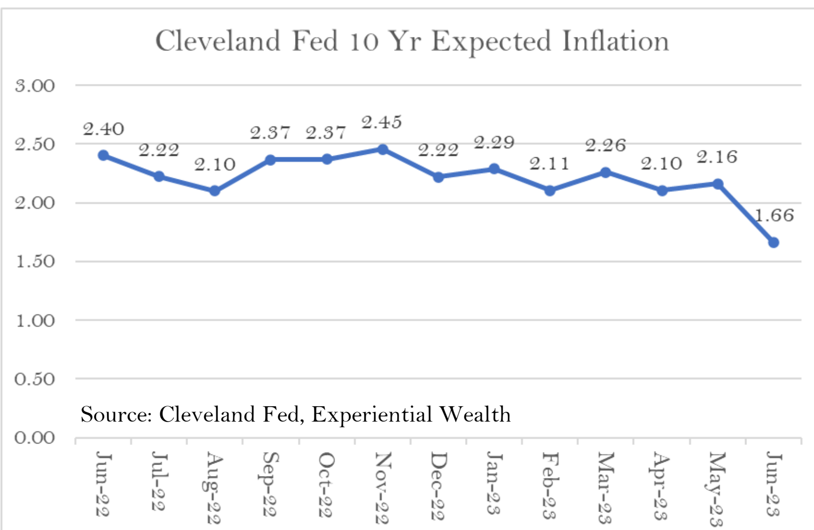
Source: https://www.bls.gov/news.release/ppi.nr0.htm, Experiential Wealth

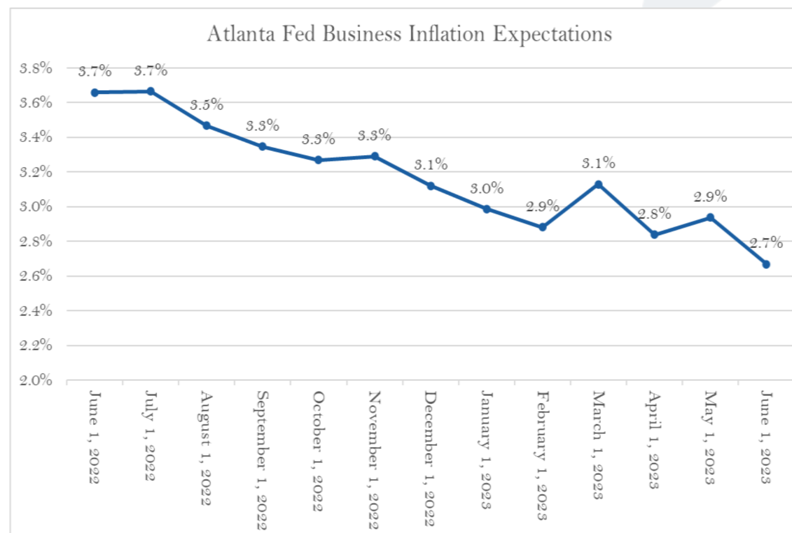
- The PPI for final demand declined 0.3% in May, seasonally adjusted. Final demand prices rose 0.2% in April and fell 0.4% in March. On an unadjusted basis, the index for final demand moved up 1.1% for the 12 months ending in May. This is good news for headline inflation. However, prices for final demand, less foods, energy, and trade services for the 12-months ending in May, increased 2.8%. This adds to core inflation stickiness.
- Final demand goods: Prices for final demand goods moved down 1.6% in May, the largest decrease since falling 1.6% in July 2022. Most of the May decline is attributable to the index for final demand energy, which dropped 6.8%. Prices for final demand foods moved down 1.3%. In contrast, the index for final demand goods less foods and energy increased 0.1%.
- Final demand services: The index for final demand services moved up 0.2% in May following a 0.3% advance in April. Leading the May increase, margins for final demand trade services rose 1.0%. (Trade indexes measure changes in margins received by wholesalers and retailers.) Prices for final demand services less trade, transportation, and warehousing edged up 0.1%. In contrast, the index for final demand transportation and warehousing services declined 1.4%.

Inflation Expectation – Survey-Based - Falling

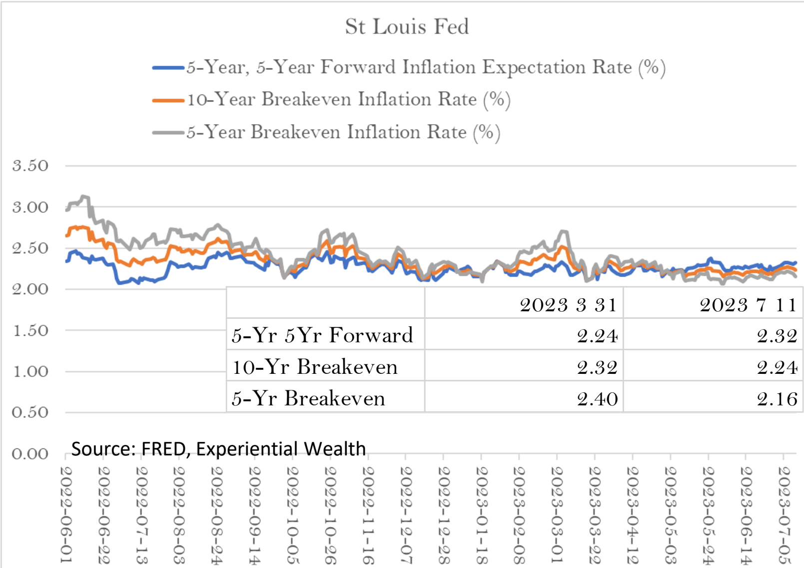


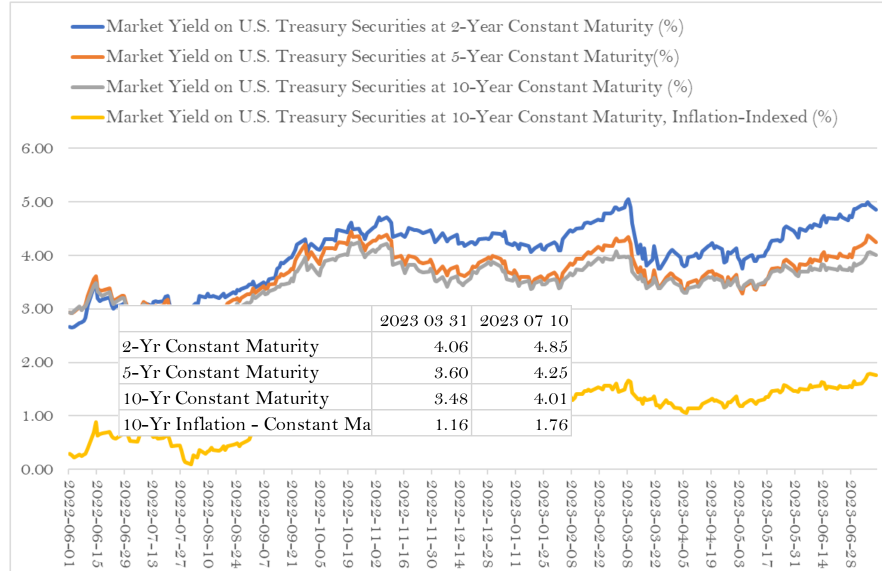






Inflation Expectation – Market-Based





5-Year, 5-Year Forward Inflation Expectation Rate is a measure of expected inflation (on average) over the five-year period that begins five years from today **@ 2.32%.**
10-Year Breakeven Inflation Rate is a measure of expected inflation derived from 10-Year Treasury Constant Maturity Securities and 10-Year Treasury Inflation-Indexed Constant Maturity Securities. The latest value implies what market participants expect inflation to be in the next 10 years, on average **@ 2.24%.**
5-Year Breakeven Inflation Rate is the measure of expected inflation derived from 5-Year Treasury Constant Maturity Securities and 5-Year Treasury Inflation-Indexed Constant Maturity Securities. The latest value implies what market participants expect inflation to be in the next 5 years, on average - **@ 2.16%.**

2-Year Constant Maturity Rate is the nominal rate of the 2-Year U.S. Treasury. The latest value is the current yield on the 2-Year Treasury **@ 4.85%.**
5-Year Constant Maturity Rate is the nominal rate of the 5-Year U.S. Treasury. The latest value is the current yield on the 5-Year Treasury **@ 4.25%.**
10-Year Constant Maturity Rate is the nominal rate of the 10-Year U.S. Treasury. The latest value is the current yield on the 10-Year Treasury **@ 4.01%.**
10-Year Constant Inflation Indexed Maturity Rate is the real rate of the 10-Year U.S. Treasury. The latest value is the current yield on the 10-Year Treasury **@ 1.76%.**

Market based expectations remain somewhere around 2% in the long run and appear to be well anchored.

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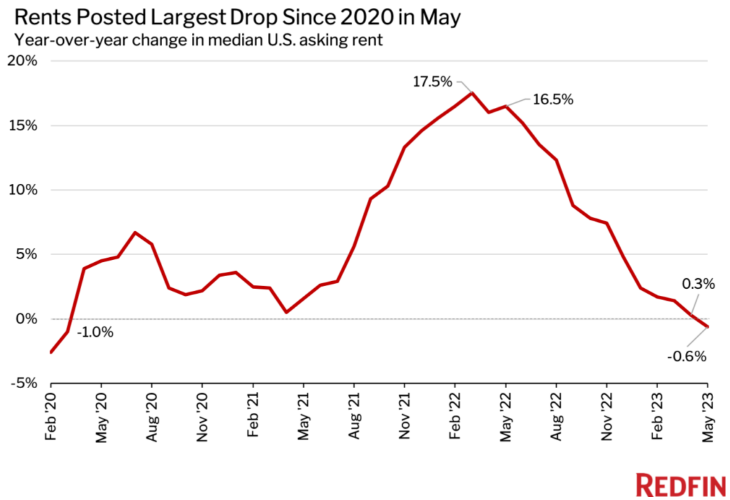
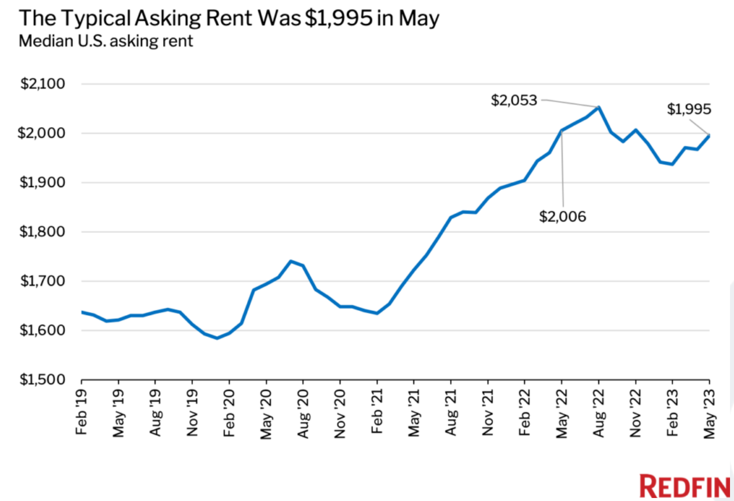
Rent – Post-Covid Peak Increase is Behind Us

	West	Midwest	South	Northeast
Median Rent	$1,663	$1,406	$2,409	$2,495
YOY rate Change	-2.1%	4.9%	0.8%	5.4%





https://www.redfin.com/news/redfin-rental-report-may-2023/

Redfin analyzed rent prices from Rent.com across the 50 largest U.S. metro areas. This analysis used data from more than 20,000 apartment buildings across the country. It is important to note that the prices in this report reflect the current costs of new leases during each time period. In other words, the amount shown as the median rent is not the median of what all renters are paying, but the median cost of apartments that were available for new renters during the report month. Currently, data from Rent.com includes only median rent at the metro level. This latest information supports the idea that owners' equivalent rent of residences (OER) and rent of primary residence (rent) have seen their peak. Rent is typically one of the last components to show disinflation, and the rate of increase has continued to come down, as evidenced by May 2023 data. This will impact the inflation rate forward, also impacted by the most recent housing price increases.

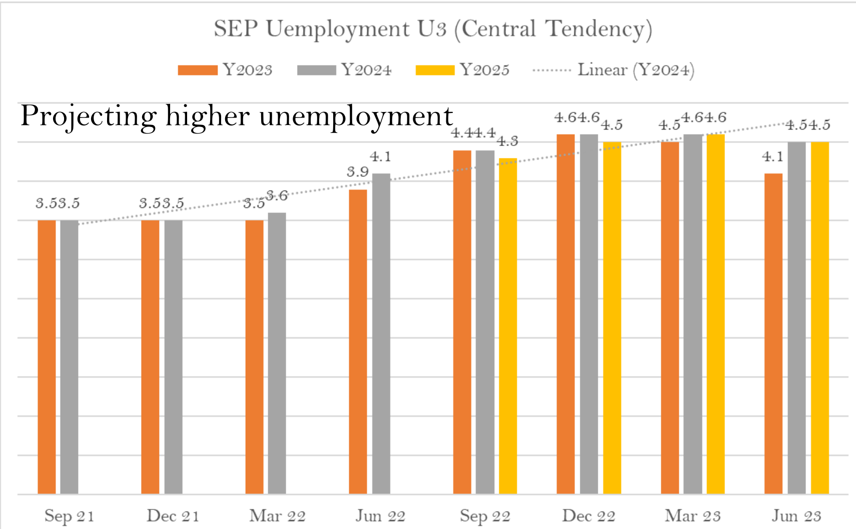
Global Inflation is Falling

Country	Last	Previous	Reference
China	0.2	0.1	23-May
Switzerland	2.2	2.6	23-May
Russia	2.5	2.3	23-May
Saudi Arabia	2.8	2.7	23-May
Spain	3.2	4.1	23-May
South Korea	3.3	4.2	23-May
Japan	3.5	3.2	23-Apr
Brazil	3.9	4.2	23-May
Indonesia	4.0	4.3	23-May
United States	4.0	4.9	23-May
India	4.3	4.7	23-May
Canada	4.4	4.3	23-Apr
France	5.1	5.9	23-May
Singapore	5.7	5.5	23-Apr
Mexico	5.8	6.3	23-May
Euro Area	6.1	7.0	23-May
Germany	6.1	7.2	23-May
Netherlands	6.1	5.2	23-May
South Africa	6.8	7.1	23-Apr
Australia	7.0	7.8	23-Mar
Italy	7.6	8.2	23-May
United Kingdom	8.7	10.1	23-Apr
Turkey	39.6	43.7	23-May
Argentina	114.0	109.0	23-May

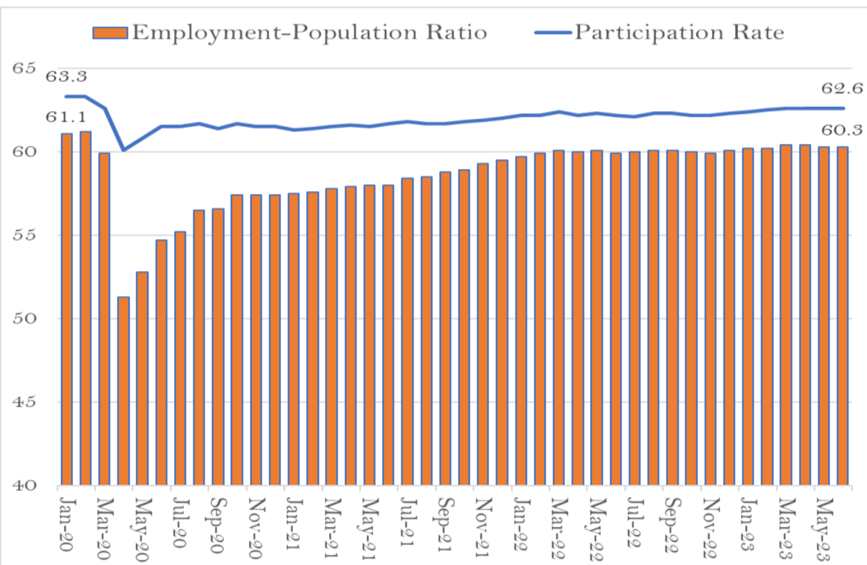
Source: Trading Economics, Experiential Wealth
https://tradingeconomics.com/country-list/inflation-rate

Most countries have seen a reduction in inflation in May 2023.

Summary of Economic Projections – Unemployment (U3)



Source: FOMC, Experiential Wealth



BLS, Experiential Wealth

https://www.bls.gov/ces/data/employment-situation-table-download.htm

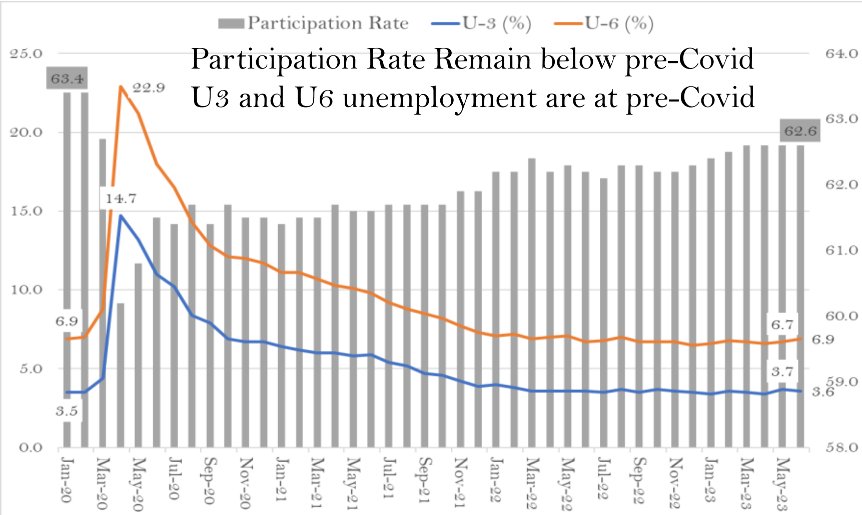
The Federal Reserve expects unemployment to move up from its current 3.6% to 4.5% by end of year. The labor market continues to remain tight from the number of employed, not-in-labor-force, and unemployed. New jobs continue to be added while the labor pool is not expanding, as evidenced by the Employment-Population Ratio and the Participation Rate.

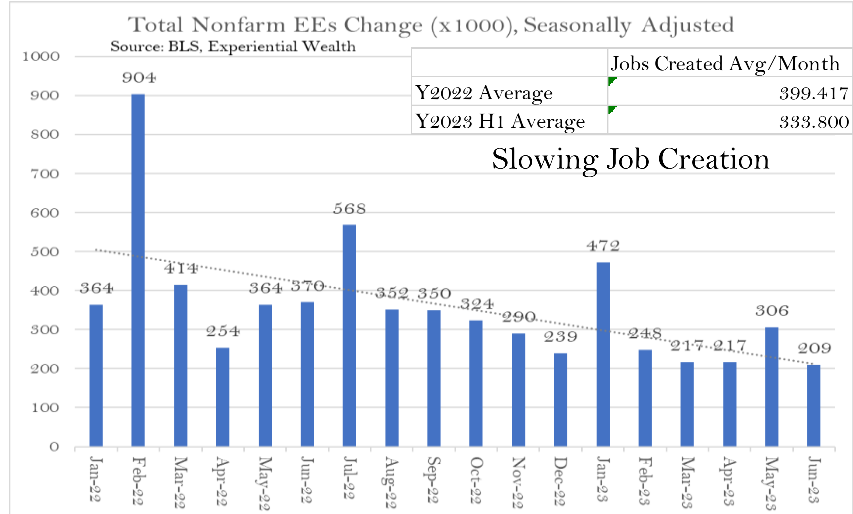
The rate of increase in employment is slowing as the economy weakens. If the Fed continues the rate hiking cycle and thereafter holds rates higher for longer, the labor market would likely weaken from here. However, it is not clear if the projected 4.5% unemployment would be reached by the end of this year.

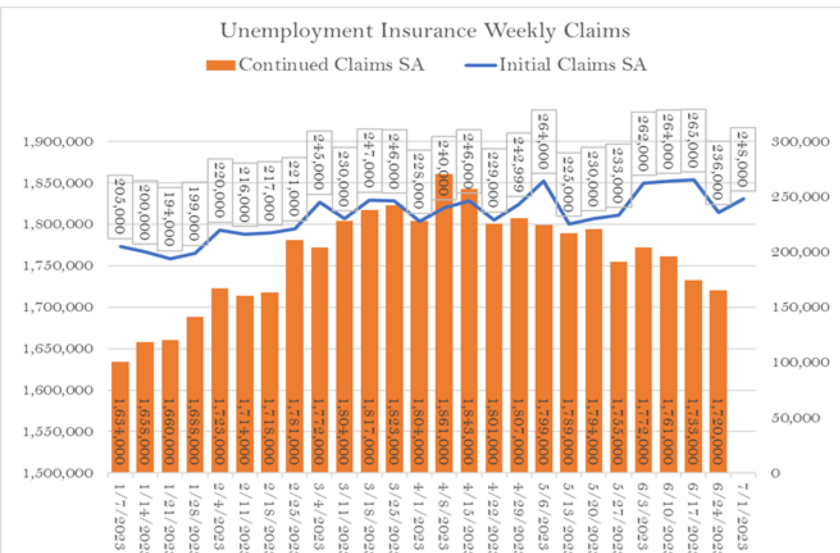
Where New Jobs are Growing…

		May-22	Feb-23	Mar-23	Apr-23	May-23	1 Month Change
	Total (x1000)	**11,443**	**9,974**	**9,745**	**10,320**	**9,824**	**-496**
More Jobs Created in May 2023	**Government**	1,064	1,015	1,034	1,029	1,132	103
	Professional and business services	2,128	1,852	1,805	1,718	1,812	94
	State and local	928	876	902	881	959	78
	Educational services	171	184	210	168	213	45
	Transportation, warehousing, and utilities	510	579	407	561	602	41
	State and local, excluding education	550	545	580	568	609	41
	State and local education	378	331	321	313	350	37
	Federal	137	140	133	149	173	24
	Construction	392	404	315	347	366	19
	Real estate and rental and leasing	153	130	130	113	127	14
	Information	241	169	181	181	190	9
Less Jobs Created in May 2023	Mining and logging	33	39	30	36	30	-6
	Wholesale trade	373	291	296	259	244	-15
	Durable goods	525	459	422	395	377	-18
	Accommodation and food services	1,406	1,210	1,220	1,222	1,183	-39
	Nondurable goods	312	248	281	273	227	-46
	Manufacturing	837	707	702	668	604	-64
	Arts, entertainment, and recreation	161	218	243	241	172	-69
	Other services	411	353	367	361	283	-78
	Trade, transportation, and utilities	2,047	1,671	1,436	1,774	1,675	-99
	Leisure and hospitality	1,567	1,428	1,463	1,463	1,355	-108
	Retail trade	1,165	801	733	954	829	-125
	Financial activities	564	461	479	565	439	-126
	Finance and insurance	411	331	349	451	312	-139
	Education and health services	2,158	1,874	1,932	2,179	1,938	-241
	Health care and social assistance	1,987	1,690	1,722	2,010	1,725	-285

Labor Market Data

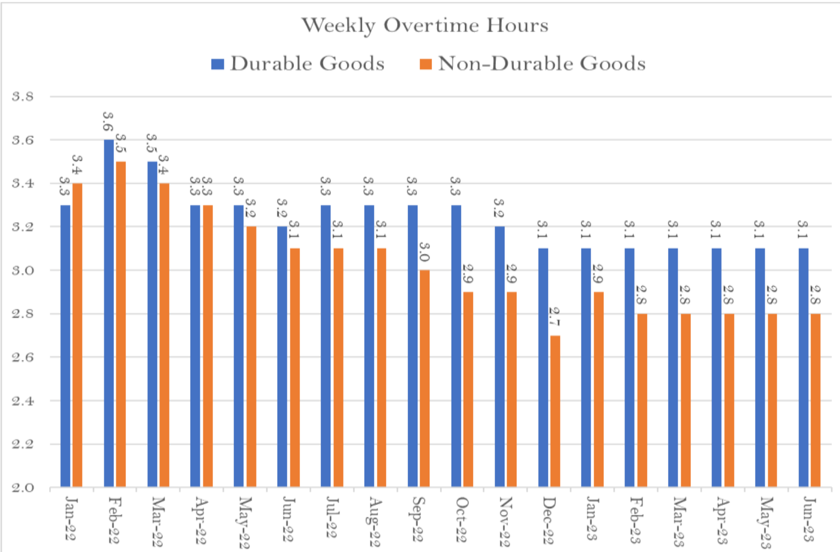


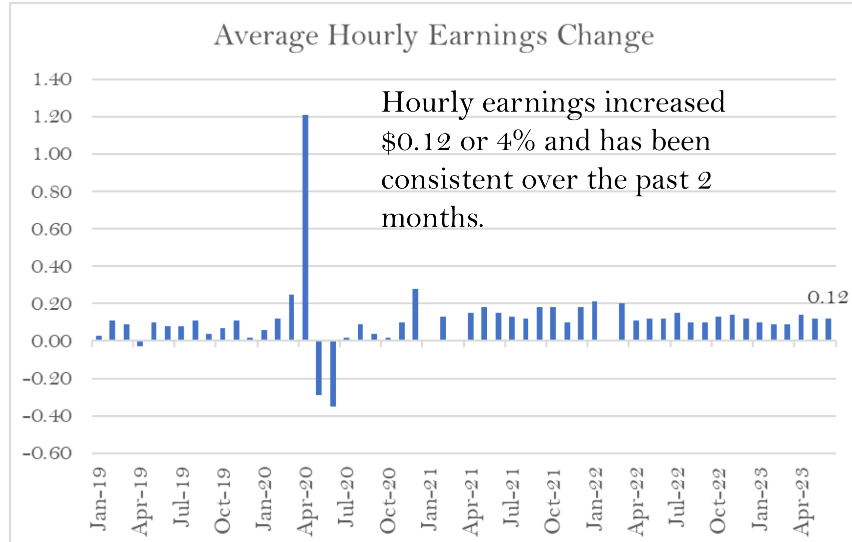




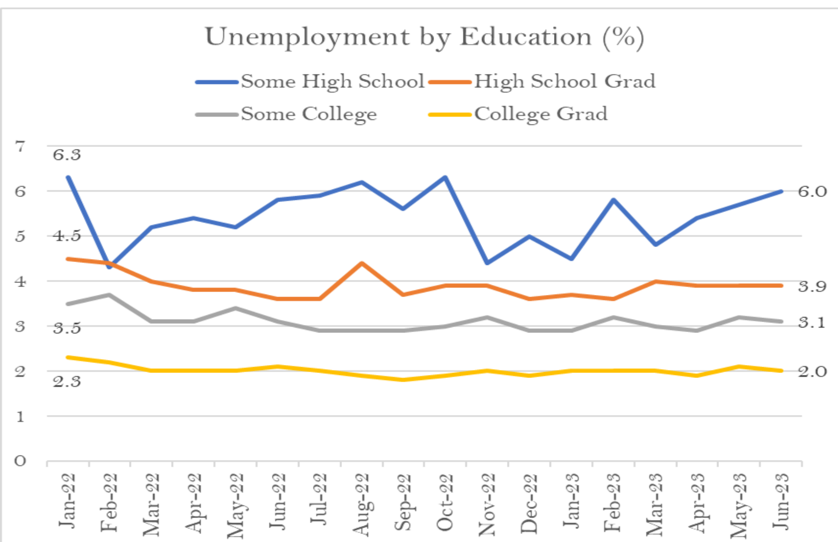
The unemployment rate remains at historically low levels. There are still "more" jobs opening than people looking for jobs. People not in the labor force has been quite steady, and there does not yet seem to be a big rush to come back into the labor force (participation rate). There is likely a mismatch of job and skills which (1) maintains a higher job opening rate and (2) causes employers to hold on to workers longer. Job creation is slowing and is a sign of a continuing slowing economy.

More Labor Market Data





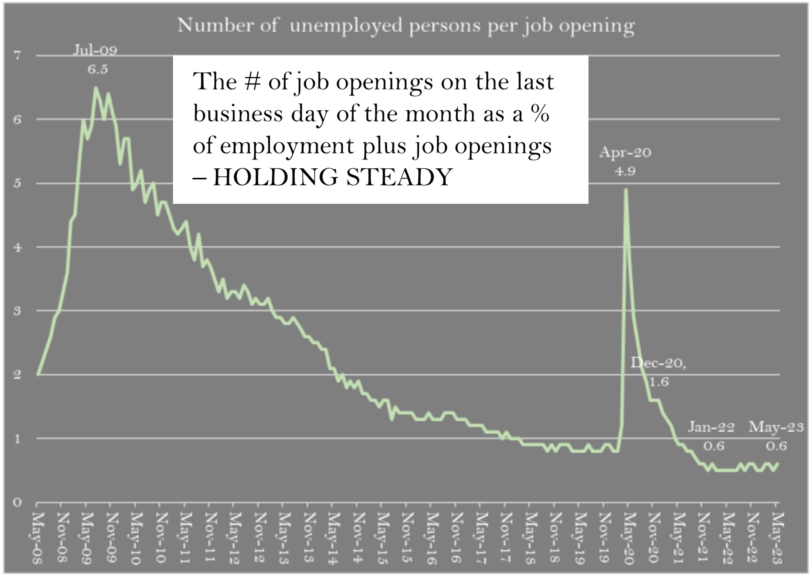
Source: BLS, Experiential Wealth

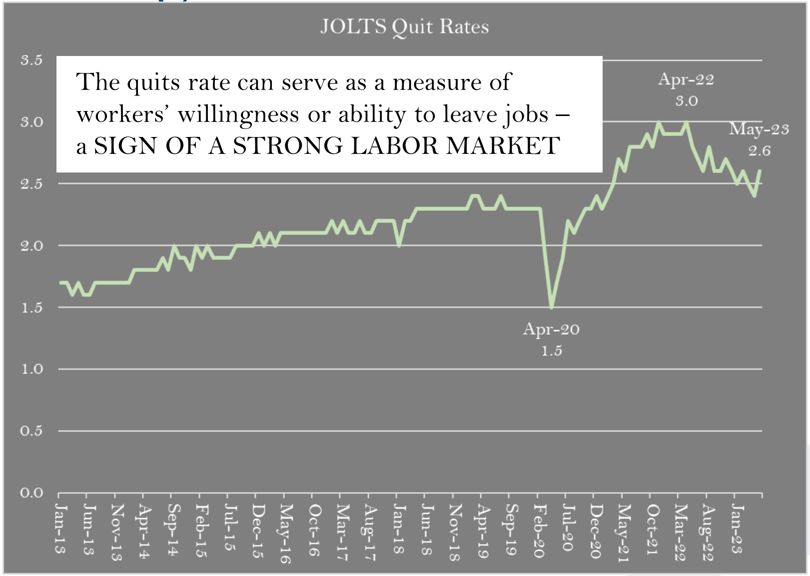


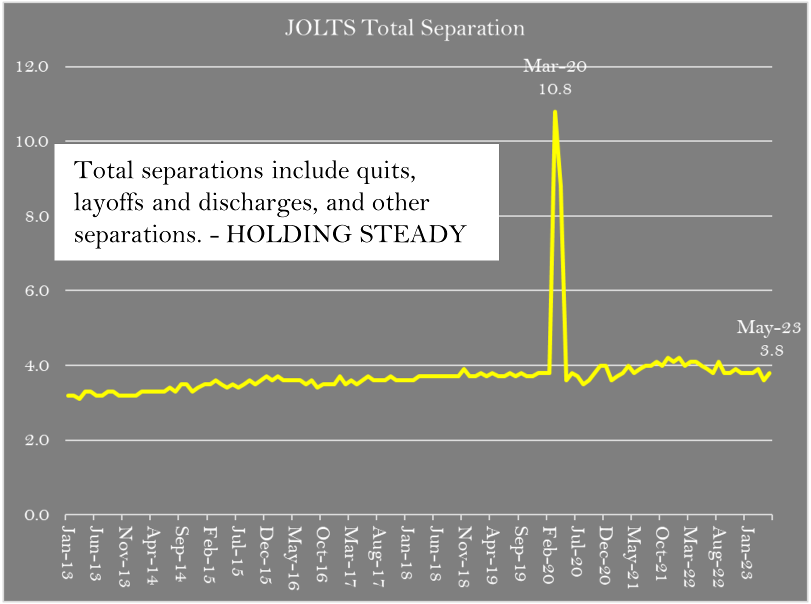
We should watch hourly wages and overtime more closely. As stated, due to a shortage of workers, employers are not likely to fire employees. However, the first sign of slowing is a reduction of overtime. The second sign would be a further slowing of wage growth. Finally, if the economy worsens further, employers will then let go of employees.

Unemployment is slowly rising in the least educated population (likely the lowest paid segment). Also, Black Americans are seeing a gradually rise in unemployment.

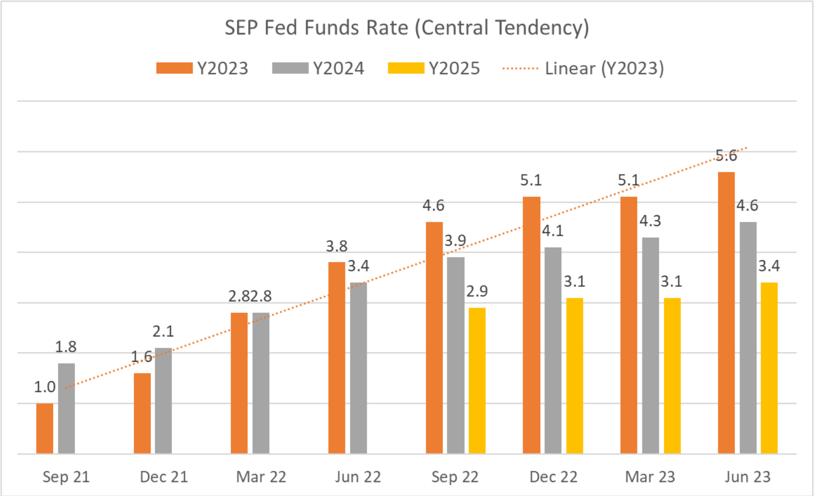
JOLTS Data – 2023 June, still a strong labor market



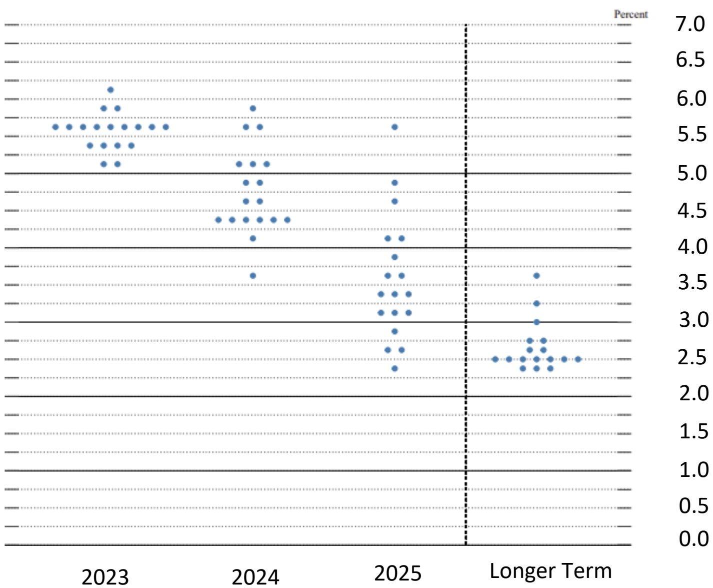




Summary of Economic Projections (SEP) – Fed Fund Rate



Source: FOMC, Experiential Wealth

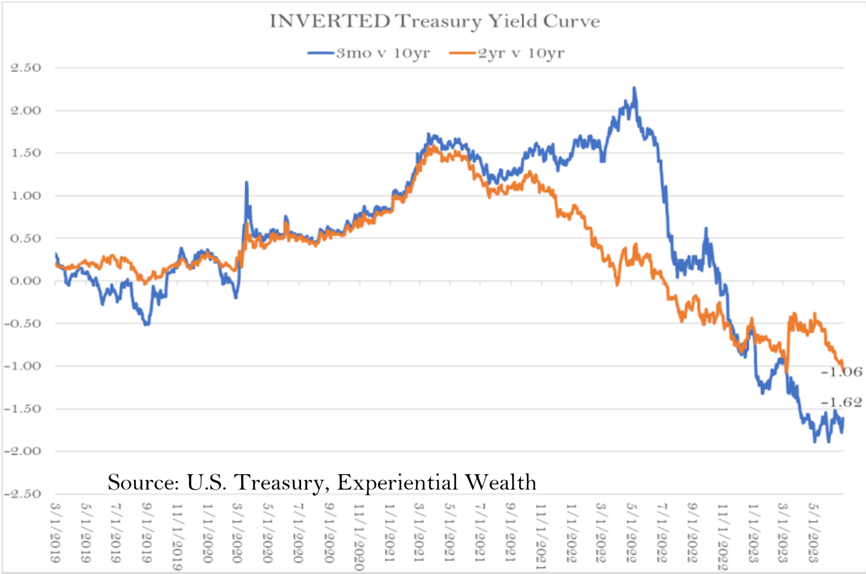


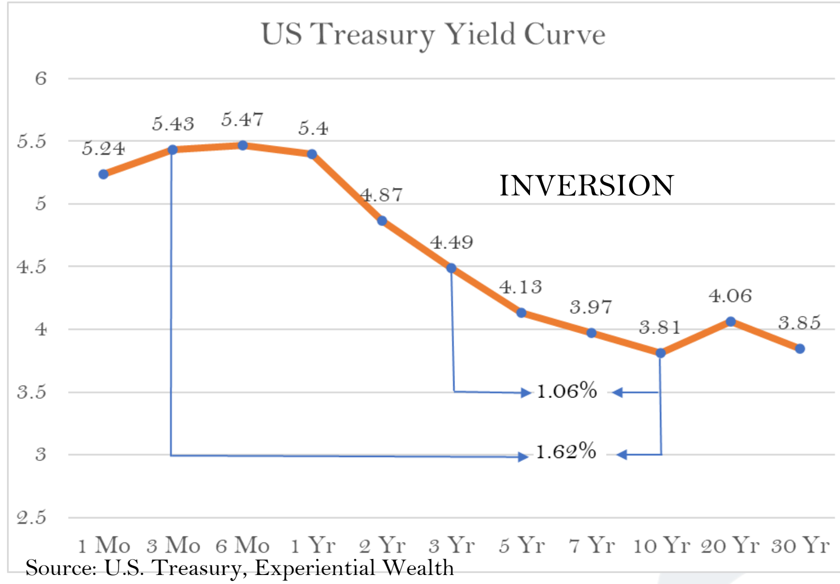
Source: FOMC, Experiential Wealth 06 2023

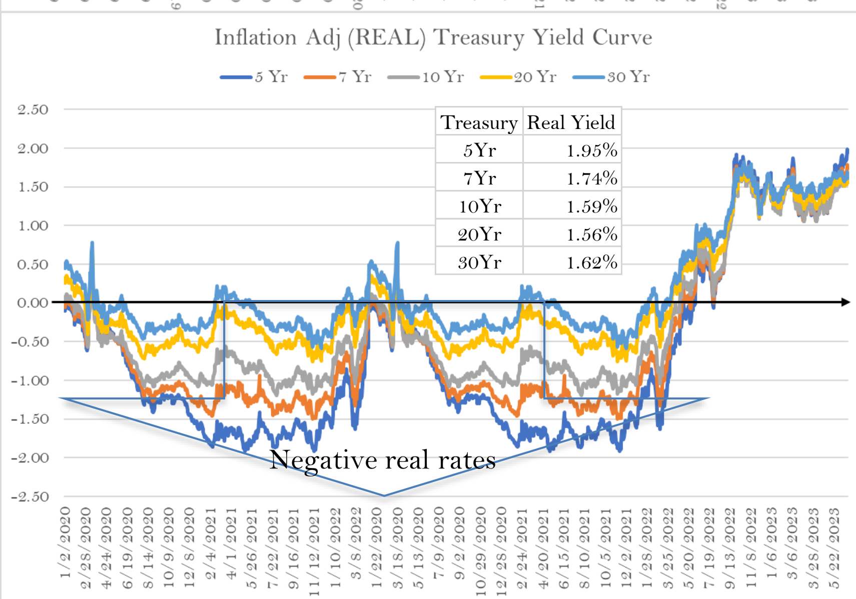
The central tendency (among all FOMC members) rate has moved up from 5.1% in March to 5.6% by the end of 2024. This represents a 50bp increase. At a 25bp drop per meeting, the FOMC is signaling that, after the June skip, the FOMC projects to hike at two more meetings. Currently, the Fed Fund rate ranges 5.0% to 5.25% and the dot plots are indicating 5.5% to 5.75%, with three more members voting for 5.75% to 6.25%. Members also raised their rate projections for 2024 and 2025 from 4.3% to 4.6% and 3.1% to 3.4%, respectively. This can be construed as the sticky inflation remaining higher than 2% even in 2025 and rates generally remaining higher for longer.

This affirms that there will be no rate cuts in 2023 and possibly a 1% cut next over four meetings at 25bp each during 2024. Rate cuts will not likely begin until mid-year in 2024 at the earliest. Of course, these are just projections, and all decisions will be heavily data dependent.

U.S. Treasury Yield Curve: Signaling Economic Contraction







The 2-10 U.S. Treasury yield curve spread (i.e., the difference in rates) has flattened somewhat since March. This was due to the banking default shock which led to market expectation for a higher probability of a U.S. economic contraction by the end of 2023. This pushed interest rates lower. Historically, in a recession, the Fed lowers rates to spur economic revival. The 3-months-10-year spread remains quite negative (i.e., the short-term rate remains higher than the longer maturity 10-year bonds). This means that the short-rates (controlled by the Fed) remain elevated as there is uncertainty regarding the Fed's policy intentions for the next two meetings and even greater speculation regarding the Fed to pause and shortly thereafter lower rates (pivot).

https://home.treasury.gov/policy-issues/financing-the-government/interest-rate-statistics

Market Expectation on Future Rates – 4-11-2023

The CME group's FedWatch Tool analyzes the probabilities of changes to the Fed rate and U.S. monetary policy, as implied by 30-Day Fed Funds futures pricing data. The Tool shows the likelihood that the Fed will change the Federal target rate at upcoming FOMC meetings, according to interest rate traders. At he March FOMC meeting, the policy rate was raised to 475-500bp.

3-31-2023

MEETING PROBABILITIES

MEETING DATE	200-225	225-250	250-275	275-300	300-325	325-350	350-375	375-400	400-425	425-450	450-475	475-500	500-525
7/26/2023	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.7%	26.8%	48.4%	23.2%
9/20/2023	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.9%	15.7%	38.9%	34.3%	10.2%
11/1/2023	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.5%	8.8%	28.0%	36.4%	21.5%	4.8%
12/13/2023	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.3%	5.2%	19.7%	32.8%	27.9%	12.0%	2.1%
1/31/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.2%	3.3%	14.1%	27.7%	29.8%	18.2%	5.9%	0.8%
3/20/2024	0.0%	0.0%	0.0%	0.0%	0.1%	2.3%	10.7%	23.5%	29.2%	21.8%	9.7%	2.4%	0.2%
5/1/2024	0.0%	0.0%	0.0%	0.1%	2.2%	10.1%	22.5%	28.7%	22.4%	10.7%	3.0%	0.4%	0.0%
6/19/2024	0.0%	0.0%	0.0%	1.0%	5.5%	15.3%	25.1%	26.0%	17.4%	7.4%	1.9%	0.2%	0.0%
7/31/2024	0.0%	0.0%	0.8%	4.7%	13.6%	23.4%	25.9%	18.9%	9.2%	2.9%	0.5%	0.1%	0.0%
9/25/2024	0.4%	2.8%	9.2%	18.5%	24.6%	22.4%	14.0%	6.0%	1.7%	0.3%	0.0%	0.0%	0.0%

At the same time, the tool projected the rate would remain at 475-500bp in the June 26th meeting (i.e., pause) and begin rate cuts in the September meeting and forward. In fact, by the middle of 2024, the rates would be in the 375-400bp range.

6-30-2023

MEETING PROBABILITIES

MEETING DATE	300-325	325-350	350-375	375-400	400-425	425-450	450-475	475-500	500-525	525-550	550-575	575-600
7/26/2023				0.0%	0.0%	0.0%	0.0%	0.0%	13.2%	86.8%	0.0%	0.0%
9/20/2023	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	10.0%	69.1%	20.8%	0.0%
11/1/2023	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	7.5%	54.0%	33.2%	5.3%
12/13/2023	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.9%	13.2%	51.4%	29.7%	4.7%
1/31/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.3%	5.5%	27.4%	43.4%	20.4%	2.9%
3/20/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.2%	2.9%	16.5%	35.4%	31.9%	11.7%	1.5%
5/1/2024	0.0%	0.0%	0.0%	0.0%	0.1%	2.5%	14.3%	32.3%	32.5%	15.0%	3.1%	0.2%
6/19/2024	0.0%	0.0%	0.0%	0.1%	1.2%	7.9%	22.5%	32.4%	24.5%	9.6%	1.8%	0.1%
7/31/2024	0.0%	0.0%	0.1%	1.0%	6.4%	19.4%	30.3%	26.2%	12.8%	3.5%	0.5%	0.0%
9/25/2024	0.0%	0.0%	0.8%	5.6%	17.3%	28.5%	26.8%	14.9%	5.0%	1.0%	0.1%	0.0%
11/6/2024	0.0%	0.7%	4.9%	15.5%	26.8%	27.1%	16.7%	6.5%	1.6%	0.2%	0.0%	0.0%
12/18/2024	0.4%	2.8%	10.3%	21.3%	27.0%	21.8%	11.5%	4.0%	0.9%	0.1%	0.0%	0.0%

As of the end of June, the Tool is showing a high confidence that the July meeting would hike rates by 25bp from the current 500-525bp range to 525-550 range. The right charts show the highest probability point for each future FOMC meeting to stay at a higher rate with rate cuts pushed out to the March 2024 meeting.

We expect rates will be at the 550-575 range and occur, at the earliest, in the back half of 2024. All indicators thus far suggest inflation to be more stubborn and lingering higher than the 2% FOMC target. If the Fed begins to cut rate (i.e., pivot) when core PCE or core CPI remains at the 3% to 3.5% range, the Fed will lose credibility and will have a very difficult time in gaining it back going forward.

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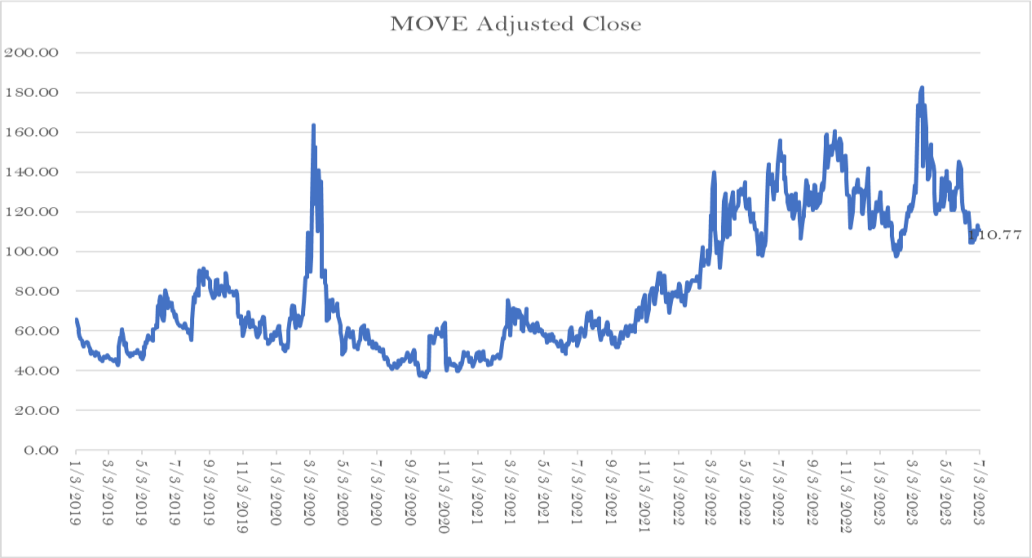
Global Central Bank Interest Rates

Central Bank	Current Rate	Direction	Previous Rate	Change
American interest rate FED	5.250 %	↑	5.000 %	**5/3/2023**
Australian interest rate RBA	4.100 %	↑	3.850 %	**6/6/2023**
Banco Central Chile interest rate	11.250 %	↑	10.750 %	10/13/2022
Bank of Korea (S.K.) interest rate	3.500 %	↑	3.250 %	**1/13/2023**
Brazilian interest rate BACEN	13.750 %	↑	13.250 %	8/4/2022
British interest rate BoE	4.500 %	↑	4.250 %	**5/11/2023**
Canadian interest rate BOC	4.750 %	↑	4.500 %	**6/7/2023**
Chinese interest rate PBC	3.650 %	↓	3.700 %	8/22/2022
Czech interest rate CNB	7.000 %	↑	5.750 %	6/22/2022
Danish interest rate Nationalbanken	3.250 %	↑	3.000 %	**6/15/2023**
European interest rate ECB	4.000 %	↑	3.750 %	**6/15/2023**
Hungarian interest rate	13.000 %	↑	11.750 %	9/27/2022
Indian interest rate RBI	6.500 %	↑	6.250 %	**2/8/2023**
Indonesian interest rate BI	6.500 %	↓	6.750 %	6/16/2016
Israeli interest rate BOI	4.750 %	↑	4.500 %	**5/22/2023**
Japanese interest rate BoJ	-0.100 %	↓	0.000 %	2/1/2016
Mexican interest rate Banxico	11.250 %	↑	11.000 %	**3/30/2023**
New Zealand interest rate	5.500 %	↑	5.250 %	**5/24/2023**
Norwegian interest rate	3.250 %	↑	3.000 %	**5/4/2023**
Polish interest rate	6.750 %	↑	6.500 %	9/7/2022
Russian interest rate CBR	7.500 %	↓	8.000 %	9/16/2022
Saudi Ariabian interest rate	5.500 %	↑	5.250 %	**3/22/2023**
South African interest rate SARB	8.250 %	↑	7.750 %	**5/25/2023**
Swedish interest rate Riksbank	3.500 %	↑	3.000 %	**4/26/2023**
Swiss interest rate SNB	1.500 %	↑	1.000 %	**3/23/2023**
Turkish interest rate CBRT	8.500 %	↓	9.000 %	**2/23/2023**

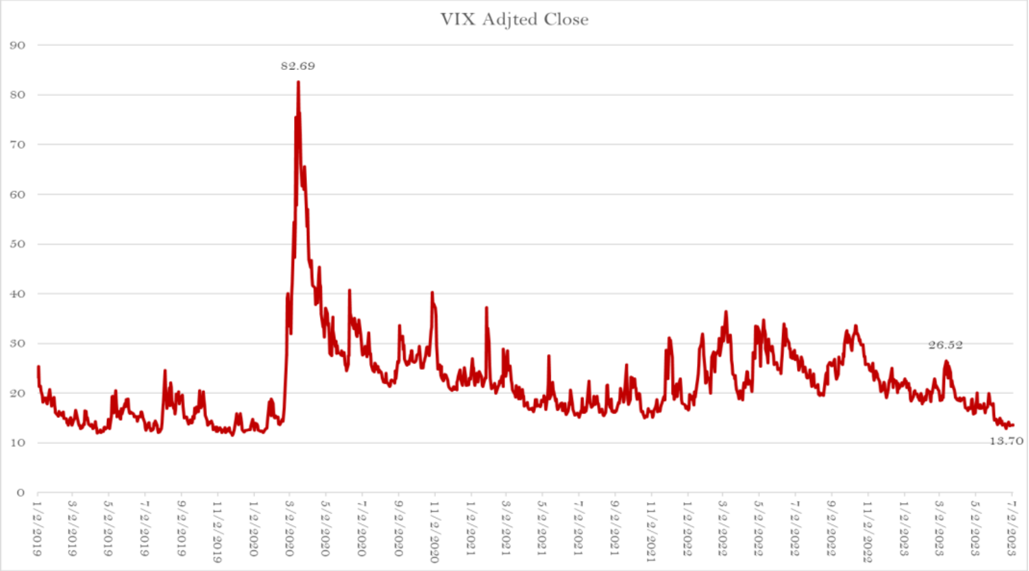
https://www.global-rates.com/en/interest-rates/central-banks/central-banks.aspx

17 out of the 26 central banks listed have raised interest rates in 2023 while 7 more increased rates (and have not reduced rates since 2022). The two countries that have been consistently taking contrary steps are China and Japan. China has lowered rates in 2022, and it is widely expected that the rate will get lower for China to support its weakening economy. Japan has remained at its zero rate since 2016, and against all market speculations, its central bank has not signaled a change to raise rates even amid substantially higher inflation. The U.S. is expected to pause or at least end the rising rate cycle while the ECB remains steadfast with its push to higher interest rates to combat inflation.

The Market: Bond and Stock Volatility



https://finance.yahoo.com/quote/%5EMOVE/history?period1=1546473600&period2=1688428800&interval=1d&filter=history&frequency=1d&includeAdjustedClose=true, Experiential Wealth



https://finance.yahoo.com/quote/%5EVIX/history, Experiential Wealth

ICE MOVE - Merrill Lynch Option Volatility Estimate- is one measure of U.S. interest rate volatility and can provide a signal for changing risk sentiment in fixed income markets. The recent spike is caused by the bank failures. As the FOMC's interest rate hikes are expected to resume, more interest rate volatility is expected, especially as the date of the next FOMC meeting approaches.

VIX - Chicago Board Options Exchange Volatility Index - is a popular measure of the implied volatility of S&P 500 index options. A high value corresponds to a more volatile market and, therefore, more costly options, which can be used to defray risk from volatility. With more interest rate hikes coming, investor complacency may wane and contribute to more elevated stock market volatility.

Our Base Case Forward

- The U.S. economy has been more resilient than most observers have expected for more than a year. After the historic 500bp interest rate increase and the shuttering of two regional banks, the economy continues to "hum" along. The unprecedented scale of fiscal transfer from the federal government during the three Covid years continues to give a sizable cushion to the economy. The tight labor market has also contributed to a rise in wages and worker complacency. The strength of the labor market appears to be quite stubborn. In the pre-Covid days, 5% unemployment was considered full employment or the neutral rate (u*). Today a 3.5% to 4% unemployment rate seems to be the new full employment rate. With 161 million working, there are 6 million unemployed (a range between 5.7 and 6.5 million since January 2022) and 100 million "not in the labor force" (those age 16 or older not working and not looking for work). Unemployment rates could rise as some of the "not in the labor force" start to look for jobs or the economy continues to weaken and employers are no longer willing to hold on to existing workers. But until the unemployment rate moves higher (the Fed is projecting 4.5% or higher), a formal "recession" is not possible (as we learned from the recent past that a back-to-back quarterly negative GDP without high unemployment is only a "technical recession"). Our base case remains that a recession will be likely in the next 12 months.
- Disinflation appears to be speeding up a bit with the latest June CPI, and this is good news. The stock market reacted favorably by anticipating fewer to no more rate hikes by the Fed and a sooner, rather than later Fed pivot to cutting rates. This will all be positive for stocks and risk assets. Clearly the higher the "risk free" rate, the higher investor expectations for return for every unit of risk. So, if the interest rate hurdle is lowering with rate cuts, the hurdle rate is lower for risk assets. Bond markets will likely get excited as well. When the overall disinflation pace is faster than anticipated and projected by the Fed, there is less pressure on interest rates (both Fed and the market). This will lead to a more normalized yield curve (faster drop in rates on the frontend and slower drop in the backend). Under this scenario, investing in longer duration (maturity) fixed income will lock in the higher yield currently while capturing capital gains when interest rates fall (inverse relationship between bond price and interest rate).
- All this sounds reasonable, but if the economy continues to slow to a point of a recession, corporate earnings would be further impacted. Consumption would continue to slow when wage growth becomes anemic with increasing unemployment. So the question is the pace and the direction of travel for economic slowdown. This is not just confined to the U.S. Globally, from Europe (with the ongoing war in Ukraine and the return of winter if not mild) to China on the precipice of deflation, everywhere it is slowing even more rapidly. The full impact of the Fed rate hikes and quantitative tightening is still not felt and will have a growing presence in the financial and the real economy.
- Our base case is still a slowing economy with rising unemployment in the next 12 months, and core inflation will not get to 2% to 2.5% in a straight line from here. We will have a period of stagflation and more market volatility to come.

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Our Investment Thinking (not advice)

- We continue to like U.S. Treasury securities. They serve two functions: (1) high current yield (5% plus) and (2) a (close to) riskless investment with almost no downside that also serves well as a great diversifier to stocks and bonds. The current warning is against complacency with high yield and to watch out for reinvestment risk as the Fed is expected to cut interest rates in 2024. As these treasury securities mature, investors will not be able to reinvest back into a 5% yield security. As such, when the 10-year treasury bond solidly exceeds 4% yield, it would a great opportunity to consider these safe and high yielding investments as a replacement and lock in the yield.
- The U.S. stock market double digit rise has been quite unexpected. Its narrow concentration in a select few technology (AI related) stocks has disproportionally driven the first 6-months market appreciation. For example, the S&P 500 returned almost 17% while the equally weighted S&P 500 returned 7%. As compared to the capitalization weighted S&P 500, the equally weighted index simply holds each stock equally. This means that most of the gains in the S&P 500 came from the largest stocks in the index, which are the technology/AI related stocks. No tree grows to the sky. Allocating to quality companies with great free cash flow and those companies that have not participated fully in this year's rally would be more cautious.
- Dollar cost averaging back to the stock as well as the core bond markets makes sense as the Fed is coming to the end of its rate rising cycle. In a high interest rate environment, multiple expanding is less likely. As such, the market is relying on improving earnings to justify higher stock price. We do expect increasing stock market volatility as earnings will likely continue to fall to coincide with a slowing economy and consumer demand. The path forward is likely to reward certain investment styles, sectors, and factors rather than a broad market index (pure beta).
- For those who are comfortable with a longer holding period and less liquidity, private markets, especially private credit, could offer more investment opportunities in the medium term as we expect a shrinking banking sector for lending.

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Disclosures and Limitations

- Experiential Wealth is an investment advisory[1] firm.
- This quarterly review is prepared for educational and informational purposes only and should not be deemed as this Firm or any member of this Firm offering investment advice to the public.
- Information provided or discussed regarding any one specific issue or trend are insufficient or incomplete for investors to rely upon in making any financial decisions.
- This document is not an offer to buy or sell any investment products and investors should consult with their independent fiduciary investment advisor before taking any related action.
- This Firm has no obligation to update this quarterly commentary going forward.

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