

## August 28, 2023 – Investment Commentary

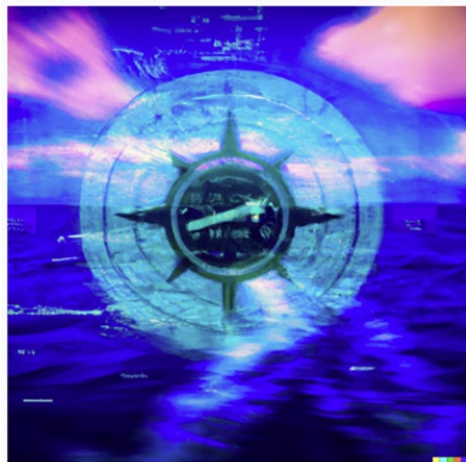
### Market Update

Last week, stocks and bond prices were up. The S&P 500 outperformed the MSCI EAFE (non-US developed) and MSCI Emerging Markets indices. As for fixed income, the 10 yr. treasury yield fell 2 bps on the week to 4.23% and the 2 year – 10 year treasury yield spread further inverted to -83 bps. High yield bond spreads were down on the week to 380 bps, still well below their 20-year average of roughly 500 bps.

The big earnings report of the week was from NVIDIA (ticker NVDA). The earnings were widely anticipated and still managed to handily beat estimates. The strength in the company earnings helped the overall S&P 500 earnings growth in Q2 improve to -4.35%. The Technology sector was forecasted to have -5.76% earnings growth at the beginning of the quarter and now is tracking +3.0%. We are seeing higher quality companies in the U.S. help hold up earnings the best. The Investment Office continues to prefer the quality factor to help mitigate earnings downside risk.

Last week, Powell delivered a short speech at the central bank, Jackson Hole symposium. The highlights to us:

1. “Two percent is and will remain our inflation target.” There have been discussions amongst economists about raising the inflation target to 3%. To us, this would create a risk to un-anchor inflation. Powell pushed back that the 2% inflation target part of the dual mandate would not change during the speech.
2. “Getting inflation sustainably back down to 2 percent is expected to require a period of below-trend economic growth as well as some softening in labor market conditions....But we are attentive to signs that the economy may not be cooling as expected. So far this year, GDP (gross domestic product) growth has come in above expectations and above its longer-run trend, and recent readings on consumer spending have been especially robust.” At least he admitted/recognized it. The lagged impact of monetary policy is not showing up in the Atlanta Fed GDPNow Q3 real GDP growth estimate of +5.9%.
3. Powell also noted that the housing sector appeared to be “picking back up” after slowing sharply over the past year and a half. “As is often the case,” he concluded, “we are navigating by the stars under cloudy skies.” The Investment Office inserted Powell’s quote above into DALL-E developed by OpenAI. It uses deep learning methodologies to generate digital images from natural language descriptions. Below is one of the images it created.



### What We Are Watching

#### IPO Window Opening?

The long-awaited initial public offering of Arm, a microprocessor maker and supplier to Apple, and smaller Instacart, an online grocery delivery firm, could reignite the lackluster IPO market in September. Both companies have filed to list on the Nasdaq. The Arm IPO is expected to surpass 2023’s biggest IPO, **Johnson & Johnson** (Ticker JNJ) spinoff **Kenvue** (Ticker KVUE), which raised \$3.8 billion.

#### U.S. Credit Card Delinquency Trends

Several retailers recently reported second-quarter results, which arguably offered a generally cautious picture of the health of the U.S. consumer. Shares of department store operator Macy’s fell sharply after the company reported falling earnings and warned of growing consumer caution, along with rising credit card delinquencies. Macy’s competitor Nordstrom, while beating earnings and revenue estimates, also cited rising late payments on its credit cards in issuing a cautious outlook. Nordstrom, discount chain Dollar Tree, and specialty retailer Dick’s Sporting Goods noted that earnings suffered from exceptionally high levels of theft from their stores.

### China Slowdown

Last week, Chinese stocks fell as investors grew more pessimistic about the country's economic outlook. The Chinese blue chip CSI 300 Index is trading at its lowest level since November 2022, while the Shanghai Composite Index is at its lowest level since last December 2022.

Disappointing data, signs of deflation, record youth unemployment, and continued liquidity problems in the debt-laden property sector have contributed to an erosion of confidence in China's economy. Signs of deteriorating growth—and a sense that China's government has relatively few good options to arrest the downturn—have raised the prospect of accelerated capital outflows.

### **Portfolio Considerations**

The bond market listened to Powell and is now pricing in the first rate cut in June of 2024. We continue to see high quality income opportunities as attractively valued here, with the U.S. Aggregate Bond yield back over 5% and investment grade corporate bonds trading around 5.77%. Over 5% on short-term interest rates are attractive as well, but we would prefer to begin locking them in when the Fed is suggesting no cuts. When they start suggesting cuts, the move lower in yields will already be behind us.

### *Disclosures*

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