The *Philadelphia* Story

A Quarterly Commentary on the Economy & the Financial Markets July 2023

From: *Philadelphia* Investment Management Group

OVERVIEW

- ***Inflation Numbers Continue to Show Improvement; However, We Can Expect Further Rate Increases Into the Second Half of 2023.*** *Barring evidence of the rate of economic growth slowing beyond expectations, our projections would be for two 25-basis point hikes in the fed funds rate during the second half of the year.*

- ***Wages and Employment Numbers Generally Have Continued to be the Announcements that Have Held the Federal Reserve in a Holding Pattern With Their Rate Hike Decisions.*** *While the economy continues to add jobs, which would indicate continued economic growth, the Fed worries that any increased demand will cause prices to further escalate and inflation numbers to remain stubbornly high.*

- ***Monetary Policymakers in the Major Developed Markets Continue to See Inflation as Their Number One Worry.*** *Market interest rate expectations have broadly reverted higher, as central banks globally continue to signal a strong commitment to bringing inflation under control.*

THE ECONOMY

Economists' expectation that inflation will continue to slow alongside a strong labor market is a contributing factor as to why economists are now pulling back on recession risks. While many economists believed throughout 2022 that a recession was inevitable as the Fed raised rates at an aggressive pace to combat high inflation, more economists now believe there is a chance for a "soft landing" whereby inflation falls to 2% without a recession. That said, while the Fed held its benchmark federal funds rate in June 2023, we do expect interest rates to remain higher for longer and project at least one additional Fed rate hike in the second half of 2023.

Going forward, we know the Fed will continue to target inflation at 2%. While we are confident that we are on the path to 2%, we also are certain that there will be no loosening of monetary policy in the foreseeable future until 2% is in sight. Chairman Powell has made this very clear on numerous occasions. We continue to believe that if there is a mild recession, it should be short-lived with economic momentum following over the course of 2024 and 2025.

FINANCIAL MARKETS

EQUITIES

As reflected in the table below, equity markets continued their positive momentum into the second quarter of 2023, entering a new bull market. The S&P 500 returned 8.74% and was ahead 16.89% year-to-date, while the NASDAQ continued its advance and was up 12.81% for the quarter and 31.73% for the first half of the year.

	Equity Returns*		
Index	**2nd Qtr**	**1st Qtr**	**YTD**
S&P 500	8.74%	7.50%	16.89%
Dow	3.97%	0.93%	4.94%
NASDAQ	12.81%	16.77%	31.73%
Russell 2000	5.21%	2.74%	8.09%

*Total: price change + reinvested dividends

Optimism surrounding artificial intelligence ("AI") technologies was a key driver of the market's strength. In fact, excluding a select group of large AI-related stocks deemed the "Magnificent Seven"—Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla—the market was relatively flat for the quarter.

From a sector perspective, Information Technology (+17.20%) and Communication Services (+13.06%) were top performers in the second quarter, resulting in year-to-date gains of 42.77% and 36.24%, respectively. Unsurprisingly, against this backdrop, large-cap and growth-oriented styles outperformed their smaller-cap and value-oriented counterparts.

	S&P 500			
		Returns*		
Sector	**Weight**	**2nd Qtr**	**1st Qtr**	**YTD**
• Energy	4.1%	-0.89%	-4.67%	-5.52%
• Materials	2.5%	3.31%	4.29%	7.74%
• Industrials	8.5%	6.49%	3.47%	10.19%
• Cons. Discretionary	10.7%	14.58%	16.13%	33.06%
• Consumer Staples	6.7%	0.45%	0.83%	1.28%
• Health Care	13.4%	2.95%	-4.31%	-1.48%
• Financials	12.4%	5.33%	-5.56%	-0.53%
• Info Technology	28.3%	17.20%	21.82%	42.77%
• Communication Svcs	8.4%	13.06%	20.50%	36.24%
• Utilities	2.6%	-2.53%	-3.24%	-5.69%
• Real Estate	2.5%	1.81%	1.95%	3.79%

06/30/23
*Price + income
Source: S&P Dow Jones

In addition to the AI frenzy, equity markets were also supported by generally strong economic data in the quarter. However, equity investors remain closely attuned to the forward path of inflation and interest rates.

FIXED INCOME

It was a mixed second quarter for bond investors. Fixed income securities sensitive to interest rates, like long duration government bonds, were beaten down as Treasury and corporate yields rose. Credit-sensitive debt also felt some pain as concern over bank liquidity remained at the forefront. Bonds with shorter duration profiles and those with lower quality and higher coupons came in with modest gains during the second quarter. This general fixed income theme of lower quality bonds outperforming their higher quality counterparts extended to municipal bonds.

Fixed Income Returns

Index	2nd Qtr	1st Qtr	YTD
Corp/Govt	-0.93%	3.17%	2.21%
Int. Corp/Govt	-0.77%	2.30%	1.52%
Long Corp/Govt	-1.39%	5.69%	4.22%
U.S. Government	-1.41%	3.08%	1.63%
- Intermediate	-1.13%	2.24%	1.08%
- Long	-2.31%	6.01%	3.57%
Corporate	-0.21%	3.45%	3.23%
- Intermediate	-0.08%	2.50%	2.42%
- Long	-0.50%	5.47%	4.94%
- Quality			
- AAA	-0.91%	4.54%	3.58%
- AA	-0.65%	3.59%	2.92%
- A	-0.37%	3.26%	2.88%
- BBB	0.02%	3.56%	3.58%
Municipal	0.02%	2.82%	2.84%
- Intermediate	-0.53%	1.80%	1.27%
- Long	0.41%	3.58%	4.00%

Source: ICE BofA

Overall, bond yields rose in the quarter as investors also continued to process the Fed's hawkish tone given strong economic data. Still, despite the Fed pausing on hiking rates in June, the two major yield curve spreads remain inverted, which is a signal that recessionary risks remain. Monitoring the path of the interest rate yield curve will continue to be important as we move forward in 2023.

****

In conclusion, we are cautiously optimistic that inflation appears to be trending in the right direction. Meanwhile, economic data remains generally solid. However, the Fed will need to continue to tread carefully in pursuit of a soft landing, which is no easy feat. The inverted yield curve is an important reminder that we have not yet avoided a recession.

Our investment philosophy remains consistent in this environment. Within equity portfolios, we continue to emphasize diversification and a focus on high quality businesses with strong balance sheets. Within fixed income portfolios, we remain focused on top-rated government and corporate bonds with short to intermediate maturities.

Philadelphia Investment Management Group
105 Clarke Avenue
Pocomoke City, MD 21851