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Quarter in Review

April didn't have ground any real ground shaking headlines, OPEC+ cut production by a million barrels a day trying to stave off the price declines which only briefly brought crude back above 80 but spent the majority of the quarter in the low 70s. In corporate news UBS continued to slash jobs after the CS merger, 11k in Switzerland and 25k worldwide. Goldman was fined $3 million by FINRA for marking 60 million stock orders long instead of short. For some perspective GS has revenues of $47 billion, and net income a little over $11 billion. So, they paid the fine with some change they found in the couch. Meta and Disney announce in the middle of the month that they too will be reducing headcount. Fox News settled its Dominion defamation suit for $787 million, half of what was being asked for. The world is still awash in capital as Sumitomo Mitsui Financial Group sold 140 billion in AT1 bonds, the same bonds that went to zero in CS merger with UBS, but people are still dumb enough to buy more. Warren Buffet is buying more Japanese stocks, increasing his holdings from 5% to 7.4%. Commercial real estate continues to show signs of trouble as Brookfield funds have defaulted on 161.4 million mortgages for a dozen office buildings, mostly around Washington DC.

The White House went into damage control as classified documents were leaked and showed how much the US is spying on its own allies. Several days later the FBI arrested Jack Teixeira, 21-year-old Airman, for the largest US intelligence leak in a decade, leaving the White House to explain how such low-level military personnel could have access to this type of information.

Internationally Chinese exports rose 14.8% in March vs. a forecast of down 7%, and its GDP grew 4.5%. The bank of Japan will no longer give future interest rate guidance, is keeping the benchmark rate where it is, and has not altered its asset purchase plan.

May started off with the third bank failure of the year, as First Republic was purchased by JPM, beating out bids from PNC financial services and Citizens Financial. BOA and US Bancorp declined to bid. Morgan Stanley and Citigroup joined the job cutting group with thousands of expected cuts even after the banks have already trimmed jobs several months ago. Microsoft froze pay this year for all full-time workers to help navigate economic uncertainty, and gold mining company Newmont paid 19.2 billion to buy Australian rival Newcrest Mining.

The Federal Reserve bank increased interest rates 25 bps to a range of 5-5.25%. The highest rate since 2007 prior to the great financial crisis.

June began with the final act of the debt ceiling Kabuki theater with Congress agreeing to suspend the debt ceiling until January 1, 2025. The war in the Ukraine continued, this time with a dam being destroyed to flood the battlefield, only to wash away several towns and create more immigration. Later in June the Wagner group (a mercenary group paid by Russia to fight in Ukraine) led a purported attack *against* Russia. The media reported the reason was because Russia attacked Wagner troops. Eventually the "invasion," looked to be called off, and a couple high ranking Russian Military officials have disappeared.

In the corporate world Coinbase was sued by the SEC, alleging their entire US business is illegal. Although this had material effect on Crypto currencies, Coinbase's stock moved from $51 to $98 as the time of this write up. UBS will face many fines from its merger with CS. US and UK regulators look to ~~extort~~ fine CS close to $428 million. UBS estimates that CS will face close to $4 billion in fines over the next 12 months. With oil holding below $80 a barrel, Saudi Arabia said it will make another 1mm barrel-a-day cut in July.

Office occupancy in NY just passed 50% since the pandemic, with cities like Washington DC and San Francisco still below the halfway mark. To that end Citibank is threatening consequences in performance ratings or pay packages for those employees that don't comply with office attendance policies. Both GS and JPM have started to cut Directors from their M&A divisions after deals have slowed to a crawl this year. Nvidia, the AI stock darling, led declines in the latter half of the month after Washington considered more curbs on exporting technology to China. Nvidia gets about 20% of its revenue from there.

In mid-June the Federal reserve paused for the first time in over a year, not increasing the funds rate for the first time since March 2022. A little over a week later the Fed Chairman stated the Fed is not done raising rates, and backed the dot plot, stating the Fed will raise rates a couple more times this year, putting the top part of the range to 5.75 before year end. At the end of June surprisingly all of Wall Street's big banks passed the annual Fed stress test. M&A deals are down 42% this year.

Markets

Growth Equity continues to rebound in the second quarter of this year. The Russell 3000 Growth index was up close to another 13% bringing the YTD return to 28%. This time the mid cap portion of the index kept up with the large cap. In fact, Mid Cap stocks performed the best throughout June, whether growth or value. Even small cap stocks did well in both value and growth. Developed Market and Emerging market stocks were up but only 5.7% and 3.9% across the value portions of their indexes. May was a tough month for bonds and were down for the quarter across the board except for High Yield and T-bills (1.6% and 1.22% respectively). In alternatives Real Estate has recovered from a tough May and finished the quarter up 2.7%, and up 5.5% for the year. Commodities however saw another down quarter -5.4% and volatility was down a huge -27% for the quarter.

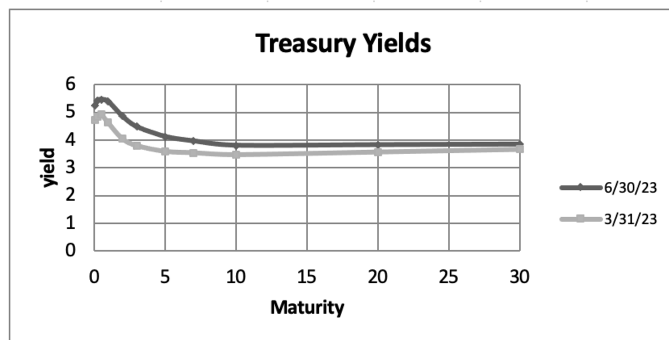
Interest Rates

The **Fed's balance sheet was back down to $8.3 Trillion as of the end of June.** They were able to shed the entire increase after several banks failed, but year to date they are only down $210 billion.

M2 velocity has been declining since the turn of the century and recently bottomed after the pandemic but has been rising since 2022. It is nowhere near the long-term average of 1.8x (the frequency that a unit of currency is used to buy a good or service over a period of time GDP/M2). Velocity typically declines during recessions and then rebounds after, but since 2000 it has been in a steady decline. And it should have been as we have increased M2 from $4.6 trillion to $22 trillion as of March 2022 (almost 7% annually over the past 23 years) and GDP has been averaging about 2.05% since 2000. Since March 2022 however, M2 has been declining and thus velocity increasing. The reduction in M2, less money chasing similar amounts of goods, is what the Fed wants to combat inflation, but reducing M2 might be able to reduce core inflation, only job loss in the past has been able to do that.

The month of May was the only increase in the funds rate for the Fed in the quarter, they increased it by 25bps, but then took a pause in June. The communication directly afterwards was strange in that is spoke of two more rate increases for the year. If the intent was to continue the increase, why pause?

Years	6/30/23	3/31/23	Difference
0.08	5.24	4.74	0.5
0.24	5.43	4.85	0.58
0.5	5.47	4.94	0.53
1	5.4	4.64	0.76
2	4.87	4.06	0.81
3	4.49	3.81	0.68
5	4.13	3.6	0.53
7	3.97	3.55	0.42
10	3.81	3.48	0.33
20	3.83	3.575	0.255
30	3.85	3.67	0.18



Interest rates continued to climb across the curve inverting to levels last seen in 1981. As of quarter end the 2s-10s spread was almost -107 bps. And with the Fed increasing rates two more times, this could invert even more.

The Primary Mortgage Market Survey from Freddie Mac showed the 30-year conforming balance fixed rate mortgage at 6.71% at the end of June, up 44 bps from the March number, but has not gone over 7% since November of last year. The 15-year conforming balance rate was 6.06% at the end of June, up 52 bps as of the end of March.

Leading Economic Indicators

The Conference Board's leading economic indicator index (LEI) stood at 106.1 as of the end of June. This is down 4.2% over the last six months. It has been flashing a recession signal since the end of 2022, but even after six months the NBER has still not called a recession. GDP is still positive; we have only had two months of negative industrial production and one month of negative household employment. There were more positive components of the LEI this month compared to March, but the only material contributor was the S&P 500 returns for the past month as well as the last 6 months. The interest rate spread (2s-10s), business conditions and the ISM new orders index were the most negative contributors.

Jobs

Nonfarm payrolls for Q2 were up 732k, although a more believable number, total job gains for the first half of the year are 1.7mm, a pretty large number for an economy which is stalling, stalled, or contracting. It is really hard to get a hold of what is happening in the economy regarding jobs. Almost every survey's response rate is still in decline (https://www.bls.gov/osmr/response-rates/). The Current Employment Statistics Survey (CES) is where the bulk of the nonfarm payroll data comes from, and its response rates has gone from a 60% pre-pandemic average to 42.7%, and worse the Job Openings and Labor Turnover Survey (JOLTS) is at 31%, from a 60% average.

Temporary help services contracted again this quarter and the participation rate was stuck 62.6. The surprise data point in jobs this quarter came from the Challenger Index which showed companies planned layoffs were only 187k for the quarter and only 40k in June, down from 80k in May. Claims data showed an increase in June to 257k but has reversed back to 228k as July 15th. Anything sub 400k is a good number and the vacillations around low 200k are just noise.

The JOLTS report for May shows there was 9.8 million jobs available down close to 500k jobs from May. This year has seen large 500k job swings from month to month, but looking back through the data to 2000, the standard deviation of the index has been larger at times. The top three standard deviations for the past 23 years were in fact 2020, 2021, and 2022. Interestingly the 4th largest was during 2001 think dot com crash and 911, and the 5th was 2008 during the great financial crisis. BLS does provide Median Standard Errors (a better relative measure) for the data but not over time, so we can't really see how reliable the data has been through the decline in response rates. The JOLTS survey undergoes 7 adjustments to the data, but my feeling is it suffers more from non-sampling errors or failures to include certain segments of the economy. Unfortunately, now more than ever many outside economists and investors feel that many data points have politicized.

Manufacturing added 15k jobs for the year, compared to 235k for the first half of last year. The ISM survey briefly rose above 50 during April and May, but back down to 48.1 in June. The unemployment number didn't really move during the quarter as I had expected, and the above Challenger index numbers confirmed this.

Industrial production

Q2 IP was down -0.41%, compared to revised lower Q1 number of 1.16% (37 bps lower). Capacity utilization continued to fall, now at 78.9. It seems to be normalizing to the pre pandemic 77 number. **Manufacturers' New Orders** were up every month in Q2, which makes very little sense since inflation is falling. Why wouldn't you put off purchases until prices decline (unless you expected them to reinflate). Durable goods ex defense and transportation was also up year over year, a surprising reversal from the first two months of the quarter. My expectations last quarter of this number dropping significantly heading into a recession was also a wrong call.

How is industrial production down, ISM at 46 with new orders 45.6, and Census new orders up? None of this makes a lot of sense.

Housing

New Home Sales were 697k per year to end June, down -2.5% from May but up 23.8% from June of last year. The median sales price of new homes sold in June was 415k, it has cooled off from the 438k in February, but still above the 397k from 2021. **Existing homes sales for June 2023** was down -3.26% for the month, and down over -18% for the year. Case Shiller 20 city index has rebounded and is heading up again as of May of this year. The one-month return was up 1.48% while the year over year is only down -1.7%. Another anomaly in statistical data while the 30- and 15-year mortgage rates climbed close to their recent highs. My thoughts last quarter were once again up ended, seems like I simply don't understand the consumer. The Fed is still raising rates, as of the time of this write up, they raised the funds rate again 25 bps and consumers have either run out or running out of any savings, while credit card debt is climbing. How is the real estate market defying gravity?

The Consumer

The **Conference Board's consumer confidence index stood at 110.1 in June,** a drastic recovery from a year ago at 98.4. Again, my belief that consumer confidence would decline last quarter was misplaced. The decline in inflation numbers has obviously changed people's minds. People have jobs, unemployment is down, claims are under control. The university of Michigan index too was up to 64.4, from 50 last June. **Retail Sales were up 1.15% in q2** vs a revised Q1 number of 0.42% (down from 1.9%). This ties well with BEA's quarterly personal expenditures growth rate of 1.35%. What is somewhat surprising is the 2.31% increase in the quarter by consumers spent on

durable goods. Now we only have consumer credit data for May at this point but there was contraction in non-revolving debt and very small increase in revolving debt, which would point to a consumer that is tapped out. But this is the only truly negative data point from the consumer space. Did the coyote just run off the cliff?

Inflation

April – 4.93%, May – 4.05%, June – 2.97%

By this rate Powel might just get the Nobel Prize in economics just like Bernanke. Just don't tell that to core inflation which looks stubbornly close to 4% per PCE and 4.8% for CPI. Looking at food inflation over the past twelve months it is up 5.7% with restaurant inflation at 7.7%. New vehicles are up 4% while used are down -5%. Interestingly CPI Gas looks like it is down 26% for the year, but when you look at gasoline futures, they are up over 7% ending July. Fuel Oil is down almost 37% over the past twelve months as well. Shelter and transportation services are up about 8% for the last twelve months. So, if the economy is running hot, which is what Q2 GDP just showed at 2.6% over the last twelve months, compare to 1.8% from Q1, what happens to CPI when energy costs reverse going into winter. And if core is really stuck, why was Powell so insistent on a one and done in July. Ah hubris such a wonderful thing.

In Closing

A third bank failure this quarter felt like just a pebble in the road as JPM hoovered up another bank and the federal government (that is you and I to those reading that still haven't figured it out) takes on all the bad assets. Stock markets rose again defying gravity, but as long as there is an extra 5-6 trillion still on the Fed's balance sheet, I guess it is all good. The debt ceiling theater came to its traditional close, kicking the can down the road, straddling the next generation with an impossible amount to repay. Stocks have reaccelerated and the Buffet Indicator is back at 169% (Whilshire 5000 to GDP Ratio).

Waiting for Godot is just that, waiting. I have capitulated or given up is really a better way of saying it. Everything I learned in finance in undergrad or grad school doesn't matter. Every statistic seems manipulated and impossible to confirm or counter with sound data or logic. I know that the stock market is overvalued, I know that the Federal Reserve has manipulated the securities markets. I know that investors are stupid, greedy, impetuous lemmings that are running off the cliff. But being alone will destroy my business. So as of this June, I am slowly bringing the portfolios to normalization, a balance of stock and bonds and should end sometime in October, right in time for equities to crash. I have been wrong more times in the past 13 years than I will admit, what is one more really going to do.