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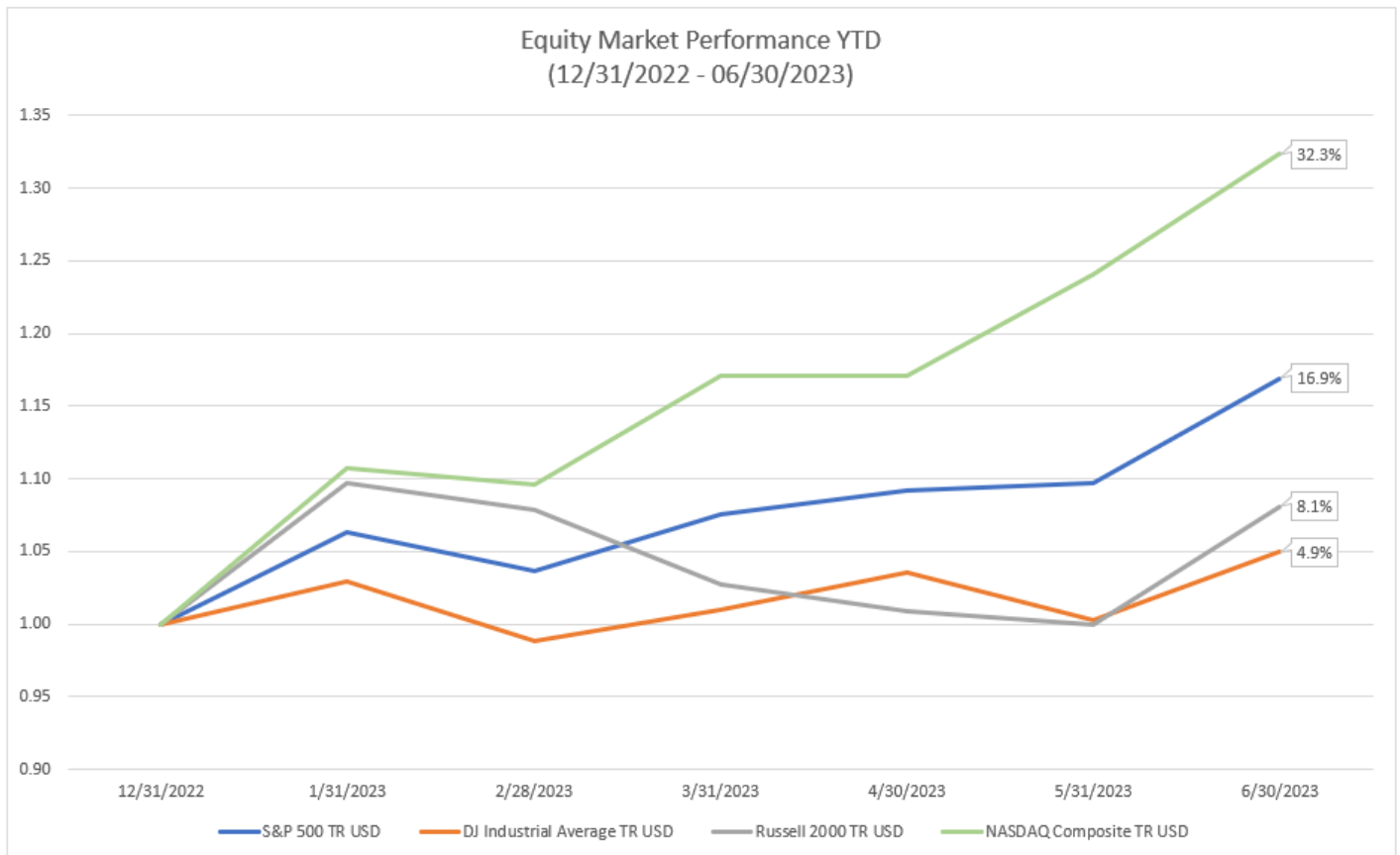
EQIS Quarterly Commentary

Q2 2023



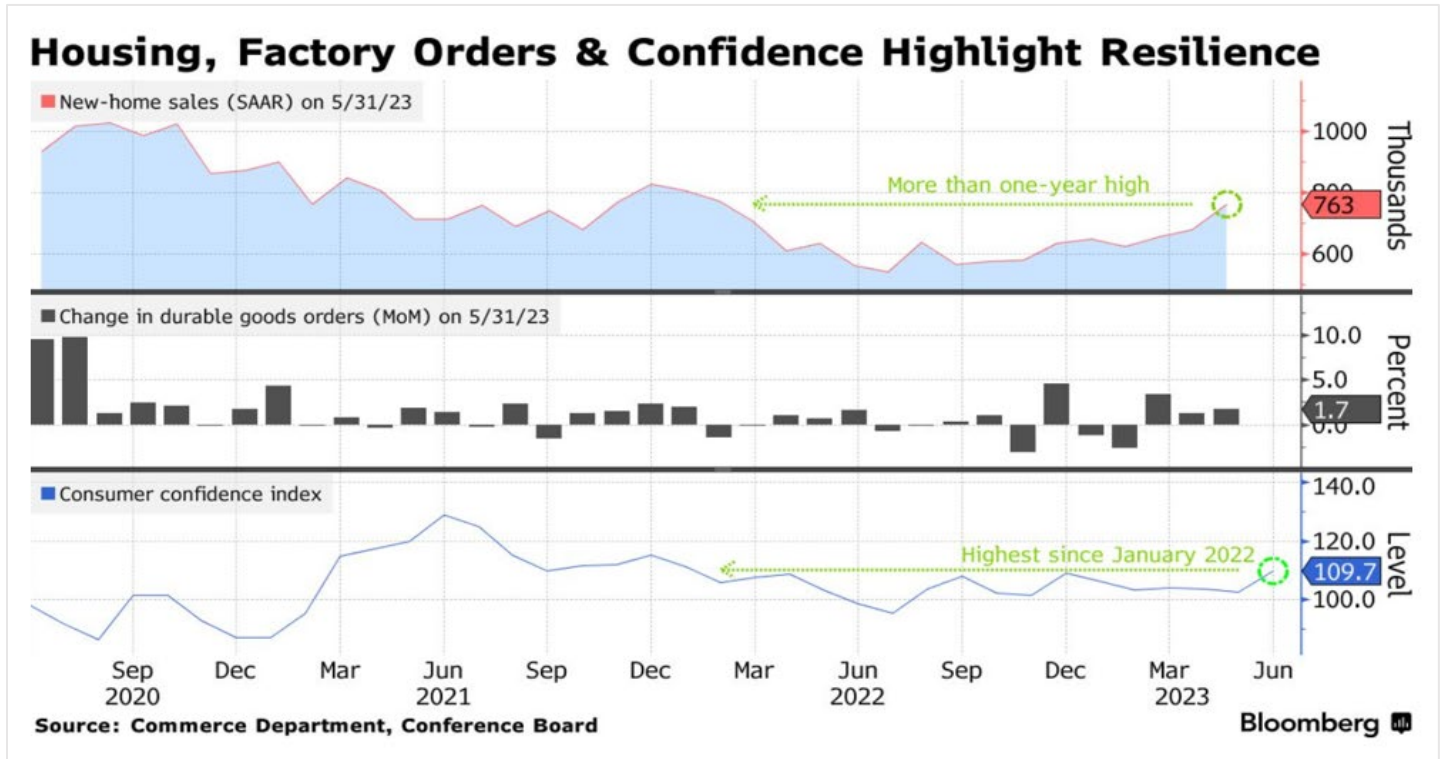
US Economy Shows Signs of Resilience

Equity markets finished the quarter strong, with the tech-heavy Nasdaq leading the way with a 32.3% return for the year's first half. The S&P 500, Dow Jones Industrial Average and Russell 2000 posted positive returns, gaining 16.9%, 8.1% and 4.9%, respectively. Despite interest rates rising throughout the quarter and above-target inflation, forecasts for a US recession continue to be pushed down the road.



Source: Morningstar Direct

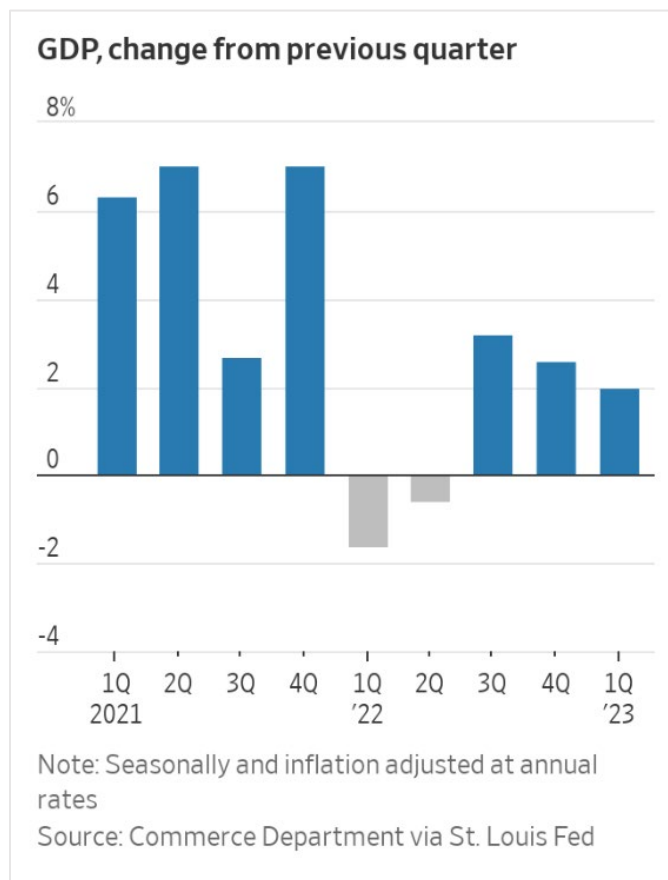
The consensus view of many economists this year has been for an impending recession in the near term; however, US economic data continues to show strength and equity markets entered bull market territory. Recent data has shown positive trends in new home purchases increasing to the fastest rate in a year, durable goods orders topping estimates, and consumer confidence levels that have not been this high since the start of 2022.



Source: <https://www.bloomberg.com/news/articles/2023-06-27/-resoundingly-solid-us-economy-delays-recession-calls-even-more?srd=premium>

The June ADP report showed an increase of 497,000 jobs, twice the survey expectations of 225,000. Payrolls mainly surged in the leisure and hospitality industries, and the reported quits rate ticked back up. The monthly quits rate is a closely tracked measure of workers' confidence in finding better jobs. The trend had fallen below pre-pandemic levels last month before the recent reading. Still, other metrics point to labor imbalances improving. The trends in average hours worked are rising, and wage growth is rising at a slower pace. Employers feel less pressure to increase salaries as the labor pool of workers ages 25-54 expands. While the June nonfarm payrolls report from the US Department of Labor missed forecasts to the downside, with 209,000 jobs added vs. the surveyed forecast of 230,000, the unemployment rate decreased from 3.7% to 3.6%. The recent data show some welcome signs of cooling in the labor markets, but still, they are unlikely to prevent the Fed from continuing to hike interest rates.

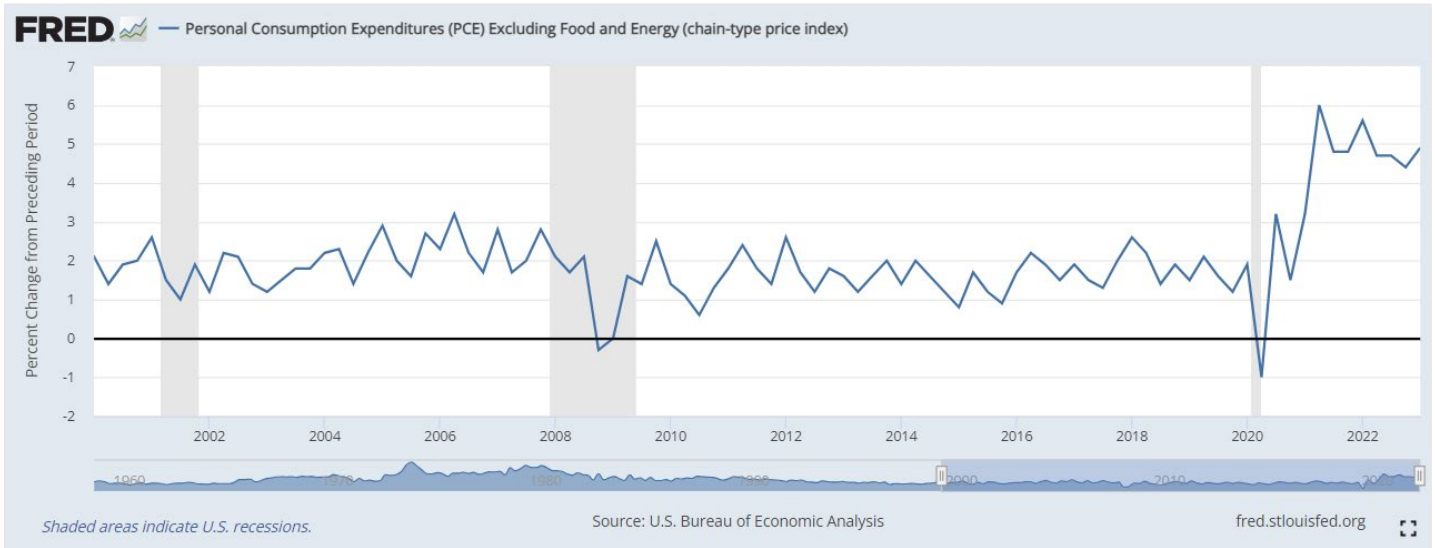
In a report published by S&P Global Market Intelligence, the expected GDP growth for the second quarter was revised upwards to 1.7% from its previous estimate of 0.8%. The US Commerce Department revised the GDP growth rate in the first quarter to 2.0% from 1.3%. The spate of recent positive news continues pushing out the recession timeline and will likely allow the Fed to follow through with its expected hike at the July meeting.



Source: <https://www.wsj.com/articles/u-s-economy-shows-surprising-vigor-in-first-half-of-2023-1a8a32eb>

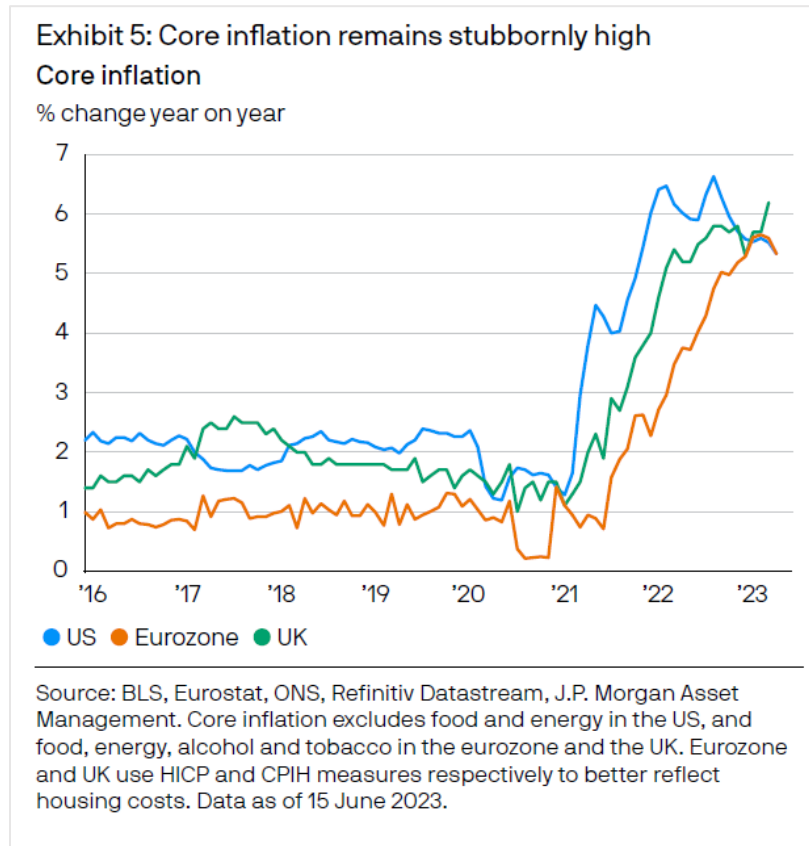
Domestic Fixed Income Markets

At the June meeting of the Federal Reserve, the committee unanimously voted to pause rate hikes. Still, it struck a hawkish tone that suggested further hiking was necessary. The recent labor market and consumer activity have increased the committee's probability of following up with another hike at the July 25-26 meeting. The Fed's preferred inflation gauge, the core Personal Consumption Expenditures Price Index for May, showed a slight decrease in inflation to 4.6% year-on-year. The prior month's reading was 4.7%, suggesting underlying inflation remains sticky.



Source: <https://fred.stlouisfed.org/series/PCEPILFE>

Core and headline inflation remains stubbornly high as central bankers in the US and worldwide work to drive down wage growth. Still, consumers continue to drive service demand and may only curtail their spending once a recession hits. In a recent JPMorgan report, the banks see an underlying change in the stable level of goods price inflation. The potential for higher medium-term inflation and inflation volatility could pose a threat if central banks cut rates at some point in the second half of 2023 to avoid a recession.



Source: <https://am.jpmorgan.com/us/en/asset-management/per/insights/market-insights/investment-outlook/>

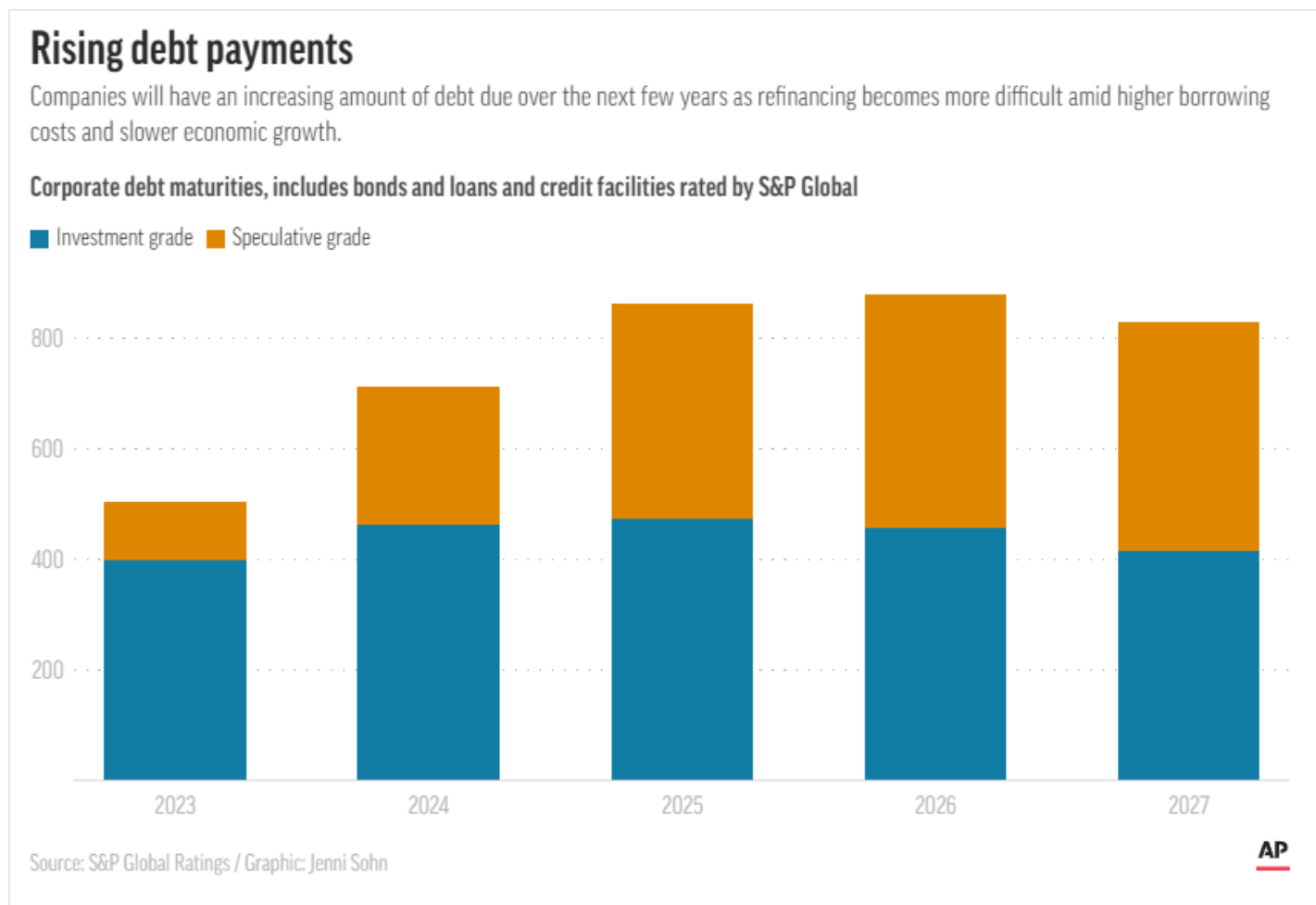
The sustained strength of the US economy has continually hurt fixed-income investors who believed that growth would slow after the Fed hiked rates to their highest level in decades. However, there has been a recent pick up in yields in the US and abroad as concern rises that central bankers will need to raise rates even further to tame inflation.

While rates continue to rise, there is another headwind for credit as a looming wall of \$2.6 trillion in corporate debt comes due from 2023-2025. The need for businesses to refinance at higher interest rates can potentially erode credit fundamentals in lower-quality companies. The companies better equipped to handle the looming "refinancing wall" will be higher-quality borrowers, as lower-quality borrowers will see the lending landscape become increasingly challenged. As a result, investment-grade credit is expected to outperform as spreads may widen for lower-quality bonds.

Companies with leveraged loans will likely face the highest uncertainty as interest expenses continue to rise faster than EBITDA earnings for the median loan borrower in the 4th quarter and into 2023. With increasing interest expenses and declining EBITDA earnings, corporations are seeing vital interest coverage ratios decline. By Morgan Stanley's estimate, assuming earnings growth remains flat, investment coverage ratios on these loans will likely trend below historical

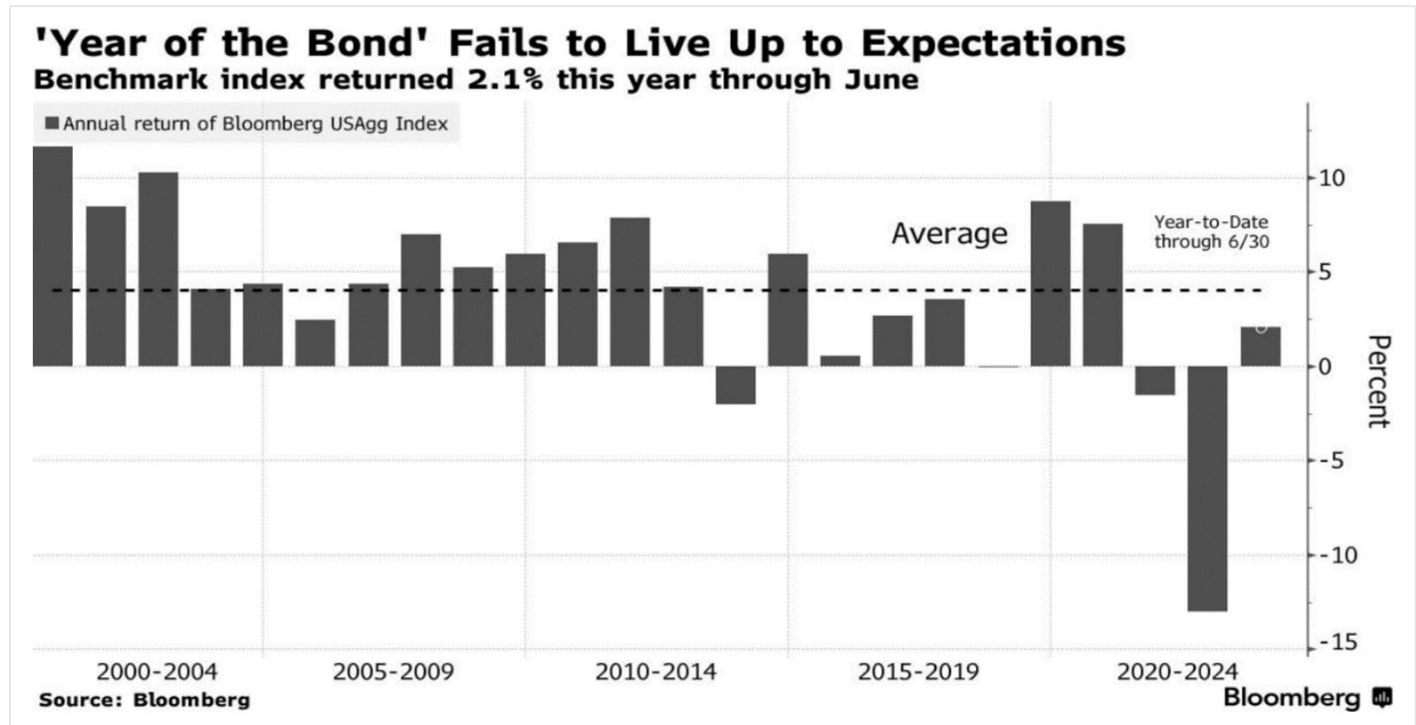
averages, dropping to 4.5 from a peak of 5.5 in the fourth quarter of 2021. If earnings growth further deteriorates, interest coverage ratios (ICR) could fall closer to recessionary troughs and significantly increase the number of companies with stressed ICRs. Morgan Stanley's assessment only includes the current and existing debt.

The nearing refinancing wall of debt will further complicate the outlook for lower-quality companies. High-quality companies are expected to perform better with the looming challenges as interest coverage ratios remain healthy and robust for investment-grade bonds.



Source: <https://apnews.com/article/corporate-debt-economy-inflation-interest-rates-c448df0dde9302205207240dfeac61bf>

Bond yields remain near their recent highs, and returns have underperformed in the second quarter of 2023. Many investors expected this year to be the "Year of the Bond" with assumptions that the Fed would be transitioning to a rate-cutting cycle by now. However, strong labor markets and stickier inflation have kept the Fed in a hawkish position, with further rate hikes predicted. Returns have been buoyed by income yields that have been the highest in years, but total returns have not lived up to expectations.



Source: <https://www.bloomberg.com/news/articles/2023-07-05/year-of-the-bond-loses-luster-as-robust-growth-imperils-bulls>

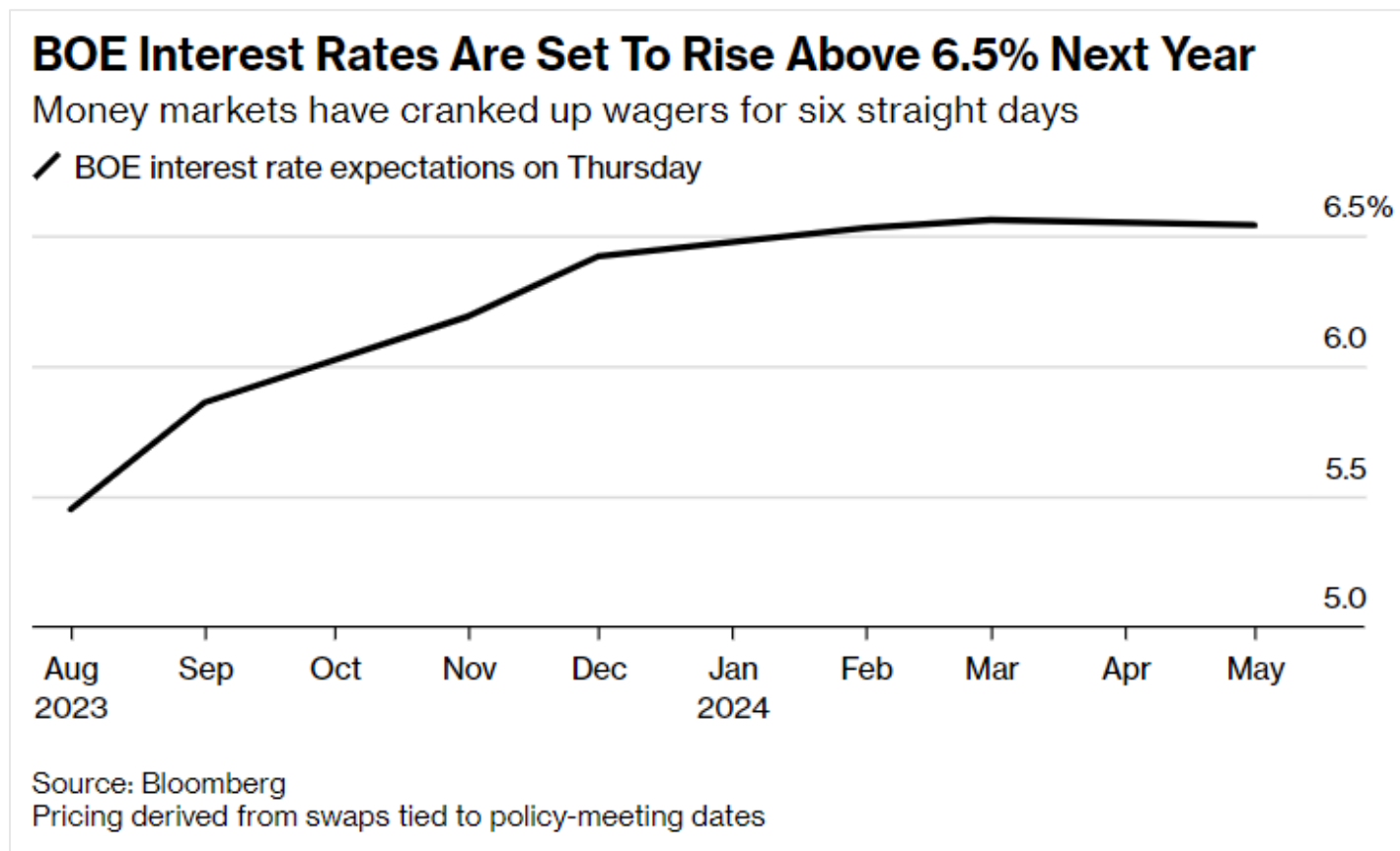
The longer-dated government treasuries posted negative returns, while the shorter-end, 1- and 3-month bills posted positive returns. In the fixed-income sectors, the most robust returns came from convertibles, leveraged loans and corporate high yield returning 4.4%, 3.2% and 1.7%, respectively, for the second quarter.

Rates	QTD%	YTD%	Fixed Income	QTD%	YTD%
USTREAS T-Bill Cnst Mat Rate 1 Mon	1.2	2.3	Bloomberg US Treasury Bills TR USD	1.2	2.3
USTREAS T-Bill Cnst Mat Rate 3 Mon	1.2	2.3	Bloomberg US MBS TR USD	-0.6	1.9
USTREAS T-Bill Cnst Mat Rate 2 Yr	-0.4	1.3	ICE BofA US Corporate TR USD	-0.2	3.2
USTREAS T-Bill Cnst Mat Rate 10 Yr	-1.8	2.3	Bloomberg Municipal TR USD	-0.1	2.7
USTREAS T-Bill Cnst Mat Rate 30 Yr	-2.3	3.9	Bloomberg US Agency TR USD	-0.4	1.6
Benchmark 1: Bloomberg US Treasury Bills TR USD	1.2	2.3	Bloomberg ABS TR USD	-0.1	1.7
			Morningstar US Leveraged Loan Index	3.2	6.6
			Bloomberg US Convertible Comp TR USD	4.4	9.0
			Bloomberg US Corporate High Yield TR USD	1.7	5.4
			Benchmark 1: Bloomberg US Agg Bond TR USD	-0.8	2.1

Source: Morningstar Direct

International Fixed Income Markets

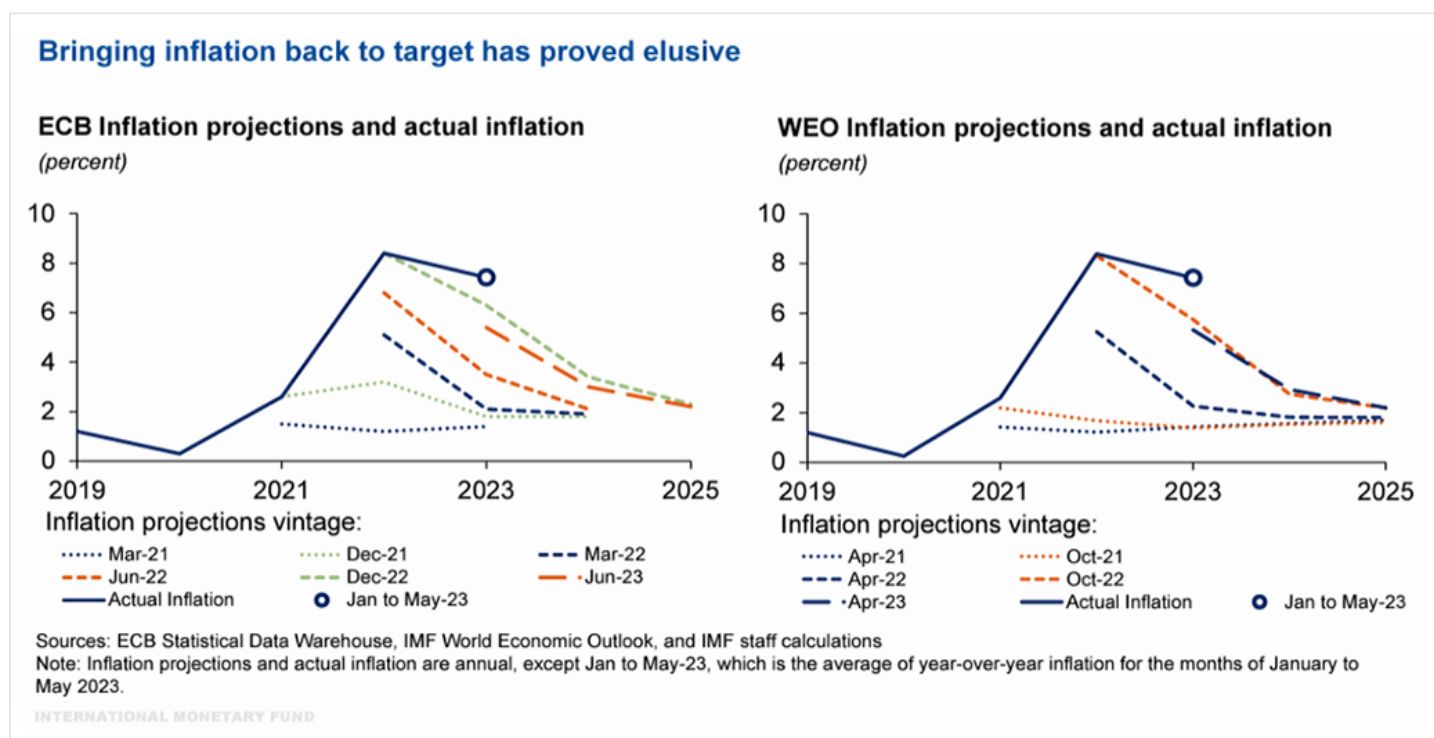
UK bond yields soared in the second quarter of 2023 as traders lost confidence in the Bank of England's (BOE) ability to tame inflation without hurting the UK economy. Current money market funds are pricing in a 6.5% interest rate by February 2024 and potentially a peak of 6.75%. A benchmark lending rate of 6.75% would mark the highest level of rates since 1998 and a dramatic increase from two months ago, when rates were expected to top out at 5%.



Source: <https://www.bloomberg.com/news/articles/2023-07-06/traders-lift-bets-on-boe-terminal-interest-rate-to-6-5-by-march>

The continuation of rate hikes in an economy that has struggled since the pandemic could further the pain as mortgage rates and business credit costs rise. Inflation levels in the UK have surprised to the upside for four consecutive months and sit at 8.7%, well above the Bank's target rate of 2%. BOE Governor Andrew Bailey acknowledged that inflation is still "far too high" and pointed to "greedflation" as a potential culprit. Greedflation has been a recent concern for central bankers as companies in the UK, Europe and the US have taken the opportunity to increase profit margins to record highs while blaming rising costs. Economists and bankers warn that the BOE may have to push rates as high as 7% to combat inflation and that a hard landing is possible for the economy.

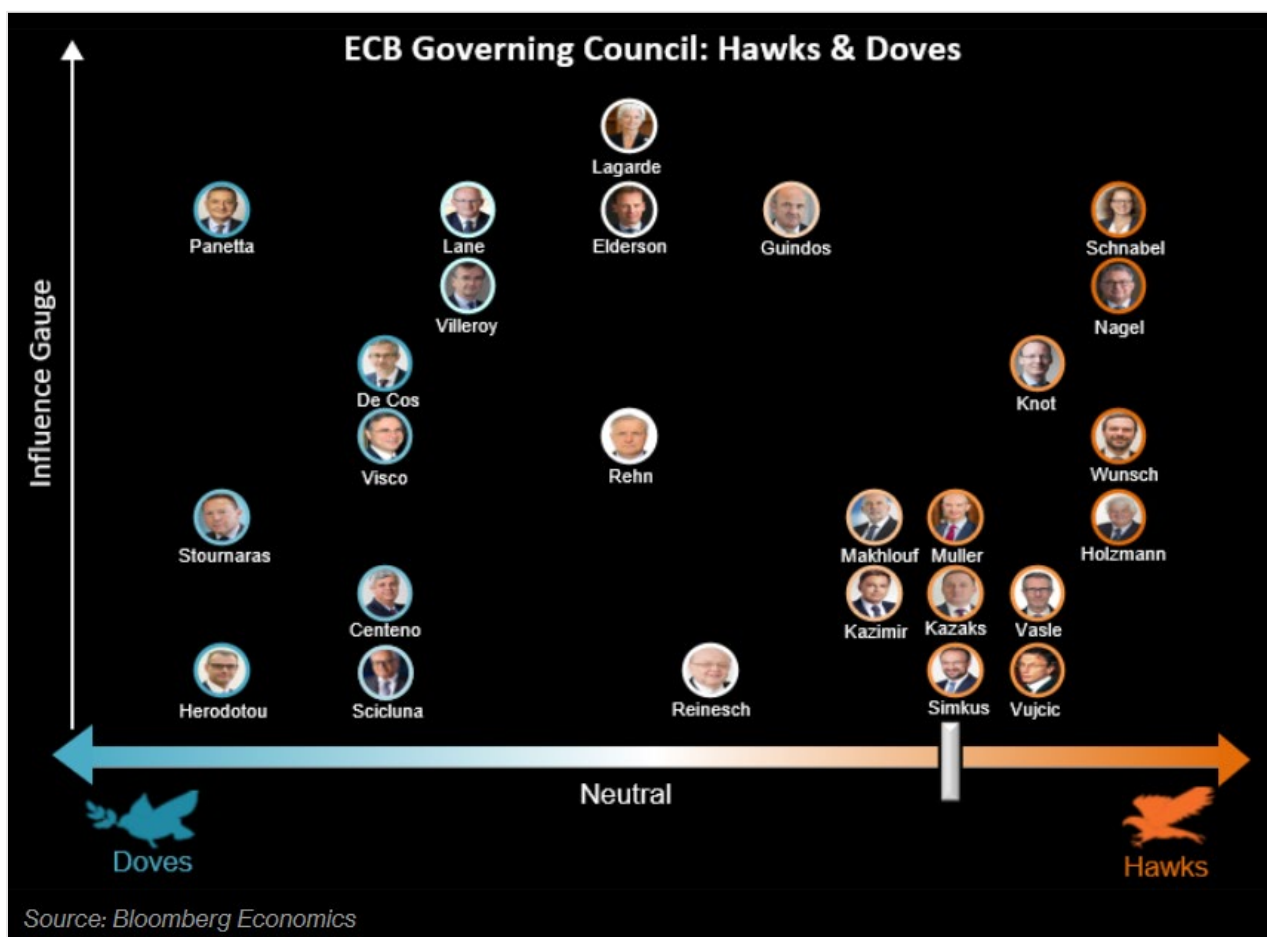
The European Union and European Central Bank (ECB) face similar challenges to the UK and US as inflation is taking longer than expected to reach the central bank's target. Inflation levels remain above projections as investors believe rates will drop soon due to the decrease in energy prices. However, this has not happened as headline inflation remains high, particularly in the services sector. Estimates from the ECB and International Monetary Fund (IMF) have pushed back expectations for inflation normalization to 2025.



Source: <https://www.imf.org/en/News/Articles/2023/06/26/fdmd-speech-sintra-3-uncomfortable-truths>

Again, the causes of sticky inflation in the EU are similar to the UK and the US, as the ECB has hiked rates by the most in its history only for activity to slow modestly. The unemployment rate is at a historic low, while strong wage growth and household savings show continued pent-up demand. Financial conditions appear to have not tightened sufficiently enough to slow the economy, and the pandemic-induced shutdown lowered output and productivity. Restrictive monetary policy will likely need to continue while inflation remains high and risks remain to the upside for inflation. Recent stresses in the financial sector have shown the impact of rates rising higher than market expectations, and a continued rate hiking campaign could give way to a rapid repricing of assets and widening credit spreads.

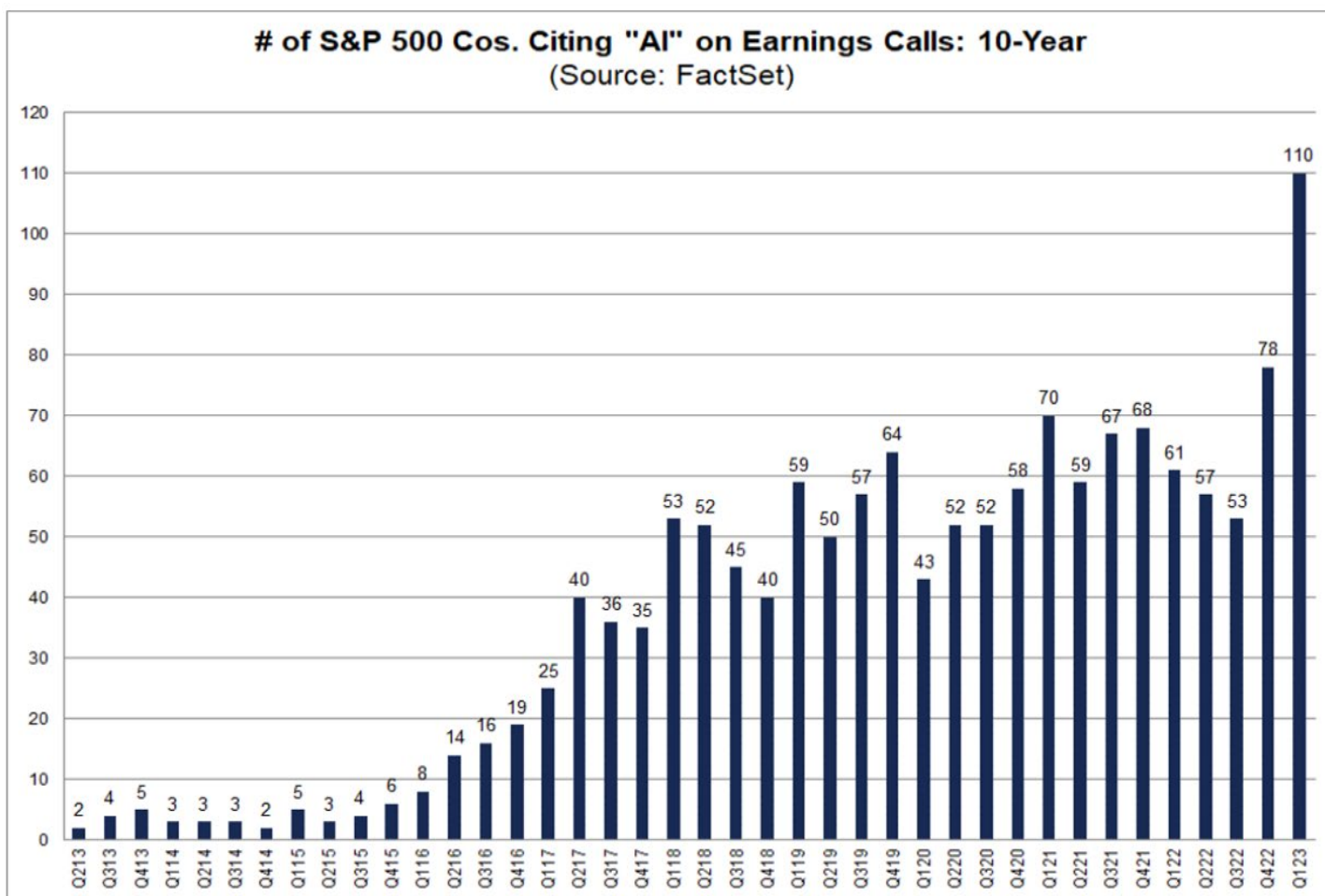
The ECB is expected to raise rates at its next meeting in July, but any subsequent rate hikes are still undetermined. Several hawks believe the central bank needs to continue its inflation fight. In contrast, others fear the economic consequences of more hikes. Bloomberg's euro-area economist David Powell noted, "The ECB is approaching the end of its hiking cycle. Underlying inflation has crested, and monetary tightening is having a significant impact on credit conditions. Bloomberg Economics forecasts two further 25-bp hikes in July and September. That will leave the deposit rate deep in a restrictive territory at 4.00% — our estimate of neutral is 1.50% to 1.75%. We expect the first cut in June next year as underlying inflation decelerates".



Source: <https://www.bloomberg.com/news/articles/2023-07-04/interest-rates-latest-inflation-slog-grips-fed-ecb-as-global-policy-decouples>

US Equity Markets

Equity markets remained resilient throughout the second quarter as technological advancements in the artificial intelligence (AI) space boosted the tech-heavy Nasdaq. The mega-cap names typically associated with high multiples and cheap liquidity have seen their share prices rally in the face of declining revenue growth. The excitement over AI proved a strong counterforce for many companies that pivoted from announcing layoffs to promoting investments in AI. Microsoft, which has dubbed itself the vanguard of AI with its investment in OpenAI (ChatGPT), has seen its stock price rise 41%. At the same time, Nvidia has tripled its share price on the premise that AI will bolster its business. In recent earnings calls from companies in the S&P 500 from March through mid-May, 110 businesses cited AI in their plans. According to FactSet, that is a record amount and three times the 10-year average.



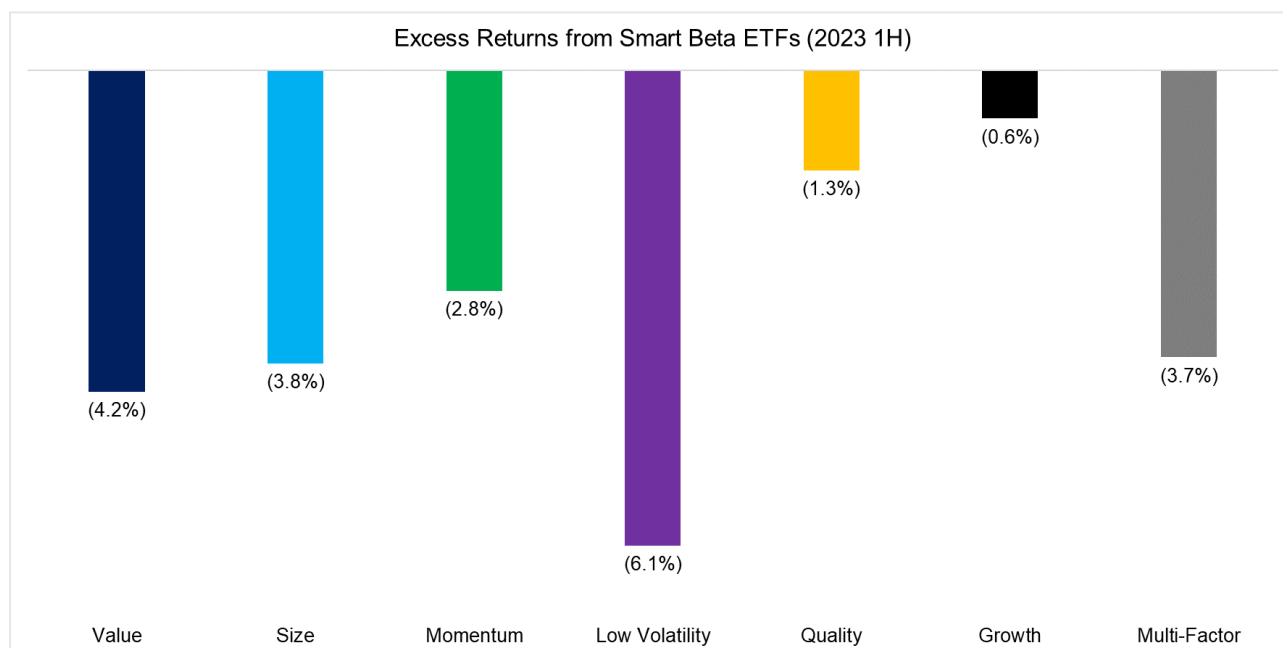
Source: <https://insight.factset.com/highest-number-of-sp-500-companies-citing-ai-on-q1-earnings-calls-in-over-10-years>

While AI mania took over for much of the second quarter, the final month saw some breadth added to the market as both mid and small-cap equities outperformed large-cap stocks. A rotation into consumer cyclical, industrial and materials sectors accompanied the change in leadership for equity size.

US Equity Size	June 2023	US Sector	June 2023
Russell Mid Cap Value TR USD	8.7	S&P Consumer Disc Select Sector TR USD	12.3
Russell Mid Cap TR USD	8.3	S&P Industrial Select Sector TR USD	11.3
Russell 2000 Growth TR USD	8.3	S&P Materials Select Sector TR USD	11.1
Russell 2000 TR USD	8.1	S&P Energy Select Sector TR USD	6.9
Russell 2000 Value TR USD	7.9	S&P Financial Select Sector TR USD	6.7
Russell Mid Cap Growth TR USD	7.7	S&P Telecom Select Industry TR USD	6.6
Russell 1000 Growth TR USD	6.8	S&P Technology Select Sector TR USD	6.2
Russell 1000 TR USD	6.8	S&P Real Estate Select Sector TR USD	5.6
Russell 1000 Value TR USD	6.6	S&P Health Care Select Sector TR USD	4.4
		S&P Cons Staples Select Sector TR USD	2.8
		S&P Utilities Select Sector TR USD	1.6

Source: Morningstar Direct

Equity factors had a rough start to the year as all factors posted negative returns. This performance is the worst factor returns over the last decade and a sharp reversal from 2022. While the economic picture has not drastically changed from 2022, with high inflation and rising rates, the underlying demand for growth stocks has helped propel the Nasdaq Composite past the S&P 500 in a change from last year.

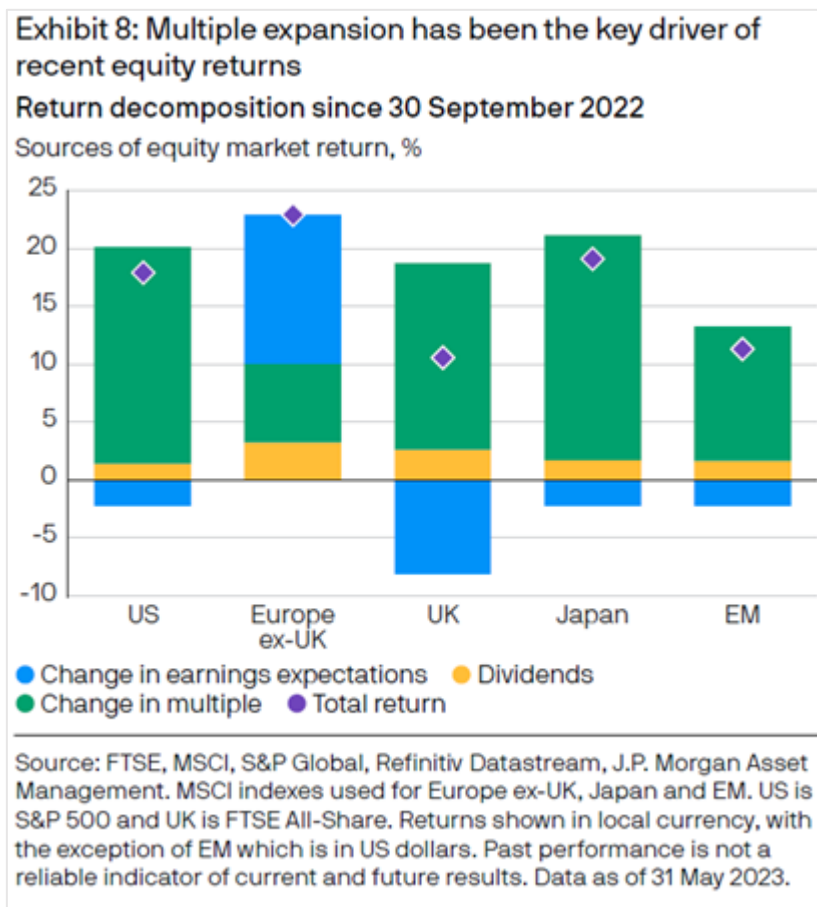


Source: <https://insights.finominal.com/research-factor-olympics-2023-1h/>

International Equity Markets

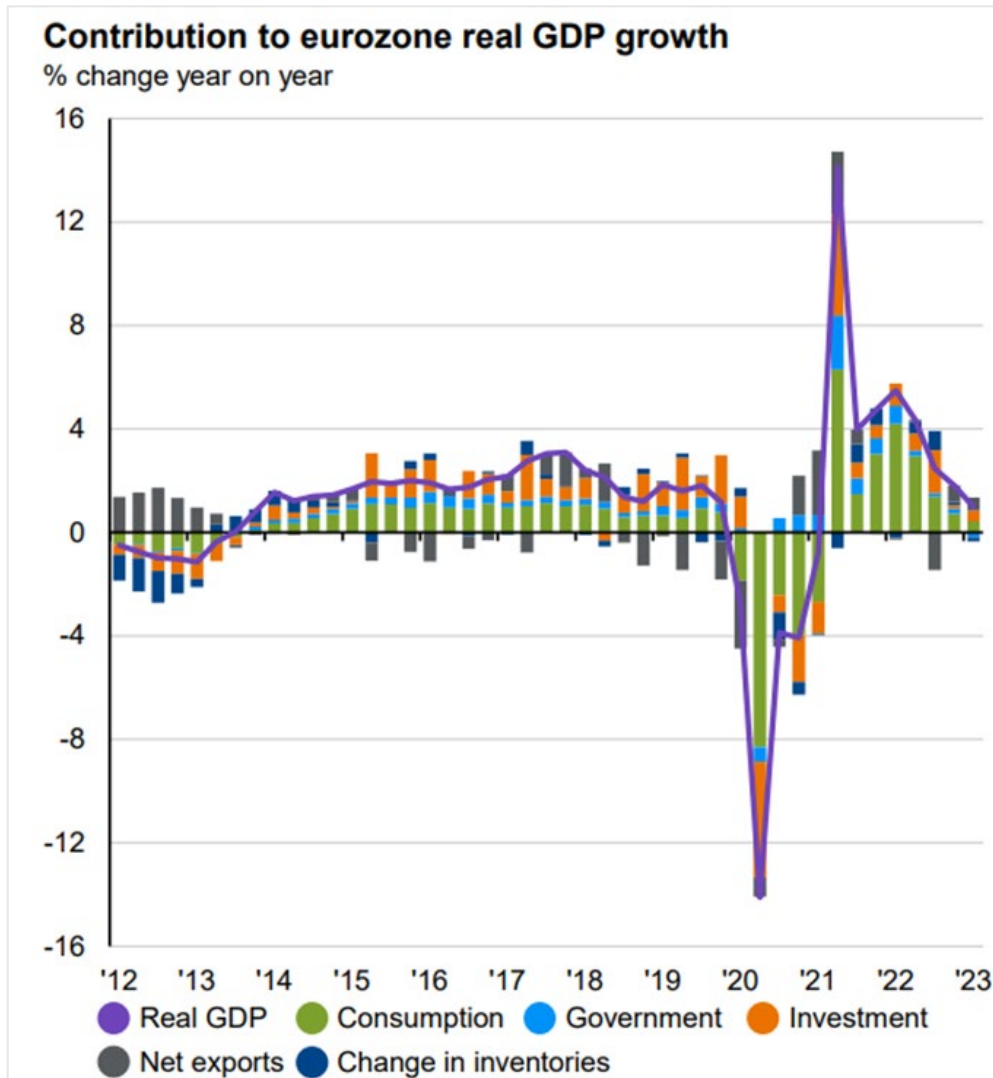
Developed markets outside the US had mixed returns for the quarter as central banks continued hiking campaigns and inflation remained high in many parts of the world. The most robust returns came from Japan, Ireland and Italy, returning 18.5%, 6.1% and 6.1%, respectively.

Europe managed to sidestep an energy crunch during the winter as warmer-than-expected weather helped the region overcome supply shortages. The warm weather has put it in a comfortable position for next winter as natural gas inventories sit unseasonably high. The backstop of having storage tanks near 70% capacity, close to the high range over the last decade, is that it can mitigate potential future energy price surges. The Europe-ex UK region has outperformed its peers since the end of September, helped by fading energy supply risks and rising valuations. Multiple expansion has driven the bulk of equity returns outside of Europe-ex UK.



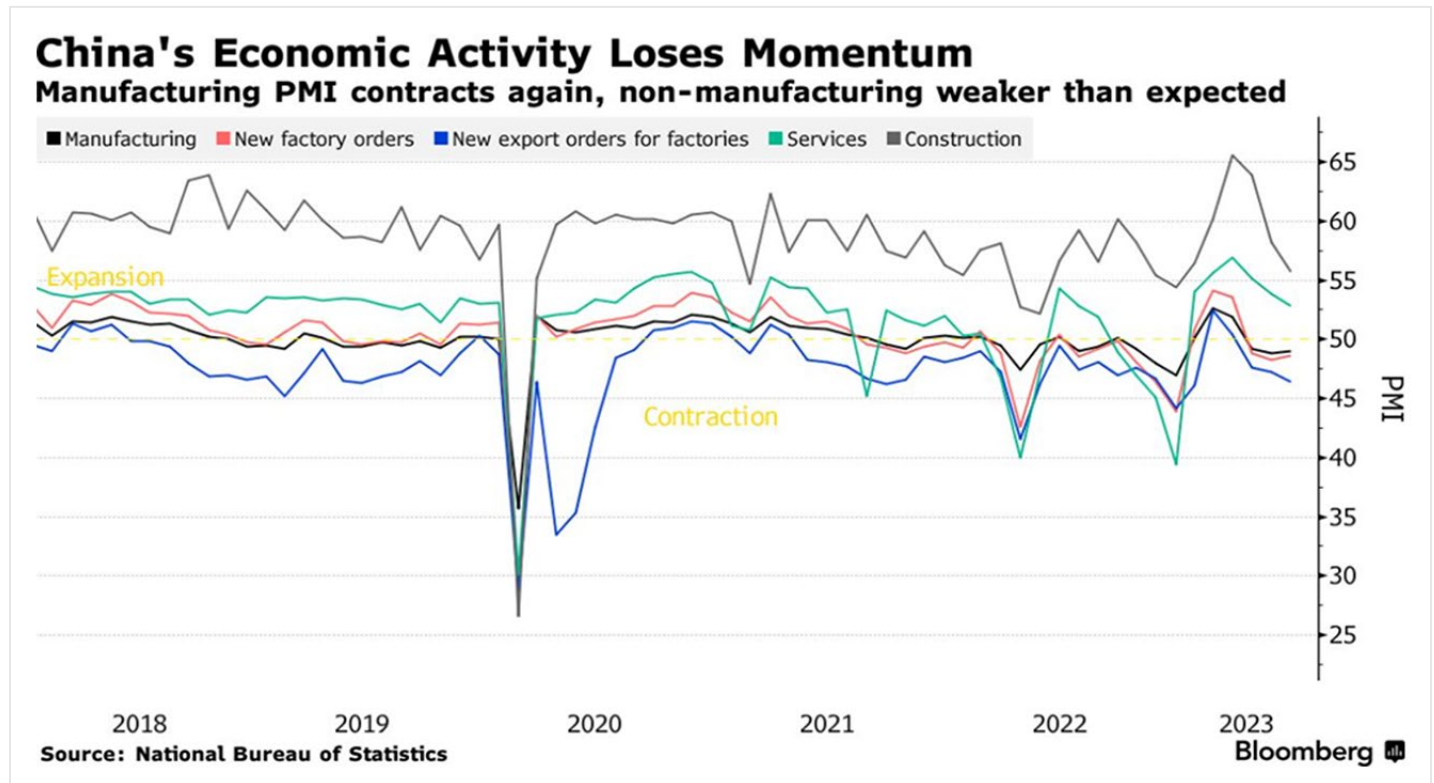
Source: <https://am.jpmorgan.com/us/en/asset-management/per/insights/market-insights/investment-outlook/>

However, growth data for the region showed that the Eurozone experienced a mild recession over the winter, with two consecutive quarters of negative GDP in Q4 2022 and Q1 2023 posting -0.1% for both quarters. Growth is expected to continue slowing as the effects of rate hikes continue to be felt throughout the broader economy.



Source: <https://am.jpmorgan.com/content/dam/jpm-am-aem/global/en/insights/market-insights/guide-to-the-markets/mi-guide-to-the-markets-ce-en.pdf>

China's economic recovery looks to be weakening as key inflation gauges show a deflationary environment. Core inflation, excluding food and energy costs, slowed to 0.4% from 0.6%, and producer prices dropped 5.4% year-over-year. The official manufacturing purchasing managers' index fell to 49 in June for the third consecutive month, while the non-manufacturing gauge slipped to 53.2. Economic activity continues to soften in factory goods, and the industrial deflation shows no signs of easing.



Source: <https://www.bloomberg.com/news/articles/2023-06-30/china-s-growth-momentum-slows-further-amid-rising-stimulus-calls>

China's economy has been dealing with a struggling real estate market as new home prices have fallen, property sales have continued to decline, and housing starts have trended downwards. Earlier in the year, the government responded by lowering lender's deposit rates and reducing its policy rate. Policy banks may provide more loans for infrastructure projects, and local governments may be allowed to issue more bonds, though they are already heavily indebted. Some economists are optimistic that the government's measures will be sufficient to meet the growth target, expecting a rebound in employment and increased consumer spending. However, others are less hopeful, suggesting that further monetary easing may not be practical given the limited demand for loans from property developers. If monetary easing proves inadequate, fiscal stimulus may be necessary. China's fiscal authorities, however, tend to prioritize durable assets over short-term handouts, which may limit the scope of fiscal measures in boosting consumer spending.

There has been widespread speculation that the government will step in at some point soon to support the world's second-largest economy as its recovery loses steam. However, the expected policy support will not likely come during its Politburo meeting in July, which typically sets the tone for economic policy for the second half of the year as China's leaders prefer to wait and weigh their options. Goldman Sachs' economists noted, "Local clients did not expect major policy easing measures or structural reform measures to be rolled out in the July Politburo meeting."

Intl Equity	QTD%	YTD%
MSCI China NR USD	-9.7	-5.5
MSCI AC Asia NR USD	1.5	6.6
MSCI EM Asia NR USD	-0.8	4.0
MSCI FM Asia NR USD	2.8	5.7
MSCI ACWI NR USD	6.2	13.9
MSCI World ex USA NR USD	3.0	11.3
MSCI ACWI Ex USA PR USD	1.4	7.7
MSCI EAFE PR USD	1.9	9.7
MSCI Europe NR USD	2.7	13.6
S&P Europe 350 NR USD	2.9	13.5
MSCI EM NR USD	0.9	4.9
MSCI EM Latin America NR USD	14.0	18.5
Nikkei 225 Average NR JPY	18.5	28.4
Benchmark 1: MSCI ACWI Ex USA NR USD	2.4	9.5

Source: Morningstar Direct

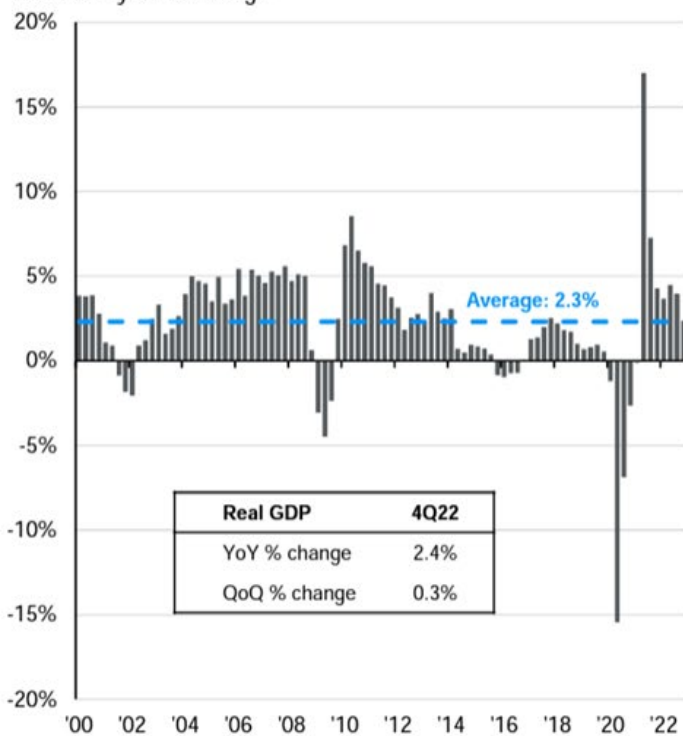
The broad-based emerging market Latin American index returned 14.0% for the quarter as Argentina, Colombia and Brazil posted strong double-digit returns of 39.7%, 25.6% and 24.2%, respectively. Investors in the region are hopeful that major central banks, which have aggressively hiked rates over the last two years, will be some of the first to start a rate-cutting cycle as inflation eases in major economies like Chile and Brazil.

Latin America: Economic growth, inflation and real rates

GTM LATAM 4

Real GDP

Year-over-year % change



Inflation

Year-over-year % change



Real policy rates by country

Nominal policy rate deflated by 12-month inflation expectations



Source: J.P. Morgan Global Economic Research, J.P. Morgan Asset Management; (Bottom right) Central Bank of Brazil, Central Bank of Chile, Central Bank of Colombia, Central Bank of Peru, Central Bank of Mexico. Latin America aggregate GDP growth includes Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru and Uruguay. Inflation does not include Argentina, Ecuador or Venezuela. Inflation expectations are based on surveys conducted by each central bank.
 Guide to the Markets - Latin America. Data are as of June 30, 2023.

J.P.Morgan
 ASSET MANAGEMENT

Source: <https://am.jpmorgan.com/content/dam/jpm-am-aem/americas/br/en/insights/market-insights/mi-gtm-latam-br-en.pdf>

Investment Strategy and Outlook

The second half of the year poses many of the same challenges to start 2023. Inflation remains sticky, and the Fed is still in a rate-hiking cycle. While there are expectations for a recession, the risks and subsequent rate-cutting cycle are being pushed into 2024. The Fed has continued to communicate it expects to hike rates at least 25 more basis points and maintain a higher terminal level for longer. Our neutral equity relative to fixed income view remains with slowing US and global growth expectations. The outlook for duration has improved as we have increased our exposure and shifted our preference to investment-grade credit over high yield.

Despite the recent rally in mega-cap growth stocks, we prefer value-oriented stocks and recognize that the rally in tech lost steam in the quarter's final month. The downside risks to GDP growth will likely favor the higher-quality dividend-paying and value-oriented stocks during the remainder of the year.

We have downgraded our preference for alternatives as liquid alts can be replaced with meaningful yield in fixed income. While inflation remains high while trending downward, we see downside risks to commodities in the near term. With a global slowdown in growth, we expect the demand to fall for the sector and see lower total returns in the near term. The real estate sector faces uncertainty as commercial real estate continues to suffer double-digit losses for the year while residential real estate posts double-digit solid returns.

[View Our Q2 2023 Reallocation Letter](#)

[See commentary from our sister company, 3D→](#)

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Except as otherwise specifically stated, all information and portfolio manager commentary are as of June 30, 2023.