ACIMA
PRIVATE WEALTH

ECONOMIC & INVESTMENT PERSPECTIVES

July 3, 2023

JUNE: EQUITY STRENGTH DESPITE RISING YIELDS
MID-YEAR PERFORMANCE REVIEW

Figure 1: 6/30/2023 Returns (source: Bloomberg)

Conditional formatting: green (high) to red (low) for each time period

Bonds	ETF	MONTH	QTR	YTD	1YR	vs. 52-wk High	vs. 52-wk Low
US Aggregate Fixed Income	AGG	-0.4%	-0.9%	2.3%	-1.0%	-6.2%	5.1%
Investment Grade Corp Bonds	LQD	0.8%	-0.4%	4.3%	2.0%	-6.0%	9.9%
U.S. Treasury Bonds	GOVT	-0.8%	-1.5%	1.8%	-2.1%	-6.1%	3.5%
U.S. 20+ YR Treasuries	TLT	0.2%	-2.5%	4.7%	-7.8%	-14.7%	12.1%
Muni Bonds	MUB	0.6%	-0.3%	2.3%	2.8%	-1.9%	5.3%
US High Yield	HYG	1.8%	0.7%	4.5%	7.8%	-5.4%	6.6%
Non-US Corp Bonds	IBND	1.4%	-0.1%	3.2%	2.3%	-4.1%	17.4%
Emerging Markets Bond LC	EMLC	2.8%	2.8%	8.1%	10.8%	-0.6%	14.2%
Global Equity							
ACWI Global Equity	ACWI	5.8%	6.3%	14.2%	16.4%	-0.9%	26.7%
ACWI Global Equity ex US	ACWX	4.6%	2.6%	10.0%	12.1%	-2.3%	26.8%
International Developed	EFA	4.5%	3.2%	12.5%	18.6%	-2.1%	32.8%
Emerging Markets	EEM	4.4%	1.0%	5.2%	0.9%	-7.0%	18.1%
Global Equity by Region							
United States	VTI	6.7%	8.3%	16.1%	18.8%	-0.5%	26.0%
Europe	IEUR	4.3%	2.8%	13.3%	20.6%	-4.0%	36.6%
Asia ex-Japan	AAXJ	3.1%	-1.5%	3.2%	-2.3%	-9.0%	22.3%
China	MCHI	4.5%	-9.5%	-4.9%	-17.9%	-20.2%	28.3%
Japan	BBJP	5.3%	6.5%	14.8%	18.7%	-3.3%	29.3%
Latin America	ILF	12.3%	15.9%	20.9%	32.7%	-2.2%	30.9%
US Equity							
US S&P 500	IVV	6.6%	8.8%	16.9%	19.5%	-0.2%	27.5%
NASDAQ 100 QQQ	QQQ	6.3%	15.3%	39.1%	32.7%	-0.9%	45.3%
US Large Growth	IWF	6.7%	12.8%	28.9%	26.9%	-0.3%	36.2%
US Large Value	IWD	6.6%	4.1%	5.0%	11.3%	-2.6%	17.7%
US Eqwt S&P 500	RSP	7.7%	3.9%	6.9%	13.5%	-3.9%	19.8%
US Mid Cap	IJH	9.2%	4.8%	8.9%	17.6%	-4.2%	20.3%
US Small Cap	VTWO	8.1%	5.2%	8.1%	12.4%	-7.2%	15.2%

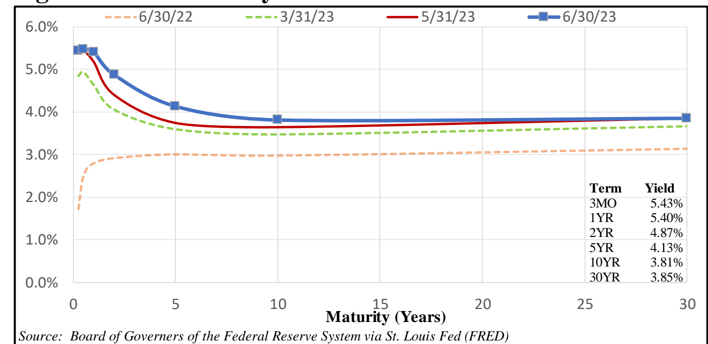
Global equity markets were strong in June, ending the second quarter (Q2) on a high note, but bonds remained under pressure as interest rates rose amid continued economic strength. Performance highlights for the month and quarter are summarized below. (Note: Year-to-date returns are discussed on page 2.)

- Bonds: The U.S. Aggregate index (AGG) fell 0.4% (-0.9% Q2) as interest rates rose. Narrowing credit spreads benefitted corporate bonds (LQD), which gained 0.8% (-0.4% Q2), and high yield bonds (HYG), which rose 1.8% (+0.7% Q2). Non-U.S. bonds (IBND and EMLC) out-performed as global currencies continued to strengthen versus the US dollar.
- Global equities (ACWI) rose 5.8% in June (+6.3% Q2).
- U.S. Equity: The broad market (VTI) rose 6.7% (+8.3% Q2), and the S&P 500 (IVV) gained 6.6% for the month (+8.8% Q2). Small (VTWO) and mid-cap stocks (IJH) out-performed in June but remain well behind large growth-oriented stocks (QQQ and IWF) in Q2, YTD and beyond. All sectors posted positive returns for the month, led higher by economically-sensitive sectors (consumer discretionary, industrials, materials) while defensive sectors (utilities, staples, health care) lagged. Despite better breadth of gains in June, the utilities, energy and staples sectors were actually down in Q2.
- Non-U.S. Equity: Developed market stocks (EFA) rose 4.5% (+3.2% Q2), with gains in Europe (IEUR) and Japan (BBJP). Emerging markets (EEM) gained 4.4% (+1.0% Q2), led by a 12.3% gain in Latin American stocks (ILF +15.9% Q2) on strength in Brazil. China equity (MCHI) rose 4.5% but has struggled as their economy re-opens after COVID (-9.5% Q2).

Interest Rates and the Economy

The yield curve (Figure 2) plots the yields (Y-axis) for various maturities (X-axis) of US Treasuries. The Federal Reserve (Fed) paused their rate-hike cycle in June, leaving the Fed Funds target rate unchanged at 5.00-5.25%. Even so, strong economic data drove short-term yields higher with expectations for at least one more rate hike. The inverted curve (short-term yields higher than long-term yields) continues to warn of an economic slowdown or recession. The 10-year Treasury now yields 3.81%.

Figure 2: US Treasury Yield Curve

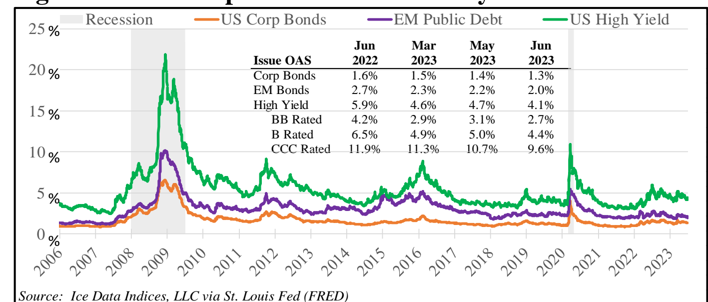


Source: Board of Governers of the Federal Reserve System via St. Louis Fed (FRED)

For bonds other than US Treasuries, we track the option-adjusted spread (OAS) between yields and Treasuries of comparable maturities (Figure 3). Low or narrowing spreads signal optimism, while high or rising spreads signal fear. Spreads narrowed in June and Q2 and remain at historically low levels.

- Investment grade corporate bond spreads narrowed to +1.3% and have marched incrementally lower over the past year.
- High yield (non-investment grade) spreads narrowed to +4.1%, down from +4.6% last quarter and well below year-ago spreads of +5.9%. The riskiest bonds (rated CCC & below) have declined over the past year and now yield +9.6% over Treasuries.
- Emerging market bond spreads have narrowed steadily as well, now yielding an average of +2.0% over US Treasuries. Returns on non-US bonds have been strong recently as credit spreads fell and global currencies strengthened versus the US dollar.

Figure 3: Credit Spreads vs. US Treasury Yields



Source: Ice Data Indices, LLC via St. Louis Fed (FRED)

2023 Mid-Year Market Review

Global stocks and bonds posted significantly negative returns in 2022 as global central banks sought to tame decades-high inflation by aggressively raising interest rates. Despite the cumulative weight of tighter financial conditions, markets have staged a stunning recovery this year. The next three figures summarize returns for the first half of 2023 across various stock and bond markets and segments, proxied by liquid ETFs (sorted from best to worst).

Figure 4 plots the returns of various broad fixed income ETFs. Bonds have posted solid returns across the board and now offer the most compelling yields since the early 2000s.

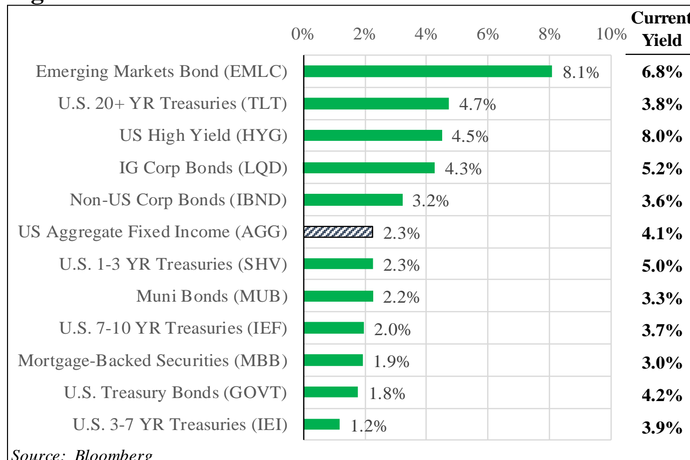


Figure 4: YTD Bond ETF Total Returns

The Bloomberg/Barclays US Aggregate Fixed Income benchmark index has gained 2.3% this year and carries an attractive current yield of 4.1%. Emerging market bonds out-performed significantly (+8.1% YTD) thanks to a current yield of 6.8%, narrowing credit spreads and a weakening dollar, which enhances the return on non-dollar assets via the currency translation. Long duration bonds have also performed well despite being highly sensitive to interest rate changes. Long-term yields have actually declined marginally this year even as the Fed continued to raise short-term rates, resulting in higher total returns for longer duration instruments relative to the short and intermediate maturity issues in the chart above. Corporate credit (investment grade and high yield) has gained 3-5% in the US and globally as rising interest rates were partially offset by declining credit spreads.

Global stocks (ACWI) have returned 14.2% so far this year. The recovery has been sharp and stunning, as illustrated in Figure 5.

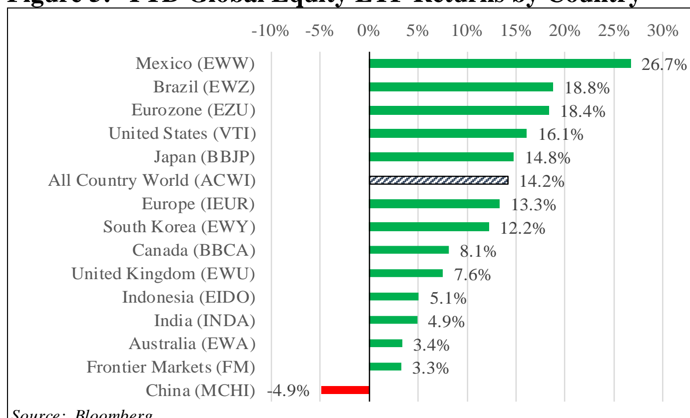


Figure 5: YTD Global Equity ETF Returns by Country

As Americans, we tend to be more focused on the strong performance of US equities (VTI +16.1% YTD), but Latin American markets have generated even better returns. Mexican stocks surged 26.7% on expectations that their economy will benefit from a US recovery and "near-shoring" of US manufacturing in the wake of pandemic-era supply chain disruptions; Brazil's commodity and energy stocks powered gains of 18.8%. Additionally, eurozone equities (including Germany, France, Italy, Spain, etc.) out-performed the US despite on-going war in Europe as a mild winter eased fears of an energy crisis in the region. Other commodity-oriented economies and markets (Canada, UK, Australia) fared well in 2022 but have under-performed this year. China is the only major equity market that is down this year as their economy struggles to re-open from draconian COVID lockdowns amid sluggish demand for exports in a slowing global economy.

As we have written previously, the US equity recovery has been highly concentrated, powered by the potential earnings growth of a few huge technology-oriented growth stocks. Figure 6 plots the year-to-date performance of the eleven economic sectors.

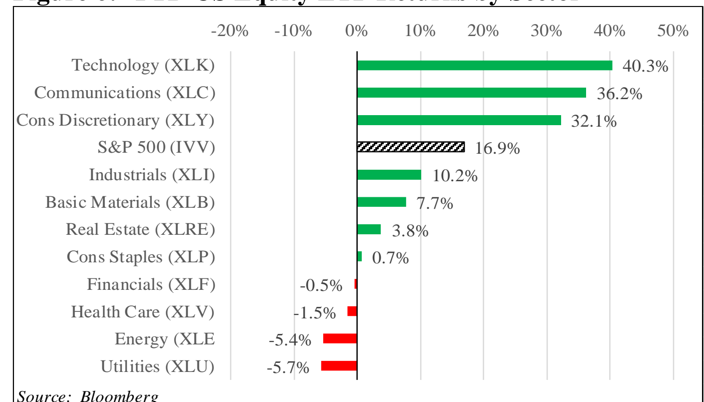


Figure 6: YTD US Equity ETF Returns by Sector

While the S&P 500 is up 16.9% so far this year, three sectors have surged, accounting for nearly all the return of the index. Technology (primarily Apple, Microsoft and Nvidia) is up 40.3%; Communications (dominated by Alphabet/Google and Meta/Facebook) has risen 36.2%; and Consumer Discretionary (powered by Amazon and Tesla) is up 32.1%. By contrast, economically-sensitive sectors (Materials, Industrials, Real Estate and Financials) offered more muted returns, and the defensive sectors (Staples, Health Care and Utilities) are flat or even down. The Energy sector is down as well with declining oil and natural gas prices.

Bottom Line

Stocks rallied in June even as interest rate expectations inched higher. US economic data continues to be strong: Real GDP growth for Q1 was revised higher to 2.0% (annualized), and employment data remains robust, with an average of 314,000 new jobs created monthly in 2023 and near-record low unemployment. Developed markets (Europe, Japan, Canada and Australia) continue to recover as well. Emerging markets have been mixed, with strong returns in Latin America and weakness in China.

Economies and markets have proven resilient under the weight of rising interest rates and shrinking money supply as global central banks seek to tame inflation. Because slowing economic growth is their common goal, recession and further market volatility are likely. Diversification remains critical, with attractive bond and money market yields serving as viable alternatives to stocks.

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