June 2023 Capital Markets Commentary

By: Robert J. Majdecki, Senior Vice President & Chief Investment Officer

"Someone is sitting in the shade today because someone planted a tree a long time ago."

Warren Buffett

Fixed Income

The 2nd Quarter of 2023 ended quite differently from the 1st Quarter. After a positive turnaround from late 2022, bonds (Intermediate to Long Term) realized slightly negative returns for the second quarter. Market participants went into the second quarter on high alert for a recession and thinking the Fed could soon be cutting rates. However, at the quarter's end, there was still no economic downturn in sight, inflation remained sticky, and the Fed was expected to keep rates higher for longer.

The U.S. Treasury yield curve was up across the maturity spectrum during the quarter, and to a greater degree from the short end to 3-years. The 10-year Treasury yield ended the quarter at 3.84%, up 37 basis points from March. The FOMC met twice during the quarter, as scheduled, and increased the overnight rate by 0.25% in May, targeting a range of 5.00% to 5.25%, before pausing in June. The information out of the Federal Reserve is that the current expectation is for another 50 bps before the end of 2023, with the possibility of more if need be. In late June, Fed Chair Jerome Powell said that central bank policy "may not be restrictive enough and it has not been restrictive for long enough." With inflation still higher than the Fed would like, the quarter ended with the markets in flux, and thinking that Fed funds could go as high as 6% before the Fed stops.

As can be seen below, returns were meager to down slightly across all spectrums during the quarter. The Barclays U.S. Aggregate posted a -0.84% return for the quarter. The Barclays Intermediate Index was at -0.81% and the short end of the curve also was negative with the 1-3 Year Government Index at -0.58% for the quarter. Only the truly short end of the curve was positive, with the 1 Year T-Bill returning +0.46 for the quarter. The 10-year Treasury yield ended the quarter at 3.81%. The 5-year Treasury yield ended at 4.13%, and the 2-year Treasury yield ended at 4.87%.

Fixed Income Markets - Looking Ahead

At the June meeting, the Fed paused. (Why, is another matter. Is politics involved?)

U.S. Fixed Income markets will continue to take their cue from the Fed, but uncertainty regarding the timing for potential rate hikes or rate cuts will be a key aspect for trading activity. The inverted yield curve offers no urgency to move out in duration. 5.40% in 1-Year securities is historically exceptionally good.

Within the U.S. credit markets, the increase in yields within HY offers a cushion for investors should spreads widen out from current readings. As mentioned above, the bond market, at least in the near-term, may have has mis-calculated the Fed's willingness to tone back on rate increases. Also, the implications of tighter bank lending standards will probably take time to exhibit in overall economic data. Given the Fed "only" delivered a 25bps rate hike in May (instead of 50bps) and skipped June, they might be less interested in the speed at which they reach their target, and merely interested in simply making it to that target. The expectations are that interest rates might snap back to the reality of higher for longer, perhaps reaching a range of 5.50-5.75%.

U.S. 10-year Treasury yields approached 15-year highs above 4% after U.S. jobs data showed a still tight labor market and that wages still growing even after the Fed's rapid rate hikes. Markets seem to be coming around to the view that central banks will be forced to keep policy tight to curb inflationary pressures. (Hold Tight)

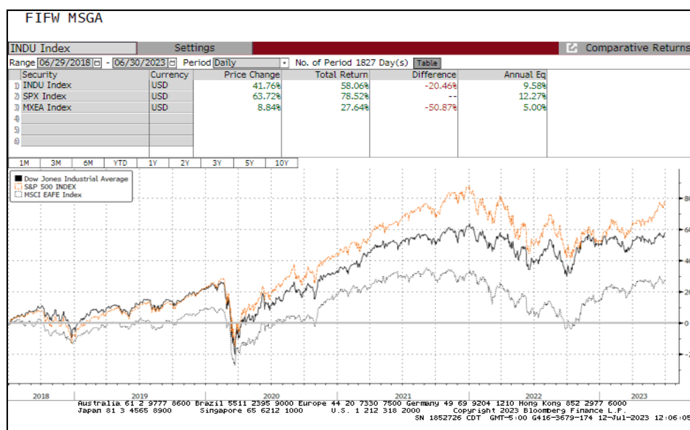
Equity

Equity markets were in contrast to expectations in both the 1st and 2nd quarters of 2023. This happened even as inflation remained elevated, and the Fed continued a rate-hiking campaign that had not happened since the 1980s. The S&P 500 ended the second quarter of 2023 at a 14-month high and most major stock indices again had solid gains in the second quarter following a pause in the Fed's rate hike campaign, stronger-than-expected corporate earnings and the relatively drama-ridden resolution of the debt ceiling. Markets started 2nd quarter positive but weak. Both April and May had small gains. However, as June progressed there was an increase in investors' hopes that the Fed might be able to deliver an economic soft landing.

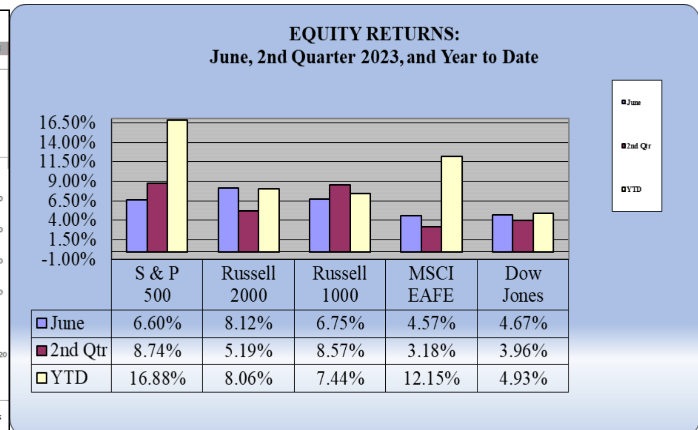
The 2nd quarter began with investors still focused on inflation and the Banking system. However, these fears resided, as the Federal reserve and the Treasury Department's lending programs shored up the system. The Federal Reserve did hike rates again in May but held off in June. With the banking systems problems eased, market concerns and equity markets in the 2nd quarter finished strongly.

In summary, the markets were quite resilient in the 2nd quarter and throughout the first half of 2023. The better earnings numbers, expectations for possibly less-aggressive rate hikes, evidence of a softer economic landing, and relative stability in the regional banks, pushed the S&P 500 to a 14-month high.

Both U.S. and International equities were positive in the 2nd quarter. On the U.S. side, the S&P 500 ended with a positive return for the quarter, showing a return of +8.74%. The Russell 1000 index returned +8.57%, the Russell 2000 index returned +8.57%, and the Dow returned +3.90%. The International markets were also positive in the 2nd quarter, returning +3.96%.



Security	Currency	Price Change	Total Return	Difference	Annual Eq
1) INDU Index	USD	41.76%	58.06%	-20.46%	9.58%
2) SPX Index	USD	63.72%	78.52%	--	12.27%
3) MXEA Index	USD	8.84%	27.64%	-50.87%	5.00%



	S & P 500	Russell 2000	Russell 1000	MSCI EAFE	Dow Jones
June	6.60%	8.12%	6.75%	4.57%	4.67%
2nd Qtr	8.74%	5.19%	8.57%	3.18%	3.96%
YTD	16.88%	8.06%	7.44%	12.15%	4.93%

Equity Markets - Looking Ahead

<u>2023</u> – Lets keep it going. The 1st quarter was great, and the 2nd quarter was even better. Do we see a pattern here?

As we start the third quarter of 2023, the outlook for stocks and bonds is still positive, as inflation has slowed (A bit), economic growth and the labor market remain impressively resilient, and the Fed paused for a month, its rate hiking campaign.

That improvement in the fundamental outlook has been reflected in both stock and bond prices so far this year, as the S&P 500 continues in its forward motion and more cyclical sectors led markets higher during the quarter on rising hopes for a broad economic expansion.

As we move into the 3rd quarter 2023 and beyond, the markets begin facing multiple sources of uncertainty including the path of inflation, future economic growth, the number of remaining Fed rate hikes, and the start of the political season. However, the markets have proven quite strong over the past six months.

Looking ahead, forecasts are, that the rate of economic growth will slow in the third and fourth quarters, then possibly bottom out in the first quarter of 2024. While many view the broad market as undervalued, between slowing economic growth, tight monetary policy, and reduced credit availability, the rate of market gains may be limited as we move into the 3rd and 4th quarters.

As we are now halfway through 2023, and it's looking like the bull market for stocks may be over. But with the Federal Reserve still warning of interest rate increases to come, is the coast really clear either way?

AMALGAMATED
Bank of Chicago

The Economy

The Economy

Through the first six months of the year, financial market performance has had a strong showing. This despite a disconnect between interest rate forecasts, what the Fed was targeting, and of course the debt ceiling early on.

At the start of the year, the debt ceiling became a national and global storyline when Congress struggled to agree on a budget, and the GOP used the debt ceiling as leverage to achieve some of its desired cuts. As the second quarter began, that storyline became more pronounced as market participants, political commentators and politicians made a lot of noise surrounding the economic position each party was putting us in. Not surprisingly, there was very little market reaction after an agreement was made to raise the debt ceiling.

The Fed's continued manipulation of interest rates was a major storyline, although for different reasons than the past few quarters. During the quarter, the Fed began to telegraph that it was likely to pause rate hikes after a series of 10 increases dating back to March 2022. The hints of a pause were realized when the Fed chose to leave the rate unchanged in their June meeting.

What has surprised many analysts and economists in the 2nd quarter and also the 1st quarter, is that the U.S. economy has not yet fallen into the recession that many had expected following 500 basis points of Federal Reserve (Fed) tightening over the last 15 months. After gross domestic product (GDP) growth of 2.0% in the first quarter, the second quarter is expected to have grown at roughly the same rate, which is close to the longer-term potential growth rate of a mature developed market economy like the United States.

The Economy - Looking Ahead

Economic Growth? Jobs? Inflation? Recession? Global problems? The more things change the more they remain the same.

Many economists have been forecasting a recession for 2023 due to the continued tight monetary policy by the Federal Reserve. But that recession has not arrived yet, as fiscal policy is still stimulative; real interest rates are not yet restrictive (the nominal yield on Treasury bills remains below nominal GDP growth); the household sector still has high savings that was built up during the pandemic; corporations extended the maturity of their loans, making them less vulnerable to higher rates; and the dominant service sector is less sensitive to interest rates.

The strength and resiliency of the U.S. economy in the first half of the year has pushed back concerns for a recession into 2024. Consumer spending will be driven by continued jobs growth through the summer and ample accumulated savings. There is likely to still be strong movement toward spending on services and other things, but lower inflation rates and more discounting could increase consumer interest in certain sectors. Businesses are likely to focus spending on technology outlays to maintain competitiveness in a tight labor market. Housing might arguably be the most interesting sector moving into the second half of the year. Mortgage rates have stopped increasing (at least for now), which helps affordability, and inventory of new and existing homes for sale remains too low to satisfy the demographic demand.

As mentioned, the Fed recently paused in hiking short-term interest rates. That said, Fed Chair, Jerome Powell, was recently clear that they expect to continue raising them. Currently, the bond market is expecting rates will rise an additional 0.5%. While the Fed has been the target of almost everyone for hurting the finances of the average American, their higher priority is confirming a commitment to lower inflation, regardless of the political cost. Failure to lower inflation would do more damage over the long run and severely hurt the Fed's credibility.

The outlook for continued economic growth with no recession through year-end could and should continue to exert upward pressure on interest rates throughout the yield curve. The expected progress on inflation may begin to limit rate increases at the short end of the curve as the Fed ends its tightening cycle. But, as mentioned before, inflation is a tricky thing, and we may have to wait until 2024 to see a drop in rates.

This report contains information and statements which have been obtained from and are based upon secondary sources Amalgamated Bank of Chicago believes to be reliable. However, Amalgamated Bank does not guarantee its accuracy, completeness, or suitability for any particular purpose. The information contained in this commentary may be incomplete or condensed. All opinions, estimates and statements, contained in this report, constitute Amalgamated Bank's judgment as of the date of the report and are subject to change without notice. A number of factors, including but not limited to economic and market conditions, which are beyond the ability of Amalgamated Bank of Chicago to control or predict, could cause actual results or events to differ materially from those contained in this report. Amalgamated Bank undertakes no obligation to update this report or any statement in light of new information or future events.

This report is for informational purposes only, is not intended to be investment advice and should not be construed or relied upon as a recommendation to buy or sell certain types of securities.