ALPHACORE WEALTH ADVISORY

# 2023 Second Quarter Commentary

## REVIEW OF THE MARKETS

Despite rapidly tightening lending conditions, equity market performance during the second quarter of 2023 remained surprisingly robust. Multiple expansion led the stock market higher, as investors seemingly wanted to mark the end of the corporate earnings contraction that began in late 2021. The S&P 500 earnings as of Q1 2023 showed a decline of approximately 16% year-over-year.

### FIGURE 1: ASSET CLASS RETURNS

| Asset Class/Peer Group | 2Q 2023 | YTD 2023 |
|---|---|---|
| NASDAQ Composite TR USD | 13.05 | 32.32 |
| Russell 1000 Growth TR USD | 12.81 | 29.02 |
| S&P 500 TR USD | 8.74 | 16.89 |
| Russell 2000 TR USD | 5.21 | 8.09 |
| US Fund Systematic Trend | 4.77 | -0.51 |
| Russell 1000 Value TR USD | 4.07 | 5.12 |
| US Fund Multistrategy | 2.04 | 3.25 |
| ICE BofA US High Yield TR USD | 1.63 | 5.41 |
| MSCI EM NR USD | 0.90 | 4.89 |
| Bloomberg US Agg Bond TR USD | -0.84 | 2.09 |
| Bloomberg US Treasury 3-10 Yr TR USD | -1.54 | 1.19 |
| iShares 20+ Year Treasury Bond ETF | -2.39 | 4.88 |
| Bloomberg Commodity TR USD | -2.56 | -7.79 |

Figure 1: Source: Morningstar, 6/30/2023

As we look forward, the bottom-up S&P 500 consensus estimates are looking for a negative 8% year-over-year growth rate when we close out Q2 earnings. This more optimistic outlook helped fuel the year-to-date performance of the S&P 500 TR Index up by 16.89% (Figure 1).

Such strong performance in equity markets was admittedly unexpected. While we recognized stocks had some positive momentum at the end of the last quarter, we did not fully anticipate the extent of the multiple expansion, especially in the face of today's elevated discount rates..

We are curiously awaiting Q2 earnings guidance to trickle in over the next few weeks, which should be a significant driver of future equity performance.

Conversely, Q2 performance across other asset classes paints a far less rosy picture. Commodity markets, for example, lagged in response to weakening energy consumption by consumers and manufacturers alike. According to the Bloomberg Commodity Index, commodity markets are down another 2.56% for the quarter and down 7.79% year-to-date (Figure 2). Bond yields drifted higher following their rapid declines in the March as inflation risks remained a concern for fixed-income assets.

### FIGURE 2: BLOOMBERG COMMODITY INDEX

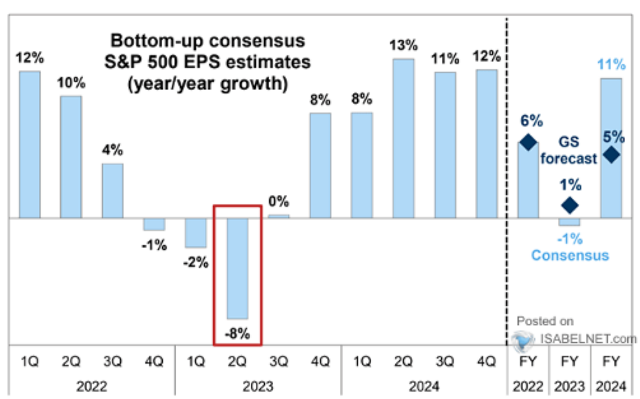



Figure 2: Source: Goldman Sachs

## ECONOMIC OBSERVATIONS AND OUTLOOK

During Q1, U.S. Real GDP remained positive, growing at a pace of around 2%. This is in line with the U.S. economy's projected long-term growth rate, and Q2 estimates show this trend continuing. This expansion was driven primarily by services-related consumption, such as travel, tourism and live events. However, manufacturing and industrial-focused sectors have slowed considerably over the past year. Several other macroeconomic observations are noted below:

- While inflationary pressures have fallen meaningfully from the highs of 2022, core measures of inflation remain far too elevated far from the target level of most central banks.
- The unemployment rate has still not budged, reflecting the ongoing labor supply shortage that emerged during the pandemic.
- Overall growth remains on decent footing despite rapidly rising borrowing costs. Thanks to an increase in consumer credit and tight labor markets, consumption remains resilient.
    - That said, manufacturing-heavy sectors have experienced a slowdown.
- Stocks remain elevated, which is evidence of the wealth effect potentially reasserting itself.
- The Fed's policy stance and forward-looking guidance remains tight, which is supported by the data above.

## INFLATION AND EMPLOYMENT

While headline inflation has decreased from its peak in 2022, the availability of labor has been affected by supply-side shocks, leading to tight employment levels. As a result, wage inflation remains stubborn - around a nominal 5%. Another important barometer, the personal consumption expenditure measure (PCE), also remains stubbornly elevated at about 5% (Figure 3). In summary, inflation, especially service-based, is still far off the Fed's target 2% rate. As such, the Fed's stance is more hawkish than markets previously forecasted, with several indications that rates will stay elevated.

FIGURE 3

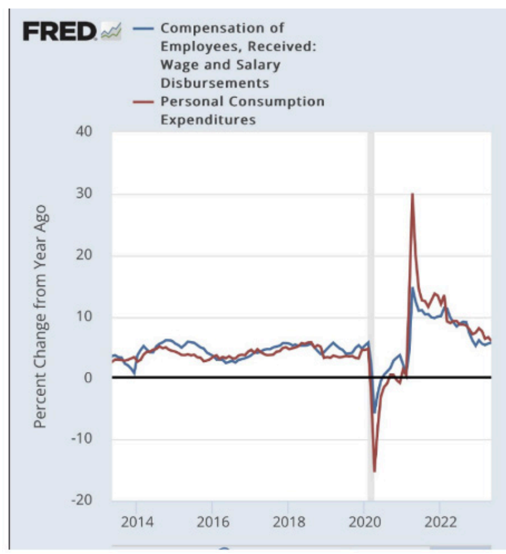



Figure 3: Source: FRED

## HOUSING

terest rate-sensitive areas of the economy, especially housing, are critical to monitor given the rapid rise in borrowing costs and the lending pullback in the banking sector since March. Even though pending home sales fell by 2.7% in May, new home sales nevertheless saw a 12.2% uptick in transaction volume. I It is worth noting that this boost to new home sales is driven in large part by price cuts from builders who needed to clear inventory. According to the U.S. Census Bureau, top-line homebuilder sales prices through May saw a 16% decline from their peak, which was eight months ago, leading us to also wonder about the price impact on existing home sales. Additionally, buyers are struggling with affordability due to elevated mortgage rates.

## OUTLOOK

The challenge of navigating the financial markets in 2023 cannot be overstated, and AlphaCore will endeavor to do so with a healthy dose of humility. Deciphering market phenomena and broader macro trends is always a perplexing task for strategists, but more so this year than ever before with today's increasingly convoluted economic backdrop. We underestimated consumer's propensity to spend and take on additional leverage despite ongoing uncertainty. Overall, we are holding fast to our macro thesis that has been laid out over the past few quarters. We expect the U.S. economy to be in a slower growth, higher inflation regime for some time, as various structural forces, such as de-globalization and labor shortages, push to reorganize the economy. In our opinion, the central bank's tightening policies aimed at achieving 2% inflation help support this outcome.

The persistent yield curve inversion mentioned in our Q1 commentary is worth revisiting. As it stands, nearly the entire Treasury curve is inverted, and all the while, both short and long-term yields have increased. This is an interesting dynamic, since prior periods of contraction were preceded by inversions driven by the collapse of long-end rates. We believe this is the market's way of pricing in a structurally-higher inflation regime. Central banks and markets will be undergoing a process of normalizing cost of capital. This levies valuation pressure on all risk assets from both a discounting perspective and corporate bottom lines, as borrowing costs rise. We view this setup as tremendously advantageous for our investment style. We believe the most prudent allocation strategy is to remain as diversified as possible, and thus more defensive. Also, this is typically the environment where highly skilled active managers shine.

The current rate of personal consumption will need to persist to support both economic growth and current equity prices. However, extending leverage to consumers to prop up their spending habits becomes more difficult with high borrowing costs. We expect spending to rein in at some point, but if labor markets remain tight, nominal spending could remain higher for longer, dragging out the current cycle. For now, we still project a slight slowdown in the back half of this year (Figure 4).

FIGURE 4

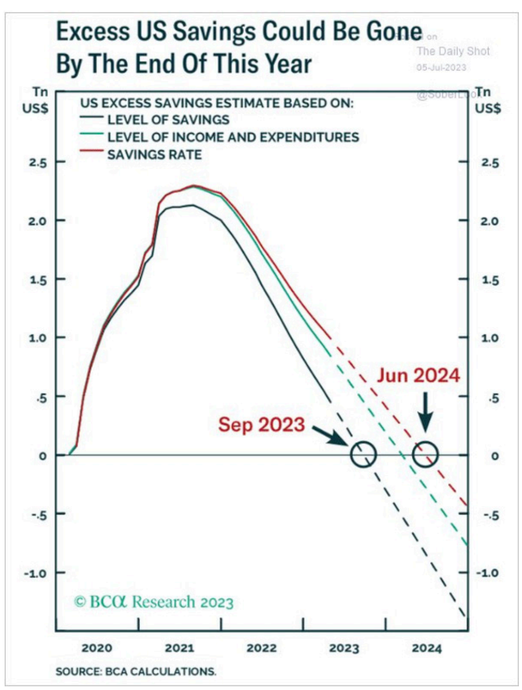



Figure 4: Source: BCA Calculations

## FIXED INCOME MARKETS

Bond yields across all maturities ticked up during Q2 from their March low. The 10-year Treasury yield closed out the period at 3.84%, increasing 37 bps (Figure 5). Better than expected economic and labor data points indicate persevering modest growth. However, the close of the second quarter marked one full year of yield curve inversion, which reached its lowest level since the 80's at the end of the quarter at negative 107 bps. As we have written before, this typically portends an economic slowdown. The *Bloomberg Aggregate Bond* Index posted a modest negative return for the period of around 85 bps, bringing total year-to-date performance to 2.09%. **With the Fed continuing to hike rates, bonds and duration provide more value now than in the past.**

FIGURE 5

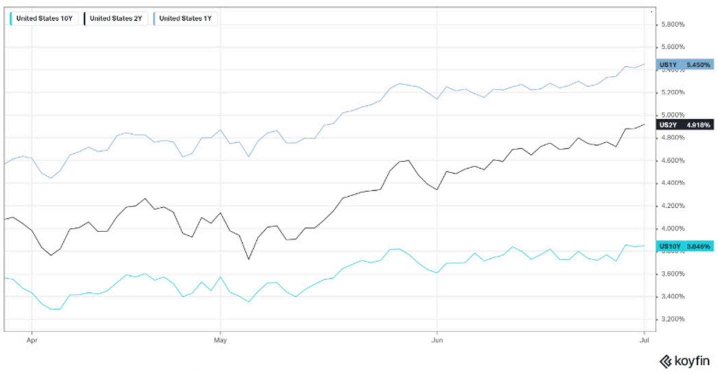



Figure 5: Source: Koyfin

FIGURE 6

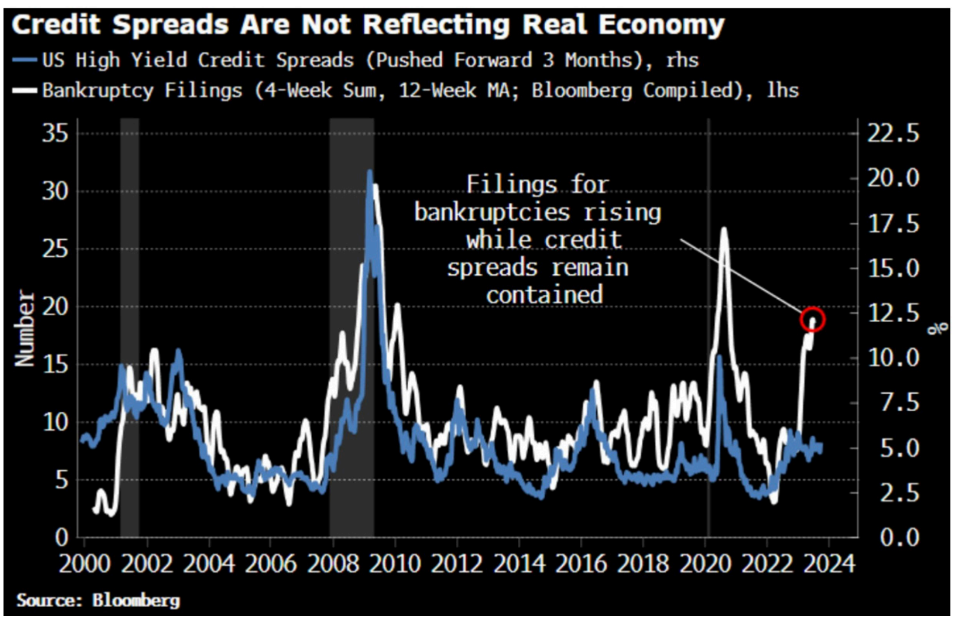



Figure 6: Source: Bloomberg

Credit markets outperformed bonds during the quarter. The ICE BofAML US High Yield Index was up 1.63% for the period, bringing 2023 year-to-date performance to 5.41% for the year. Spreads narrowed, reflecting investor's rather laissez-faire outlook, despite several fundamental data points pointing to an elevated risk of credit losses ahead. There has been a concerning uptick in bankruptcies within the corporate sector, approaching the levels witnessed during the peak of the Covid-19 pandemic-induced shutdowns in 2020 (Figure 6). Additionally, ever since the March banking crisis, lending activity by banks has diminished. With that said, high yield spreads have yet to reflect these concerns, with actual default rates remaining below the approximately 3.5% average annualized default rate. Still, we maintain our cautious stance on corporate credit, preferring short-term government bonds and U.S. mortgage-backed securities, both of which have repriced appropriately to accommodate the increasing rates.

## EQUITY MARKETS

Shifting over to equities, U.S. large cap stocks led the way once again, posting a 8.74% second quarter return, bringing the first half of 2023 performance to 16.89%, as represented by the S&P 500 TR Index. This rally is being driven almost entirely by the index's largest players, with the S&P's top 10 companies accounting for over 95% of the year-to-date performance. Investors continue to favor growth-oriented tech and AI names. Excluding mega-caps (primarily tech names), the index would nearly be flat for the period. Furthermore, the S&P is becoming more and more concentrated, with the seven largest stocks comprising nearly 30% of the index, leaving investors particularly vulnerable to valuation risk (Figure 7).

U.S. small caps lagged their large cap peers in the first half of 2023 due to the lower earnings quality and higher exposure to underperforming cyclical sectors. International developed market stocks and emerging market stocks delivered returns of 11.2% and 4.8%, respectively, for the period. A weaker U.S. dollar and relatively positive economic conditions in both regions underpinned returns. Unfortunately, emerging market stock's momentum diminished toward the end of quarter with China's underwhelming economic print.

### FIGURE 7

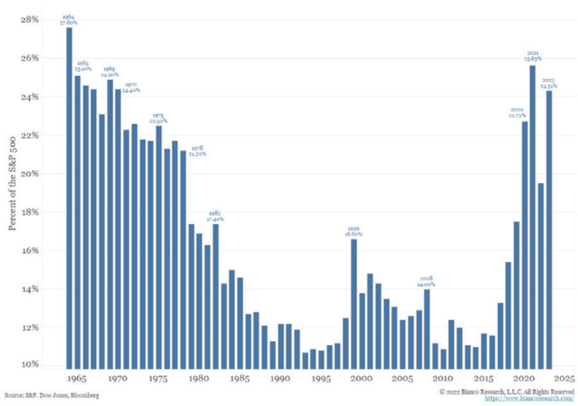


Figure 7: Source: Bloomberg, F5 Investments

### FIGURE 8

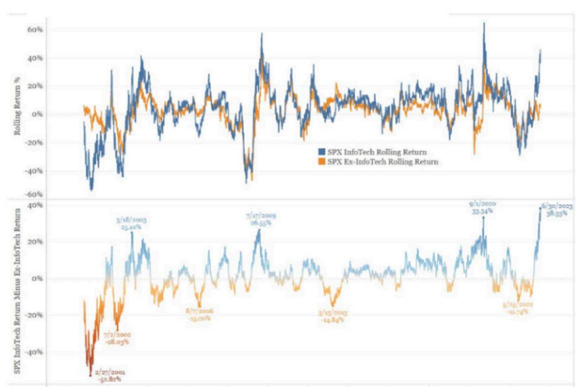


Figure 8: Source: Bianco Research, LLC & Bloomberg

Though it is extremely tempting to chase this rally, investors need to stay disciplined. Several charts illustrate just how extreme the first half moves in equity markets have been. Figure 7 highlights the historical concentration levels of the S&P 500 over history. Today's concentration risk in mega caps is very elevated from the average. Figure 8 highlights the major discrepancy between the rolling six-month return of the S&P 500 IT sector and the S&P 500 non-IT sectors.

At our core, we are fundamental-driven investors. Though the recovery in U.S. equity markets this year has been swift and strong, the realities of weakening economic growth and corporate earnings remain. We do not believe investors will be rewarded chasing expensive growth stocks at this stage, as it is our view that it is unlikely that they will be able to continue to outpace slowing macro growth. Furthermore, although investors in the S&P 500 Index think that they are buying a diversified basket of 500 companies, with the concentration levels today, that is simply not the case. Capital deployed into the market-cap-weighted S&P 500 is increasingly a bet on just a few companies. For most investors, relying on this strategy can be too big of a gamble. Lastly, we find it more attractive to own less expensive, quality and value segments of the market that are trading at reasonable valuations that carry strong underlying fundamentals.

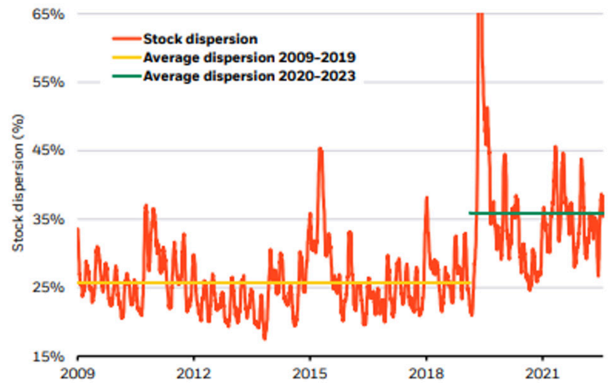
## ALTERNATIVE INVESTMENTS

Alternative investment performance this quarter was somewhat of a mixed bag again. Across our hedge fund platform, credit and yield-focused managers did quite well. These funds delivered consistent returns throughout the quarter with underlying loans and securities providing stable income and issuer-specific credits appreciating in price. Managed futures also delivered positive returns during the period, recouping nearly all the losses incurred during the March banking crisis. Strong trend activity prompted increases in gross exposures across most CTA programs, including long positions in equities and short positions in fixed income, commodities and metals and the U.S. versus foreign currencies.

On the other hand, discretionary global macro managers had a much more difficult time, since their defensive positioning prevented them from reaping the spoils of the risk-on equity rally. Our value-biased long-short equity manager faced a more challenging market environment this period, too, posting negative returns, as growth stocks and high-beta stocks created headwinds for their short book.

FIGURE 9

**Range of individual stock returns vs. Russell 1000**




**Past performance is not a reliable indicator of current or future results, and index returns do not account for fees. It is not possible to invest directly in an index.** Source: BlackRock Investment Institute, with data from Refinitiv, June 2023. Notes: The chart shows the dispersion in Russell 1000 stock returns based on a 21-day moving average (dark orange line), average dispersion from July 2009 after the global financial crisis through 2019 (yellow line), and average dispersion from 2020 through June 8, 2023 (green line).

*Figure 9: Source: BlackRock*

We have a strong conviction in active stock picking strategies during this period of high dispersion in equity markets. The rise in capital costs creates more variability in macro and consumption dynamics, leading to greater volatility in corporate fundamentals. The Stock dispersion chart from BlackRock (Figure 9) highlights the current elevated dispersion regime, which should persist if these factors remain in play. Skilled long-short managers thrive in this type of environment. However, other alternative strategies, like convertible arbitrage, market neutral long-short equity and multi-strategy, delivered more muted, albeit still positive, returns during the period.

Looking ahead to the second half of this year, we remain cautious on rate-sensitive sectors that are still digesting the new reality of higher borrowing costs. These include private real estate and private equity. Transactional challenges will likely persist, and accretive growth opportunities in these asset classes appear to be less abundant in the near future. That said, there are still areas within the private markets, which can be accessed via specialized strategies, that we believe present attractive opportunities to deploy capital.

Within our strategic portfolio risk allocation to private markets, we are building more conviction around opportunistic credit and special situations-focused platforms that leverage market dislocation from spread volatility. The secondaries market for both corporate bonds and loans, as well as all mortgage-related structured credit, has also proven fertile ground, as this sub-market has already meaningfully repriced. Additionally, bankruptcy-related corporate restructurings and other specialty financing opportunities are being capitalized upon by specialized managers with highly-scaled platforms and experienced lending teams. These groups will undoubtedly be sought after for capital solutions for a variety of unique corporate and real estate situations. In the last 18 months, the tables have turned drastically, and now lenders have a more advantaged seat at the table. Allocators should embrace this dynamic, tilting more toward debt over equity-based structures. With central banks have less monetary fire power and traditional lending sources pulling back, we believe private solutions will be increasingly relied upon to execute on transactions or facilitate balance sheet improvements or restructurings going forward. With increasing consolidation among smaller banks and less lending from traditional players, we project an increased demand for non-bank lending and private credit.

## CONCLUSION

***"Doubt is an uncomfortable condition, but certainty is a ridiculous one" – Voltaire.***

We believe we have the appropriate framework in place to deliver strong risk-adjusted returns for our clients despite this uncertainty. Our recommended approach for clients is to adopt a well-rounded and diversified portfolio that aligns with their long-term objectives. It is crucial to maintain this strategy even during challenging periods/and lagging periods, That means during down markets, our approach should limit downside losses - an objective that we delivered on in 2022. Divergent macro versus market trends can make the experience uncomfortable at times, but if we stick to our disciplined process, we believe we can execute well for our clients.

These commentaries are intended to provide our best and latest thinking across each asset and sub-asset class, highlighting the rich multi-asset environment in place today. We remain confident our diversified approach is very well situated for this type of regime. As always, thank you for your trust and confidence in our team, and please reach out to me or your advisor if you have any questions.

**JOHANN LEE, CFA®**
Director of Research

- **BLOOMBERG BARCLAYS CAPITAL US AGGREGATE BOND INDEX:** The index consists of approximately 17,000 bonds. The index represents a wide range of securities, from investment grade and public to fixed income.

- **ICE BOAML HY INDEX:** The index is a commonly used benchmark index for high-yield corporate bonds. It tracks the performance of US dollar denominated below investment grade rated corporate debt publically issued in the US domestic market.

- **RUSSELL 3000 INDEX:** The Russell 3000 Index is a market-capitalization-weighted equity index maintained by the FTSE Russell that provides exposure to the entire U.S. stock market. The index tracks the performance of the 3,000 largest U.S.-traded stocks which represent about 98% of all U.S incorporated equity securities.

- **RUSSELL 2000 INDEX:** The Russell 2000 Index is a small-cap stock market index of the smallest 2,000 stocks in the Russell 3000 Index. It was started by the Frank Russell Company in 1984. The index is maintained by FTSE Russell, a subsidiary of the London Stock Exchange Group.

- **MSCI ACWI (ALL COUNTRY WORLD) INDEX:** The MSCI ACWI is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. The MSCI ACWI Index is comprised of stocks from both developed and emerging markets.

- **MSCI EMERGING MARKETS INDEX:** The MSCI Emerging Markets Index is used to measure the financial performance of companies in fast-growing economies around the world. The index tracks mid-cap and large-cap stocks in 27 countries, dominated by Chinese, Taiwanese, and South Korean companies.

- **S&P 500 INDEX:** S&P 500 index is a float-adjusted market-cap weighted index, largely reflecting the large-cap US equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

- **NASDAQ 100 INDEX:** The Nasdaq 100 Index is a basket of the 100 largest, most actively traded U.S companies listed on the Nasdaq stock exchange. The index includes companies from various industries except for the financial industry, like commercial and investment banks.

- **PURCHASING MANAGERS' INDEX (PMI):** PMI Index is an indicator of economic health for manufacturing and service sectors. The purpose of the PMI is to provide information about current business conditions to company decision makers, analysts and purchasing managers.

- **ISM MANUFACTURING INDEX:** The ISM Manufacturing Index is a widely-watched indicator of recent U.S. economic activity. The index is often referred to as the Purchasing Manager's Index (PMI).

- **THE BLOOMBERG COMMODITY TOTAL RETURN INDEX:** The BCOM TR Index is composed of futures contracts and reflects the returns on a fully collateralized investment in the BCOM. This combines the returns of the BCOM with the returns on cash collateral invested in 13-week (3 Month) U.S. Treasury Bills.

- **CBOE VOLATILITY INDEX (VIX INDEX):** The VIX Index is a real-time market index used to measure the market's expectation of future volatility. Being a forward-looking index, it is constructed using the implied volatilities on S&P 500 index options (SPX) and represents the market's expectation of 30-day future volatility of the S&P 500 index which is considered the leading indicator of the broad U.S. stock market.

## MORNINGSTAR CATEGORIES

**MORNINGSTAR MULTI-STRATEGY:** This is a Morningstar alternative strategy category. For a multi-asset strategy to qualify in an alternative category, greater than 30% of a strategy's gross exposure must be allocated to alternative substrategies. Alternative substrategies should provide an 'alternative' exposure to the dominant risk factors found in traditional indices, and as standalone strategies, would generally fall into one of the other Morningstar alternative categories: Equity Market Neutral, Event Driven, Macro Trading, Options Trading, Relative Value Arbitrage, and Systematic Trend.

**MORNINGSTAR SYSTEMATIC TREND:** This is a Morningstar alternative strategy category. Systematic trend funds mainly implement trend-following, price-momentum strategies by trading long and short liquid global futures, options, swaps, and foreign-exchange contracts. Strategies invest across geographies and assets, including equities, fixed income, commodities, currencies, and more.

## IMPORTANT INFORMATION

This material is being provided for informational purposes only. This commentary represents the current market views of the author, and Al- phaCore Capital in general, and there is no guarantee that any forecasts made will come to pass. Due to various risks and uncertainties, actual events, results or performance may differ materially from those reflected or contemplated in any forward-looking statements. The opinions are based on market conditions as of the date of publication and are subject to change. No obligation is undertaken to update any informa- tion, data or material contained herein.

Neither the information nor the opinions expressed herein constitutes an offer or solicitation to buy or sell any specific security, or to make any investment decisions. AlphaCore provides investment advice only within the context of our written advisory agreement with each AlphaCore client. Past performance is not indicative of future results. The value of an investment may be affected by a variety of factors, including eco- nomic and political developments, interest rates and foreign exchange rates, as well as issuer-specific events.

Any specific security or strategy is subject to a unique due diligence process, and not all diligence is executed in the same manner. All invest- ments are subject to a degree of risk, and alternative investments and strategies are subject to a set of unique risks. No level of due diligence mitigates all risk, and does not eliminate market risk, failure, default, or fraud.

The commentary may utilize index returns, and you cannot invest directly into an index without incurring fees and expenses of investment in a security or other instrument. In addition, performance does not account other factors that would impact actual trading, including but not limited to account fees, custody, and advisory or management fees, as applicable. All of these fees and expenses would reduce the rate of return on investment.

# Upcoming Events

**July 11, 2023**
**10a.m. PST**

## WEBINAR: UNCOVERING UNTAPPED YIELD: EXPLORE NEW OPPORTUNITIES

Speakers:
AlphaCore CEO and Founder Dick Pfister, CAIA®
AlphaCore Director of Research Johann Lee, CFA®
Invenomic Managing Partner & Portfolio Manager Ali Motamed, CFA®
Invenomic President & Chief Compliance Officer Ben Deschaine, CAIA®

**Learn More Here**

**Sept. 14, 2023**
**8 a.m. - 8 p.m. PST**

## ALPHACORE WEALTH SUMMIT

Join us to learn about new approaches to wealth planning, asset allocation and alternative investments. Keynote speakers include three global macro economists from Blackstone, iCapital and Charles Schwab.

Where: The Conrad | 7600 Fay Ave. La Jolla, CA 92037

**To save your spot or learn more, please call 858-875-4100 or email us at events@alphacorewealth.com.**