MARKET INSIGHT

Second Quarter 2023

NEWS & VIEWS FROM LPL RESEARCH

The economic forecasts set forth in the presentation may not develop as predicted. Please note: all return figures are as of June 30, 2023 unless otherwise stated. This information is not intended as authoritative guidance or tax or legal advice. You should consult with your attorney or tax advisor for guidance on your specific situation.

LPL Research

Second Quarter 2023

MARKET INSIGHT QUARTERLY

Q2 2023 at a Glance

Sector	Q2 2023
Gross Domestic Product*	1.3%
S&P 500 Index	8.7%
Bloomberg U.S. Aggregate Bond Index	-0.8%
Bloomberg Commodity Index	-2.6%

Source: LPL Research, Bloomberg, FactSet, 6/30/2023

* Bloomberg consensus as of 6/30/2023

Figures for S&P 500 Index, Bloomberg Aggregate Bond Index, and Bloomberg Commodities Index are total returns from 04/03/2023 - 06/30/2023 (Q2)

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment.

Past performance is not indicative of future results.

Equities Cap off Strong First Half with Solid Second Quarter Gains as Inflation Eases

The S&P 500 continued its rebound from the first quarter of this year, returning 8.7% including dividends in the second quarter to bring its first-half gain to 16.9%, its best since 2019. The Dow Jones Industrial Average posted a gain of 4**%**, but the big winner was the Nasdaq Composite, which gained 13.1**%** during the quarter as growth outpaced value on significant gains in mega-cap technology stocks. Nasdaq's more than 32% first-half gain was its best since 1983.

Price pressures have steadily declined with the consumer inflation rate down to 4% on an annual basis as of May 2023, compared with 8.6% a year ago. Given improvement with the inflation landscape, some market participants believe prices will continue to decline and the Federal Reserve (Fed) could still produce a soft-landing.

Corporate resilience surprised Wall Street during first quarter earnings season as corporate America faced several headwinds. Still-high inflation and related cost pressures along with stress in the banking system that caused financial conditions to tighten after the bank failures in March were among analysts' concerns going into first quarter reporting season in April. Actual earnings came in about five percentage points better than expected, helping markets push forward this quarter.

Even with an improving price outlook and better-than-anticipated earnings, the global economic and geopolitical landscapes remain challenging. The Fed and other major global central banks remain hawkish, with 'more work to do' in their fights against inflation, increasing the risks of an eventual recession.

Large Caps Outperformed Small Caps on Big Tech Strength

Large and small cap stocks delivered gains during the second quarter, however, large caps continued their outperformance on the back of strong performance from the consumer discretionary and technology sectors. During the quarter, the large cap dominated Russell 1000 Index returned 8.6**%,** compared to 5.2**%** for the small cap Russell 2000 Index. Year to date, large caps have more than doubled up their small cap counterparts, 16.7% to 8.1%.

Even as small caps valuations appear attractive and provide less exposure to international economic risks, they are more susceptible to domestic economic challenges and financial stress, evidenced by their notable underperformance following the banking turmoil in March.

Growth Added to its Dominating Lead in 2023

Growth-style stocks far outpaced their value counterparts during the second quarter, as the Russell 1000 Growth Index returned 12.8**%,** compared to the 4.1**%** return for the Russell 1000 Value Index. Even as growth outperformed, the gap was smaller than in Q1 as some investors took advantage of attractive valuations and the possibility of an economic soft-landing. As during the first quarter of this year, growth received a boost from its overweights in the information technology and consumer discretionary sectors during the second quarter. Growth-leaning technology topped all sectors for the quarter.

Following concentrated returns in the first quarter when 10 of the largest technology names contributed to 88% of the S&P 500 Index returns, market breadth improved during the second quarter. The S&P 500 Equal Weight Index performed better this quarter than the previous quarter, although it still trailed the standard, market-cap-weighted S&P 500 Index both quarters. Improving market breadth will likely be a key ingredient of the next leg of the young bull market when it arrives.

The first half outperformance by large growth, 29% to 5.1%, was the second largest gap since 1979, the largest coming in the first half of 2020. The top eight stocks in the Russell 1000 Growth Index drove 75% of the first half gain.

International Equities Struggled to Keep Up With the U.S.

The U.S. took back the regional leadership baton from international as the MSCI EAFE Index returned 2.3% during the second quarter, well behind the S&P 500's nearly 9% gain. Emerging markets (EM) fared worse, as the MSCI EM Index was only able to manage a 1% gain, though EM saw significant dispersion. China lost nearly 10%, while Latin America gained 14.3%, powered by a 20.8% surge in Brazil. During the first half, the S&P 500's nearly 17% gain far outpaced that of international (+11.7%) and EM (+4.9%).

Strength in the mega-cap U.S. growth stocks made it difficult for developed international equity markets to keep up, especially with Germany mired in a technical recession. Still, Japan's 6.3% second quarter gain in U.S. dollars was certainly respectable as its economy continues to hold up relatively well amid continued accommodative monetary policy. A budding trend toward more shareholder friendly corporate practices and recent breakouts to multi-decade highs for some of Japan's most widely-followed market indexes are also increasing interest in Japanese equities.

Strong Quarter for Credit as Higher Interest Rates Pressure Core Bonds

Core bonds, as defined by the Bloomberg U.S. Aggregate Index, lost ground during the quarter as central bank hawkishness pushed rates higher. The 0.8% decline for the index in the second quarter brought its first-half gain down to 2.1%.

Global central banks remain steadfast in curbing price pressures, even as inflation declines. The most credit-sensitive sectors of the bond market, including bank loans, corporate high-yield bonds, and preferred securities, outperformed during the second quarter, while the most interest rate sensitive sectors lagged, most notably U.S. Treasuries.

High yield credit outperformed during the quarter despite tightening bank lending standards following the regional bank stress in March. The fundamental backdrop for corporate borrowers is starting to deteriorate as the global economy slows. Given our expectations of a slowing economy, LPL Research doesn't think valuations in general are compelling to invest in the riskier fixed income markets, with the exception of preferred securities where valuations continue to look attractive in the aftermath of the regional bank stresses.

Commodities Struggle as Inflation Improves

The Bloomberg Commodity Index gave back an additional 2.6% this quarter after losing ground during the first quarter, leaving the index down 7.8% during the first half. Signs of cooling inflation in the U.S., slowing global growth, warmer weather reducing seasonal heating demand, and declining crude oil prices were among the reasons commodities sold off during the quarter.

Natural gas rebounded this quarter following the commodity's over 50% decline in the first quarter as traders initiated positions amid oversold conditions. Both precious and industrial metals lost ground this quarter as the dollar recovered and China's reopening sputtered. Gold has managed to gain ground this year as global central banks increasingly diversify away from the U.S. dollar.

The case for commodities as an inflation hedge is less compelling with inflation likely to continue its steady decline in the months ahead. LPL Research prefers precious metals as a hedge against geopolitical risk and as a way to position for a potentially weaker U.S. dollar.

All commodities performance is based on Bloomberg commodity indexes

A LOOK AHEAD

Economy. The LPL Research baseline forecast is that the U.S. economy tips into recession toward the end of 2023 as consumer spending fades. A cooling job market could be the impetus for a modest economic contraction if consumers face declines in disposable income. The Fed is expected to end its rate hiking campaign soon as inflation cools further. While a cooling job market over the next six months may put some downward pressure on inflation, housing inflation will likely also get some help from strong multi-family construction. For more on the LPL Research economic outlook, see the *Midyear Outlook 2023* publication, due out on July 11 and available on the LPL Newsroom.

Stocks. LPL Research sees only modest second half gains for stocks as first half gains have left valuations elevated and stocks overbought from a technical analysis perspective. That said, corporate America's resilience has been impressive, the Fed's rate hiking campaign is nearly over, and the latest economic data has increased the odds of a soft landing for the U.S. economy. Also consider that strong first halves for the stock market tend to be followed by solid second half gains. LPL Research maintains its year-end S&P 500 fair value target of 4,300–4,400, based on a price-to-earnings ratio (P/E) of approximately 19 and a 2024 EPS estimate of $230. If stronger earnings come through, it may justify a higher fair value S&P 500 target range.

Bonds. After one of the most significant rate hiking campaigns from the Fed in history, short term interest rates are at their highest levels in two decades. The risk is these yields won't last, forcing investors to reinvest proceeds at lower rates. So, unless investors have short-term income needs, it may make sense to extend the maturity profile of fixed income holdings to lock in higher yields for longer. Historically, core bonds, as proxied by the Bloomberg Aggregate Bond Index, have performed well after the Fed has paused prior interest rate hiking cycles. LPL Research expects 10-year Treasury yields may end the year between 3.25% and 3.75%, supporting attractive fixed income returns.

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U.S. Treasuries may be considered "safe haven" investments but do carry some degree of risk including interest rate, credit, and market risk. They are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

Please see our Outlook 2023: Finding Balance publication for additional descriptions and disclosures.

SECOND QUARTER DATA

Technology Tops Sector Rankings as Energy and Utilities Lag

S&P 500 sector performance, ranked by second quarter returns*

Sector	Q2 2023
Information Technology	17.2%
Consumer Discretionary	14.6%
Communication Services	13.1%
S&P 500	8.7%
Industrials	6.5%
Financials	5.5%
Materials	3.3%
Healthcare	3.0%
Real Estate	1.8%
Consumer Staples	0.5%
Energy	(0.9)%
Utilities	(2.5)%

Large Cap Growth Continues to Lead Equity Asset Classes

Domestic and international asset class performance, ranked by second quarter returns**

Asset Class	Q2 2023
Large Growth	14.4%
S&P 500	**8.7%**
Russell 3000	8.6%
Small Growth	7.1%
Mid Growth	6.2%
Large Value	4.1%
Mid Value	3.9%
Small Value	3.2%
Large Foreign	3.2%
Emerging Markets	1.0%

Bank Loans Lead Amid Banking Crisis, Credit Concerns

Bond market performance, ranked by second quarter returns**

Sector	Q2 2023
Bank Loans	3.3%
Preferred Stocks	2.0%
High-Yield Corporates	1.8%
High-Yield Munis	1.7%
Foreign Bonds (Unhedged)	0.5%
Foreign Bonds (Hedged)	0.1%
Munis	(0.1)%
Investment-Grade Corporates	(0.3)%
MBS	(0.6)%
Bloomberg U.S. Agg	(0.8)%
U.S. Treasuries	(1.3)%
TIPS	(1.4)%

**Sources: LPL Research, FactSet as of 6/30/2023

All data as of 6/30/2023

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The sectors are represented by the 11 S&P 500 Global Industry Classification Standard (GICS) indexes.

Asset class returns are represented by the returns of indexes and are not ranked on an annual total return basis. It is not possible to invest directly in an index.

Bond Market Asset Class Indexes: Foreign Bonds (hedged) – Citigroup Non-U.S. World Government Bond Index Hedged for Currency; Preferred Securities – Merrill Lynch Preferred Stock Hybrid Securities Index; Treasury – Bloomberg U.S. Treasury Index; Mortgage-Backed Securities – Bloomberg U.S. MBS Index; Investment-Grade Corporate – Bloomberg U.S. Corporate Bond Index; Municipal – Bloomberg Municipal Bond Index; Municipal High-Yield – Bloomberg Municipal High Yield Index; TIPS – Bloomberg Treasury Inflation-Protected Securities Index; Bank Loans – Bloomberg U.S. High Yield Loan Index; High-Yield – Bloomberg U.S. Corporate High Yield Index; Emerging Market Debt – JP Morgan Emerging Markets Global Index; Foreign Bonds (unhedged) – Citigroup Non-U.S. World Government Bond Index (unhedged)

IMPORTANT DISCLOSURES

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

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Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

Yield is the income return on an investment. This refers to the interest or dividends received from a security and are usually expressed annually as a percentage based on the investment's cost its current market value or its face value.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

Small cap is a term used to classify companies with a relatively small market capitalization. The definition of small cap can vary, but it is generally a company with a market capitalization of between $300 million and $2 billion. The prices of small cap stocks are generally more volatile than large cap stocks.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

For a list of descriptions of the indexes referenced in this publication, please visit our website at lplresearch.com/definitions.

The Bloomberg Global Aggregate Index measures the performance of global investment grade debt. The index includes treasury, corporate, and securitized fixed-rate bonds. Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, geopolitical events, and regulatory developments. The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

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