Investment Watch

2nd Quarter, 2023

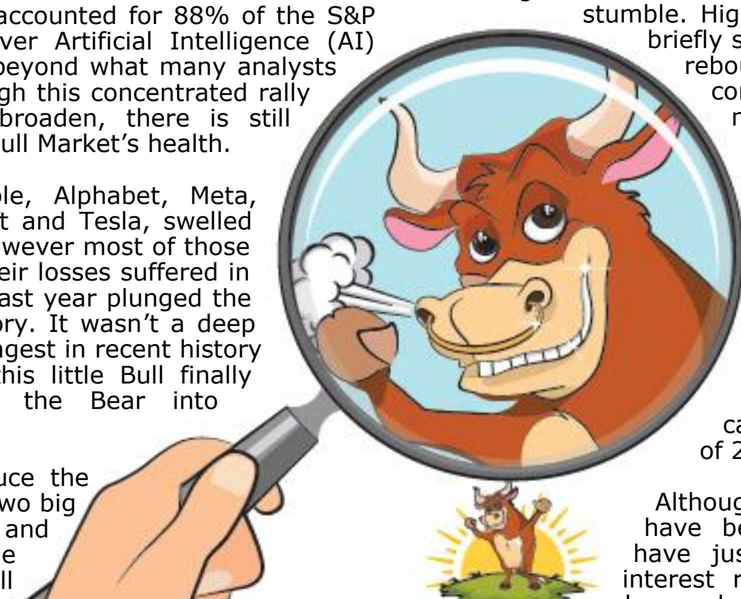
Where's the Bull

The S&P 500 stock index climbed a wall of worry into *Bull Market* territory this quarter. Since its most recent low on 10/12/2022, the S&P 500 index added 20.04% by June 8th. *Bull Markets* occur when the stock market rises 20% from a low, while *Bear Markets* result when the stock market falls 20% from a high.

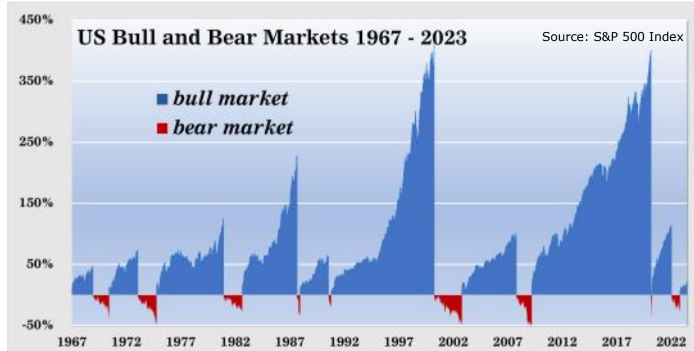
At the start of the year, forecasters almost guaranteed a recession this year, but it refused to arrive. Aided by the drop in energy prices and wage gains due to a tight labor market, consumers opened up their pocketbooks and spent freely. Add to this, Americans had locked in low, long-term mortgage rates and conserved piles of pandemic stimulus cash which aided their spending spree on services and travel as the economy opened up. Now, economists, the Federal Reserve, and investors have all given up on the idea of recession realizing that the resilient US economy has underlying strength. Will the stock market grow with the economy?

The red-hot technology sector delivered almost all of the gains that propelled stocks into this new Bull Market. Seven giant tech stocks accounted for 88% of the S&P gains this year. Hype over Artificial Intelligence (AI) juiced their stock prices beyond what many analysts feel is reasonable. Although this concentrated rally is finally beginning to broaden, there is still concern for this nascent Bull Market's health.

Seven tech giants, Apple, Alphabet, Meta, Nvidia, Amazon, Microsoft and Tesla, swelled by $3 trillion this year, however most of those gains merely recouped their losses suffered in 2022. Those tech losses last year plunged the S&P 500 into Bear territory. It wasn't a deep downturn, but was the longest in recent history lasting 359 days, until this little Bull finally broke through sending the Bear into hibernation.



Will this puny Bull produce the long-lasting gains of the two big Bull Markets, the 1990s and the last decade, or will he fizzle out? This tiny Bull



rose in the face of extreme headwinds. The Federal Reserve, with rapid rate hikes, struggled to slow the economy in order to squelch inflation. The Fed raised rates 10 times within the past 15 months from near zero to 5.0%, leading to expensive borrowing costs. At the same time, rising interest rates caused extreme stress on the entire banking system due to the significant losses in the banks' bond reserves.

Surprisingly, the US economy has absorbed the impacts of resurgent inflation and Fed rate hikes without a stumble. Higher mortgage rates had only briefly stalled the housing market. It rebound in May when new home construction surged to 1.63 million, a 21.7% increase from April and home values are now starting to stabilize. The US job market remains robust with 339,000 jobs added in May and 1.5 million this year with wages accelerating 6% keeping pace with higher inflation. Talk of recession has vanished while the Atlanta Fed forecasts steady solid GDP growth of 2.2% for this quarter.

Although the Fed's rate increases have been painful, in reality they have just restored a more normal interest rate environment. The Fed's abnormal zero-rate policy since The Great Recession, yielded only paltry returns for bond investors. Then recent Fed rate hikes caused severe bond losses, but now bond holders can look forward to much greater interest payments.

The Fed's work is almost done. After their June meeting, they held rates steady at between 5.0% and 5.25%, but penciled in two 0.25% rate hikes yet this year due to stubbornly high inflation. But these are very small hikes that should have little impact. This tiny Bull rose up in spite of the fastest Fed rate hikes in 40 years. With a strong economy pushing him forward, let's hope he grows up into that magnified bull in his mind's eye.

Will Artificial Intelligence transform our world?

OpenAI released an early demo of ChatGPT on November 22, 2022 and woke up the world to the transformative potential of *Generative* AI. ChatGPT went viral. Imagine a language-based AI that understands context, nuance, and even humor. No longer just a futuristic concept, but a neural network akin to the human brain that can generate original content based on vast amounts of data to understand language context, infer intent, and be independently creative.

With 100 million users in its first 3 months, ChatGPT quickly became the fastest-growing consumer application in history. Its explosive popularity has given the public a glimpse into the future of computer systems that can instantaneously analyze vast amounts of data that would take humans years to accomplish. In the fields of healthcare, finance, self-driving vehicles, and transportation, AI will assist humans or make decisions independently. AI is not without controversy. Bad actors will use AI to power scams with manipulated video and voice and imbedded AI in social media platforms will influence users.

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