STOKES CAPITAL ADVISORS, LLC

Market Commentary
June 30, 2023

Quarterly Market Review

Global equities continued to dismiss any concerns of an economic recession in 2023 and have discounted the impact of record monetary policy tightening, declining corporate earnings and persistent inflationary pressures.

The S&P Index recorded an 8.7% gain for the quarter, bringing the year-to-date total return to 16.9%. Impressive gains from a select group of technology stocks helped propel equities higher during the quarter. However, if you remove the top seven holdings in the S&P 500, the return year to date was -1.92%.

In a true reversal of last year's trends in the equity market, the tech heavy NASDAQ as of June 30, 2023, recorded its best first half since 1983 with a 32.3% gain. In addition, the growth versus value trade flipped and the best/worst performing sectors in 2022 (Energy & Technology respectively) have flipped as well. Once again proving that predicting macro trends in the broader equity market remains a very difficult task.

Index Description	2023*	2022
NASDAQ Composite	32.3%	-32.5%
Russell 1000 Growth	29.0%	-29.1%
Russell 1000 Value	5.1%	-7.5%
S&P Energy Select Sector	-5.5%	64.5%
S&P Technology Select Sector	40.4%	-27.6%
Note: As of June 30, 2023		

Turning to the bond market, investors must feel like they are in an industrial washing machine. Coming off the worst bond market on record (-13% in 2022), bond investors are a long way from getting "clean". The Barclays U.S. Aggregate Bond index recorded a -0.84% decline for the quarter. Yet again, a painful reminder for bond investors who have suffered under a repressive Federal Reserve. As of June 30, the 10-year annualized return for bonds was 1.52% compared to the 10-year annualized return equity investors have enjoyed of 12.86%.

Index Description	10 Yr Return	Growth $10,000
Barclays Aggregate Bond Index	1.52%	$11,628
S&P 500 Total Return Index	12.86%	$33,527

The Federal Reserve holding interest rates artificially low for over a decade essentially punished savers while simultaneously enticing households, corporations, and Governments to borrow at artificially low rates. Fast forward 10 years later, we now find the Federal Reserve behind the curve and attempting to contain runaway inflationary by raising rates at an unprecedented pace taking short term interest rates from 0.0% to 5.25% in just 15 months. The "washing machine" is on the spin cycle.

A quick tour of the commodity markets provides some good news on the inflation front. Year-to-date, oil and natural gas are down -12% and -22% respectively, corn is down -15% and eggs are down -78%! (Chicken Little was right). Precious metals, while up for the year, are all down from their highs back in April. Furthermore, the June year-over-year Headline CPI reading came in better than expected at 3.0% versus the 1 year ago reading of 8.9%. While this is welcome news and the trend is in the right direction, if the Federal Reserve is to reach their 2.0% inflation target, the housing or shelter component, which represents 33% of the CPI statistic, displays no signs of slowing and remains entrenched at multiyear highs.

Finally, we know that monetary policy acts with long and variable lags. The Fed will likely need to keep interest rates elevated to win the inflation battle even if this forces the U.S. economy into recession, a potential outcome than is not currently reflected in the equity market.

In summary, when looking across the capital markets from currencies, commodities, bonds and equities, markets mostly agree that the Federal Reserve is close to the end of their tightening cycle with little expectation of rate cuts over the next 12 months. The next hurdle for the markets may very well be corporate earnings, which are expected to report a -6.8% year-over-year decline, marking three consecutive quarterly declines in earnings.

Investment Strategy & Outlook

As of June 30, the S&P 500 is just 7% from its all-time high put in on January 3rd, 2022 and has rallied more than 27% from the October 2022 low. Since October, the Federal Reserve as raised short term interest rates another 2.75%,

several regional banks suffered catastrophic losses in their bond portfolios which triggered a run on their deposits, corporate earnings are declining, and the U.S. Treasury yield curve has further inverted by the deepest margin since 1981, but the equity market has rallied almost 30%! A popular Wall Street creed could be inserted here, “Markets can stay irrational longer than you can stay solvent”. Indeed, betting against the “house” has proven to be a very risky business, just ask any of the hedge fund managers that have either retired or closed their funds.

There is another time-tested and well-established truth in finance and investment lore. We know that interest rates are the most critical input to all matters in finance, whether you are valuing a business, real estate, currencies, commodities, equities, or bonds, the “price of money” is arguably the most important variable in the equation. So how can the price of money stay at 0% for nearly a decade and then increase to 5.25% in less the 15 months, and the valuation equation not “break”? Well, the global bond market bubble was the first to break erasing $trillions of negative yielding sovereign debt last year alone and leaving investors with a -13% decline in their bond portfolios, the worst performance on record. Next, U.S. Banks now have an estimated $1.7 trillion of unrealized losses on the bonds they carry on their balance sheets creating liquidity and solvency issues for several large regional banks which prompted a run on their deposits and eventual failure.

The commercial real estate market could be the next victim. There is an estimated $3.0 trillion of commercial real estate loans outstanding of which almost half must be refinanced over the next two years. Higher loan rates, declining lease payments due to higher vacancy rates could create a perfect storm at the absolute worst time for the Banks that hold these loans. As Warren Buffett says, “When the tide goes out, we get to see who is swimming naked”. These collective events could create a wave of market volatility, tighten liquidity conditions, as well as force additional bank mergers.

And finally, we have the equity market, similar to the late 1990s, investors seem to be blinded by the latest technological creation, Artificial Intelligence or AI. (Not used to write this commentary) While big tech will learn how to convert a new revolutionary technology into profits and cash flow just as they have done with the internet, cell phones, and the cloud, the value of this new technology is unknown. The recent meteoric rise in several AI related stocks looks unsustainable and should be avoided in our opinion.

In summary, if the era of easy money is indeed over, this will have profound investment implications for all investors as we travel down a new path littered with excessive debt, stagnating growth, fiscal uncertainty/insanity, and higher levels of inflation. Higher interest rates, higher labor costs, and unsustainable debt levels are likely to dampen equity returns in our opinion. Dividends will account for a larger portion of total return, like the stagflation decade of the 1970’s where dividends accounted for 73% of equity total returns. Furthermore, dividend growers will likely outperform non-dividend payers as they have since 1973.

Average Annual Returns by Divided Policy 1973 - 2022

	Dividend Growers	**Dividend Non-Payers**	**Equal-Weighted S&P 500 Index**
Annualized Return	10.24%	-0.60%	7.68%

In terms of asset allocation, bonds could be a more productive part of a balanced portfolio this decade providing higher current income and total return potential as the Federal Reserve may have to cut interest rates to offset slowing growth and more frequent recessions in the years ahead. As always, investors are advised to avoid chasing returns and/or deviating from their long-term asset allocation policy which should be evaluated annually.

Stocks, Bonds and Cash by Decade

	1950s	**1960s**	**1970s**	**1980s**	**1990s**	**2000s**	**2010s**
Stocks^	19.6%	7.7%	5.9%	17.4%	18.1%	-0.9%	13.4%
Bonds*	1.5%	2.8%	6.2%	13.0%	8.4%	7.3%	5.6%
Cash#	2.0%	4.0%	6.3%	8.8%	4.9%	2.7%	0.6%

^ S&P 500 Index Total Return, * U.S. Govt/Credit Bond, # UST 30 Day T-Bills

Capital Markets Scorecard

Benchmark Description	**Q2**	**YTD**	**1 Year**
U.S. Treasury 3 Month T-Bill	1.22%	2.35%	3.74%
Barclays Aggregate Bond Index	-0.84%	2.09%	-0.94%
Bloomberg US High Yield Bond	1.76%	5.38%	9.06%
S&P 500 Index Total Return	8.74%	16.89%	19.59%
NASDAQ Composite Total Return	13.05%	32.32%	26.14%
NASDAQ Dividend Achievers TR	5.97%	8.02%	15.55%
Russell 2000 Index Total Return	5.21%	8.09%	12.31%
Alerian MLP Index Total Return	5.38%	9.70%	30.51%
MSCI Emerging Markets Index	1.85%	5.76%	3.76%
China SCI 300 Index LC	-4.02%	0.46%	-12.2%
U.K. FTSE 100 Index LC	-0.46%	2.61%	9.15%
Japan Nikkei 225 Index LC	14.45%	22.69%	28.6%

Performance data as of 06/30/2023. Stokes Capital Advisors, LLC is a Registered Investment Adviser. This market commentary is solely for informational purposes. Advisory services are only offered to clients or prospective clients where Stokes Capital Advisors, LLC and its representatives are properly licensed or exempt from licensure. Past performance is no guarantee of future returns. Investing involves risk and possible loss of principal capital. No advice may be rendered by Stokes Capital Advisors, LLC unless a client service agreement is in place.