



Quarterly Insights – July 2023

A Pause in Rate Hikes, Falling Inflation, and a Resilient Economy Power Stocks Higher in the Second Quarter

The S&P 500 ended the second quarter and first half of 2023 at a 14-month high and most major stock indices logged solid gains in the second quarter following a pause in the Fed's rate hike campaign, stronger-than-expected corporate earnings (especially in the tech sector) and the relatively drama-free resolution of the debt ceiling.

The second quarter began with markets still in the throes of the regional bank crisis following the March failures, and investors started the month of April wary of contagion risks. Those concerns proved mostly overdone, however, as throughout most of the month regional banks were stable. That stability allowed investors to re-focus on corporate earnings, and the results were much better than feared as 78% of S&P 500 companies reported better-than-expected Q1 earnings, a number solidly above the 66% long-term average. Additionally, 75% of reporting companies beat revenue estimates for the first quarter, also well above the long-term average. That solid corporate performance was a welcome sight for investors and coupled with general macroeconomic calm, allowed stocks to drift steadily higher throughout most of April. However, following an underwhelming earnings report, concerns about the solvency of a regional bank weighed on markets late in the month and the S&P 500 declined into the end of April to finish with a modest gain.

The Fed hiked rates at the May 2nd FOMC meeting, but importantly altered language in the statement to imply it would pause rate hikes at the next meeting. That change was expected by investors, however, and as such it failed to ignite a meaningful rally in stocks. Instead, the tech sector helped push the S&P 500 higher in mid-May, thanks to an explosion of investor and financial media enthusiasm around Artificial Intelligence (AI). However, like in April, the end of the month saw an increase in volatility. This time it was thanks to the lack of progress on a U.S. debt ceiling extension and rising fears of a debt ceiling breach and possible U.S. debt default. However, a two-year debt ceiling extension was agreed to by Speaker McCarthy and President Biden on May 28th and was signed into law a few days later, avoiding a financial calamity. The S&P 500 finished May with a slight gain.

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With the debt ceiling resolved, a Fed pause in rate hikes expected and continued stability in regional banks, the rally in stocks resumed in early June and was aided by several potentially positive developments. First, inflation declined as the Consumer Price Index (CPI) hit the lowest level in two years. Second, economic data remained impressively resilient, reducing fears of a near-term recession. Finally, in mid-June, the Federal Reserve confirmed market expectations by pausing rate hikes and that helped fuel a broad rally in stocks that saw the S&P 500 move through 4,400 and hit the highest levels since April 2022. The last two weeks of the month saw some consolidation of that rally thanks to mixed economic data, political turmoil in Russia and hawkish rhetoric from global central bankers, but the S&P 500 still finished June with strong gains.

In sum, markets were impressively resilient in the second quarter and throughout the first half of 2023, as better-than-feared earnings, expectations for less-aggressive central bank rate hikes, more evidence of a “soft” economic landing and relative stability in the regional banks pushed the S&P 500 to a 14-month high.

Second Quarter Performance Review

The second quarter of 2023 saw an acceleration of the tech sector outperformance witnessed in the first quarter, as “AI” enthusiasm drove several mega-cap tech stocks sharply higher. Those strong gains resulted in large rallies in the tech-focused Nasdaq and, to a lesser extent, the S&P 500 as the tech sector is the largest weighted sector in that index. Also like in the first quarter, the less-tech-focused Russell 2000 and Dow Industrials logged more modest, but still solidly positive, quarterly returns.

By market capitalization, large caps outperformed small caps, as they did in the first quarter of 2023. Regional bank concerns and higher interest rates still weighed on small caps as smaller companies are historically more dependent on financing to maintain operations and fuel growth.

From an investment style standpoint, growth handily outperformed value again in the second quarter, continuing the sharp reversal from 2022. Tech-heavy growth funds benefited from the aforementioned “AI” enthusiasm. Value funds, which have larger weightings towards financials and industrials, relatively underperformed growth funds, as the performance of non-tech sectors more reflected the broad economic reality of mostly stable, but unspectacular, economic growth.

On a sector level, eight of the 11 S&P 500 sectors finished the second quarter with positive returns. As was the case in the first quarter, the Consumer Discretionary, Technology, and Communication Services sectors were the best performers for the quarter. The surge in many mega-cap tech stocks drove the gains in those three sectors, and they handily outperformed the remaining eight S&P 500 sectors. Industrials, Financials, and Materials saw moderate gains over the past three months, thanks to rising optimism regarding a “soft” economic landing.

Turning to the laggards, traditional defensive sectors such as Consumer Staples and Utilities declined slightly over the past three months, as resilient economic data caused investors to rotate to sectors that would benefit from stronger than expected economic growth. Energy also posted a slightly negative return for the second quarter, thanks to weakness in oil prices.

US Equity Indexes	Q2 Return	YTD
S&P 500	10.32%	16.89%
DJ Industrial Average	5.28%	4.94%
NASDAQ 100	17.33%	39.35%
S&P MidCap 400	6.70%	8.84%
Russell 2000	7.24%	8.09%

Source: YCharts

Internationally, foreign markets lagged the S&P 500 thanks mostly to the relative lack of large-cap “AI” exposed stocks in major foreign indices, combined with some late-quarter worries about the EU economy and pace of Bank of England rate hikes, although foreign markets did finish the second quarter with a modestly positive return. Foreign developed markets outperformed emerging markets thanks to a lack of significant economic stimulus in China, which weighed on emerging markets late in the quarter.

International Equity Indexes	Q2 Return	YTD
MSCI EAFE TR USD (Foreign Developed)	3.63%	12.13%
MSCI EM TR USD (Emerging Markets)	1.50%	5.10%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	3.13%	9.86%

Source: YCharts

Commodities saw modest losses in the second quarter as most major commodities declined over the past three months. Oil prices witnessed a moderate drop despite a surprise production cut from Saudi Arabia and an increase in geopolitical tensions in Russia, as concerns about future economic growth and oversupply weighed on oil. Gold, meanwhile, posted a modestly negative return as inflation declined while the dollar failed to meaningfully drop.

Commodity Indexes	Q2 Return	YTD
S&P GSCI (Broad-Based Commodities)	-1.45%	-7.54%
S&P GSCI Crude Oil	-5.21%	-12.40%
Gold Price	-3.08%	5.23%

Source: YCharts/Koyfin.com

Switching to fixed income markets, the leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) realized a slightly negative return for the second quarter of 2023, as the resilient economy and hope of a near-term end to Fed rate hikes led investors to embrace riskier assets.

Looking deeper into the fixed income markets, shorter-duration bonds outperformed those with longer durations in the second quarter, as bond investors priced in a near-term end to the Fed’s rate hike campaign, while optimism regarding economic growth caused investors to rotate out of the safety of longer-dated fixed income.

Turning to the corporate bond market, lower-quality, but higher-yielding “junk” bonds rose modestly in the second quarter while higher-rated, investment-grade debt logged only a slight gain. That performance gap reflected investor optimism on the economy, which led to taking more risk in exchange for a higher return.

US Bond Indexes	Q2 Return	YTD
BBgBarc US Agg Bond	-0.38%	2.09%
BBgBarc US T-Bill 1-3 Mon	1.23%	2.33%
ICE US T-Bond 7-10 Year	-1.32%	1.62%
BBgBarc US MBS (Mortgage-backed)	-0.41%	1.87%
BBgBarc Municipal	0.04%	2.67%
BBgBarc US Corporate Invest Grade	0.40%	3.21%
BBgBarc US Corporate High Yield	2.60%	5.38%

Source: YCharts

Third Quarter Market Outlook

As we begin the third quarter of 2023, the outlook for stocks and bonds is arguably the most positive it’s been since late 2021, as inflation hit a two-year low, economic growth and the labor market remain impressively resilient, the Fed has temporarily paused its historic rate hiking campaign, the debt ceiling extension is resolved, and we’ve seen no significant contagion from the regional bank failures from earlier this year.

That improvement in the fundamental outlook has been reflected in both stock and bond prices so far this year, as the S&P 500 hit the best levels since last April and more cyclically focused sectors led markets higher late in the quarter on rising hopes for a broad economic expansion.

However, while clearly the past quarter brought positive developments in the economy and the markets, leading the financial media to proclaim a “new bull market” has started, it’s important to remember that potentially significant risks remain to the economy and markets. Put more bluntly, the market has taken a decidedly positive view on the ultimate resolution of multiple macroeconomic unknowns, but their outcomes remain very uncertain and thanks to the strong year to date rally in stocks, there is now little room for disappointment.

First, the economy has not yet felt the full impact of the Fed’s historically aggressive hike campaign, and while the economy has proved surprisingly resilient so far, we know from history that the impacts of rate hikes can take far longer than most expect to impact economic growth. Put in plain language, it’s

premature to think the economy is “in the clear” from recession risks, and we should all expect the economy to slow more as we move into the second half of 2023. The key for markets will be the intensity of that slowing, as at these valuation levels stocks are not pricing in a significant economic slowdown.

On inflation, clearly there’s been progress in bringing inflation down, as year-over-year CPI has fallen from over 9% in 2022 to 4% in less than a year’s time. However, even at 4%, CPI remains far above the Fed’s 2% target. If inflation bounces back, or fails to continue to decline, then the Fed could easily hike rates further, like the Bank of Canada and Reserve Bank of Australia did in the second quarter, following pauses of their own. Those higher rates would weigh further on economic growth.

Turning to banks, markets have taken the regional bank failures in stride caused minimal volatility in the second quarter. However, it’s likely premature to consider the crisis “over” and at a minimum, reduced lending by regional banks poses an additional threat to the commercial real estate market and small businesses more broadly. Bottom line, measures taken by the Fed in March have “ringfenced” the regional bank stress for now, but this remains a risk to the economy.

Finally, markets are trading at their highest valuation in over a year, and investor sentiment has turned suddenly, and intensely, optimistic. The CNN Fear/Greed Index ended the second quarter at “Extreme Greed” levels, while the American Association for Individual Investors (AAII) Bullish/Bearish Sentiment Index hit the most bullish level since November 2021, right before the market collapse started in early 2022. Positive sentiment does not automatically mean markets will decline, but the sudden burst of enthusiasm needs to be considered in the context of what is a still uncertain macroeconomic environment and markets no longer have the protection of low expectations and valuations to cushion declines.

In sum, clearly there have been positive macro developments so far in 2023 that have helped the stock market rebound. However, it’s important to remember that multiple and varied risks remain for the economy and markets.

As such, while we are happy with the market’s performance, we remain vigilant towards economic and market risks and are focused on managing both risk and return potential. We understand that a well-planned, long-term-focused, and diversified investment plan can withstand virtually any market surprise and related bout of volatility, including bank failures, multi-decade highs in inflation, high interest rates, geopolitical tensions, and rising recession risks.

At Ossewaarde Anderson Sanborn & Peterson Wealth Management Group of Wells Fargo Advisors, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. Successful investing is a marathon, not a sprint, and even intense volatility is unlikely to alter a diversified approach set up to meet your long-term investment goals.

Therefore, it’s critical for you to stay invested, remain patient, and stick to the plan, as we’ve worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.

We remain focused on both opportunities and risks in the markets, and we thank you for your ongoing confidence and trust. Please rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,



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The indices presented in this newsletter are to provide you with an understanding of their historical performance and are not presented to illustrate the performance of any security.

Investors cannot directly purchase any index. Stocks are subject to market risk which means their value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. Investments in equity securities are generally more volatile than other types of securities. Dividends are not guaranteed and are subject to change or elimination.

The prices of small and mid-cap company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

Investments that are concentrated in a specific sector or industry may be subject to a higher degree of market risk than investments that are more diversified.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. Investing in emerging markets accentuates these risks.

Investing in commodities is not appropriate for all investors. Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. The prices of various commodities may fluctuate based on numerous factors including changes in supply and demand relationships, weather and acts of nature, agricultural conditions, international trade conditions, fiscal monetary and exchange control programs, domestic and foreign political and economic events and policies, and changes in interest rates or sectors affecting a particular industry or commodity. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks, including futures roll yield risk.

Buying gold, silver, platinum or palladium allows for a source of diversification for those sophisticated persons who wish to add precious metals to their portfolios and who are prepared to assume the risks inherent in the bullion market. Any bullion or coin purchase represents a transaction in a non-income-producing commodity and is highly speculative. Therefore, precious metals should not represent a significant portion of an individual's portfolio.

Investments in fixed-income securities are subject to market, interest rate, credit and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in

interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and/or principal. This risk is heightened in lower rated bonds. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity.

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

The Dow Jones Industrial Average is a price-weighted index of 30 "blue-chip" industrial U.S. stocks.

The NASDAQ 100 Index is an unmanaged group of the 100 biggest companies listed on the NASDAQ Composite Index. The list is updated quarterly and companies on this Index are typically representative of technology-related industries, such as computer hardware and software products, telecommunications, biotechnology, and retail/wholesale trade.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000® Index.

The S&P Midcap 400 Index is a capitalization-weighted index measuring the performance of the mid-range sector of the U.S. stock market, and represents approximately 7% of the total market value of the U.S. equities. Companies in the Index fall between the S&P 500 Index and the S&P Small Cap 600 Index in size: between \$1-4 billion.

The MSCI All Country World ex USA Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets, excluding the USA. The Index consists of 45 country indices comprising 22 developed and 23 emerging market country indices. The developed market country indices included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. The emerging market country indices included are: Argentina, Brazil, Chile, China, Columbia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI. The MSCI EAFE Index is designed to represent the performance of large- and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada.

The MSCI Emerging Markets Index is designed to represent the performance of large-and mid-cap securities in 24 Emerging Markets.

Bloomberg U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

The Bloomberg U.S. 1-3 Year Government Bond Index is composed of all publicly issued, non-convertible domestic debt of the U.S. government and its agencies. The Index also includes corporate debt guaranteed by the U.S. government. Only notes and bonds with a minimum maturity of one year up to a maximum maturity of 2.9 years are included.

The ICE U.S. Treasury 7-10 Year Bond Index is part of a series of indices intended to assess the U.S. Treasury market. The Index is market value weighted and is designed to measure the performance of U.S. dollar-denominated, fixed rate securities with minimum term to maturity greater than seven years and less than or equal to ten years.

The Bloomberg Mortgage Backed Securities Index is an unmanaged index of mortgage pools of the Government National Mortgage Association, Federal Home Loan Mortgage Corporation and Federal National Mortgage Association.

The Bloomberg Corporate High Yield Municipal Bond Index covers the universe of fixed rate, non-investment grade debt.

The Bloomberg Municipal Bond Index is an unmanaged index of a broad range of investment-grade municipal bonds that measures the performance of the general municipal bond market.

The Bloomberg Corporate Bond Index is an unmanaged market value-weighted index of investment-grade corporate fixed-rate debt issues with maturities of one year or more.

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