

Quarterly

2023 Second Quarter Investment Market Report

A STRONG FIRST HALF FOR STOCKS... OR WAS IT?

Closing out a quarter where the financial headlines kept using the word “crisis,” whether it be regarding banks or the debt ceiling battle, those issues are in the rear-view mirror for now, and the stock market seems unworried about the prospects of a long-predicted recession. The S&P 500 climbed 8.7% for the quarter and 16.9% so far in 2023 to finish the first half of the year very strongly, at least on the surface.

| INDEX | Q2 2023 | TYD 2023 |
|------------------------------|---------|----------|
| S&P 500 | 8.7% | 16.9% |
| Dow Jones Industrial Average | 4.0% | 4.9% |
| Nasdaq Composite | 13.1% | 32.3% |

Source: Schwab Center for Financial Research

International Markets posted a solid quarter, providing some valuable diversification, although notably absent was the key driver of headline returns in the U.S., which we will be discussing in-depth. We still have strong conviction in the long-term opportunities in these markets as they continue to trade at significant discounts to the U.S. markets from a valuation perspective, even though they have posted very solid returns year-to-date.

| INDEX | Q2 2023 | TYD 2023 |
|-------------------------------|---------|----------|
| MSCI EAFE (Developed Markets) | 3.2% | 12.1% |
| MSCI Emerging Markets | 1.0% | 5.1% |

Source: Morningstar Direct; See disclosures for important benchmark information

S&P 500: MARKET PROXY OR MEGA-TECH INDEX?

So far, 2023 is looking like the year of Artificial Intelligence (AI). Moving well beyond Siri and Alexa, Chat bots and everything AI have gone beyond “viral,” propelling stock prices upward for those companies that have staked a claim in this new frontier.

All the companies below (with year-to-date returns) have made headlines regarding the value of artificial intelligence to their businesses in the future...

| | |
|--------------------|---------------------|
| • Apple: | +50% so far in 2023 |
| • Microsoft: | +43% |
| • Amazon: | +55% |
| • Nvidia: | +189% |
| • Alphabet: | +36% |
| • Tesla | +113% |
| • META (Facebook): | +138% |

These 7 companies have an eye-popping average return of 89% so far in 2023! They also happen to be the top 7 companies in the S&P 500, accounting for almost 28% of the entire index!

In late May, if you removed these 7 companies from the return of the S&P 500, the rest of the index had generated no return this year at all. Over the past month, we did see some participation from the other 493 companies in the index, although these 7 mega-tech stocks accounted for about 12.3% out of the 16.9% return for the S&P 500 in the first half of the year, meaning that without them, the index was up approximately 4.6% for the first half of the year. An version of the S&P 500 where all companies are weighted equally returned 7.0% in the first half – nearly a full 10% below the benchmark market cap-weighted version.

As you may know, all of these mega-tech stocks suffered significant declines last year. Some have moved to new record highs and some have yet to catch up to where they were before the 2022 selloff, but our attention is focused on the degree to which this small group of stocks has driven most of the “market’s” return this year, and as a result, the S&P 500 has become even more heavily concentrated in “Big Tech.” As mentioned earlier, the market capitalizations of these seven companies have

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grown so large that they now represent almost 28% of the entire S&P 500, up from 20% at the beginning of the year. Apple alone represents almost 8% of the index, and it closed out the quarter by passing the \$3 trillion dollar mark for market capitalization.

Generally, stock market rallies that show broad participation among companies across the stock market are considered to be much healthier and sustainable than when very large moves by a small handful of stocks drags the entire index higher. Over the past month, it has certainly been refreshing to see the rest of the “market” begin to participate in this year’s rally, but clearly the concern from a risk standpoint is that if these top stocks reverse course, they will again have a disproportionate impact on client portfolios. In addition, if we look at the likely causes of any such reversal, certainly a cooling of the current excitement about all things AI could do it. If this should happen at the same time the economy does actually slow down, which could then hurt much of the rest of the stock market, then that concentration risk would exacerbate the pain of a down market for US Large Caps and the S&P 500.

Fortunately, this narrow rally has benefited many clients so far this year, but with many potential storm clouds on the horizon including persistent inflation uncertainty, increasingly strong warning signs of recession risk, and geopolitical headline risk, we want to make sure clients are increasingly diversified to keep them on track to meet their financial objectives while minimizing the wild swings of boom/bust cycles that can hinder that progress. We do not try to time or predict these events, we help clients build portfolios that endure them while staying on track to achieve their goals.

With the risk that stocks and bonds can be more correlated in inflationary environments, we will continue to show you where risks are becoming more concentrated, and we will continue to show you new ideas on how we can further diversify portfolio risk.

THE FED AND INFLATION

From a market perspective, all is much calmer on the monetary policy front than it was a year ago. Last year the markets were being rocked by quarterly rate hikes of 0.75%, which eased to 0.50%, then 0.25%, and now the Fed just let the first opportunity pass without a rate increase in over a year. Fed Chairman Powell has left the door open for another couple of small hikes this year, and there is still the risk that inflation remains “stickier” than the markets expect, but the pace of action has decidedly slowed, and we appear to be getting closer to the peak interest rates that will mark the end of the rate hike campaign.

As for the bond markets, the reduction in Fed activity led to fewer headlines about inflation, and some of the panic buying of bonds during the March banking “scare” was unwound, leaving bond indices slightly negative for the quarter, but still positive for the year.

| INDEX | Q2 2023 | TYD 2023 |
|---------------------------------------|---------|----------|
| Bloomberg Global Aggregate Bond Index | -1.5% | 1.4% |
| Bloomberg US Aggregate Bond Index | -0.8% | 2.1% |

Source: Morningstar Direct; See disclosures for important benchmark information

OUTLOOK

As mentioned above, there are still numerous headline-worthy risks that are likely to continue to cause market volatility. Questions regarding the direction of the economy, inflation, and geopolitical conflict seem likely to persist well into 2024. In addition, we are likely to hear much more about the commercial real estate market in the second half of the year as there is an increase coming in the amount of debt payments owed for office buildings that are still struggling with low post-pandemic occupancy rates.

Therefore, it seems appropriate to close with our concluding paragraph from our last quarterly investment commentary:

“...we continue to focus with clients on improving portfolio diversification for the purpose of smoothing out potential ‘bumps in the road’ ahead. Seeking improved diversification and recognizing that market leadership may change in the next bull market, we have been discussing the risks posed by the concentration of technology exposure in the U.S. large cap market and how owning the market’s favorite individual technology stocks can amplify those risks. Continued volatility seems very likely, but good defense through diversification can make a big difference over the long-term for investors.”

Financial Planning News:

As more and more financial planning clients approach retirement, an increasingly frequent challenge faced by many clients is that of concentrated stock positions.

WHAT IS A CONCENTRATED STOCK POSITION? It is when a single stock represents a large portion of one's investment portfolio. They often exist in the holdings of company founders, executives or long-time employees who were compensated with stock by their publicly-traded employer. Other times they are the result of a long-time investment in a fabulously successful company. The challenge is that these positions often have such a low cost basis compared to their current value, that much of the value of holding is due to capital gains, which means there will be substantial taxes due if the stock is sold.

However, at some point many investors become more concerned with preserving the wealth they have created than they are in continuing to capture any remaining upside in the stock....and rightly so...

Over the past 35 years, 39% of the stocks in the Russell 3000® went down by at least 50% and never recovered.

Last year was a harsh reminder of this possibility for many investors as several high-flying tech stocks saw stock declines in the neighborhood of 50-75%. Fortunately, most have seen some degree of recovery, but the statistic above highlights an all too frequent adverse outcome in these situations.

*Over the past 35 years, 39% of the stocks in the Russell 3000® went down by at least 50% and never recovered**

*Never recovered is defined as the stock remaining below the 50% impairment level in price.

Source: Aperio, MSCI. Data from January 1987 through February 2022.

This is a complex question with no single right answer. It is often an emotional issue for clients who owe their wealth to the company in question. Part of our role at Montis is to help and advise on such major financial planning decisions. There are traditional approaches to managing these concentrated positions and the related tax issues, and there are also newer, innovative approaches as well. It is a complex problem, and the best solution for a given client will depend on several client-specific factors, but we have a range of solutions at our disposal, and a thoughtful analysis will help identify the most appropriate for each client situation.

MONTIS COMPANY NEWS:



MEET CLAUDINE SCHROCK

We are thrilled to announce that Claudine Schrock has joined Montis Financial as a Senior Financial Advisor! Prior to joining Montis, she served as Wealth Advisor at Adviser Investments. In her role, Claudine provides comprehensive and holistic financial planning solutions for her clients, including evaluating tax efficiency, reviewing estate and insurance plans, providing investment and portfolio management expertise to clients, with a high degree of focus on financial education to families' next generation. To learn more, please see Claudine's full bio on our website. Welcome to the Montis Family, Claudine!

TEAM EXPERTISE: UPDATE

Montis Financial is proud of the depth and breadth of our advisors' collective education, certifications, and experience. We concentrate on providing you with ongoing communication about the financial markets due to their constant fluxuation, requiring regular review and nimble thinking. In addition, there are ongoing changes and updates in financial planning that are just as valuable and our team is versed in all of the latest information available.

This year, Brian Burke, Senior Financial Advisor, added to his impressive skillset by earning the Certified Private Wealth Advisor® certification. Brian successfully completed coursework covering 11 main topics in advanced wealth planning, including charitable giving and estate planning strategies, tax planning, investment management, and unique planning solutions for corporate executives and closely-held business owners.

Important Disclosure Information

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Historical performance results for investment indices, benchmarks, and/or categories have been provided for general informational and comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your Montis account holdings correspond directly to any comparative indices or categories. Please Also Note: (i) performance results do not reflect the impact of taxes, (ii) comparative benchmarks and indices may be more or less volatile than your Montis accounts, and (iii) a description of each comparative benchmark and index is available upon request.

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