2023 Second Quarter Investment Report

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Fears of an imminent recession are getting kind of old at this writing; any investors who retreated some or all their portfolios to the sidelines in anticipation that the economy was about to tank are now ruing their luck, as the markets delivered another quarter of solid returns. It's another version of the lesson: listen to the pundits predicting disaster at your (financial) peril.

The market gains in the second three months of the year were stronger for larger stocks, but all sectors participated in the sunny investment climate. The Wilshire 5000 Total Market Index—the broadest measure of U.S. stocks—picked up 6.67% gains in the second quarter and is now up 16.30% in the first six months of 2023. The comparable Russell 3000 index is up 16.17% so far this year.

Looking at large cap stocks, the Wilshire U.S. 2500 Large Cap index gained 6.67% in the most recent quarter and is up 16.53% through the first half of the year. The Russell 1000 large-cap index has gained 16.58% so far this year, while the widely quoted S&P 500 index of large company stocks jumped 8.30% in the second quarter and has now gained 15.91% during the year's first half.

Meanwhile, the Russell Midcap Index is up 9.01% through the second quarter. The Wilshire Midcap index gained 4.55% in the recent quarter, to stand at a positive 8.30% so far this year.

As measured by the Wilshire U.S. Small-Cap index, investors in smaller companies received a 5.58% gain for the most recent quarter and are now sitting on 9.83% gains. The comparable Russell 2000 Small-Cap Index posted an 8.09% return over the past six months. The technology-heavy Nasdaq Composite Index, the biggest loser in 2022, is on a tear this year, posting a 31.73% return in this year's first six months.

Foreign markets are delivering positive returns as well. The broad-based EAFE index of companies in developed foreign economies gained 9.66% in the first half of 2023. In aggregate, European stocks are up 8.95% this year, while EAFE's Far East Index delivered a positive 2.58% performance. Emerging market stocks of less developed countries, as represented by the EAFE EM index, gained 3.46% in dollar terms over the last six months.

Despite rising concerns about the impact of remote work and e-commerce on commercial properties, real estate securities produced decent returns. The Wilshire U.S. REIT index posted a 6.66% gain in the first quarter of 2023. However, other alternative parts of a diversified portfolio were not so fortunate. The S&P GSCI index, which measures commodities returns, lost 11.41% of its value in the most recent six months. Utility stocks are posting a rare 7.16% loss so far this year.

Bond rates rose dramatically last year, but that trend seems to have moderated. 30-year U.S. government bond yields barely moved from where they were three months ago, with current yields at 3.86%. 10-year government bonds are yielding 3.84%, and from there we enter the inverted yield curve: 5-year government securities are yielding a higher 4.16%, 2-year Treasuries are yielding 4.90%, one-year government bonds are yielding 5.39% and 6-month securities are now yielding 5.41%. To say this is not normal is an understatement. Whenever shorter-term bonds are paying bond investors more than their longer-term counterparts, it means that bond investors (and, maybe, most professional investors) are feeling cautious about the future of the market.

Municipal bonds are a somewhat less dramatic story at the moment, but there is still inversion going on; 30-year munis, on average, are yielding 3.57%, and 10-year maturities are yielding 2.55%. But the inversion can be seen in 5-year (2.61%), 2-year (2.92%), and 1-year (3.01%) aggregate yields.

Of course, we're all wondering: will the second half of the year be as rewarding as the first half was? Our economic future has seldom been as cloudy as it is today, which is to say that the indicators are all over the place. In America's manufacturing sector, the ISM Purchasing Managers Index, a closely watched indicator of the health of manufacturing firms overall, suggests that manufacturing has been in a recession for the past seven months. Global indicators are saying essentially the same thing about manufacturing competitors overseas. New export orders for goods have been falling globally at the fastest pace since the end of 2022.

Adding to the downbeat news, the Conference Board's Leading Economic Index has been declining for 13 consecutive months, and the most often-cited recession indicator, the dramatic yield curve inversion in the bond market, is flashing its signals louder than ever. The corporate sector has not been unaffected by all this: financial and non-financial U.S. corporations have reported lower profits for the past two quarters.

But those indicators might actually make up less than half the story. The unemployment rate in the U.S. remains under 4% (bouncing between 3.4% and 3.7%) and the labor participation rate among workers aged 25 to 54 stands at a very strong 83.4%—the highest level since 2007. Consumer spending has remained brisk, with durable goods orders up 1.7% last month over the previous month. U.S. households are still flush with cash that was saved during the pandemic; the Federal Reserve Bank of San Francisco has estimated that households still have sufficient savings to support current spending levels at least through the fourth quarter of 2023. Indeed, the most recent consumer confidence index, measured by the Conference Board, rose to 109.7, the highest since early 2022.

And, not incidentally, the inflation rate keeps falling. Last year, alarm bells were sounding because June's annualized rate hit 9.1%. Today's rate is an annualized 4.0%.

There's no reason to imagine that any of us can predict the future with any accuracy, except to point out that markets have, historically, trended upward and rewarded patient investors. It's possible that a future recession will test our collective patience once again, but it's a test that will be easier to pass due to the gains that this year has provided us already.

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