THE BOSTON FAMILY OFFICE
INVESTMENT SERVICES

Market Update

Second Quarter 2023

Equity Markets (Total Return)	2Q'23	1-Year
Dow Jones Industrials	4.0%	14.2%
S&P 500	8.7%	19.6%
S&P Mid-Cap	4.9%	17.6%
S&P Small-Cap	3.4%	9.8%
MSCI All-Country World	6.3%	17.1%
MSCI Foreign Developed Markets	3.2%	19.4%
MSCI Foreign Emerging Markets	1.0%	2.2%
US Bond Markets (Total Return)	**2Q'23**	**1-Year**
Bloomberg US Treasury	-1.4%	-2.1%
Bloomberg US Municipal	-0.1%	3.2%
Bloomberg US Corporate Investment Grade	-0.3%	1.5%

Except for emerging markets, the broad stock market indices we present here had solid positive returns for the second quarter, and even more robust returns over the last year. The S&P 500 index fared the best over both periods due to its heavy weighting in technology, continuing a trend that has played out over much of the time since the Great Financial Crisis of 2008-'09.

Treasury yields rose during the quarter but did not quite get back to the levels reached in March just before the bank panic unfolded. Companies' first quarter earnings reported during April and May were stronger than expected, reflecting an overall economy that continues to defy all expectations for a recession, and the rate of inflation is gradually coming down. At about 4% year-over-year as reported in June, it is still above the Fed's long-term target of 2%, but well below the peak of about 9% a year ago.

Following the release of several functional artificial intelligence (AI) tools over the last seven months, investor euphoria has spread about the potential for AI and the infrastructure needed to facilitate its evolution and expanded use. Large-cap technology stocks led the market up during the pandemic because many of the companies' products coincidentally benefited from the spending patterns we adopted or were forced into. It was more predictable that technology companies like Microsoft, or semiconductor chip maker Nvidia, would benefit from increasing AI capabilities, but as with 2020-'21 there has been quite a bit of attention paid to the fact that the market's gains this year have been attributable to a relatively narrow group of very large companies. This can be seen from the fact that the total return of the market cap-weighted S&P 500 is about 17% year to date, whereas the equal-weighted S&P 500 return is only about 7%.

That technology companies have a new secular tailwind with tremendous potential (albeit of still unknown scope) allowed their stocks to trade above the inflation and recession-related concerns that weighed down much of the rest of the market. The rally did broaden out a bit in

June with more cyclical sectors trading up on the hopes that we might still avoid a recession, and in fact much of the S&P 500's return for the quarter occurred in June alone. Concerns that the chaotic aftermath of a possible default on the US Government's bonds could lead almost instantly to a recession were alleviated with a last-minute deal to raise the debt ceiling at the end of May. While a third sizable bank did fail in April and other bank stocks have generally not recovered anywhere near pervious levels, no other banks have succumbed to the crisis which now seems largely behind us. So far there has also not been a huge change in banks' collective lending behavior, making a recession caused by suddenly tighter bank lending standards less likely. Of course, the primary concern continues to be the possibility the Fed does not get the end of this tightening campaign quite right and raises interest rates too high or keeps them high for too long.

The Fed left interest rates flat in June while making it fairly clear there still would be more rate hikes to come later in the year if conditions warrant. The more rate-sensitive areas of the economy have or are slowing down with borrowing costs up and as consumers continue to shift from spending on goods to services. Of course, the Fed's goal is not necessarily to cause a recession, just to bring inflation down to its target of a 2% average over time. The risk is that the services part of the economy is less rate sensitive and more affected by wage growth, and employment still is tight, possibly forcing the Fed to put excessive downward pressure on the economy with more rate hikes in search of its inflation target. Regardless of the exact remaining path of interest rate increases, most of them are surely behind us so looking forward we do not expect materially higher rates to pressure equity valuations as they did in 2022.

What did not happen with the debt ceiling negotiations is a good reminder that investors often worry about a looming issue that seems sure to wreak havoc in the stock market and get it completely wrong. Rarely have we seen investors move on so quickly as they have from this particular concern. Investors also do not always get things right about something they are positive about, which is certainly possible with the rosiest of projections for AI's economic impact. The last several years since the pandemic selloff have seen the market go up and down and back up again, with rapidly rotating leadership among sectors. Energy, which outperformed to an astonishing degree in 2022 is now one of the worst performers year-to-date, and we have outlined technology's huge runs in 2020-'21 and year-to-date that sandwich significant underperformance in 2022.

It is impossible to get all these short-term market moves exactly right, and tax consequences also typically limit our ability to make repeated tactical changes. As steward of our clients' investments, what we hope to get right are the bigger, long-term decisions about the returns offered by the various asset classes, allocating appropriate amounts to a diversified portfolio of stocks to make the most of these overall prospective returns while also not taking too much risk, and controlling the expenses that clients have to bear as much as we can. Sticking to the big picture plan, both when the landscape looks bleak and when others are unusually optimistic is ultimately the key to investing success.

The information contained in this market update has been taken from sources which we deem reliable. We do not represent that it is accurate or complete, and it should not be relied upon as such. Any opinions expressed herein reflect our judgment at this date and are subject to change.

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