# Investment Strategy Update July 3, 2023

MATTHEW B. KENASTON, CFP®     THOMAS BAKER, CFA, J.D.

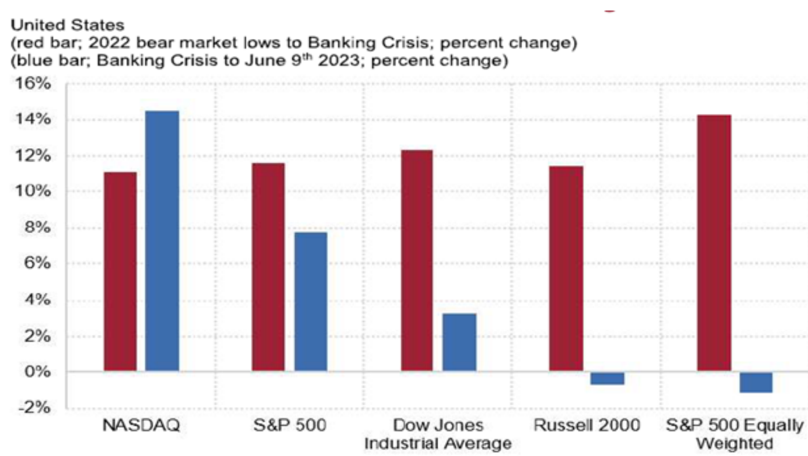
*What experience and history teach is this – that nations and governments have never learned anything from history.* – German Philosopher Georg Wilhelm Hegel, Lectures on the Philosophy of History, 1832.

Since the October lows of 2022, several market indices have posted healthy returns amidst a rather volatile backdrop. While it already seems so long ago, it was just in March that the possibility of a banking crisis emerged when Silicon Valley Bank collapsed. Reminding many of the banking crisis in 2008-09, concerns grew that we may be facing a global meltdown in our banking system. This was a different problem than we faced in 2008-09, yet the lagged effects of the most aggressive rate raising campaign in 40 years remain. Banks are tightening lending standards, and the combination of persistently higher rates and tighter standards will work together to reduce demand for loans and thus slow down the economy.

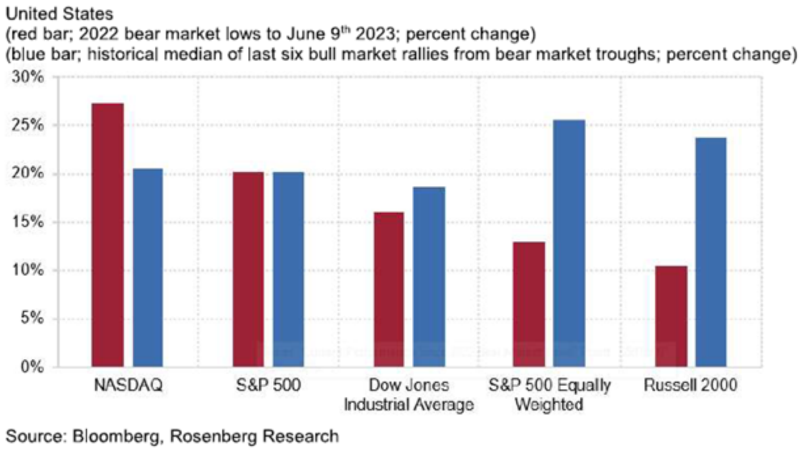
Today, it is as if the environment that caused the bank problems and their potential for downstream economic weakness have been resolved and we have collectively had a 'what me worry' moment. Stocks, driven largely by those with connections to Artificial Intelligence, have zipped ahead. This rally though has been incredibly concentrated with just a few stocks driving performance this year. When we talk about markets as narrow, we are referring to 'market breadth'.

'Good breadth' means there is broad participation by many diverse stocks and industries. A healthy market, with good breadth, is the type of market that can turn into durable bull markets. On the other hand, stock market performance that is driven by a few standout companies with exceptional growth prospects, innovative products, or disruptive business models may only provide great returns for their respective sectors and lack durability.

The chart below, from our colleagues at Rosenberg Research (*Breakfast with Dave* 6/13/2023), is helpful in discerning the messages from the market today. From the October 2022 lows, as measured by the red bars, all indices have done well and show balanced, healthy appreciation. Investors experienced a solid rally that could show promise of developing into a new bull market.



Further, if we consider what history tells us, the blue bars in the second chart reflect the median return for multiple indices observed after the last six bull market rallies from bear market lows. Again, the message is broad participation from a variety of indices and styles of investing is what leads to a durable, new bull market. We note that the S&P 500 Equal Weighted is a top performer, reflecting broad and healthy participation in the historic rallies. Small company stocks, as measured by the Russell 2000 also participate in broad rallies as they are typically more responsive to the economy than large companies.




The red bars in this second chart reflect our current markets. Our concern lies in the comparison between history and today. Today's market does not display the characteristics consistent with history in terms of a durable bull market. That is not to say that today's current momentum cannot continue – it can, but there is reason to be suspect. We are watching for this current rally to broaden and to include more sectors and industries before celebrating a march to higher highs in the market.

History helps to guide us and patience helps to inform us. When managing portfolios, there is always a tension between capital preservation and return maximization. At this point in the economic cycle, we believe capital preservation should be emphasized over return maximization and have positioned portfolios accordingly.