Hutchinson
CAPITAL MANAGEMENT

July 2023

INVESTMENT PERSPECTIVES

The Halfway Point: What is Driving the Markets in 2023?

The stock market continued to march higher in the second quarter, as stronger than anticipated economic growth and enthusiasm for artificial intelligence (A.I.) boosted technology shares. The period was marked by the rise of a concentrated group of stocks, dubbed by some market participants as the 'Magnificent Seven' (see below). These mega-cap companies accounted for nearly three-quarters of this year's gains, as companies levered to the A.I. trend saw their shares bid up to lofty levels. As detailed below, these advances have altered the valuation landscape, as growth expectations have risen sharply alongside their shares. The second quarter didn't come and go without some investor caution. The beginning of the quarter was dominated by concerns around the US debt ceiling and the potential for a US default. However, Congress approved legislation that suspended the debt ceiling in early June and set the stage for the strong returns we saw in the last month of the quarter.

Magnificent Seven Responsible for Almost Three-Quarters of Market Gains

Name/Ticker	Index Weighting (%)	YTD Return (%)	YTD Contribution to Index Return (%)
Apple AAPL	6.05	43.01	2.27
Microsoft MSFT	5.34	37.66	1.83
Nvidia NVDA	1.68	178.11	1.75
Amazon.com AMZN	2.36	51.58	1.05
Meta Platforms META	1.16	131.40	0.96
Alphabet GOOGL	3.00	34.13	0.92
Tesla TSLA	1.26	95.69	0.86

Source: Morningstar. Data as of June 26, 2023.

Recession or 'Soft Landing'

Contributing to the change in investor sentiment has been moderating inflation levels and signs that the US economy remains resilient in the face of higher interest rates. While an impending recession has long been predicted and much talked about, the strength of the economy has certainly extended the timeline for such an event. A revised first quarter GDP of 2% annualized was much stronger than the estimated growth of 1.3%, buoying sentiment and reintroducing the idea that the long-sought-after economic 'soft landing' is a real possibility.

As for the Fed, the rate raising cycle continued in May, with another 25 basis points increase. The quarter was marked by the first major change in Fed policy since early 2022, as rates were put on pause in June. This pause notwithstanding, the Fed has indicated work remains to return inflation back to their long-term targets of 2%. Furthermore, the market is still predicting two additional rate increases in 2023 and bringing us closer to the end of this rate raising cycle.

Broadly speaking, the economy remains in decent health. This is underpinned by a stubbornly healthy job market. The US unemployment rate did see an increase in May from 3.4% to 3.7%, but from a historical context, the job market remains very tight.

Valuations: Cheap, Expensive or Somewhere In-between?

To some extent, valuation (what an asset may be worth) is in the eye of beholder. You can look at the markets more broadly and identify trends that provide historical context. One measure we consistently pay attention to is the relative spread between Value and Growth stock valuations (as depicted below).

	Forward PE		Div. yield**	
Style	Current	Long-term avg.*	Current	Long-term avg.*
Value	14.36x	14.09x	2.34%	2.59%
Growth	25.69x	20.79x	0.95%	1.34%

Source: FactSet, FTSE Russell, NBER, J.P. Morgan Asset Management.

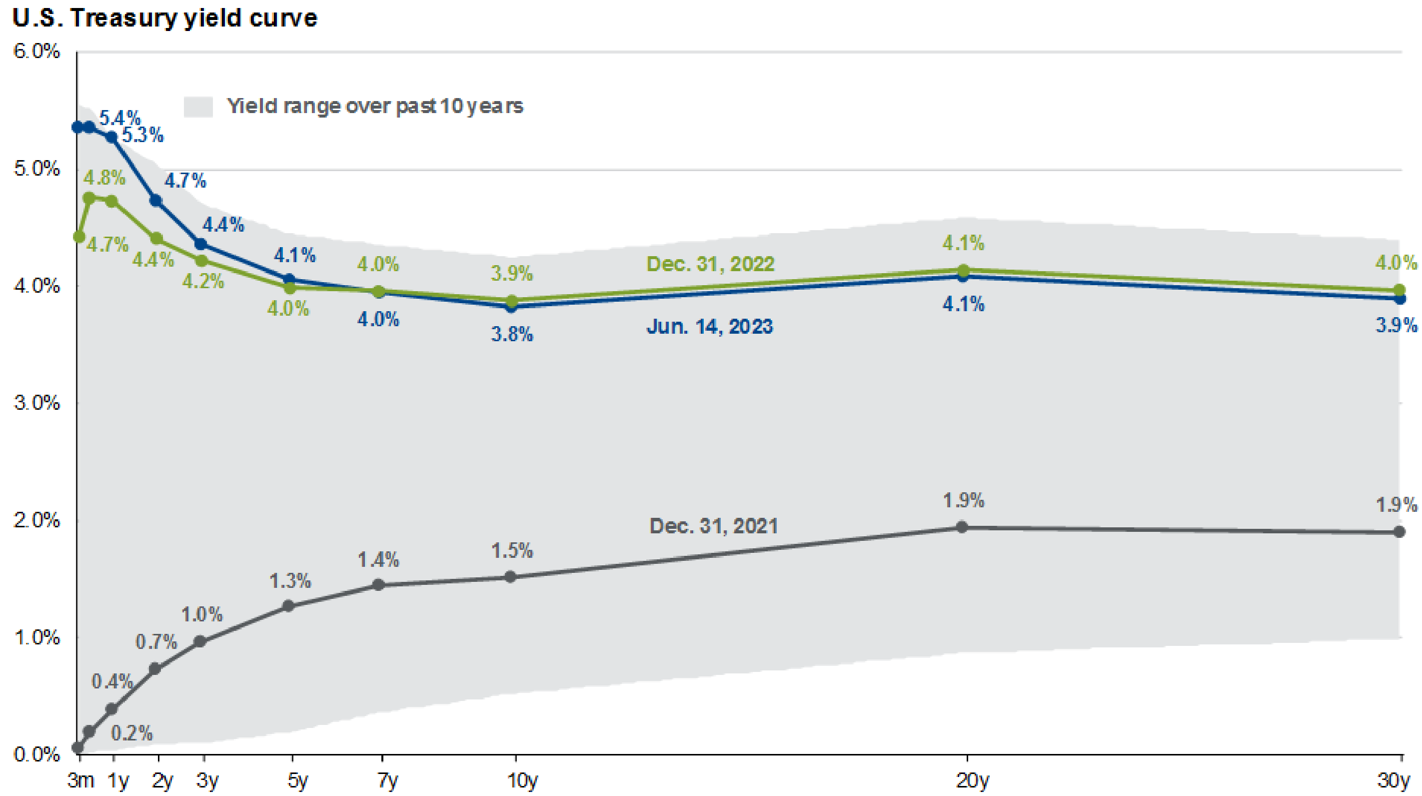
While value stocks closed the performance gap in 2022, the rise of the A.I.-fueled rally in 2023 has widened that gap once again. As shown above, value stocks are relatively cheap compared to their growth counterparts and if the rally is going to continue in the second half of the year, value stocks will need to participate in a more meaningful way. How does this relative divide play out in your portfolios? With the rally being concentrated in a handful of stocks/sectors, it makes intuitive sense that opportunities remain in the undervalued stocks/sectors that were left behind by the most recent rally. Looking for these rebalancing opportunities will be a focal point as we move into the second half of the year.

Chasing the Trend

As is always the case, there is a behavioral element to what has transpired so far this year. The desire to chase what has been working well, coupled with the perceived safety of joining the crowd. The trend of retail investors chasing performance is well documented and this time looks to be no different. This phenomenon has historically not led to great results for investors. If you look to the market as a source of advice, you may be falling victim to short-term thinking.

The Bond Markets

The landscape for bonds continues to be marked by an inverted yield curve, whereas short-term rates are yielding more than their intermediate and long-term counterparts. This is predicated on the assumption that the Fed will beat inflation and interest rates will trend lower over time. While the rapid rise in rates that we experienced in 2022 wasn't good news for bond investors, it has culminated in appreciably higher yields.



Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.

While we have been excited by the opportunity in inflation protected bonds, or "TIPs", their performance has been uneven. Long-term inflation expectations have remained in check due to the vigilance shown by the Fed to continue to raise rates, along with their strong anti-inflation rhetoric. We continue to value the protection they add to your portfolios over the long-term, while inflation has moderated from roughly 9% to around 4%, we're concerned that the path to 2% may be a bumpier ride than the market is anticipating.

The effect of higher interest rates continues to ripple throughout the economy. Mortgage rates hovering at around 7% impacts affordability and as a result, pressures real estate prices. While this trend is moderating, banks are still fighting for deposits as yield-starved investors look to maximize their return on cash. As a result, bonds can now compete with real estate based on yield; this may certainly have an impact on the performance of real estate moving forward.

We are excited again by not only the diversification benefits of bonds but the potential long-term performance they can add to portfolios.

<u>In Closing</u>

All of this adds up to continued uncertainty as the Fed attempts to tamp down inflation without tipping the economy into a recession. The future is largely unknowable and there are always factors present that can alter the economic and market landscape. We continue to see investment opportunities but between slowing economic growth, tight monetary policy, and tightening credit, we anticipate that returns will be harder to come by over the remainder of the year. Our overarching message remains consistent and focused on the disciplined execution of your long-term investment plan. This long-term approach helps us tip the balance in our favor as we guide your portfolios through these uncertain times.

PLEASE SEE IMPORTANT DISCLOSURES BELOW:

As of July 31st, 2023, Hutchinson Capital Management (HCM) held:
164,086 shares of Apple Inc (AAPL)
5,066 shares of Amazon.com Inc (AMZN)
73,752 shares of Microsoft (MSFT)
29 shares of Tesla Inc (TSLA)
80 shares of NVIDIA Corp (NVDA)
354 shares of Meta Platforms Inc (META)
146,024 shares of Alphabet Inc Class A (GOOGL)

As of July 31st, 2023 (Prices in USD unless noted otherwise)
Apple Inc (AAPL) closed at $196.45
Amazon.com Inc (AMZN) closed at $133.68
Microsoft (MSFT) closed at $335.92
Tesla Inc (TSLA) closed at $267.43
NVIDIA Corp (NVDA) closed at $467.29
Meta Platforms Inc (META) closed at $318.60
Alphabet Inc Class A (GOOGL) closed at $132.72

As of July 31, 2023, the following were the ten largest holdings of HCM:

Name of Issuer	% of Equity Portfolio	7/31/2023 Closing Price
Berkshire Hathaway Inc Class B	7.33%	$351.96
Apple Inc	7.05%	$196.45
Microsoft Corp	5.42%	$335.92
Bank of America Corp	5.06%	$32
Alphabet Inc Class A	4.24%	$132.72
Jacobs Solutions Inc	4.14%	$125.41
Progressive Corp	3.95%	$125.98
Verisign Inc	3.76%	$210.95
Capital One Financial Corp	3.23%	$117.02
Exxon Mobil Corporation	3.13%	$107.24

For a complete list of holdings, please see our most recent 13F filing on the following SEC website:
http://www.sec.gov/edgar/searchedgar/companysearch.html
HCM's investment decision making process involves a number of different factors, not just those discussed in this document. The views expressed in this material are subject to ongoing evaluation and could change at any time.
Past performance is not indicative of future results, which may vary. The value of investments and the income derived from investments can go down as well as up. It shall not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities mentioned here. While HCM seeks to design a portfolio which reflects appropriate risk and return features, portfolio characteristics may deviate from those of the benchmark.
Although HCM follows the same investment strategy for each advisory client with similar investment objectives and financial condition, differences in client holdings are dictated by variations in clients' investment guidelines and risk tolerances. HCM may continue to hold a certain security in one client account while selling it for another client account when client guidelines or risk tolerances mandate a sale for a particular client. In some cases, consistent with client objectives and risk, HCM may purchase a security for one client while selling it for another. Consistent with specific client objectives and risk tolerance, clients' trades may be executed at different times and at different prices. Each of these factors influence the overall performance of the investment strategies followed by the Firm.
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