LaFleur & Godfrey
PRIVATE WEALTH MANAGEMENT

Summer 2023 Quarterly Commentary

Dan Van Timmeren John Koczara
Chris Walker Aaron Ritsema

Something for Everyone!

Economic Perspective:

One of the foundational topics we discuss at our monthly Investment Committee meetings is what we are seeing in the economy. We feel it is an effective exercise to bring & share each of our individual perspectives on the state of the economy. It is an important part of our investment process to not only manage risk but to also spot opportunities.

We have seen several economic data points lately that feed both the bull & bear case arguments. First, with respect to employment trends. Last month, ADP payrolls bullishly advanced almost 500,000 jobs (more than double what was expected) but the very next day Nonfarm Payrolls (which is the official government report) rose to just over 200,000 jobs (lower than expected) with downward revisions to prior months. It was the slowest month for job creation since December 2020. Net-net, these reports provided something for everyone.

Wages are rising at a 4.4% clip. Why? Well, demand for labor remains strong and, while the gap between job openings and those unemployed has closed, supply has yet to catch up to demand. The JOLTs survey has declined from last year's peak of 12 million available jobs to 9.8 million today. This is encouraging. We expect this data point to continue to decline, putting the jobs market in better balance. We need disinflation in wages to help alleviate the sticky inflation we are experiencing.

The ISM readings are also mixed. The ISM Manufacturing Index recently contracted for the eighth consecutive month to 46 (below 50 is considered contraction in the sector). The softness follows a 28-month period of expansion post-COVID. All key components of the report remained weak, which certainly supports the economic bear case. However, the all-important ISM Services Index (the largest component of the U.S. economy) rebounded nicely from the May lows just above 50 to a surprising 53.9 level in June. This report was heralded by the economic bulls that a second half of the year recession may be off the table. Goldman Sachs certainly thinks so. Their economic forecast for Q3 and Q4 is for economic growth of 0.6% and 0.9%, respectively, which compares quite favorably to Wall Street consensus of (0.5%) and (0.2%), respectively. Our investment committee has for a while now been in the economic not-too-hot, not-too-cold camp. We believe we have yet to feel the full effect of the 500 basis points (5%) rate hikes but are likely to stave off recession. FYI, the full economic impact of changes in monetary policy typically lags by about 6-12 months.

Market Perspective:

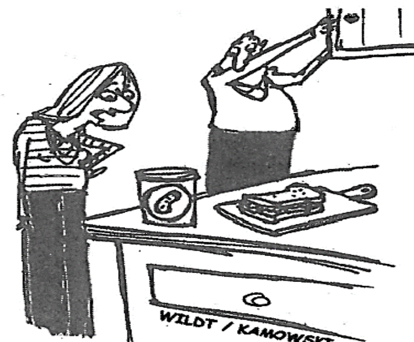
The stock market continues to climb the 'wall of worry'. During the first half of the year, growth names, which were decimated throughout 2022, have vastly outperformed their value counterparts. In fact, the Russell 1000 Growth Index has advanced 29% year-to-date versus only 5% for the Russell 1000 Value Index. While some may look at the above-mentioned index performance data and say the worst is behind us, we are cognizant that the market's strong returns this year have been very narrow & led by

about 10 names. As a result, the stock market experienced its worst market breadth in history! In 2023, the market cap-weighted S&P 500 Index has advanced almost 17% but the equal-weighted S&P 500 Index has returned only 7%. Quite the divergence! This tells us that there is still considerable doubt in the minds of investors that our economy is on solid footing and that corporate earnings will rebound in 2024 as the current consensus estimates suggest. As we have mentioned in numerous quarterly commentaries before, the bond market's yield curve inversion, with short-term interest rates higher than long-term interest rates, has raised alarm bells for some time now.

With all that said, when looking at the broader market, valuations are reasonable and near 10-year historical averages. For example, the top eight largest companies in the S&P 500 Index (Alphabet, Apple, Amazon, Meta, Microsoft, Netflix, NVIDIA and Tesla) have an average forward P/E valuation multiple around 30. In contrast, the next 492 names in the index have a valuation about half that! This is why context matters & the devil is always in the details. Our investment committee continues to look for opportunities that will benefit from an improving economic environment over the coming quarters. We will look to add a new name or two to your equity portfolio over time. Your existing holdings are well-positioned to benefit as we get more economic clarity. When this happens, we expect a change in market leadership and a broadening out of equity returns.

Looking Ahead:

It is hard to believe that just a few short months ago many pundits in the financial media were suggesting that we were on the brink of a Global Financial Crisis 2.0. Yes, we experienced two of the three largest bank failures in U.S. history. However, several of the 'problem banks' had isolated issues & those stormy waters have now calmed. Importantly, all 23 of the systemically important banks in the U.S. just passed their Federal Reserve-mandated annual stress tests with flying colors. Goodbye, GFC 2.0! We do see that sector ripe for change, disruption and merger activity in the coming years. We will be closely watching how credit availability is affected and its impact on both consumers and businesses. A well-known market veteran that we respect (Edward Yardeni of Yardeni Research) recently stated that he believes our economy is currently transitioning from a rolling recession to a rolling recovery. We tend to agree. We certainly believe there will bumps along the recovery road (due to higher interest rates) but, for the most part, our economy should continue to grind higher over the next twelve months. In fact, the Atlanta Fed is now forecasting over 2% economic growth for Q3 – even higher than the Goldman Sachs bullish estimate. As consensus 'moves up', there should be an upward bias to equity returns.



"Really? A password for a jar of pickles?"

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