FULLEN FINANCIAL GROUP

Quarterly Market Summary – Q2 2023

Market Results as of the Second Quarter of 2023
Selected Index Results for Q2 – 2023

Index(1)	**%Growth For FY 2022**	**%Growth For YTD 2023**	**%Growth For Q2 2023**
DJIA	-8.78%	3.80%	3.41%
Core U.S. Aggregate Bond Index (U.S. multi-sector bond)	-14.98%	0.99%	-1.70%
S&P 500 (large cap)	-19.44%	15.91%	8.30%
S&P 400 (mid cap)	-14.48%	7.9%	4.39%
Russell 2000 (small cap)	-21.56%	7.24%	4.79%
MSCI EAFE Index (developed international)	-28.81%	10.45%	1.37%
iShares MSCI Emerging Market Index	-28.60%	4.38%	0.25%
iShares Dow Jones US Home Construction	-37.24%	40.98%	21.55%
MSCI US REIT Index	-30.15%	3.26%	1.59%
Amex Oil Index	27.65%	-6.04%	-3.03%
Barclays Global Agg ex-US Corp Bond Index	-27.46%	2.38%	-0.56%

(1) These results do not include reinvestment of dividends.

Q2 Quick Summary

- Stock values continued to advance globally in Q2, although growth rates among regions and sectors remain mixed. Concerns remain, however, with the U.S. Fed likely to continue raising interest rates, and weakening economies in the Euro zone and China.
- The U.S. economy continued its stronger-than-expected start to the year, although consumer spending is expected to soften in the second half. Growth projections for the full year are now a modest 1.5% as the Fed continues to fight inflation and government spending slows.
- The outlook for the global economy improved modestly in the second quarter, offset by a downward revision of growth expectations for 2024. Growth in the Euro zone remains flat to slightly negative, while the Chinese economy appears to be slowing rapidly after a Q1 surge driven by the relaxation of Covid restrictions.
- U.S. headline inflation decreased to 3.0% year-over-year in July, and core inflation (excluding food and energy) declined to 5.0%. While these trends validate recent Fed tightening, inflation remains above the Fed’s stated target of 2%.
- The Fed raised its benchmark interest rate by 0.25% in Q2, with a quarter-point increase in May. The current target rate is 5.0% - 5.25%. The Federal Open Market Committee (FOMC) voted not to increase rates at their June meeting; however, current expectations are that they will raise rates by 0.25% at their meeting later this month.

Stock Values Continue to Recover

As we look back on the first half of 2023, many of the things expected to happen in the first six months did in fact occur. Inflation eased, U.S. economic growth slowed, the Fed appears to be approaching the end of its tightening cycle, and the U.S. debt ceiling standoff was resolved with limited financial market impact. Through all of this, performance in the U.S. and global stock markets was unexpectedly strong, highlighted by almost 16% growth in the S&P 500 index.

Despite this positive performance, some concerns remain going into the second half of the year. First, market performance has become more "top-heavy" in recent months, with gains led by a handful of large stocks. With the majority of member stocks underperforming the overall S&P 500 index, concentration risk becomes more of a concern. Second, enthusiasm around artificial intelligence (AI) stocks has increased significantly in recent months, despite uncertainties about applications of the technology and related profitability. Finally, investor sentiment has gained momentum in the first half and such optimism, if it were to become excessive, could lead to more bouts of market volatility and weakness.

Continued Economic Growth, But the Outlook is Modest

The U.S. economy has managed to avoid recession thus far in 2023, with a stronger-than-expected start to the year. Thankfully, Congress came to an agreement to suspend the debt ceiling, removing a key source of risk to financial markets. The lower spending trajectory in the Fiscal Responsibly Act is estimated to create a mild drag on the economy in 2024 and 2025, increasing the possibility that 2024 could be a challenging year for economic growth. Once again, the U.S. consumer has carried the growth torch, with inflation-adjusted spending rocketing ahead in the first half. If there is one area that could again surprise on the upside, it's the resiliency of the consumer. However, experts forecast a winddown of spending momentum as the year rolls forward, as headwinds from higher interest rates continue to build and some households face a new challenge related to the end of a three-year student debt payment moratorium.

Business investment is already showing the markings of higher borrowing costs and tighter credit conditions. The performance has been uneven, however. Most of the burden has been reflected in equipment outlays, while investment in non-residential structures has delivered surprising strength. The latter appears to be already reaping the benefits from onshoring and various measures passed by Washington to encourage domestic high-tech production have started to goose the construction of manufacturing facilities. Meanwhile, the U.S. labor market continues to plow ahead. Not surprisingly, a resilient labor market and consumer means resilient inflation. As a result, the outlook for inflation in 2024 is trending higher, and core inflation may not reach the Fed's 2% target until the first half of 2025.

The global economy continues to perform largely as expected. There is a modest upward revision to global growth this year, offset by a slight downgrade in 2024. The euro area is the exception to this pattern, and the recent rise in European natural gas prices is a reminder of the persistent risk of shortages the region could face next winter. Meanwhile, China's economy burst out of a zero-Covid world more vigorously than expected in the first quarter, but the near-term signals suggest it is slowing rapidly. Growth is expected to cool through the remainder of the year, and many economists have downgraded China's GDP outlook for 2024. How Chinese policymakers respond to slowing growth will impact forecasts for both economic growth and inflation going forward.

The second half of 2023 may hold the potential for fewer surprises, with a U.S. debt ceiling deal in place until early 2025, global central banks moving toward a pause on interest rates, bank stress stabilizing, and signs of a potential cooling in U.S.-China tensions. Despite these positives, economic headwinds remain, particularly if weakness spreads to the services sector as higher interest rates reduce both inflation and job growth.

The Inflation Battle Continues

The bitter taste of high inflation continues to linger two years after its liftoff in the aftermath of the pandemic. U.S. inflation hit a peak of 9.1% year-over-year in June 2022. While it has moved steadily lower since then — reaching 3.0% in June of this year — it is still above its pre-pandemic rate and the Fed's 2% target. The drivers of inflation have shifted over time. In the early stages, supply chain dislocations and an abrupt change in spending patterns toward goods and away from services led to accelerated price growth.

This early period was also marked by a widening in corporate profit margins, leading to charges that surging profits were responsible for the rise in prices. Since then, profit margins have narrowed, and the sources of inflation have shifted from goods to more labor-intensive services. Wage growth now accounts for a significant share of the rise in prices. The pattern of corporate profits rising in the early stages of an economic recovery is not unique to this economic cycle, but something that has occurred consistently over history. Businesses raise prices early in the economic cycle in response to strong demand and anticipation of higher costs. As those higher costs come to fruition, profit margins narrow. Elevated wage and profit growth are symptoms of an economy in which demand exceeds supply.

Faster wage growth has resulted in unit labor costs accounting for an increasingly larger share of price pressures. In the first quarter of 2023, labor costs accounted for half of the change in per unit prices. This is consistent with the dearth of available workers relative to demand, reflected in the ratio of job openings-to-unemployed persons reaching an all-time high in March 2022. Service-related industries, including leisure and hospitality, which boast one of the highest job opening rates, have experienced some of the highest wage increases.

When compared to historical norms, most corporations are acting in a typical forward-looking manner. Where the current environment differs is the job market. As businesses rushed to keep up with demand, competition for workers has pushed up wages in many industries. Labor costs now account for an unusually large role in explaining inflation. To be clear, workers are not the villains in the inflation story any more than corporations. Instead, the root issue is an economy running hot, with demand in excess of supply. As demand slows and the economy cools, price pressures will follow.

The Fed Sticks to Its Strategy

The Federal Reserve continues to follow its playbook to hike, hold and recalibrate. After rapid rate hikes over the past 16 months, the decision to pause at the most recent meeting signals a subtle shift to the "hold and recalibrate" phase. The Fed made it clear that the door is still open to more rate hikes, with the median estimate among the members suggesting another two rate hikes of 0.25% each could be seen by the end of this year. However, with growth sluggish and the financial system still dealing with the fallout of bank failures, a more cautious approach seems to be warranted.

As we enter the second half of 2023, there are some key indicators that point to the likelihood the peak in short-term rates may be near. First, inflation pressures are in fact easing. Overall, or "headline" inflation has declined sharply from its peak level, but the core rate hasn't made much progress on the downside in recent months as consumer spending on services such as travel remains firm. However, with wage gains slowing, the savings rate coming down and the unemployment rate starting to rise, it's likely that consumers will start to be more cautious going forward.

Second, real interest rates are high. As monetary policy achieves its intended effect, higher real interest rates (nominal rates adjusted for inflation) tend to have the sharpest impact on the economy. With the Fed hiking rates at the fastest pace in modern times, real interest rates are now back at the highest levels since 2009. Those rates make it more expensive for consumers to purchase goods such as homes and cars, and for businesses to finance investment, hiring and expansion.

While the Fed may choose to hike rates again later this year, possibly at its next meeting later this month, further tightening at this stage may risk pushing the economy into a recession. It's likely to be a bumpy ride to future easing, as each data point is scrutinized for its potential policy impact.

Conclusions

We believe economic uncertainty and market volatility will remain high for the remainder of this year. It's important during this transition period to maintain a well-balanced, diversified portfolio, with a risk profile consistent with your goals. Your portfolio should contain an appropriate mix of investments, including cash, bonds, and various types of stocks (large cap, mid cap, small cap, domestic and international) in appropriate allocations based on your goals, investment time horizon and tolerance for market risk.

Projecting stock market direction is always rife with problems, doing so in such an environment can quickly make even the most thoughtful projections irrelevant. In a rapidly growing economy with rising inflation, assets with exposure to high nominal growth rates, including value stocks and commodities, may hold up well, whereas bonds could struggle. Should tightening Fed policy, higher inflation or a change in consumer sentiment start to weigh heavily on the economy, however, bonds will be seen as a safe-haven alternative to equities. This highlights the benefits of a well-diversified portfolio and a consistent investment strategy to navigate through the volatility.

Fundamentally, stock valuations are based on long-term expectations for dividend payments and price appreciation. Assuming the economy continues to return to more "normal" levels of activity, the long-term impact on economic growth and equity values should not be significant. However, as we have stated previously, the ongoing and unprecedented level of government stimulus, both fiscal and monetary, continues to raise concerns about deficit spending and the corresponding growth in national debt. While such stimulus may be critical in times of stress, the long-term implications for economic growth are likely to be negative. In the near term, uncertainties around these policies (among other developments) will likely result in continued high levels of market volatility.

In periods of higher market volatility, maintaining investment discipline will be more difficult emotionally. However, we need to remember that market timing as an investment strategy has never worked consistently (and results in lower longer-term yields). Trying to time markets has a high probability of creating permanent losses in your portfolio.

As always, stay with a consistent and disciplined investment strategy; it is the only course of action with any track record of success (in any investment environment). There is no reason to believe, even with the changing economic dynamics, that the disciplined approach to investments will be less effective than in the past at delivering the best possible relative returns.

At the most fundamental level, match your investment time horizon to your spending timeline – if you have short term cash needs then those funds should be in short term investments. These are simple asset/liability matching principles practiced by the most sophisticated investment managers every day (but far too complex to explain in sound bites and not conducive to selling products). Additionally, don't try to solve short-term financial problems with long-term equity exposure. If you try to chase returns, you may get lucky sometimes but, if pursued long enough, it always ends in extreme frustration and often with serious financial losses. The reality is that no one has ever consistently predicted investment markets and they never will - and there is always a consequence to continued unsound financial behavior.

As always, if your personal or family situation has changed (or is likely to), a discussion with us as to how this may impact your financial plan and your overall asset allocation is warranted. Or, if you simply feel a need to discuss any aspect of your portfolio and/or financial plan, or you haven't had a planning update within the last 12 months, please contact us to review your financial plan and investments.

Risks

Investors should be aware of the risks associated with all portfolio strategies and variable market conditions. Monetary policy changes, military activity abroad, the level and change in market interest rates, corporate earnings, domestic and foreign governmental policies, global economic data, and other geopolitical events can have a substantial effect on portfolio performance and the effectiveness of strategic and tactical portfolio approaches.

Your financial plan is the most important financial document that you possess! Keep it updated and use it.

Please note that you are entitled to receive Fullen Financials' Form ADV whenever you would like to. This document outlines many details of who Fullen Financial is, their investment methodologies and their advisor's education and experience. You may do so by contacting Paula Miller (paula@fullenfinancial.com) and requesting such. Alternatively, you can go to the Fullen Financial website at www.fullenfinancial.com and click on "Resources" in the top menu bar, and then on "Client Forms."

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Appendix: Economic Indicators and Outlook

Economic Indicators: G7 & Europe				
	2021	2022	2023F	2024F
Real GDP (annual per cent change)				
G7 (30.1%)*	5.3	2.3	1.1	0.8
U.S.	5.9	2.1	1.5	0.8
Japan	2.2	1.0	1.3	1.0
Euro Area	5.3	3.5	0.4	0.6
Germany	2.6	1.9	-0.4	0.6
France	6.4	2.5	0.5	0.6
Italy	7.0	3.8	1.2	0.5
United Kingdom	7.6	4.1	0.2	1.0
Canada	5.0	3.4	1.6	0.5
Consumer Price Index (annual per cent change)				
G7	3.3	7.3	4.8	2.1
U.S.	4.7	8.0	4.3	2.7
Japan	-0.2	2.5	3.0	1.5
Euro Area	2.6	8.4	5.6	2.3
Germany	3.2	8.7	6.2	2.4
France	2.1	5.9	5.4	2.5
Italy	1.9	8.7	6.8	2.2
United Kingdom	2.6	9.1	7.1	2.5
Canada	3.4	6.8	3.8	2.7
Unemployment Rate (per cent annual averages)				
U.S.	5.4	3.6	3.6	4.3
Japan	2.8	2.6	2.5	2.4
Euro Area	7.7	6.7	6.8	7.6
Germany	5.7	5.3	5.7	5.9
France	7.8	7.3	7.4	7.8
Italy	9.5	8.1	8.1	8.7
United Kingdom	4.5	3.7	4.2	4.7
Canada	7.5	5.3	5.3	6.3

*Share of 2019 world gross domestic product (GDP) at PPP.
Forecast as at June 2023.
Source: National statistics agencies, TD Economics.

Global Economic Outlook				
Annual Per Cent Change Unless Otherwise Indicated				
	2021 Share*	Forecast		
Real GDP	(%)	2022	2023	2024
World	100.0	3.3	2.8	2.6
North America	19.0	2.3	1.6	0.8
United States	15.8	2.1	1.5	0.8
Canada	1.4	3.4	1.6	0.5
Mexico	1.8	3.0	2.4	1.6
European Union (EU-28)	14.8	3.6	0.5	0.8
Euro Area (EU-19)	12.0	3.5	0.4	0.6
Germany	3.3	1.9	-0.4	0.6
France	2.3	2.5	0.5	0.6
Italy	1.9	3.8	1.2	0.5
United Kingdom	2.3	4.1	0.2	1.0
EU accession members	2.8	4.6	1.4	1.6
Asia	44.0	3.5	4.4	4.0
Japan	3.8	1.0	1.3	1.0
Asian NIC's	3.5	2.1	1.5	2.4
Hong Kong	0.3	-3.5	4.4	2.2
Korea	1.7	2.6	1.7	2.5
Singapore	0.4	3.6	1.1	2.6
Taiwan	1.0	2.4	0.4	2.4
Russia	3.1	-1.6	-0.6	1.2
Australia & New Zealand	1.2	3.5	1.6	1.6
Emerging Asia	32.5	4.5	5.6	4.9
ASEAN-5	5.5	6.0	4.8	5.1
China	18.5	3.0	5.9	4.3
India**	7.0	7.3	6.0	6.6
Central/South America	5.5	4.0	1.1	1.6
Brazil	2.4	3.0	1.8	1.5
Other Emerging Markets	13.3	3.4	3.4	2.9
Other Advanced	1.1	3.6	1.7	1.9

*Share of world GDP on a purchasing-power-parity (PPP) basis.
Forecast as at June 2023. **Forecast for India refers to fiscal year.
Source: IMF, TD Economics.

Investors should consult with their investment advisor to determine the appropriate investment strategy and investment vehicle. Investment decisions should be made based on the investor's specific financial needs and objectives, goals, time horizon and risk tolerance.

Except for the historical information contained in this report, certain matters are forward-looking statements or projections that are dependent upon risks and uncertainties, including but not limited to such factors and considerations such as general market volatility, global economic risk, geopolitical risk, currency risk and other country-specific factors, fiscal and monetary policy, the level of interest rates, security-specific risks, and historical market segment or sector performance relationships as they relate to the business and economic cycle.