ALTMAN
INVESTMENT MANAGEMENT

MARKET PERSPECTIVE

AUGUST, 2023

IN FOCUS:

The outlook that the economy will continue to avoid falling into a recession has yet again improved with the latest inflation report. The June CPI came in at 3% year-over-year, down sharply from the 9.1% level just last year. The housing market has remained relatively tight despite rising mortgage rates. Unemployment ticked up at its last reading, but remains at 3.7% as supply and demand appear to be trending in a more balanced direction. The Federal Reserve after holding rates steady in June lifted the target range yesterday to 5.25-5.5%, as it continues to assess the full effects of policy actions to bring inflation to a run rate of 2.0% without causing a recession. The Fed chairman expressed concern over headwinds from tight credit conditions which are expected to weigh on economic activity, hiring, and inflation. Taking all of this into consideration raises the probability that even with the Fed considering additional rate hikes, the end of the tightening cycle is near.

The GDP data released today appears to have corroborated Fed policymakers' decision to tighten monetary policy. Real GDP growth accelerated to a buoyant 2.4% annualized in Q2, significantly surpassing expectations, with consumer spending and business investment as the main engines of growth. Overall, the economy withstood pressures from recession fears, elevated interest rates, the Fed's hawkish policy, and tighter bank lending standards.

Turning to the markets, the decline in stocks during 2022 was the result of rising interest rates and growing consensus calls for a recession that hobbled growthier sectors like Technology and Communication Services. The AIM composite outperformance against the S&P 500 index was primarily due to the resilience of the Energy and Consumer Staples sectors and the overall attractive fundamentals of value stocks versus growth stocks during volatility. As was evident during this selloff, protection against systematic market risk is vital to long term relative and absolute performance. While it's understandable to see some degree of reversal following a year of significant out-performance on our part, the extent of the dispersion this year is surprising. Market leadership returned its narrow base of mega cap Technology and Communication Services companies to the forefront, fueled by the Q1 banking crisis and enthusiasm for Artificial Intelligence.

During the first half of the year, this small basket of mega cap stocks was responsible for 73% of the S&P 500 index performance. The last time we saw this phenomenon was in 1978 when IBM and AT&T hit their peak prices only to underperform the overall market for the following two decades. We believe current momentum in higher valuation stocks is attributable to excess liquidity created by global money supplies which is likely fading. In conjunction with higher for longer interest rates and Fed policy uncertainty, it will become harder for investors to continue to ignore lofty valuations which are poised to compress. Therefore, we do not view this narrow market leadership as sustainable and expect a broadening of participation in the months ahead.

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