PERFORMA

Q2 2023

MARKET COMMENTARY

A QUARTERLY REVIEW OF THE MARKETS FEATURING MACRO AND GENERAL ASSET CLASS COMMENTARY

MACROECONOMIC OVERVIEW

Markets spent the first six weeks of the second quarter processing the banking sector turmoil from the prior quarter. Price action was uninspired and rangebound as U.S. Treasuries and risk markets moved sideways. Around the middle of May, a more optimistic narrative emerged as banking sector volatility subsided, economic activity proved resilient and inflation gradually moderated. The positive shift in market sentiment sent interest rates and risk assets meaningfully higher into quarter end.

Despite the Federal Reserve's best efforts, we have seen little to no evidence of any softening in labor market conditions. Remember, the Fed believes that returning inflation to its 2% target will likely require some weakening in labor market conditions. However, job creation averaged 244,000 per month during the second quarter, filings for unemployment benefits remained historically low and job openings are still elevated, albeit somewhat below the recent highs. During Q2, we saw continued improvement in headline year-over-year inflation measures. With that being said, the latest reading on the Fed's preferred measure of core inflation, which strips out the volatile food and energy components and is thought to be a better predictor of future inflation, came in well-above their inflation target at 4.6%. With inflation still elevated and a historically strong labor market, the Fed has struck a more hawkish tone recently and is now forecasting at least two more 0.25% rate hikes by year end 2023.

Other economic indicators were somewhat mixed during the second quarter. We saw some improvement in housing data after aggressive Fed tightening was a major headwind for the sector in 2022. Record low mortgage rates obtained during the pandemic are a key factor limiting the supply of existing home sales. The historically low supply of existing homes for sale has boosted new home sales and underpinned house prices more generally. The manufacturing sector continues to face headwinds as evidenced by the widely followed ISM Manufacturing survey that has now recorded

eight consecutive monthly readings below 50, which indicates slowing activity. High frequency data was robust and service sector activity remained expansionary. Of note during the quarter is that TSA throughput data has now fully recovered from COVID. Nonetheless, meager real wages (adjusted for inflation) and rising credit card debt have us concerned about the prospects for future consumption.

ASSET CLASS OVERVIEW

INVESTMENT GRADE BONDS: The Federal Reserve paused their hiking campaign in June after hiking 25 bps in May to a range of 5.00%-5.25%. Hawkish rhetoric from Chairman Jerome Powell and a "*we're not done yet*" message sent the U.S. Treasury yield curve higher. The one-month U. S. Treasury Bill increased 61 bps to 5.14% during Q2. Meanwhile, further out the curve, 2-year U.S. Treasuries yields jumped 87 bps to 4.90% and the 10-year yield was higher by 37 bps to close the quarter at 3.84%. The Bloomberg U.S. Aggregate Index, a broad measure of the investment grade bond market, lost -0.84% during Q2 despite the option-adjusted spread (OAS) on the index tightening 8 bps to 0.49%, driven by the narrowing of credit spreads by -15bps to an OAS of 1.14%. All sectors in the Agg were negative over the period, except for sovereign debt and financials, which gained 0.66% and 0.21%, respectively. U.S. Treasuries fared the worst, losing -1.38%, followed by utilities, which lost -1.19%. On a ratings basis, lower quality bonds outperformed with BBB's returning -0.03%, A's -0.40%, AA's -0.66%, and AAA's -1.06%. The index had a yield-to-worst (YTW) of 4.81% and a modified duration of 6.31 years as of June 30th.

HIGH YIELD BONDS: During Q2, the ICE BofA U.S. Cash Pay High Yield Index gained 1.60%. The return was comprised of -0.02% in negative price performance driven by rising rates (yields up, prices down) but buoyed by tighter spreads as the OAS on the index tightened 51 bps to 401 bps. Income/coupon produced an additional 1.62% of return during the period. The effective yield on the index increased 7 bps to 8.31% as rising rates outpaced spread tightening. Meanwhile, the effective duration of the index shortened by 0.18 years to 3.66 years. Of the major sectors within the index, banks were the only sector in negative territory for the quarter (-1.51%). Retail bonds gained the most (4.63%), followed by leisure (2.89%) and real estate (2.76%). The consumer goods and utility sectors were up the least (0.31% and 0.21%). Similar to investment grade bonds,

lower rated bonds generally outperformed their higher rated peers over the period, with C's up 24.27%, CC's 2.79%, CCC's up 4.10%, B's 1.86% and BB's 0.80%.

U.S. EQUITIES: The S&P 500 Index, widely regarded as the best single gauge of large-cap U.S. equities, was higher for the third quarter in a row, returning 8.74% during the second quarter. For Q2, the top ten stocks in the index were responsible for 74% of the overall return (APPL, MSFT, NVDA, AMZN, META, TSLA, LLY, GOOG, AVGO, BERK). Technology shares soared more than 17.25%, led by contributions from Apple (17.79%), Microsoft (18.38%) and Nvidia (52.31%). Consumer discretionary stocks gained 14.56%, led by Amazon (26.21%) and Tesla (26.18%). Utility stocks were the worst performer in the index, falling -2.52%. The generic WTI crude oil contract was down -8.84% and, as a result, energy stocks declined -0.90%.

Mid-cap stocks, as represented by the Russell Midcap Index, underperformed their larger cap peers, but posted a respectable 4.76% gain during Q2. Industrial stocks were the big winners, gaining 11.07%, led by logistics company XPO Inc, which jumped 84.95%. The biggest contributors to return within the sector were Transdigm, Delta Air Lines and Parker Hannifin. Information technology (7.30%) and consumer discretionary (7.36%) followed. Utility stocks fell -2.11% while consumer staples managed a 0.61% gain.

Small-cap stocks, as represented by the Russell 2000 Index, gained 5.19% during Q2, weighed down by the value component (3.18%). The growth portion of the index was up 7.05%. For the total index, health care (11.43%), industrials (9.95%) and technology stocks (8.52%) contributed the most. Utilities (-3.60%) were down the most followed by financial stocks (-1.08%).

INTERNATIONAL EQUITIES: The iShares EAFE ETF, which tracks the MSCI EAFE Index, and covers developed countries in Europe, Australasia, Israel and the Far East, gained 3.20%, underperforming U.S. stocks in a period where the U.S. dollar gained 0.40% against a basket of major world currencies. Industrials gained the most (6.51%), led by Keisei Electric Railway (34.60%), Mitsubishi (34.33%) and Toyota Industries (28.49%). Technology shares rose 6.06% and consumer discretionary stocks gained 5.44%. Communications services (-2.36%), real estate (-1.81%) and material stocks (-1.43%) were down the most.