# MACRO MUSINGS

July 18, 2023

## First Half 2023 Review: Markets Rebound But Economic Risks Remain

Rush Zarrabian, CFA®
Corbett Road
*Managing Partner, Portfolio Manager*

CORBETT ROAD
WEALTH MANAGEMENT

# SUMMARY

- **macro**cast™ indicates the risk of a recessionary bear market remains elevated. Our current **micro**cast™ signal is suggesting a neutral allocation. The **macro**cast™ score and neutral **micro**cast™ allocation suggest the market environment for stocks remains uncertain.
- Leading indicators continue to signal potential economic softness on the horizon, while the robustness of coincident indicators paints a picture of a healthy economy. We predict that this divergence will likely sort itself out by the end of 2023 or the beginning of 2024, resulting either in a downturn or a positive inflection in the business cycle.
- Major asset classes enjoyed a strong first half, a mirror image to the first half of 2022. While the S&P 500 rose to double-digit gains, the average stock lagged the largest names in the index.
- Historically, strong first halves led to mostly positive returns for the rest of the year. Even in years that saw negative returns in the second half, drawdowns were minimal, with one exception.

*The chart(s)/graph(s) shown is(are) for informational purposes only and should not be considered as an offer to buy, solicitation to sell, or recommendation to engage in any transaction or strategy. Past performance may not be indicative of future results. While the sources of information, including any forward-looking statements and estimates, included in this (these) chart(s)/graph(s) was deemed reliable, Corbett Road Wealth Management, Spire Wealth Management LLC, Spire Securities LLC and its affiliates do not guarantee its accuracy.*

# THE MESSAGE FROM **macro**cast™ AND **micro**cast™

As a reminder, **macro**cast™ and **micro**cast™ are Corbett Road's two proprietary investment models. **macro**cast™ measures the appeal of risk assets by looking at the **VITALS** of the market—**V**aluation, **I**nflation, **T**echnical Analysis, **A**ggregate Economy, **L**iquidity, and **S**entiment. By looking at multiple factors, we seek to better gauge market conditions and the probability of a major, sustained market decline. **micro**cast™ examines market price action, looking at **TUMS** —**T**rend, **U**nderlying Breadth, **M**omentum, and **S**entiment. While **macro**cast™ focuses on recession risks and how that might impact risk assets, **micro**cast™ focuses solely on market technicals and volatility, without considering the broader macroeconomic environment.

**macro**cast™ has been consistent since last spring, which corresponds with a volatile environment for risk assets. **micro**cast™ recommended a defensive allocation for the majority of 2022, but as price action improved and technical indicators became more constructive earlier this year, the model increased its equity exposure and has been recommending a neutral allocation since early April.

The current recommendations from our risk models stand in stark contrast to the models' outputs during the second half of 2020 through 2021. During that period, the signals from both **macro**cast™ and **micro**cast™ reflected a more accommodative macro and market environment, supportive of strong equity returns and a major bull market. While this year's market rally has been encouraging (and welcome), neither **macro**cast™ nor **micro**cast™ is suggesting an all-clear signal just yet.

# COMPARING LEADING INDICATOR **WITH COINCIDENT INDICATORS**

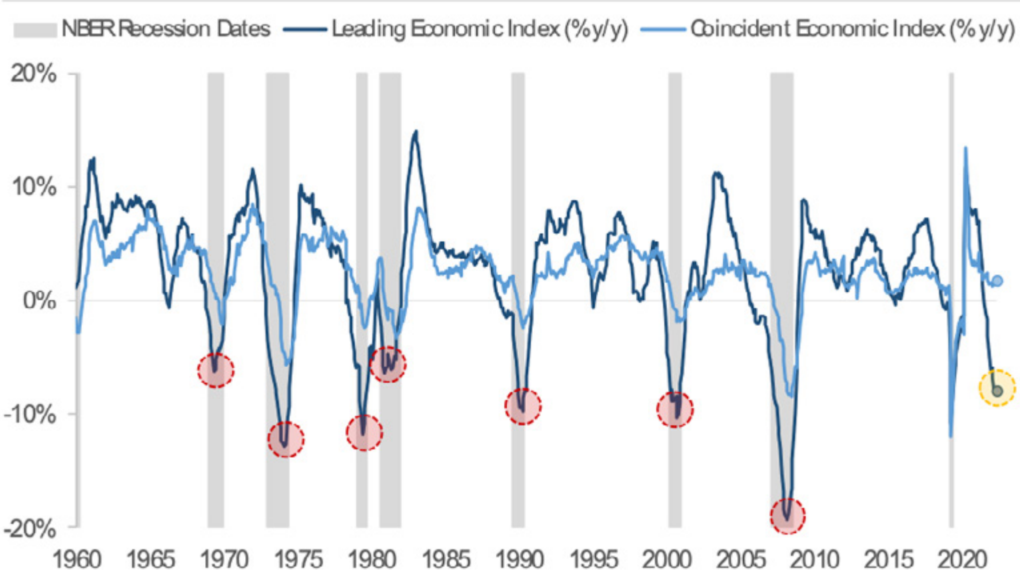
Is the United States' economic strength sustainable? An index of leading economic datapoints suggests the U.S. economy may be near a possible inflection.

Figure 1 compares the year-over-year change in the Conference Board's Leading Economic Index (LEI) against the Coincident Economic Index (CEI). To give some background, the LEI consists of ten economic indicators that typically foreshadow broader economic shifts. These include factors like unemployment claims, building permits, and manufacturing hours worked. We've previously compared the LEI with our own **macro**cast™ model's output to showcase the similarities and differences.

*Please see important disclosures at the end of this article*

While the LEI aims to provide an early indication of significant turning points in the business cycle by looking at leading indicators, the CEI is made up of four indicators that move in tandem with the economy, offering real-time snapshots of economic conditions and reflecting the current state of the economy. These indicators include metrics like industrial production and personal income. The periods shaded in gray denote previous U.S. recessions (Chart from MarketDesk Research):

**FIGURE 1 – Leading Economic Index vs Coincident Economic Index**




Source: U.S. Conference Board, National Bureau of Economic Research US (NBER). Time period is from December 1960 to May 2023. Data as of June 30, 2023.

The chart highlights the wide divergence between the two indices. While leading indicators have fallen 8% over the past year—a level of contraction that has historically led to recession—coincident indicators have seen a 2% uptick over the same period, reflecting the current strength of the economy.

So, what does this divergence between LEI and CEI suggest? While a buoyant CEI doesn't guarantee the economy will avoid a recession, its upward trend reflects the resilience of the U.S. economy; despite the rapid rise in interest rates, coincident economic data remains robust. It is not unusual for the LEI to dip while the CEI remains positive, as highlighted by the red circles on the chart. These points mark previous instances where the LEI dropped first, followed by a CEI downturn.

However, the gray-shaded areas on the chart highlight prior recessions, and each time the LEI declined by more than 5% within a year, the CEI was also trending lower, reflecting a U.S. economy that was teetering on the edge of a recession. Currently, this doesn't seem to be the case.

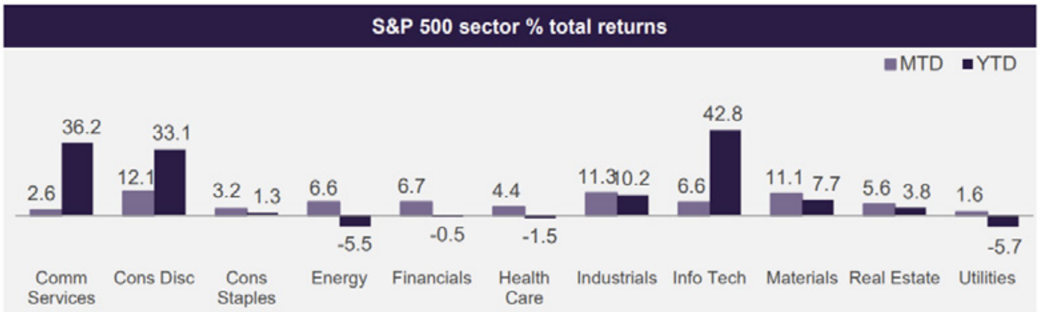
*Please see important disclosures at the end of this article*

The current climate stands apart from any other business cycle we've observed. We anticipate that the picture will become clearer as the year draws to a close. Our outlook continues to be in line with our previous assessments—there's a potential for a recession by the fourth quarter of 2023 or the first quarter of 2024. However, if a recession doesn't materialize, we foresee the global cycle pivoting upwards, effectively resetting the probability of a recession.

# ASSET CLASS REVIEW: **POSITIVE RETURNS LED BY TECH**

The following chart highlights major asset class returns for the first quarter (table from Truist):

| Index % Total Return | MTD | QTD | YTD | 1 Yr |
|---|---|---|---|---|
| MSCI ACWI (net) | 5.81 | 6.18 | 13.93 | 16.53 |
| S&P 500 | 6.61 | 8.74 | 16.89 | 19.59 |
| MSCI EAFE (net) | 4.55 | 2.95 | 11.67 | 18.77 |
| MSCI Emerging Markets (net) | 3.80 | 0.90 | 4.89 | 1.75 |
| Dow Jones Industrials | 4.68 | 3.97 | 4.94 | 14.23 |
| Bloomberg Commodity Index | 4.04 | -2.56 | -7.79 | -9.61 |
| Bloomberg Aggregate | -0.36 | -0.84 | 2.09 | -0.94 |
| ICE BofA US High Yield | 1.63 | 1.63 | 5.41 | 8.87 |




Some additional insights:

**The 5th best start since 1989.** Equity markets are off to a strong start this year. After a steep sell-off in the first half of 2022, the S&P 500 returned +16.8% (total return including dividends) in the first half of 2023. The year-to-date gain ranks as the fifth strongest first-half return since 1989.

**The vast majority of S&P 500 gains came from 3 sectors.** The S&P 500 saw an impressive surge of over 16% in the first half of this year. Yet, it's notable that the driving forces behind the bulk of these gains were from three sectors: Information Technology, Communication Services, and Consumer Discretionary. These sectors, comprising more than 45% of the index, are home to the 7 largest companies in the index, by market capitalization. Interestingly, when we consider the equal-weighted S&P 500, which

*Please see important disclosures at the end of this article*

neutralizes the influence of the biggest companies, the index saw a relatively modest 6% increase. This difference is a clear indicator of the outsized impact these dominant sectors and companies had in the first half.

**Commodities have underperformed as China's recovery stalled.** Entering 2023, there was a widespread expectation that China's revised Covid-19 strategy would stimulate a surge in growth, potentially pushing commodity prices upward. However, this prediction has not played out. Commodity prices have actually dipped, an intriguing development given the weaker US dollar—a trend that typically spurs commodities in the opposite direction.

**Bonds sold off as interest rates moved higher.** The Bloomberg Aggregate Bond Index fell around 1% in Q2 after a strong start to the year. However, the start of Q3 has shown an upswing in bond returns, spurred by lower interest rates in anticipation of the Federal Reserve halting rate increases due to subsiding inflation.

# HOW THE MARKET PERFORMED
# AFTER A HISTORICALLY STRONG START

With the first half of the year marked by double-digit gains, we thought it would be interesting to explore what history says about the rest of the year. Data from Bespoke highlights prior instances, post-WWII, when the market has risen by 10% or more through the first six months of the year: (chart to the right)

S&P 500 10%+ Gains in the First Half Since WW2

| | % Chg | | | | | |
|---|---|---|---|---|---|---|
| Year | First Half | June | July | Next 3 Mths | Next 6 Mths | Next Year |
| Jun-54 | 17.73 | 0.07 | 5.72 | 10.61 | 23.18 | 40.47 |
| Jun-55 | 14.04 | 8.23 | 6.07 | 6.43 | 10.85 | 14.48 |
| Jun-58 | 13.13 | 2.61 | 4.31 | 10.65 | 22.04 | 29.24 |
| Jun-61 | 11.24 | -2.88 | 3.28 | 3.23 | 10.69 | -15.30 |
| Jun-67 | 12.83 | 1.75 | 4.53 | 6.70 | 6.43 | 9.86 |
| Jun-75 | 38.84 | 4.43 | -6.77 | -11.89 | -5.25 | 9.55 |
| Jun-76 | 15.62 | 4.09 | -0.81 | 0.92 | 3.05 | -3.64 |
| Jun-83 | 19.53 | 3.52 | -3.30 | -1.21 | -1.89 | -8.88 |
| Jun-85 | 14.72 | 1.21 | -0.48 | -5.09 | 10.13 | 30.75 |
| Jun-86 | 18.72 | 1.41 | -5.87 | -7.78 | -3.46 | 21.19 |
| Jun-87 | 25.53 | 4.79 | 4.82 | 5.87 | -18.72 | -10.03 |
| Jun-88 | 10.69 | 4.33 | -0.54 | -0.58 | 1.54 | 16.26 |
| Jun-89 | 14.50 | -0.79 | 8.84 | 9.80 | 11.14 | 12.59 |
| Jun-91 | 12.40 | -4.79 | 4.49 | 4.50 | 12.37 | 9.96 |
| Jun-95 | 18.61 | 2.13 | 3.18 | 7.28 | 13.07 | 23.11 |
| Jun-97 | 19.49 | 4.35 | 7.81 | 7.02 | 9.64 | 28.10 |
| Jun-98 | 16.84 | 3.94 | -1.16 | -10.30 | 8.41 | 21.07 |
| Jun-99 | 11.67 | 5.44 | -3.20 | -6.56 | 7.03 | 5.97 |
| Jun-03 | 10.76 | 1.13 | 1.62 | 2.20 | 14.10 | 17.07 |
| Jun-13 | 12.63 | -1.50 | 4.95 | 4.69 | 15.07 | 22.04 |
| Jun-19 | 17.35 | 6.89 | 1.31 | 1.19 | 9.82 | 5.39 |
| Jun-21 | 14.41 | 2.22 | 2.27 | 0.23 | 10.91 | -11.92 |
| Jun-23 | 15.78 | 6.35 | ? | ? | ? | ? |
| | | Average | 1.87 | 1.72 | 7.73 | 12.15 |
| | | Median | 2.73 | 2.72 | 9.98 | 13.53 |
| | | % Positive | 63.6% | 68.2% | 81.8% | 77.3% |
| | | Avg. All Other Years | 0.96 | -0.13 | 3.13 | 7.19 |

The first key takeaway is that such a rally is not rare. This year marks the 23rd time the market has experienced a double-digit increase in the first half since 1945. The second insight is that momentum often has staying power. Only 4 out of the prior 22 instances saw markets decline, following a robust start, and those dips were generally mild. The glaring exception was the Crash of 1987, but as we've pointed out before, that crash is notable because of its rarity. It's also worth noting that before the October 1987 plummet, the S&P had already soared by over 30%.

So, historical trends suggest that when the market starts strong, it often stays strong. However, we must keep in mind that these historical trends are not crystal balls that predict future market action. They simply show us that a stellar start doesn't automatically equate to a downturn as the year progresses.

To summarize, as we pivot into the latter half of 2023, investors are left contemplating the sustainability of continued positive economic growth. Indicators, such as the LEI, continue to suggest a pending shift in the direction of the economy while current data remains strong. While the market rallied strongly in the first half, the S&P 500's advance was predominately driven by the largest companies in the index, which accounted for a significant part of the gains.

There are plenty of known risks, including a potential rise in bankruptcy filings—owing to issues with refinancing and falling profit margins—as well as the end of the moratorium on student loan repayments this fall, which could put further pressure on the economy and unsettle the market.

Still, one cannot simply ignore the positive price action of the past several months. Strong starts to the year usually continue, and the market continues to climb a "wall of worry" as it rebounds from a very difficult year in 2022. Over the next few weeks, as companies begin to report second quarter results, a focus will be on earnings and management guidance. Positive surprises and a corresponding increase in market breadth (more stocks participating in the rally) would be an encouraging development.

We remain vigilant and ready to adjust our portfolio strategies in response to any shift in the landscape as the year unfolds.

## SUMMERTIME

Summer vacations can give you a chance to recharge your battery, enjoy time with your family, and/or get some needed time to reflect. Many of our clients mention the 'peace of mind' that they feel as a result of having put together and periodically reviewed their financial plan. Contact your Corbett Road Wealth Manager today to discuss your financial picture!

# IMPORTANT DISCLOSURES

*The chart(s)/graph(s) shown is(are) for informational purposes only and should not be considered as an offer to buy, solicitation to sell, or recommendation to engage in any transaction or strategy. Past performance may not be indicative of future results. While the sources of information, including any forward-looking statements and estimates, included in this (these) chart(s)/graph(s) was deemed reliable, Corbett Road Wealth Management (CRWM), Spire Wealth Management LLC, Spire Securities LLC and its affiliates do not guarantee its accuracy.*

*The views and opinions expressed in this article are those of the authors as of the date of this publication, are subject to change without notice, and do not necessarily reflect the opinions of Spire Wealth Management LLC, Spire Securities LLC or its affiliates.*

*All information is based on sources deemed reliable, but no warranty or guarantee is made as to its accuracy or completeness.* ***macro****cast™ and* ***micro****cast™ are proprietary indexes used by Corbett Road Wealth Management to help assist in the investment decision-making process. Neither the information provided by* ***macro****cast™ or* ***micro****cast™ nor any opinion expressed herein considers any investor's individual circumstances nor should it be treated as personalized advice. Individual investors should consult with a financial professional before engaging in any transaction or strategy. The phrase "the market" refers to the S&P 500 Total Return Index unless otherwise stated. The phrase "risk assets" refers to equities, REITs, high yield bonds, and other high volatility securities.*

***Use of Indicators***
*Corbett Road's quantitative models utilize a variety of factors to analyze trends in economic conditions and the stock market to determine asset and sector allocations that help us gauge market movements in the short- and intermediate term. There is no guarantee that these models or any of the factors used by these models will result in favorable performance returns.*

*Individual stocks are shown to illustrate market trends and are not included as securities owned by CRWM. Any names held by CRWM is coincidental. To be considered for investment by CRWM, a security must pass the Firm's fundamental review process, meet certain internal guidelines, and fit within the parameters of the Firm's quantitative models.*

*Spire Wealth Management, LLC is a Federally Registered Investment Advisory Firm. Securities offered through an affiliated company, Spire Securities, LLC, a Registered Broker/Dealer and member FINRA/SIPC. Registration does not imply any level of skill or training.*

CORBETT ROAD
WEALTH MANAGEMENT


**Washington, D.C.**
7901 Jones Branch Dr
Suite 800
McLean, VA 22102
Local: 703.748.5836

**Boston, MA**
101 Arch St
8th Floor
Boston, MA 02110
Local: 617.600.7930

**Los Angeles, CA**
1901 Avenue of the Stars
Suite 200
Century City, CA 90067
Local: 310.591.5674

**Fort Lauderdale, FL**
2598 E. Sunrise Blvd
Suite 2104
Ft. Lauderdale, FL 33304
Local: 954.507.6028

**Knoxville, TN**
800 S. Gay St
Suite 700
Knoxville, TN 37929
Local: 865.444.4520

**Phoenix, AZ**
2375 E. Camelback Rd
Suite 600
Phoenix, AZ 85016
Local: 602.807.1145

**St. Louis, MO**
7777 Bonhomme Ave
Suite 1800
Clayton, MO 63105
Local: 314.463.0132

**Toll Free: 844.688.4955**
info@corbettroad.com
www.corbettroad.com
linkedin.com/company/corbettroad

CRWM_MM_7.18.2023