July 2023

The stock market, as measured by the S&P 500, returned 16.9% in the first half of 2023, surprising most Wall Street strategists. For the first time in decades, strategists predicted a down year for stocks. A Bloomberg survey of strategists in December 2022 reflected a -1.5% return target for the S&P 500 in 2023, the only negative forecast since 2000. Amidst aggressive interest rate hikes from the Fed, the US economy has managed to defy expectations for a recession, and the stock market has reacted to this unexpected strength.

While we would not argue that 2023 is off to an impressive start, if we explore the drivers of this performance, it becomes clear that this has not necessarily been a good year for all stocks. Thus far in 2023 the market has experienced a reversal of leaders and laggards from 2022. The table to the right highlights the magnitude of rotation for sector performance. Energy, the only materially "positive" sector in 2022, with a 66% return, has declined year-to-date in 2023. The most dramatic reversal has been in 2022's worst performing sectors: Communication Services, Consumer Discretionary, and Information Technology. Those three sectors have dominated performance this year, delivering returns in the 33% to 45% range.

Sector	Full Year 2022	YTD through 6/30/23
Energy	66.2%	-5.5%
Utilities	1.3%	-5.7%
Consumer Staples	-0.6%	1.4%
Health Care	-2.0%	-1.6%
Industrials	-5.7%	9.9%
Financials	-10.5%	1.9%
Materials	-12.2%	7.7%
Real Estate	-26.3%	4.1%
Information Technology	-28.1%	45.4%
Consumer Discretionary	-37.1%	33.8%
Communication Services	-39.8%	36.2%
S&P 500	***-18.1%***	***16.9%***

Digging deeper reveals that the returns from the S&P 500 have been driven by a very narrow list of stocks, all large and nearly all technology related. How is this possible? Remember that the S&P 500 is a market capitalization weighted index. This means that larger companies account for a larger weight in the index. So far in 2023, the largest companies in the index have posted remarkably strong returns. While not all of these "mega cap" companies technically reside in the Information Technology Sector, they all have very strong growth and technology aspects to their businesses.

How strong has their contribution been? If we take just the top eight contributors to the S&P 500 returns this year, they have generated 12.7% of the overall 16.9% return for the index. These eight companies represent 29% of the index weight, but account for 75% of its return through the first six months of 2023.

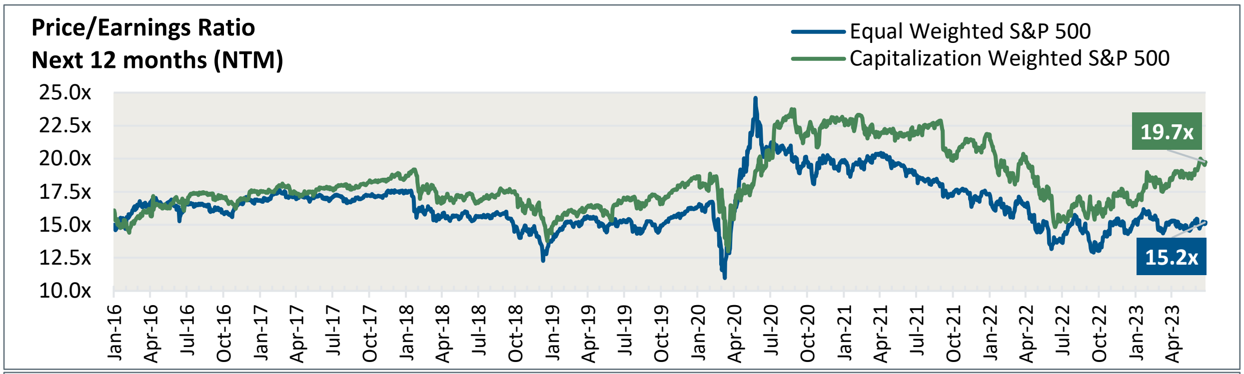
S&P 500 Total Return
30-DEC-2022 to 30-JUN-2023

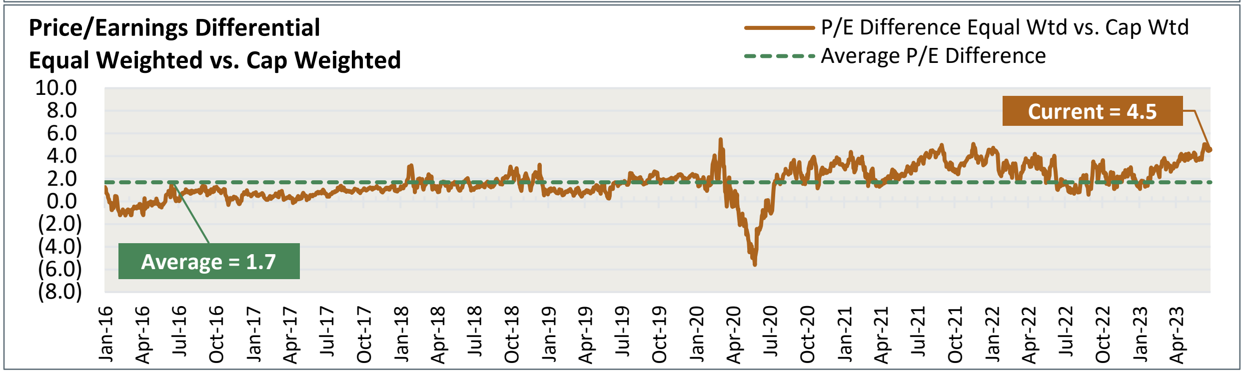
Ticker	Stock	Ending Weight	Total Return	Contrib. to Return	% of S&P 500 Return
AAPL	Apple Inc.	7.8%	49.7%	3.0%	
MSFT	Microsoft Corporation	6.8%	42.7%	2.4%	
AMZN	Amazon.com, Inc.	3.1%	55.2%	1.3%	
GOOGL	Alphabet Inc. Class A	1.9%	35.7%	0.6%	
GOOG	Alphabet Inc. Class C	1.7%	36.3%	0.6%	
NVDA	NVIDIA Corporation	2.8%	189.5%	2.2%	
TSLA	Tesla, Inc.	1.9%	112.5%	1.1%	
META	Meta Platforms Inc. Class A	1.7%	138.5%	1.2%	
BRK.B	Berkshire Hathaway Inc. Class B	1.7%	10.4%	0.2%	
	Top 8 Stocks	**29.4%**		**12.7%**	**75.0%**
	Remaining Stocks	70.6%		4.2%	25.0%
	Total S&P 500	**100.0%**	**0.0%**	**16.9%**	**100.0%**

Two other common benchmarks further illustrate the point that not all stocks are performing as well as the mega-cap technology related stocks. The S&P 500 *Equal Weight* Index weighs all 500 companies in the index equally, which removes the skew that larger companies can contribute to results. The equal-weight benchmark is up just 7.3% YTD, almost 10% less than the market capitalization weighted index. Similarly, the MSCI US Dividend Equity Index is comprised of companies that all pay a regular dividend. Because very few of the eight stocks listed above pay a dividend, dividend stocks have lagged significantly this year. Through the first six months of 2023 the MSCI US High Dividend Equity Index is unchanged, returning -0.2%.

A natural concern after a rapid market run, particularly against a backdrop of relatively modest earnings growth, is whether the market has become "expensive" using the Price/Earnings (P/E) ratio. As highlighted by the first table below, after starting the year at 16.5x P/E using next twelve months (NTM) projections, the market multiple has risen to 19.7x NTM P/E and is no longer historically "cheap." However, large, high multiple mega-cap stocks represent more of the S&P 500 than has historically been the case.

If we instead look at the average P/E multiple for stocks in the S&P 500 equal-weighted, we can see that valuations have not moved appreciably this year with the current multiple at 15.2x compared with 15.3x at the start of 2023. In fact, the second chart below notes the difference between the P/E of the overall S&P 500 vs. the average company multiple. The current difference of 4.5x is well-above the average 1.7x difference over the past eight years (the period for which data was available).





The equal-weight P/E suggests that many attractively valued investment opportunities remain in the market despite its surprisingly strong start to the year. More importantly, we are encouraged by the operating fundamentals of our portfolio companies (business remains pretty good!) and believe their valuations remain reasonable and attractive.