C&N VANTAGE POINT

Quarterly Market Recap & Outlook | Second Quarter, 2023

Meet A Team Member

Jay M. Over, CFA, CIPM

Investment Strategist

Jay has been with the C&N Wealth Management Team for 7 years and has worked in the financial services field since 2009. As an Investment Strategist, he is extensively involved with investment research and due diligence, implementing trades and rebalancing client portfolios and investment operational matters. Jay also has responsibility and oversight for fixed income strategies. Additionally, he is a regular contributor to the Investment Team's Monthly Market Review.

Helping clients achieve their financial needs and goals is the driving force motivating Jay to perform his job. Jay is grateful to be a part of the C&N Wealth Management Team because of the knowledge and experience this group brings to the table. "Our Team is an outstanding group of professionals that puts clients first".

Jay holds the Chartered Financial Analyst® designation. He also holds the Certificate in Investment Performance Measurement™ designation. Jay graduated from Saint Francis University with degrees in both accounting and finance.

When not at work, Jay enjoys being outdoors and spending time with family and friends.

Key Equity Indexes - As of Quarter End	%YTD Return**	NTM P/E**	P/B**	Dividend Yield**
S&P 500	16.89	19.13	3.93	1.51
Russell 2000	8.09	21.23	1.89	1.44
Russell 1000 Growth	29.02	27.01	9.89	0.72
Russell 1000 Value	5.12	14.48	2.30	2.30
MSCI EAFE	12.13	13.12	1.69	2.96
MSCI EM	5.10	12.36	1.56	2.65

Sources: JP Morgan Weekly Market Recap; Northern Trust. Past performance does not guarantee future results, which may vary.
** As of 6/30/2023

Key Interest Rates	2023			
	9/30/22	12/30/22	3/31/22	6/30/23
2-yr Treasury Note	4.22	4.41	4.06	4.87
10-yr Treasury Note	3.83	3.88	3.48	3.81
30-yr Treasury Note	3.79	3.97	3.67	3.85
30-yr Fixed Mortgage	6.52	6.34	6.45	6.75
Corp. Bond Index	5.69	4.68	5.17	5.48
High-Yield Bond Index	9.7	8.99	8.59	8.58

Sources: JP Morgan Weekly Market Recap & Oppenheimer Markets Review At-a-Glance
Past performance does not guarantee future results, which may vary.

2023 YTD Style Performances**

	US Equity Style			MSCI World Style			US Fixed Income Maturity***			
Equity Size	Value	Core	Growth	Value	Core	Growth	Short	In-termed.	Long	Quality
Large	5.12%	16.68%	29.02%	3.94%	16.42%	29.40%	0.95%	1.10%	3.72%	Government
Medium	5.23%	9.01%	15.94%	4.12%	7.76%	12.55%	1.75%	2.33%	4.88%	Corporate
Small	2.50%	8.09%	13.55%	4.02%	7.64%	11.38%	4.95%	5.39%	5.16%	High Yield

Source: Northern Trust, Goldman Sachs Asset Management Market Monitor & Oppenheimer Markets Review At-a-Glance | US Equity Style Returns - Russell Indices Past performance does not guarantee future results, which may vary.
**As of 6/30/2023

PARTY ON?

The U.S. economy continues its post-pandemic expansion – resisting the growth-dampening intentions of restrictive monetary policy. The Federal Reserve (Fed) has hiked interest rates by a cumulative 5% the past five quarters (a brisk 1% per quarter pace); in response, the labor market has added nearly five million jobs over that timeframe. Interestingly, the U.S. economy regained pre-pandemic employment levels exactly one year ago – meaning the bulk of the jobs created during the current Fed rate hiking campaign (roughly five million) aren't just refilling the pandemic hole, but instead represent true growth in the U.S. employment base. This has kept the U.S. consumer in spending mode, averaging 2.1% real growth (above and beyond inflation) the past five quarters. Put another way, the party has not slowed as the Fed had hoped.

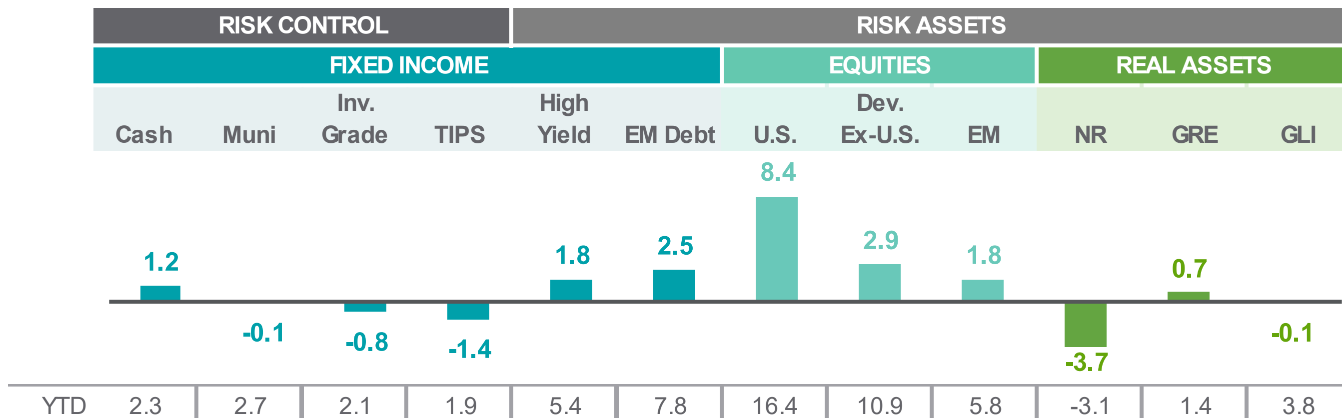
Closing time. While the Fed has been hiking interest rates since March of 2022, only since (approximately) last September has the Fed been in restrictive territory – that is, above the neutral (not inflationary nor disinflationary) policy rate, thought to be near 2.5%. Even still, the Fed effectively announced "last call" nine months ago – so why has the economic party continued? Milton Friedman famously noted the "long and variable lags" of monetary policy. Today those long lags are being further lengthened by the continued shift to a service economy (requires less investment capital and shows less interest rate sensitivity) and the large number of homeowners still enjoying 3% mortgages (and spending the saved money elsewhere).

Economic hangover? A potential problem with this is that the longer the economy resists the Fed's proverbial calls to go home, the more likely financial markets may regret it in the proverbial morning. Continued strong labor demand raises the specter of continued wage pressures (still stubbornly above 4% after mostly staying below 3% during the post-global financial crisis, pre-pandemic era). This, in turn, increases the risk of a sustained price-wage spiral (higher prices lead to higher wage demands that lead to even higher prices) and may force the Fed to refocus its inflation-fighting efforts. At present, the Fed is telegraphing two more rate hikes (though investors expect only one more hike) to 5.75% before an elongated pause. The longer the Fed must enforce restrictive policy, the greater the risk of eventual investment portfolio pain.

Portfolio painkillers. The "hair of the dog" outcome would be for labor supply relief (early AI job applications or late-to-the-party jobs entrants aiming to offset restarted student loan payments?) to sustain the economic expansion sans high inflation, paving the way for further equity market gains. Short of that outcome, a few portfolio painkillers may be in order. Natural resource equities and inflation-linked bonds can help with new inflationary risks – especially should those risks arise from oil or other commodity supply shocks (a growing risk in this new geopolitical climate). For those worried about volatility, high yield bonds (and their 8.5% yield) could offer a similar return to equity markets, but with historically lower risk.

SECOND QUARTER 2023 TOTAL RETURNS (%)

U.S. equities posted their best quarter since 2021 as the perceived odds of a soft landing increased.



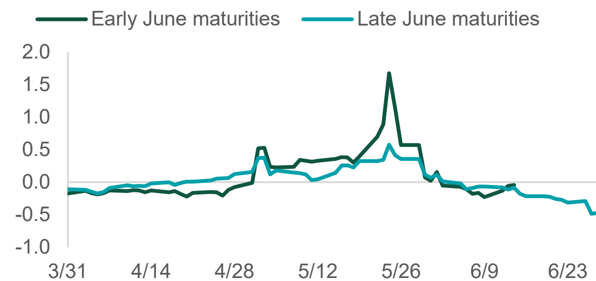
Source: Northern Trust Asset Management, Bloomberg. NR: Natural Resources; GRE: Global Real Estate; GLI: Global Listed Infrastructure. Indexes are gross of fees.

KEY DEVELOPMENTS

Debt Dislocations Resolved

Investors digested two major risks broadly related to debt in 2Q: the debt ceiling and bank sector stability. The former did not lead to much market concern other than in short-dated Treasury yields (see chart) – the "low-probability, high-impact" U.S. default risk case was removed after a deal in D.C. took the debt ceiling off the table until early 2025. The latter risk has also faded. While First Republic failed in early May, bank stress eased through May and June. The amelioration of both risks, overall, was supportive of equity markets.

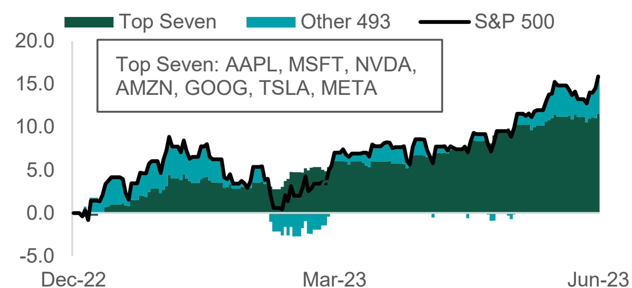
TREASURY BILL YIELDS MINUS FED FUNDS RATE (%)



Artificial Intelligence, Artificial Up Market?

AI saw heavy investor interest, leading to strong returns for large tech-related companies. An improved fundamental outlook helped these stocks outperform during a time of rising interest rates – often considered a headwind for the group. By late May, the S&P 500 was up ~10% year-to-date, but all of that gain was driven by the seven largest stocks and the contribution from the other companies was slightly negative. While the market gains broadened in June, the "Top Seven" continue to account for a majority of 2023's return.

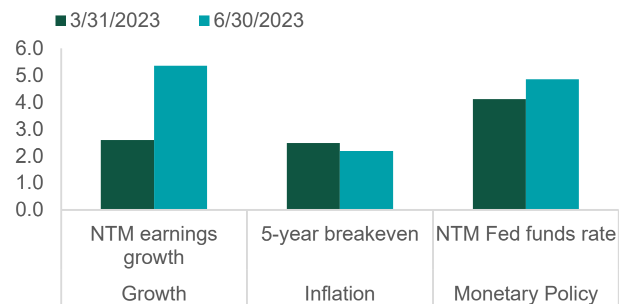
S&P 500 2023 RETURN BREAKDOWN (%)



Growing Soft Landing Hopes

Hopes of a soft landing remain as the U.S. growth outlook followed a narrative of continued resilience (via a solid labor market) with signs of softening. Inflation expectations dropped yet the pace and magnitude of the decline in core inflation remains a key question. Finally, investor Federal Reserve policy expectations moved up to reflect one (or two) more rate hikes beyond the current 5.1% level in addition to phasing out the possibility of a large rate cut – a sharply negative scenario that would not have been helpful for equities.

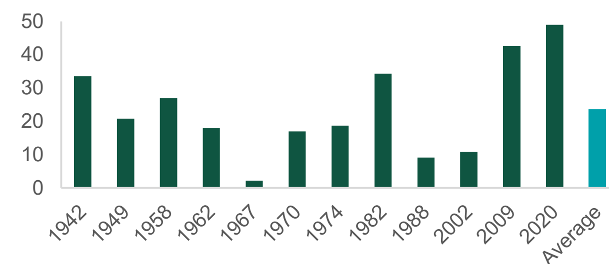
MARKET EXPECTATIONS AS OF… (%)



Can Bears Become Bulls?

The S&P 500 exited bear market territory on June 8 by a commonly used convention (20% off the low). The bear market stretched back to early January of 2022 with the low falling in mid-October. Equity returns have typically been positive in the year following the exit from a bear market. However, this time could be different as equity market rebounds have often been accompanied by a recovering economy and/or a reversal to a more-accommodative monetary policy stance – neither of which are particularly likely over the next 6-12 months.

1-YEAR RETURNS AFTER BEAR MARKET EXITS (%)



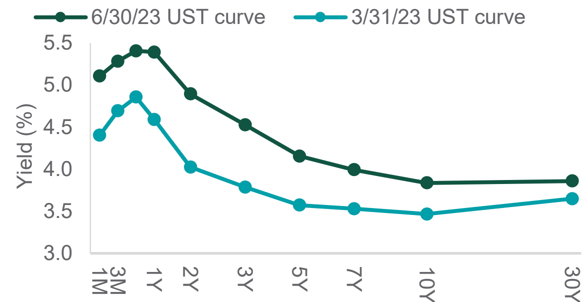
Source: Northern Trust Asset Management, Bloomberg. Data as of 6/30/2023. Note: early June (6/1 to 6/15); late June (6/16 to 6/30); NTM = next-twelve-months; Average goes back to 1940. Past performance is not indicative or a guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

MARKET REVIEW

Interest Rates

The U.S. debt ceiling was resolved with a short-lived and contained impact on Treasury yields. Meanwhile, the Fed decided to hold its policy rate in June, but the “pause” was more of a “skip” as it projected two more rate hikes this year. Disinflation was embraced, but core prices remain high while employment is still solid. The Fed was among a crowd of major global central banks, with China as a notable exception, suggesting more tightening needs to occur. The Treasury curve bear flattened with the 2-year yield up 87 basis points (bps).

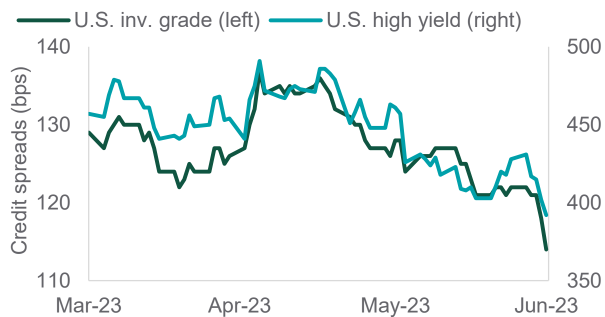
U.S. TREASURY YIELD CURVE



Credit Markets

After First Republic Bank entered receivership the banking system found its footing and credit spreads retraced almost all of the widening that had occurred since March due to regional bank strains. Investment grade (IG) and high yield (HY) spreads narrowed 15 and 65 bps, respectively, on the quarter. Default activity ticked up but stayed fairly benign and lower-quality credits outperformed. Credit risk was favorable to duration with the more interest rate-sensitive IG Fixed Income (-0.8%) trailing HY Fixed Income (+1.8%).

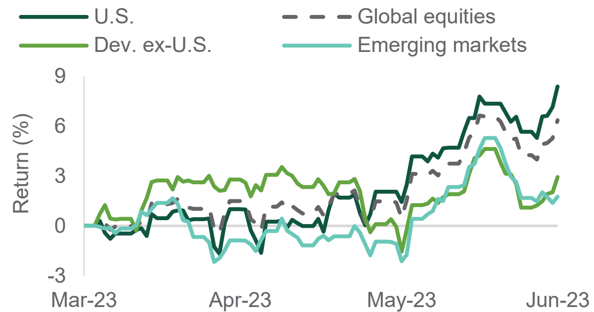
CREDIT SPREADS



Equities

It was a strong quarter for global equities (+6.4%). Declining inflation and upside economic surprises underpinned an 8.4% gain in the U.S., while optimism on artificial intelligence drove robust returns in a narrow set of mega cap tech stocks. Valuations offered most of the support, though for the first time in eight months forward earnings estimates increased. European equities were bogged down by economic recession and tight policy. China’s slow recovery dragged on, but near the end of the quarter policymakers started to step in.

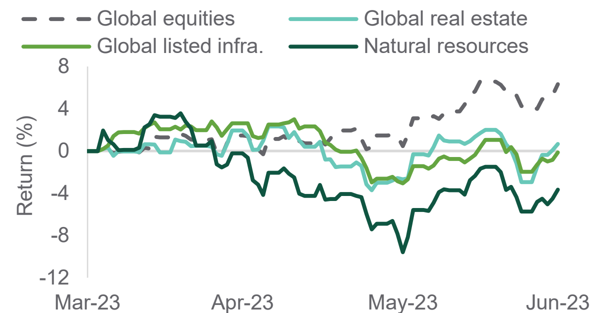
REGIONAL EQUITY INDICES



Real Assets

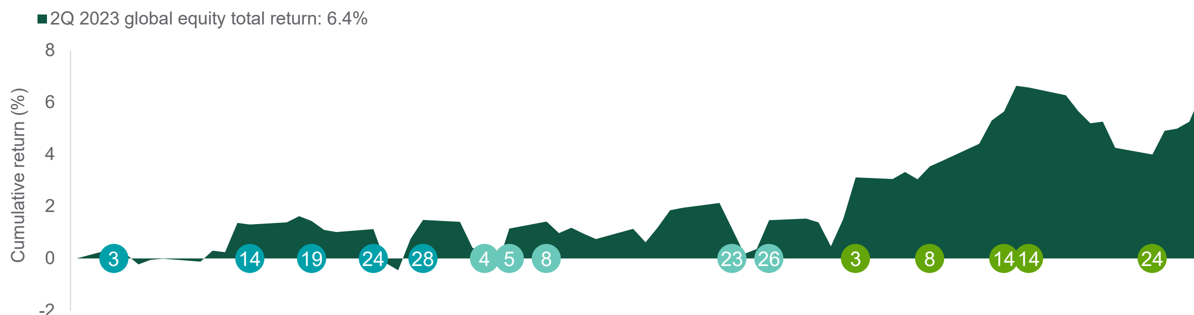
It was an underwhelming quarter for real assets as global real estate (+0.7%), listed infrastructure (-0.1%), and natural resources (-3.7%) lagged global equities. Higher interest rates were a headwind for real estate (RE) and infrastructure, but RE was helped by a more favorable credit backdrop and saw some improvement in lagging sectors like office. Global growth concerns continued to weigh on commodity prices with metals particularly soft on weak manufacturing activity. That said, late-quarter China stimulus offered some support.

REAL ASSET INDICES



Source: Bloomberg. Returns in U.S. dollars. Indexes are gross of fees. Past performance is not indicative or a guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

MARKET EVENTS



APRIL	MAY	JUNE
3 Oil prices increase following a surprise OPEC-plus announcement of a meaningful supply reduction.	**4** The European Central Bank (ECB) delivers a 25-basis point (bp) rate hike and indicates more are on the horizon.	**3** Markets price out U.S. default risks after Congress extends the debt ceiling past the 2024 Presidential Elections.
14 1Q23 earnings season unofficially begins; aggregate year-over-year (y/y) earnings growth finishes slightly negative but tops expectations of a larger decline.	**5** Regional bank stocks decline ~10% for the week, but the banking system proceeds to find its footing over the next several weeks as deposit outflows slow.	**8** The S&P 500 Index pushes into a new bull market after it crosses the 20% threshold above its October 2022 low.
19 U.K. inflation is notably hotter-than-expected, prompting an upward repricing of investor expectations for Bank of England policy tightening.	**8** Senior Loan Officer Opinion Survey shows that U.S. banks tightened lending standards and plan to continue to do so.	**14** The People's Bank of China cuts two of its key policy rates by 10 bps, a move that could signal a willingness to provide more support moving forward.
24 First Republic Bank (FRC) reveals steep deposit outflows and later becomes the third U.S. regional bank to fail since March, but a subsidized sale to JPMorgan helps contain broader fallout.	**23** Developed market Purchasing Managers' Index data shows services activity continues to expand, supporting growth but also pushing up investor expectations for central bank tightening.	**14** The Fed unanimously votes to hold its policy rate after 5% of cumulative tightening, but the updated Summary of Economic Projections indicates two more hikes to come in 2023.
28 U.S. core Personal Consumption Expenditures tops estimates at 4.6% y/y – a mere improvement from the prior level (4.7%).	**26** Artificial Intelligence (AI) optimism boosts Technology stocks, including a 20% weekly gain for NVIDIA (NVDA) after its AI projections drive a stunning increase in its revenue guidance.	**24** A deal between Russia President Putin and Wagner Group head Prigozhin ends Prigozhin's advance toward Moscow with little immediate impact but likely longer-term implications.

C&N Wealth Management

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Prepared by Northern Trust Asset Management for Citizens & Northern Wealth Management.

Indexes used: Bloomberg (BBG) 1-3 Month UST (Cash); BBG Municipal (Muni); BBG Aggregate (Inv. Grade); BBG TIPS (TIPS); BBG High Yield 2% Capped (High Yield); JP Morgan GBI-EM Global Diversified (Em. Markets Fixed Income); MSCI U.S. Equities IMI (U.S. Equities); MSCI World ex-U.S. IMI (Dev. ex-U.S. Equities); MSCI Emerging Market Equities IMI (Em. Markets Equities); S&P Global Natural Resources (Natural Resources); MSCI ACWI IMI Core Real Estate (Global Real Estate); S&P Global Infrastructure (Global Listed Infrastructure).

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FROM CONCERN TO CHURN?

U.S. equities performed well over the past month as the resolution of the debt ceiling and further passage of time without additional regional bank issues reduced the level of concern on display in the market, including a drop in the equity market "fear index" (VIX) to pre-pandemic levels. Market leadership continues to be very narrow, however, with the seven largest stocks in the S&P 500 accounting for more than all of the year-to-date gains. The question for investors is whether the rest of the U.S. equity market will start to participate – leading to further upside for stocks broadly – or the U.S. equity market will merely "churn" – with profit-taking in big tech (and tech-adjacent companies) used to fund a broadening of performance, capping overall return potential at the index level.

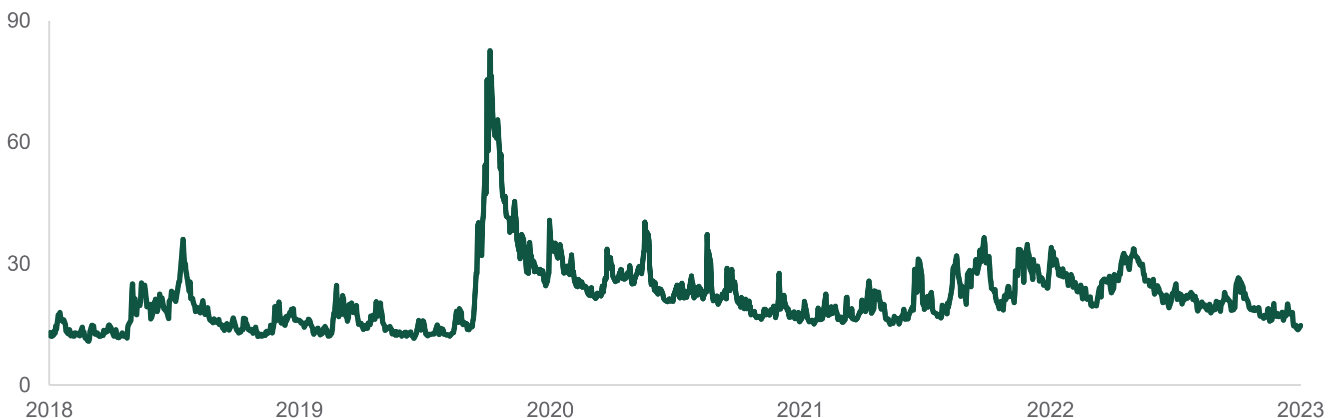
The removal of the "left-tail" risk has also repriced interest rates. Most notably, the front end of the yield curve has moved markedly higher as investors backed out odds of material rate cuts. While we believe the Fed is at/near a peak rate for this cycle, the continued durability of the labor market and sticky core inflation should keep rates elevated into next year. And, with equity valuations above long-term fair value (on earnings that do not yet seem to be factoring in recession), we see limited equity market return upside in the base case.

The outlook for Europe has worsened somewhat. Recessionary conditions are approaching, but the European Central Bank (ECB) has yet to shift from their path of continuing to increase interest rates due to sticky inflation. This increases the odds of a policy mistake in Europe, where monetary policy will be tightened beyond the point necessary, instigating additional economic weakness. Meanwhile, China continues to display a very sluggish recovery – causing some speculation that the government will have to increase stimulus.

With interest rates moving toward the high end of our expected range, we narrowed the size of our underweight to investment grade bonds. This was funded by a reduction in developed ex-U.S. equities, reflecting the accumulating headwinds in Europe. As such, we are now underweight equities across all three major regions. We have been encouraged by more durable fundamentals in the U.S. – but believe valuations are too elevated with the global economy approaching stall speed. We maintain our overweight positions in high yield bonds and natural resources – alongside a small overweight to cash.

REDUCED "FEAR"

The VIX Index – a gauge of equity market "fear" – declined to pre-pandemic levels over the past month.



Source: Northern Trust Asset Management, Bloomberg. Data for the CBOE Volatility Index (VIX) from 6/12/2018 through 6/12/2023.

C&N PORTFOLIO POSITIONING:
NEUTRAL AND MODERATELY DEFENSIVE

C&N Vantage Point
July 2023

Market Views:
U.S. Equity Markets Have Narrow Leadership. Need To Broaden To Continue A Strong Rally.
Diversification Remains Paramount. Economic Risks Are Plentiful.
Fed Will Hike At Least Once And Rate Cuts Unlikely For Foreseeable Future.

Market Risks:
Earnings Decline And Price Multiples Contract Accordingly.
Federal Reserve Miscalculations Or Miscommunications.
Inflation Does Not Decline Meaningfully.

Risk Type	Asset Class	Sector Category	Under Weight	Neutral	Over Weight	Viewpoints
	Cash/Cash Alternatives	Ultrashort Bonds			●	We retain our overweight to this category as short-term rates remain attractive. This remains a source of funds for a targeted trade should opportunities develop in either fixed income or equities.
Risk Control	Alternatives (Fixed Based)	Absolute Return	●			This is a bond alternative category. Given current yields, we believe core fixed income provides better risk/reward. We retain our underweight.
Risk Control	Alternatives (Fixed Based)	Inflation-Linked Bonds	●			Inflation expectations impact TIPS pricing more than actual inflation. Expectations are leveling. We remain slightly underweight preferring US Large Value and Natural Resources as inflationary hedges.
Risk Control	Fixed Income	US Investment Grade Bonds		+		YTD yields have risen with recent economic resilience. The risk/reward for bonds remains compelling. We added to our core bond position during our April rebalance and now retain a neutral weighting.
Risk Control	Fixed Income	International Bonds	●			Although the dollar has weakend YTD, US rate hikes are ending and the international hike cycles are not as well known. We retain our slight underweight and favor domestic bonds with their higher yields.
Risk Control	Fixed Income	Emerging Markets Bonds	●			Many EM economies are more susceptible to the impacts of inflation, slowing growth, and geopolitical concerns. We retain our slight underweight favoring the risk/reward of domestic bonds.
Risk Assets	Fixed Income	High Yield Bonds		●		Yields remain attractive relative to other fixed income asset classes, but the spread to Treasuries is still average. We maintain our neutral position as the economy shows signs of slowing.
Risk Assets	Equities	US Large Cap			●	We are overweight Value for its dividend focus and slightly underweight Growth. We continue to favor domestic over international, but international's valuations are becoming more attractive.
Risk Assets	Equities	Developed Ex-US		+		We move to neutral from underweight, favoring Large Cap over Small Cap during more challenging economic times. We tilt towards Foreign Large Cap Growth favoring ther valuations to US Growth.
Risk Assets	Equities	US Mid & Small Cap	−			We move to underweight from neutral given our concerns for a slower economy we expect later this year. We retain a slight overweight to Value witin the space.
Risk Assets	Equities	Emerging Markets	●			We maintain an underweight but valuations are reasonable. We continue to monitor China's re-opening.
Risk Assets	Alternatives (Equity Based) & Real Assets	Real Estate		●		REITs have been hurt by the volatile rate environment; however, they provide a long-term inflation hedge when inflation moderates and current income is attractive. We remain neutral.
Risk Assets	Alternatives (Equity Based) & Real Assets	Commodities/Natural Resources			●	In general, commodities have lagged YTD. We maintain our slight overweight position expecting fallen commodity prices to stablize and valuations are reasonable.

Note: Views are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector. Client portfolios may or may not be at the recommended weightings above due to, but not limited to: distributions, tax management limitations, systematic purchases, etc. NOT FDIC INSURED / MAY LOSE VALUE / NO BANK GUARANTEE

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QUARTERLY MARKET RECAP & OUTLOOK SECOND QUARTER, 2023

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