Quarterly Outlook

JUNE 2023

Tandem Collective Funds®
Tandem ETF Portfolios®

Second Quarter 2023

Stocks continued to climb higher in the second quarter, driven by the large growth sectors of the market. A narrow group of big tech companies fueled the stock rally on bets that the boom in artificial intelligence will boost their profits. AI euphoria led to a return of more than 40% for the information technology sector year to date. Additionally, bank stabilization, progress on inflation, solid payrolls, and a debt-limit deal provided the impetus to push stocks higher.

Bonds struggled to make gains as the Fed signaled higher rates for longer. With last quarter's banking crisis seemingly contained, investors have priced out rate cuts, and interest rates rose across the curve.

Like the first quarter, only three sectors outperformed the overall market: consumer discretionary, communication services, and information technology. The cyclical and defensive sectors all underperformed the market, and two sectors were down: energy and utilities. Developed markets outperformed emerging markets due to weakness in Chinese equities.

Even though the Fed has paused hikes, they have signaled a willingness to keep rates higher for longer, until the sticky portions of inflation subside.

Index/Instrument	Category	Q2 2023 Total Return	Total Return Trailing 1 Year (as of 6/30/2023)
S&P 500	Large-capitalization stocks	8.74%	16.88%
S&P MidCap 400	Mid-capitalization stocks	4.84%	8.81%
S&P SmallCap 600	Small-capitalization stocks	3.36%	5.99%
NASDAQ 100	Large-capitalization stocks	15.39%	39.35%
Russell 2000 Index	Small-capitalization stocks	5.19%	8.06%
MSCI World ex USA	Developed markets international stocks	3.27%	11.78%
MSCI Emerging Market	Emerging markets international stocks	0.94%	5.02%
Bloomberg Barclays US Aggregate Bond Index	Investment-grade US bonds	-0.84%	2.09%
Bloomberg Barclays US Treasuries	US government bonds	-1.38%	1.59%
Bloomberg Barclays US Investment Grade Corps	US investment-grade corporate bonds	-0.29%	3.21%
Bloomberg Barclays US Corporate High-Yield Bond Index	US corporate high-yield bonds	1.75%	5.38%
Bloomberg Barclays US MBS Index	US mortgage-backed securities	-0.64%	1.87%
Bloomberg Barclays Global Aggregate Bond Index	Global investment-grade bonds	-1.53%	1.43%
Bloomberg Barclays Global High-Yield Bond Index	Global high-yield bonds	2.02%	5.23%
Bloomberg Barclays Investment Grade US Convertibles	US high-grade convertible bonds	0.78%	0.73%

Source: Bloomberg

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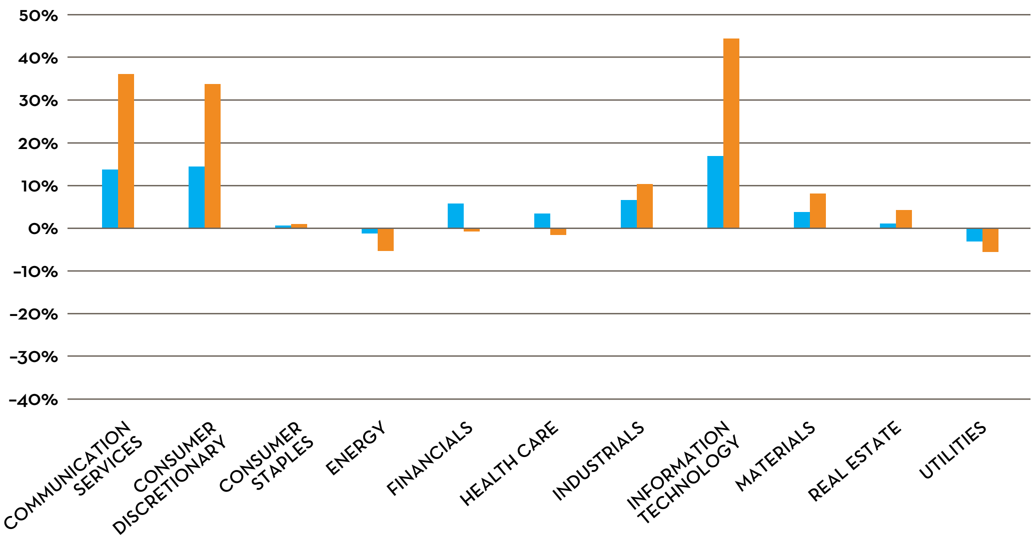
S&P 500 Sector Returns



Source: Bloomberg

Central banks in the US, EU, and England raised interest rates, while China eased rates to help with their emergence from COVID. Japan's rate policy was unchanged.

Investors now see rates peaking in November. The Fed raised rates 25 basis points in the quarter (the 10th consecutive rate hike, totaling 5%, so far), then skipped the May meeting. The fight against inflation is working, as headline inflation has declined sharply from its peak.

Yet, a tight labor market has allowed consumption and overall growth to remain stronger than expected. Core PCE, the Fed's preferred measure of inflation, is still growing at a 4.6% annual rate. The travel sector and restaurants are still exhibiting strong pricing power.

The economy has decelerated slowly, with the lagged impact taking longer than expected to materialize. A bifurcation between the soft manufacturing economy and strong service economy persists in the US and abroad. Even though the Fed has paused hikes, they have signaled a willingness to keep rates higher for longer, until the sticky portions of inflation subside. The median Fed expectation is for two more 0.25% hikes in this cycle.

Throughout the quarter consensus earnings estimates for the S&P 500 showed a modest decline, stabilized by an uptick in technology and communication services' EPS estimates. All other areas are seeing a decline in EPS growth. Analysts expect earnings growth to decline for the 3rd consecutive quarter in the Q2 reporting period before rebounding substantially at year end. The YTD rise in stocks has been mostly due to P/E multiple expansion. The forward (next 12 months) P/E multiple has now expanded from 16.8x last December to 19.2x, likely too far too fast given the backdrop of higher borrowing costs.

At the halfway mark in the year, inflation, GDP growth, and job growth have all exceeded investors' expectations given the Fed's aggressive hiking cycle. Consumers have been resilient, supported by high nominal income, falling fuel prices, and excess savings (pandemic legacy liquidity). The wave of fiscal policy unleashed to support

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US onshoring is also at odds with monetary policy, disrupting traditional economic patterns, delaying the impact of higher rates, and propping up payrolls.

Significant progress on inflation and the resiliency of the US consumer provide reason for optimism. Yet, consumers are facing some obstacles in the second half of the year including depleted excess savings, slowing nominal and real income gains, and the pending restart of student loan repayments. And while inflation normalization may be good news for real consumer purchasing power, it may present a headwind for corporate EPS for companies that have exhibited strong pricing power. The economy will most likely weaken further in the third quarter.

As the remainder of the year unfolds, we remain cautious. In this complex environment, with monetary policy unsettled and stock valuations stretched, balance and diversification remain paramount to reaching our investment objectives.

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Index Definitions

The S&P 500 Index measures the performance of the large-cap segment of the US equity market. The S&P MidCap 400 Index measures the performance of the mid-cap segment of the US equity market. The S&P SmallCap 600 Index measures the performance of the small-cap segment of the US equity market. The Nasdaq 100 is a basket of the 100 largest, most actively traded US companies listed on the Nasdaq stock exchange. The Russell 2000 Index measures the performance of the small-cap segment of the US equity market. The MSCI World Ex USA Index captures large- and mid-cap representation across 22 of 23 developed markets countries, excluding the US. The MSCI Emerging Markets Index captures more than 1,400 large- and mid-cap securities in 24 countries spanning across five regions. The Bloomberg Barclays US Aggregate Bond Index is a broad-based benchmark that measures the investment-grade, US dollar-denominated, fixed-rate taxable bond market. The Bloomberg Barclays US Treasuries Index includes public obligations of the US Treasury, i.e., US government bonds. The Bloomberg Barclays Investment Grade Corporates index measures the investment-grade, fixed-rate, taxable corporate bond market. The Bloomberg Barclays Corporate High Yield Index measures the USD-denominated, high-yield, fixed-rate corporate bond market. The Bloomberg Barclays US MBS Index measures the performance of US mortgage-backed fixed income securities. The Bloomberg Barclays Global Aggregate Bond Index tracks the performance of global investment-grade, fixed-rate bond markets. The Bloomberg Barclays Global High Yield Bond Index is a multi-currency measure of the global high yield corporate debt market. The Bloomberg Barclays Investment Grade US Convertibles Index tracks the performance of investment-grade, USD-denominated convertible securities. S&P 500 Sectors measure segments of the US stock market as defined by GICS®. All index performance data sourced from Bloomberg.

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