Cambridge ADVISORS inc.
INVESTMENT MANAGERS

ECONOMIC UPDATE JUNE 2023

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Market indices were mixed again in May. Large cap stocks in the S&P 500 index posted a slight gain of 0.4% for the month resulting in a year-to-date gain of 9.6%. On the other hand, small cap stocks in the Russell 2000 were down -0.9% bringing their year-to-date return to 0.0%. International stocks in the MSCI EAFE index were down in May -4.2%, reducing the year-to-date gain to 6.8%. Meanwhile, emerging market stocks lost -1.7% in the month but are still up 1.1% year-to-date. Yields on the Barclays US Aggregate Bond Index rose slightly so the index posted a -1.09% return in the month, reducing the year-to-date gain to 2.5%. The yield on the 10-year Treasury bond ended the month at 3.7%.

Economic Growth in the first quarter was revised slightly higher and grew at an annual rate of only 1.3% after adjusting for inflation according to the second estimate released by the Bureau of Economic Analysis last week. This is much lower than the 3.2% in the third quarter and 2.9% in the fourth quarter. Additionally, corporate profits were negative on a quarter-over-quarter basis. Unemployment remains low but jobless claims have risen. Wages are rising at a slower rate than prices, which affects purchasing power. But consumers are still spending and as a result, we are seeing credit card balances at record highs.

Inflation has seen gradual improvement but is still higher than the Fed is comfortable with and everyone else who pays bills. Over the past several years, the money supply has been significantly expanded and the federal government has spent borrowed funds at unprecedented levels. Both actions are inflationary, so the task of getting inflation under control may be more difficult than projected. The Fed's main tool for fighting inflation has been raising interest rates. The Fed meets again in June and is considering another hike. Some investors anticipate the Fed will begin cutting rates beginning in the third quarter, but unless the economy slows sharply, that is getting more unlikely. Stock prices seem to be holding up partly in anticipation that the Fed will ease later in the year in response to the economy entering a recession at that time. Even the Fed's projections for full year GDP growth indicate that they are anticipating a recession in the second half of the year.

The inverted yield curve also continues to signal a coming recession with short-term yields higher than long-term yields. In a recession, analysts expect that yields will fall across all maturities although more so at the shorter end. Because of this, strategists are advising investors to start buying longer-term debt instruments (even though they are currently yielding less than the shorter-term securities) so that investors can lock in the yields for longer periods before yields fall.

The positive returns in stock prices over the last seven months have been advantageous for investors. However, the economic backdrop remains murky. If we enter a recession, earnings will likely continue to be negatively impacted. For stock prices not to fall, that would mean Price/Earnings ratios would again be stretched and reside above historical averages. We continue to encourage investors not to try and time the market by trading in and out and instead invest according to risk tolerance. However, this could be an attractive time to make gifts of appreciated stock or to rebalance if stock allocations have drifted higher. If you have questions about the strategy for your account, please contact your advisor.