A View
FROM THE TOWER

S&P 500 Sector Total Returns, %	QTD Sorted	YTD
Technology	17.2	42.8
Consumer Discretionary	14.6	33.1
Communication Services	13.1	36.2
Industrials	6.5	10.2
Financials	5.3	-0.5
Materials	3.3	7.7
Health Care	3.0	-1.5
Real Estate	1.8	3.8
Consumer Staples	0.5	1.3
Energy	-0.9	-5.5
Utilities	-2.5	-5.7

U.S. Index Total Returns, %	QTD Sorted	YTD
Russell 1000 Growth	12.8	29.0
S&P 500	8.7	16.9
Russell 1000	8.6	16.7
Russell 2000 Growth	7.1	13.6
Russell MidCap Growth	6.2	15.9
Russell 2000	5.2	8.1
Russell MidCap	4.8	9.0
Russell 1000 Value	4.1	5.1
Dow Jones Industrial	4.0	4.9
Russell MidCap Value	3.9	5.2
Russell 2000 Value	3.2	2.5

Rates, %	6/30/23	6/30/22
1-Month Treasury	5.11	0.95
3-Month Treasury	5.28	1.63
6-Month Treasury	5.41	2.46
2-Year Treasury	4.90	2.95
5-Year Treasury	4.16	3.04
10-Year Treasury	3.84	3.01
30-Year Treasury	3.86	3.18
US Corporate AA Rated	4.82	4.04
US Corporate A Rated	5.30	4.41
US Corporate BBB Rated	5.76	5.07
US Corporate CCC Rated	12.88	13.63

Source: Bloomberg, CCTC

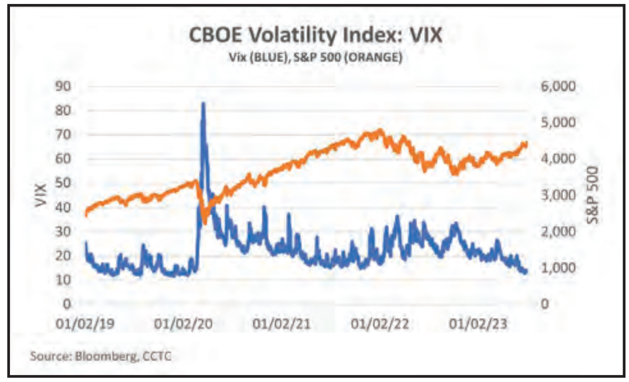
What Worked – Growth, But Not All Growth

On January 23, 2023, Microsoft announced a third round of investment in OpenAI, the creator of artificial intelligence tool ChatGPT. Later, on February 7, Microsoft announced that BING, its internet search engine, would integrate ChatGPT to produce search results. Although we have been talking about artificial intelligence (AI) for some time, the topic didn't hit home with market participants until Microsoft's announcement of a commercial application. Alphabet, not to be outdone, soon announced its own AI strategy, with plans to integrate it into its own market leading search engine. Over the subsequent weeks, companies with any association with AI began announcing their plans to Wall Street. It reminded some of us of the technology bubble in the late 1990's, when adding ".com" to your company's name seemed a sure-fire way to increase your stock price.

We are not dismissing the value that AI will bring in the future, as we believe it will create tremendous value. But it is early and the path to monetizing the tremendous investment to run AI applications is unclear. We believe a great way to gain exposure to AI is through diversified, large-cap companies that should be at the forefront of developing this technology.

With this in mind, the best performing part of the domestic equity market in the second quarter was very narrow. "Growth" outpaced "value", but only a few names worked particularly well. A group of "growth" equities being referred to as the "Magnificent Seven" drove the lion's share of gains in both "core" and "growth" indexes during the quarter. The stocks: Nvidia, Tesla, Alphabet, Apple, Meta, Microsoft, and Amazon accounted for approximately 66% of second-quarter gains in the S&P 500 and 72% of the gains in the Russell 1000 Growth index. Although these stocks performed well in the quarter, their relative weighting in individual indices helped as well. In total, these equities have a weighting of approximately 26% of the S&P 500 index and 42% of the Russell 1000 Growth index. The S&P 500 index, where larger companies account for a greater proportion of returns, returned 8.7% during the second quarter. Comparatively, the equal-weighted S&P 500 index, where every company contributes an equal portion of returns, was up only 3.5%.

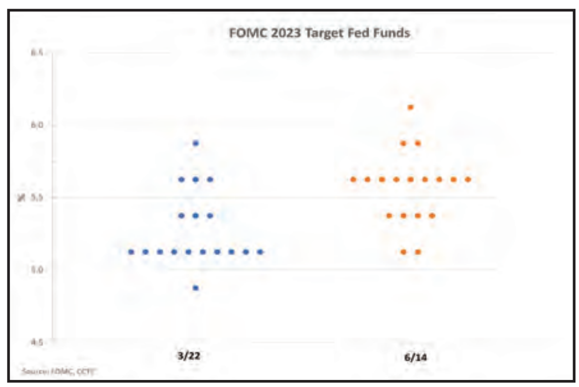
The VIX Has Reached Pre-Pandemic Levels



The Chicago Board Options Exchange (CBOE) Volatility Index, also known as the VIX, is a popular measure of market volatility and investor sentiment. It is often referred to as the "fear gauge" because it provides an indication of the market's expectation of volatility over the next 30 days. The VIX is calculated by the CBOE and is based on the prices of options on the S&P 500 index. It measures the implied volatility of these options, reflecting the market's expectations of future volatility. A higher VIX suggests greater expected volatility, indicating higher levels of fear or uncertainty in the market. Conversely, a lower VIX value suggests lower expected volatility, indicating greater confidence or complacency among investors. Generally, rising markets lead to a lower VIX, and vice versa.

The VIX closed the second quarter at 13.5, substantially lower than its three-decade median value of 17.9. The index has been in a general downward trend since markets hit their October 2022 lows. According to a recent research note from Deutsche Bank, it has now been more than three months since the S&P 500 has pulled back at least 3%, one of the longest stretches the index has seen since World War II. This interests us because almost all leading indicators are pointing to a near-term recession. However, equity markets don't seem to be buying it, at the moment at least.

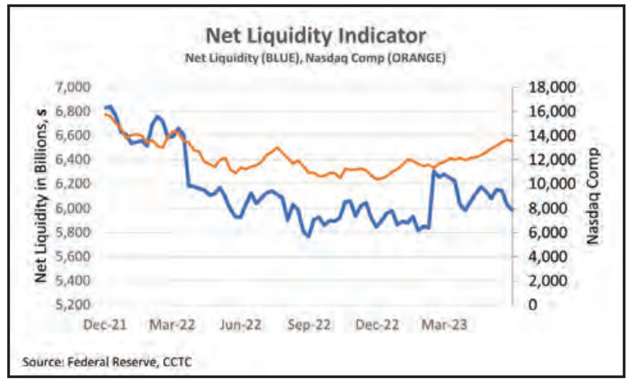
Fed Met Twice, Raised Rates Once



The Federal Open Market Committee (FOMC), twelve members of the Federal Reserve System that vote on monetary policy, met in both May and June. Markets anticipated an interest rate hike of 0.25% in May and no raise in June. Investors predicted both correctly. Interestingly, Fed Chairman Jerome Powell's June post-meeting press conference showed he was still quite concerned about future inflation. He stated many times that there was further work required to combat rising prices, and repeatedly pointed out that the median projection for the end of 2023 Fed Funds rate included two additional .25%-point hikes. So, why not raise rates in June? Well, the obvious answer is that monetary policy is conducted with a lag, and we are most likely just starting to feel the effects of past hikes. The Fed may be waiting on additional data to confirm that past monetary actions are working to slow the economy and quash inflation. As an alternative, there may be near-term liquidity concerns at play.

Liquidity Drain May Have Caused the Fed to Punt

Actions by the U.S. Treasury and the Federal Reserve Bank (Fed) can cause huge swings in the amount of money sloshing around in the economy. In simple terms, additional assets sitting on the Fed's balance sheet



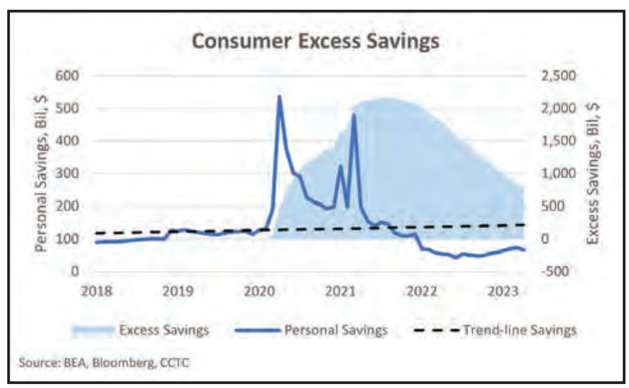
Source: Federal Reserve, CCTC

and/or a reduction in the balance of the Treasury's bank account without offsetting debt issuance is a source of cash to the economy. For example, the Fed may buy bonds from private parties, or lend against financial assets. In either case, the Fed is in possession of additional assets and has provided liquidity in exchange.

Two events led to a substantial increase of liquidity in the first half of the year. The regional banking crisis prompted an increased desire for many financial institutions to seek cash. The Fed obliged by creating emergency lending facilities and easing requirements for lending at the discount window. The Fed's balance sheet grew by $400 billion in the two weeks following the collapse of Silicon Valley Bank. In addition, the Fiscal Responsibility Act of 2023, otherwise known as the debt ceiling bill, was signed into law. Prior to the bill being passed, $524 Billion was drained from the Treasury general account (TGA), as the federal government continued paying bills without the ability to increase its debt load.

At least a partial reversal of these liquidity events is ongoing. While it will take time to reduce lending balances due to the banking crisis, the Treasury should rebuild its general account quickly. It is expected that the Treasury will ramp-up bond issuance to build its cash balance to around $600 billion. At the time of this writing, the TGA stood at $408 billion. In addition to the unwinding of liquidity offered by the TGA drain, the Fed continues its quantitative tightening program. Each month, $95 billion of bonds rolls off the Fed balance sheet. The draining of liquidity could cause a headwind to equity markets in the near-term. As we have learned numerous times since the 2008-2009 financial crises, equity markets feed on liquidity. The tech-heavy Nasdaq Composite shows the effect of liquidity on markets well, in our view.

Excess Savings



Source: BEA, Bloomberg, CCTC

While the U.S. manufacturing sector has been in contraction for months, our economy continues to expand at a rate in-line with pre-covid times. The economic environment today is very similar to the economy we had leading up to the pandemic. While manufacturing faces headwinds, the service economy continues to expand as unemployment remains low and consumers are spending. However, there is one small detail that is worth talking about. Covid-era fiscal stimulus of roughly $3.5 trillion fell to households and businesses, leading to a huge jump in savings. Although the unemployment rate jumped from 3.5% to 14.7% in the two months following February 2020, disposable income rose by 12.4%, or $2.1 trillion. Cumulative savings continues to be above the trend-line rate set before covid-era stimulus, but it has been spent down aggressively. Today, we estimate that approximately $775 billion is left. Although many signs seem to point to a pending recession, it is very difficult to experience one with robust consumer spending. The strength of the current expansion has surprised many of us, but put in perspective of the consumer, it seems to make more sense.

In Summary

As we mentioned in the first quarter's "A View From the Tower," we believe past rate hikes are finally starting to bite the U.S. economy and a slowdown may be approaching. The general level of economic activity has deteriorated somewhat over the past year, but we are awaiting consumption activity to drop meaningfully if leading recession indicators are correct. A drop in employment could be the shot across the bow. Equity markets have performed well so far this year, but we wish we experienced broader participation in the rally. In our opinion, the average large-cap stock is telling us we are in wait-and-see mode, and making a significant bet on the direction of the market is probably not our best option.

Our portfolios are managed with both your risk tolerance and return objective in mind. We truly believe that time in the market is key, as attempting to time the market is a fool's errand. In our view, compounding returns of high-quality portfolios is foundational in achieving your financial goals.

All of us at Country Club Trust Company, along with the entire Country Club Bank organization, hope that you and your families are well. Please be assured that we continue to work diligently on your behalf, providing the level of service you have come to expect and deserve. As always, we are ready and willing to be of assistance in any way we can. Should you have any questions, we are always here for you.

Take care.

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