

July 2023

Market Perspectives: “Working 9 to 5” ... and Beyond

Exploring the Employment Mandate

- ▶ The Federal Reserve (the “Fed”) operates under a dual mandate from Congress. This mandate consists of 1. maintaining price stability (i.e., inflation) and 2. promoting policy to achieve maximum employment (i.e., full employment).
- ▶ For 18 months, inflation has dominated economic (and market) headlines as measures such as the Consumer Price Index (“CPI”) surged to the highest level in decades. Now, as inflation cools from high levels and the labor market begins to potentially soften, attention may shift to the employment picture.
- ▶ The strong labor market has allowed the Fed to focus on policy tightening to work on the price stability portion of their mandate. At some point, however, markets, and the Fed may shift focus towards the labor portion of the mandate, full employment.

“Reducing inflation is likely to require a period of below-trend growth and some softening of labor market conditions. Restoring price stability is essential to set the stage for achieving maximum employment and stable prices over the long run.” - Chair Jerome Powell, June 14 Press Conference

“9 to 5”, the popular Dolly Parton song released more than 40 years ago, depicts a hard-working woman “barely gettin’ by” in a challenging working environment. While the U.S. labor force has changed over the last four decades, challenges in the modern workforce remain. In this case, labor markets are tight, job openings are abundant, presenting employees’ power to negotiate higher salaries, and a large cohort of the workforce has left. Employers have been struggling for several years with these issues.

Labor market strength has befuddled investors. On the one hand, tight labor markets have made it more difficult for employers to fill positions, which has driven wages higher, exacerbating inflationary conditions and pinching corporate margins. On the other hand, labor market strength has kept hope alive that, while monetary policy is restrictive, growth may slow but not to recessionary levels. This could potentially open the door for a soft landing in which growth slows but does not meaningfully damage the economy. As we explore below, global markets have reflected this optimism through the first half of 2023.

MARKET COMMENTARY

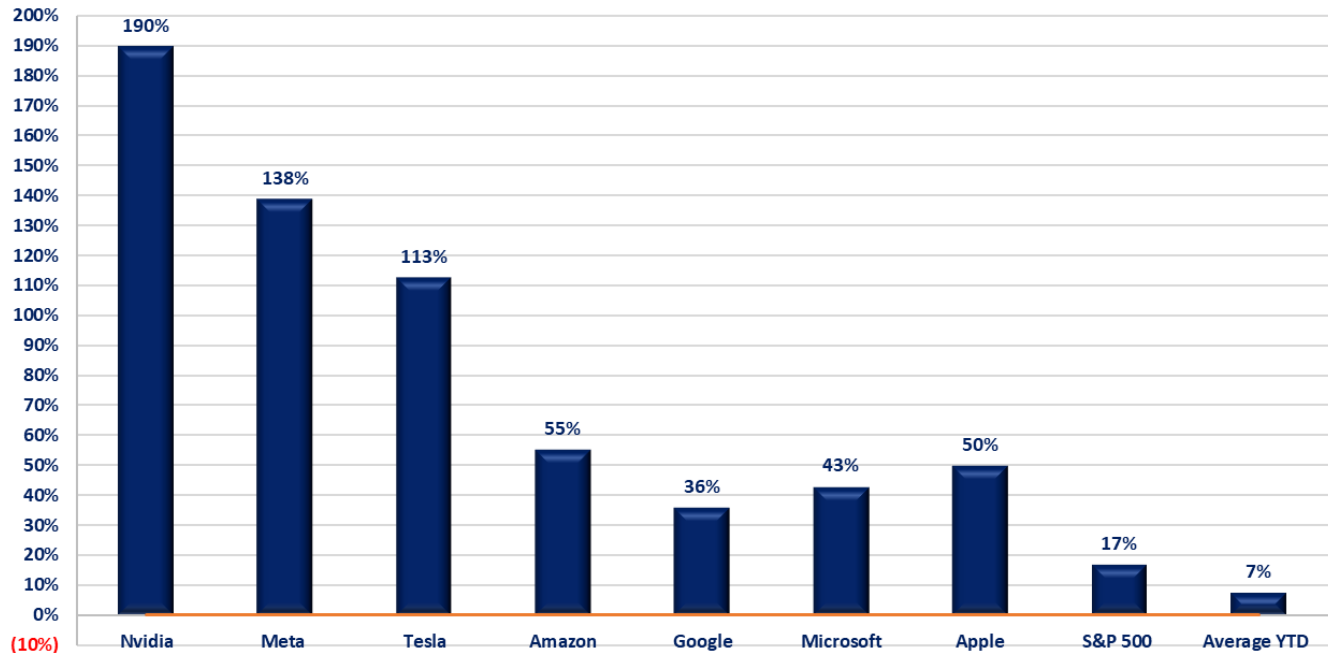
The first half of 2023 has seen markets continue a rebound which began late in 2022. The tables below show performance for equities and bonds. At a high level, stocks have enjoyed better than expected economic growth which has translated to positive surprises in profit growth. Growth stocks have been particularly strong, in part due to the optimism for how artificial intelligence (“AI”) may transform the economy. For instance, stocks with a perceived leadership position in AI, such as Nvidia, are up significantly year-to-date, with more on this later as it relates to the S&P 500 Index performance.

Value stocks and small cap stocks, which are cyclical in nature and closely tied to the economy, have not performed as strongly as growth stocks but are positive on the year. Foreign stocks have enjoyed better than expected economic outcomes in Europe and Japan, resulting in strong performance so far in 2023.

Report Date	6/30/2023	2022 Third Quarter	2022 Fourth Quarter	2023 First Quarter	2023 Second Quarter	2023 Return	2022 Return
Broad Markets							
ACWI World Equity Index		(7.2%)	9.9%	7.4%	6.3%	14.2%	(18.4%)
S&P 500 (Market Cap Weight)		(4.9%)	7.6%	7.5%	8.7%	16.8%	(18.2%)
S&P 500 (Equal Weight)		(4.7%)	11.4%	2.9%	3.9%	6.9%	(11.6%)
US Large Cap Growth		(3.5%)	2.1%	14.3%	12.8%	28.9%	(29.3%)
Nasdaq		(3.9%)	(0.8%)	17.0%	13.1%	32.3%	(32.5%)
US Large Cap Value		(5.6%)	12.2%	0.9%	4.1%	5.0%	(7.7%)
US Mid Cap Blend		(2.5%)	10.8%	3.8%	4.8%	8.9%	(13.1%)
US Mid Cap Growth		(0.7%)	8.7%	5.0%	5.1%	10.4%	(19.0%)
US Mid Cap Value		(4.0%)	12.6%	2.4%	4.6%	7.1%	(7.1%)
US Small Cap Blend		(2.1%)	6.2%	2.7%	5.3%	8.1%	(20.5%)
US Small Cap Growth		0.4%	4.1%	6.0%	7.1%	13.5%	(26.3%)
US Small Cap Value		(4.6%)	8.3%	(0.7%)	3.2%	2.5%	(14.8%)
Intl Developed Markets		(10.4%)	17.7%	9.0%	3.2%	12.5%	(14.4%)
Intl Developed Markets Growth		(9.9%)	15.7%	11.8%	2.8%	15.0%	(23.1%)
Intl Developed Markets Value		(11.2%)	20.4%	5.8%	3.6%	9.6%	(5.2%)
Emerging Market Equity		(13.0%)	10.3%	4.1%	1.0%	5.2%	(20.6%)
Data Source YCharts as of 6/30/23			Indicates best performing asset class in time period				BDO
			Indicates worst performing asset class in time period				

Taking a step back, the S&P 500's strong start to 2023 has been powered by a handful of stocks (listed in the below chart). These stocks account for a majority of the S&P 500's 16.8% YTD return. Each of these stocks are up far more than the broad index and their large market capitalizations (and their corresponding weighting in the indices) have provided an outsized boost to the broader markets. Compare the performance of these stocks versus the S&P 500 and the average return of the remaining companies, and it is easy to see the effect this select group of mega-cap companies have had.

Mega Cap Growth Stocks Dramatically Outperforming



Source: YCharts as of 6/30/23, Average consists of all S&P 500 stocks except for those listed on an equal-weighted basis using the average year to date return.

The bond market has also seen a rebound, as higher yields have offset price declines from the ongoing increase in interest rates. Shorter-term interest rates are currently in excess of 5%, with much of the yield curve sitting near 4% as the market attempts to understand the next move for the Fed.

Report Date	6/30/2023	2022 Third Quarter	2022 Fourth Quarter	2023 First Quarter	2023 Second Quarter	2023 Return	2022 Return
Bond Market Proxies							
Barclays Corporate Bond Index		(4.7%)	1.6%	3.2%	(0.9%)	2.3%	(13.0%)
Short Term Treasuries		(1.6%)	0.7%	1.6%	(0.6%)	1.0%	(3.9%)
Intermediate Term Treasuries		(3.9%)	1.2%	2.7%	(1.5%)	1.2%	(9.5%)
Long Term Treasuries		(10.3%)	(1.9%)	7.4%	(2.5%)	4.7%	(31.2%)
Treasury TIPS		(5.3%)	1.9%	3.6%	(1.5%)	2.0%	(12.2%)
Short Term Corporates		(2.1%)	2.1%	1.8%	(0.0%)	1.8%	(5.6%)
Intermediate Corporates		(4.7%)	3.6%	4.1%	(0.6%)	3.5%	(14.0%)
Long Term Corporates		(8.8%)	5.0%	6.1%	(0.4%)	5.7%	(25.5%)
High Yield Bonds		(1.7%)	4.8%	4.2%	0.8%	5.0%	(12.2%)
Short Term Municipal		(0.7%)	1.3%	1.1%	0.3%	1.4%	(0.7%)
Intermediate Term Municipals		(2.7%)	3.8%	2.4%	(0.1%)	2.3%	(6.8%)
Long Term Municipals		(4.0%)	4.7%	3.1%	0.2%	3.3%	(10.4%)
Emerging Market Bonds		(5.8%)	8.4%	2.8%	1.6%	4.4%	(18.6%)

Data Source YCharts as of 6/30/23

Indicates best performing asset class in time period

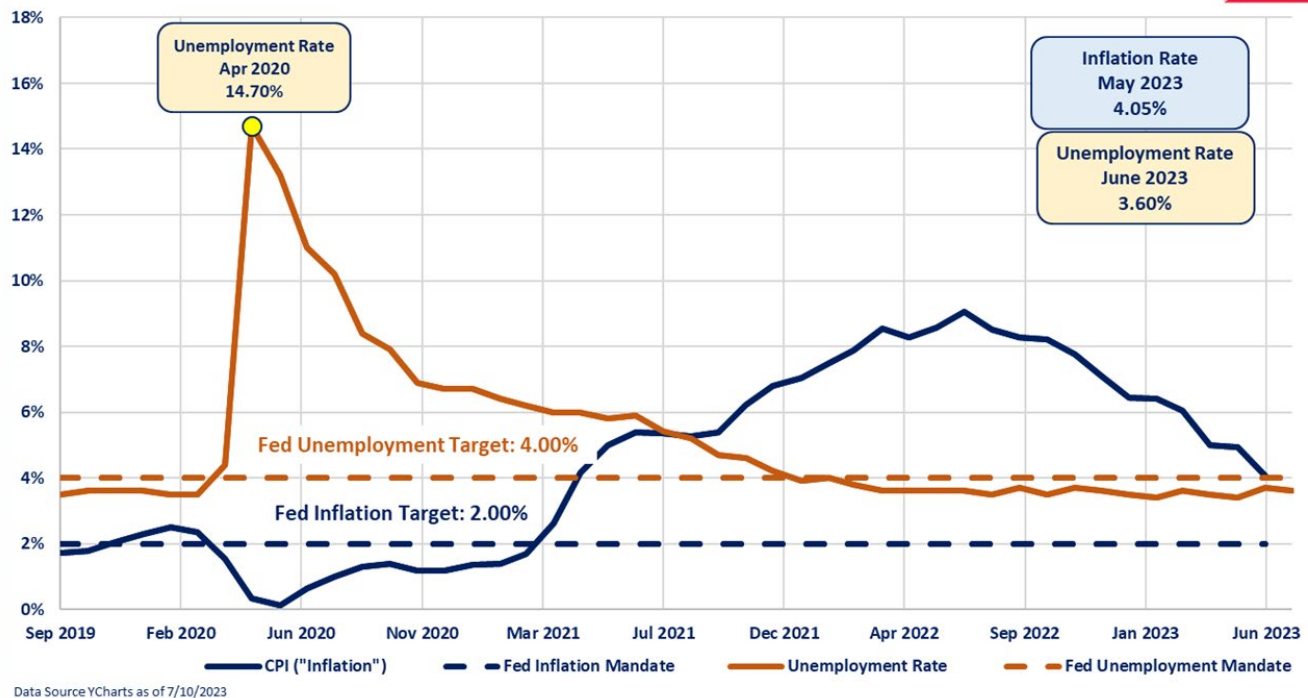
Indicates worst performing asset class in time period



LABOR MARKETS

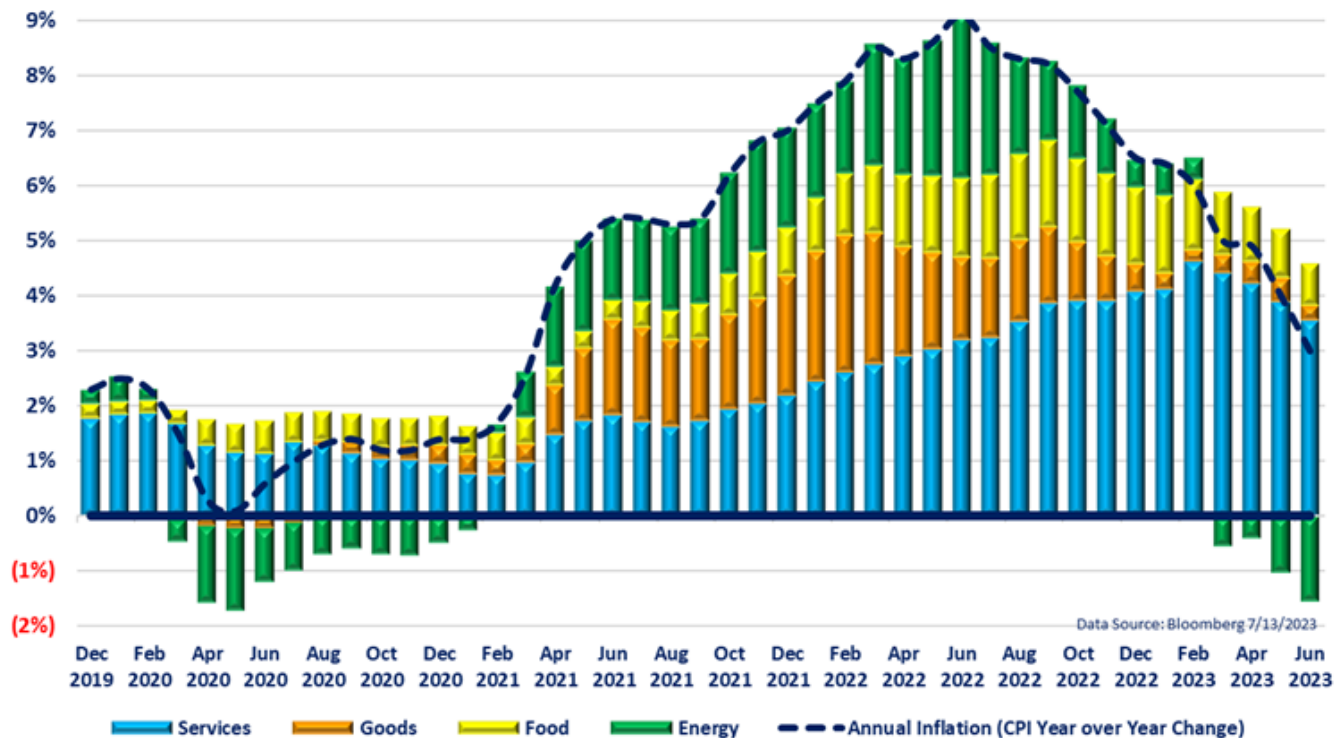
For 18 months, the Fed's focus has been centered on inflation rather than employment, as labor conditions have remained constructive. The chart below highlights why. Inflation surged to multi-decade highs - well above the Fed's 2% target - while unemployment has remained largely in check.

The Fed's Inflation & Unemployment Mandates

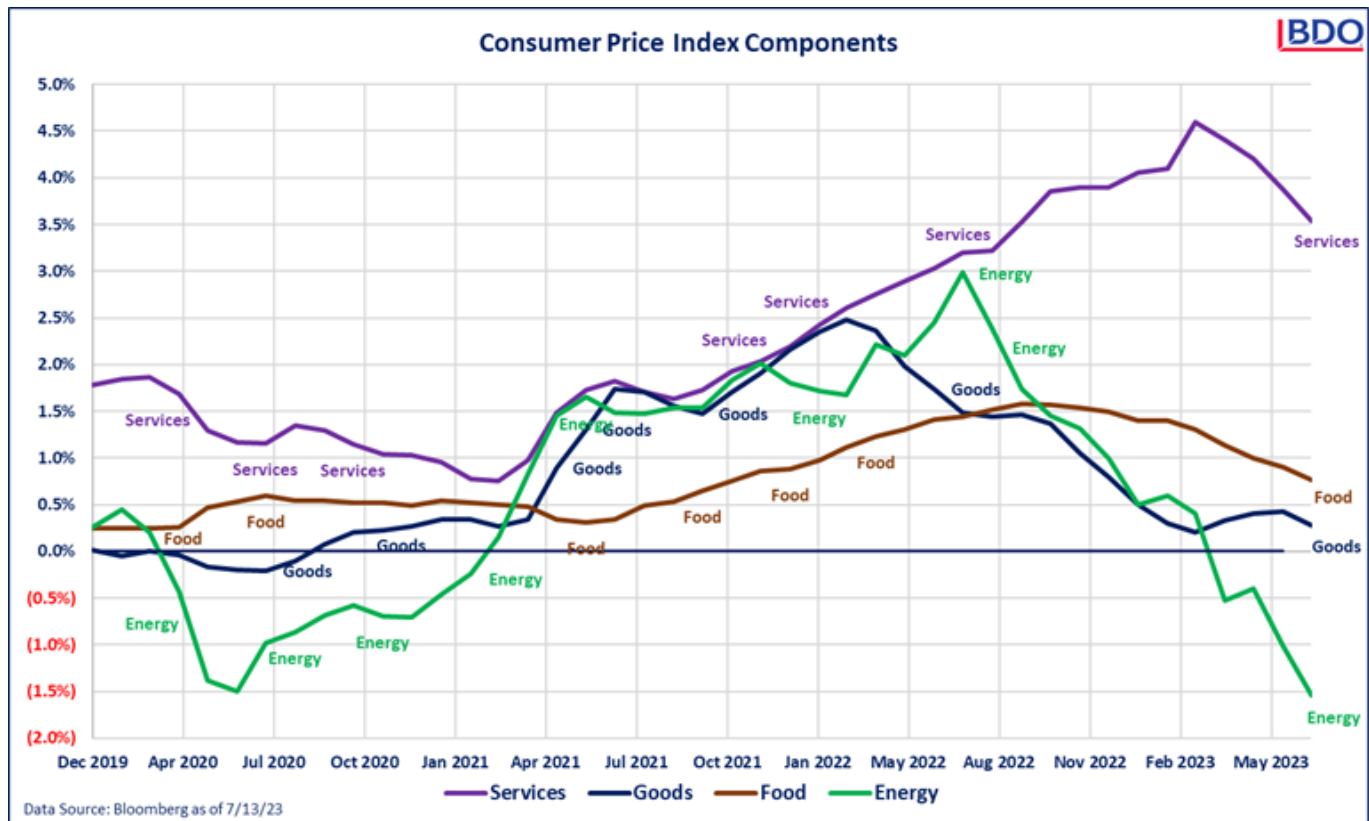


The latest CPI data released on July 12 does show the ongoing march back towards Fed targets. The major categories have all begun to come down, albeit at slower pace than initially hoped. The chart below breaks out the components of CPI inflation readings.

Component Parts of Year over Year Change in Inflation ("CPI")

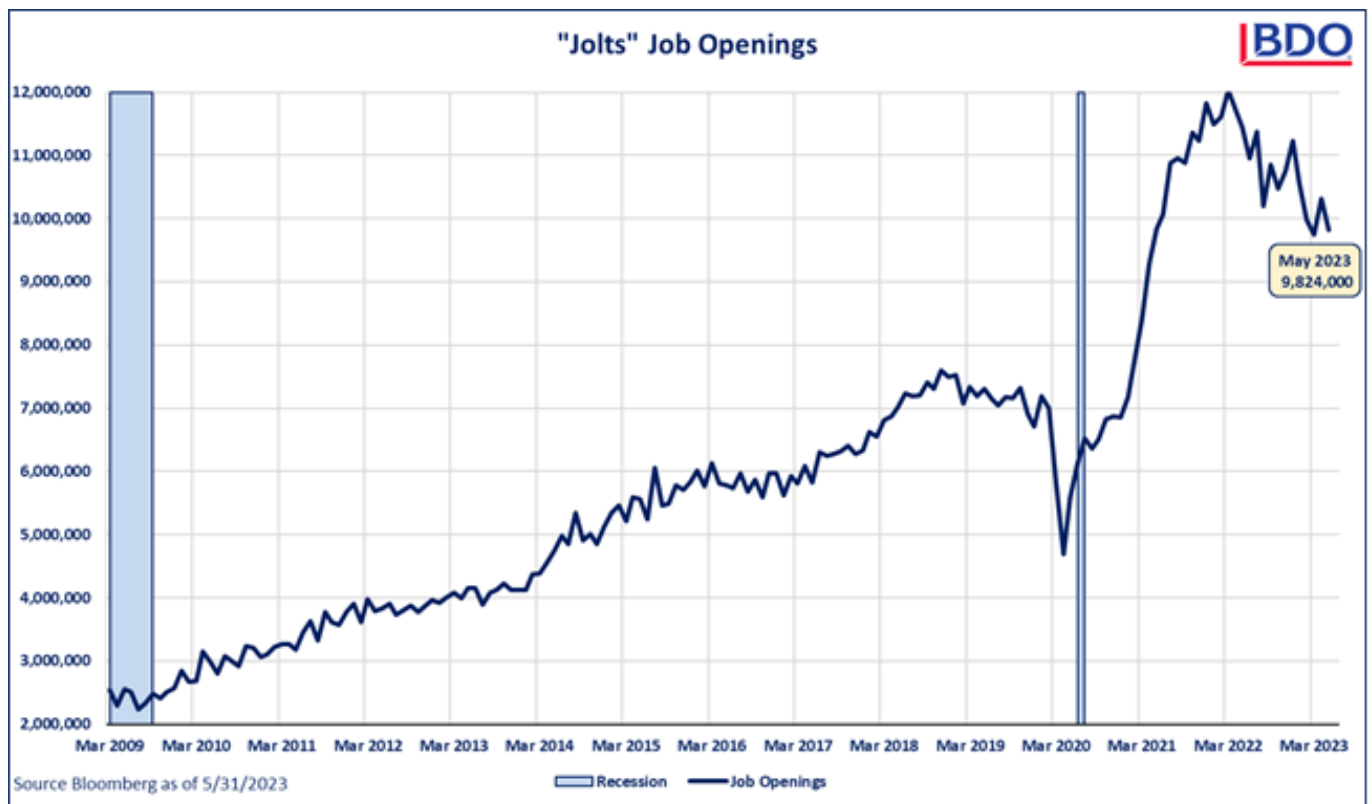
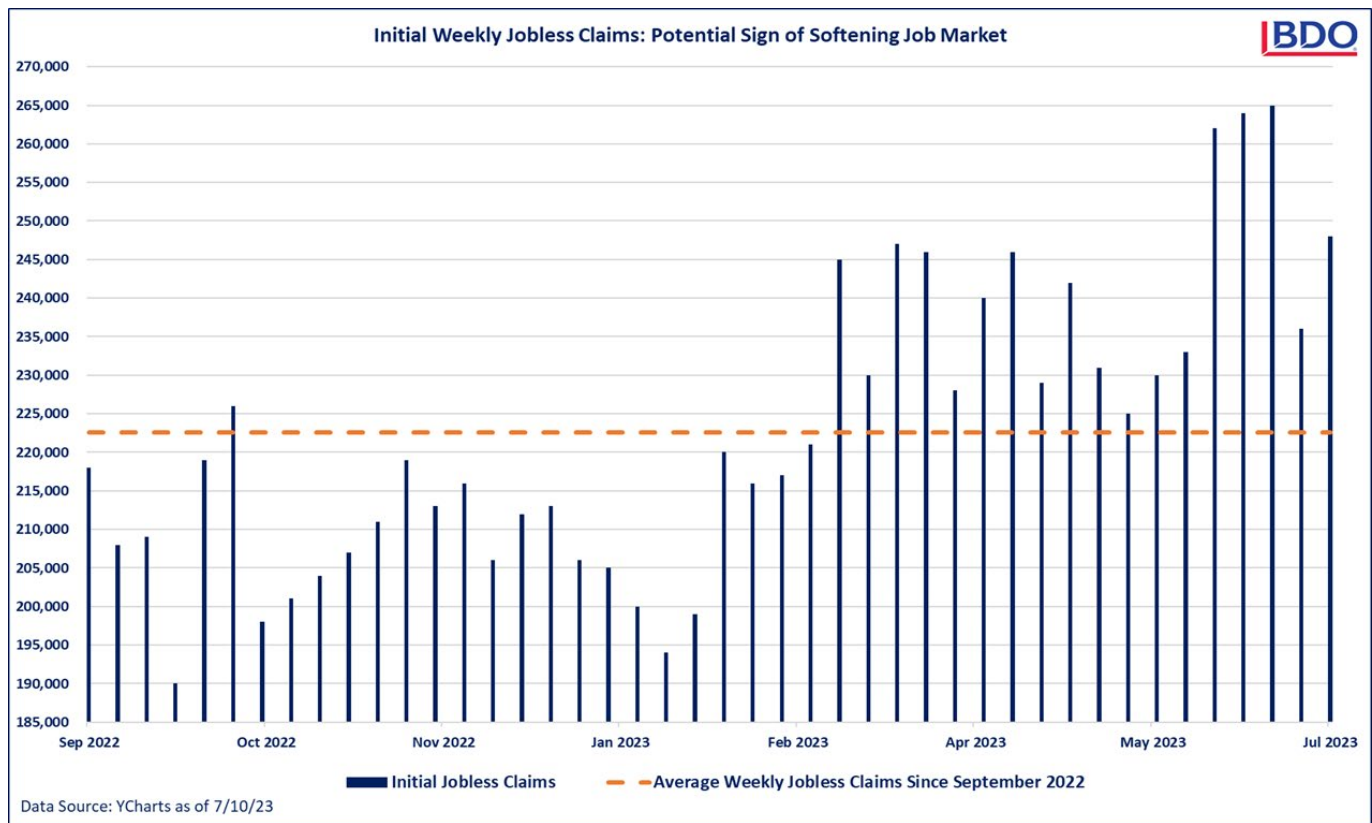


Services, which has been the last component to show declining growth has begun to do so in the last few months, while energy inflation has turned negative.



While inflation is cooling, the Fed continues to maintain a restrictive policy (i.e., they keep interest rates high to slow the economy to slow inflation) and therefore a shift of focus from inflation to labor may begin. This could be particularly true if the labor market continues to soften. To that end, the softening of the labor market has been a point of contention and the changes, so far, have been subtle:

- Jobless claims have started to rise off the cycle lows (the first graph below), and
- Job openings are coming down, although they are still quite high by historical standards (the second graph below as shown by the “JOLTs” survey data which is a job opening report by the Bureau of Labor Statistics).



Investors are paying close attention to the labor markets and despite some early signs of softening, the current strength is undeniable. As Chair Powell suggested at the June 14 news conference,

slowing growth may be key to bring inflation under control and the labor markets are a critical component. This is a major focus of market participants. While a recession could be in store as a result of the current Fed activity and inflation (amongst other risks), our team is focused on the positive long-term growth prospects underpinning the global economy. The latest economic data has also strengthened the possibility that labor could remain strong enough to help avoid a full recession and enter the soft-landing scenario in which growth cools enough to modify inflation trends, without a recession or at least without a significant recession. As we head through the second half of the year, our team remains ready to adjust to the opportunities that present themselves.

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