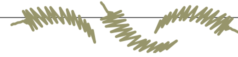
C Y P R E S S

ASSET MANAGEMENT, INC.



MARKET COMMENTARY **July, 2023**

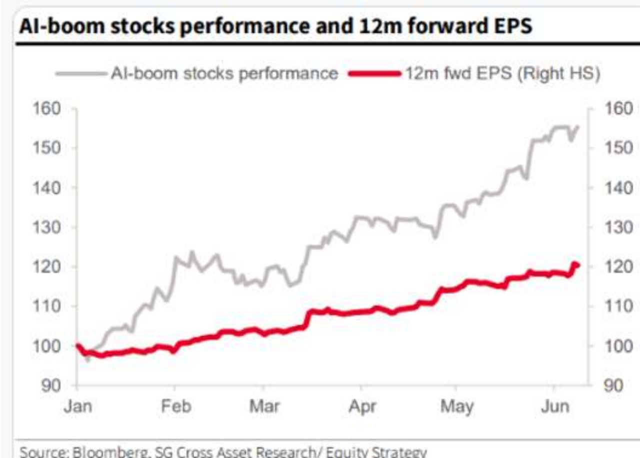
Stocks in the second quarter ended June 30, 2023 had soundly positive results:

	QTD	YTD
S&P 500 Total Return	**8.74%**	**16.89%**
NASDAQ	**12.81%**	**31.73%**
Dow Jones	**5.28%**	**4.94%**
As of June 30, 2023		

Market Summary

The quarter was highlighted by strong performance from large dominant technology stocks, most with early nascent exposure to artificial intelligence ("AI"). AI, long anticipated and discussed, burst onto the scene this quarter as Microsoft, Nvidia and other tech companies began to experience a strong uptake in their AI products leading to a significant boost in future sales and growth projections by both management and Wall Street. In a word, AI is the new thing. News related to AI should drive the market as investors focus both on revenue growth and cost cutting efficiency prospects from the ramp up in artificial intelligence throughout the economy and workplace. There are projections that AI might create a step function increase in productivity and margins, similar to the early impact of the internet and smart phones.

The impact of the rollout of AI throughout the economy, as with any new technology, likely will not be linear. The rollout could move in fits and starts, much like the gyrations of the stock market over time. The NASDAQ's first half of the year 2023 performance was the best in the last ***40 years***. Of course, that historical rally was, in effect, a rebound, coming off the heels of a NASDAQ plunge in 2022 of -32.5%. Most importantly for investors, this new evolution of efficiency should play out across a wide array of industries and represent a positive catalyst for corporate earnings and economic productivity for years to come.

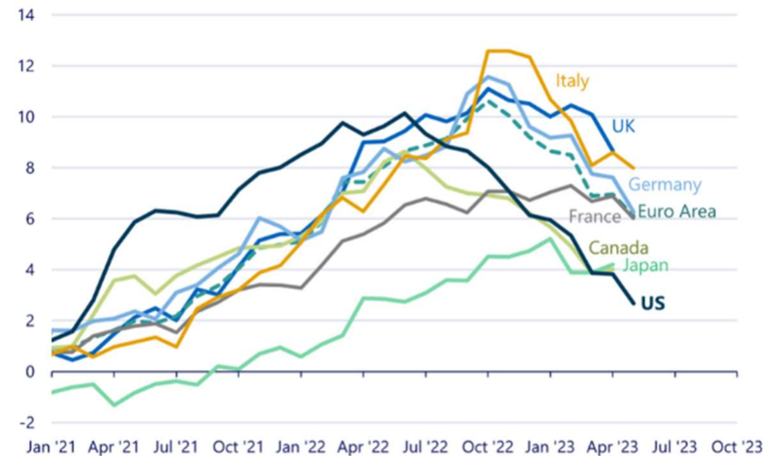


Inflation Cooling, Fed Skips a Rate Hike But Remains Hawkish

The second quarter of 2023 marked a period of relative calm in rates as inflation growth appears to have cooled to more stable levels compared to 2022. The following chart shows a synchronous decline in inflation globally over the past 9 months.

Figure 1. Harmonized Headline HICP Inflation in the G7

All items, HICP basis (Year-on-year percent)



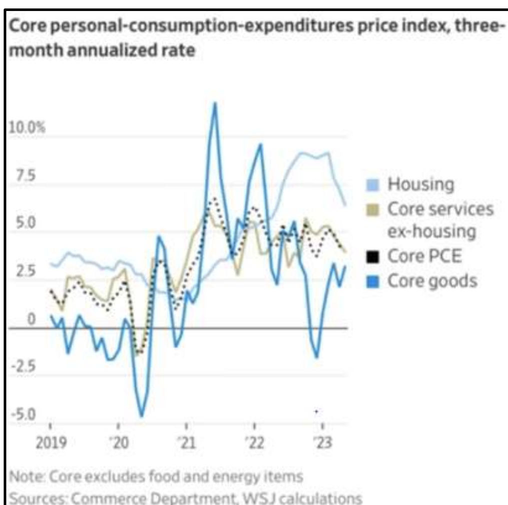
Council of Economic Advisers

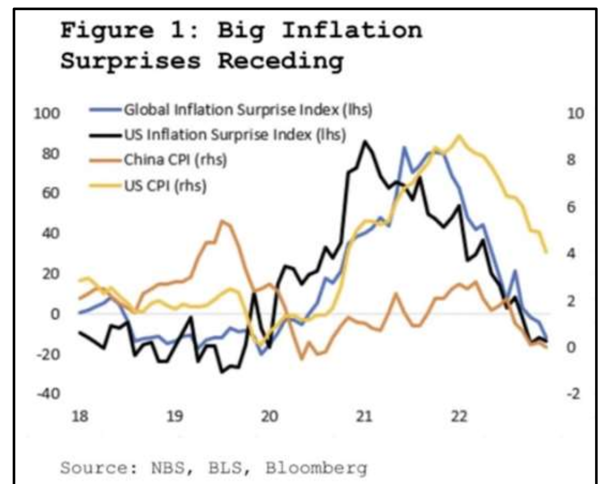
Sources: Eurostat, ONS, BLS, Statistics Canada, MEI, CEA analysis.

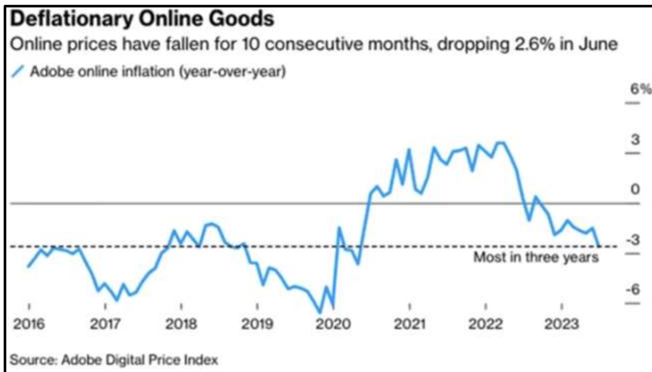
Note: Euro Area: HICP; UK: CPI; US: R-HICP-U; Canada: CPI ex. Mortgage Interest, Replacement Cost, & Property Taxes; Japan: CPI ex. Imputed Rent.

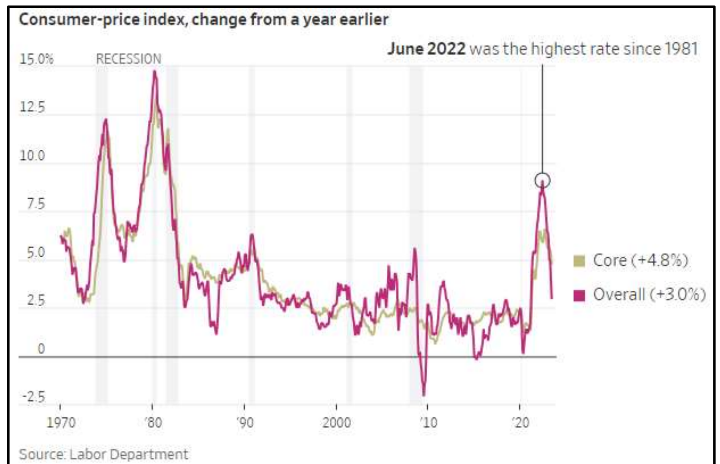
As of June 20, 2023 at 6:00pm.

June Consumer Price Index and Producer Price Indices have been released and the cooling trend in inflation continues. CPI rose at just under 3%, below expectations. Energy prices are below year ago levels but have essentially remained flat over the past 6 months, while food inflation has now declined for 11 consecutive months but still remains stubbornly high at 4.7% and continues to run above core inflation. Developments in the core inflation index are more encouraging, however, as important inputs in the CPI measurement have weakened meaningfully. Inflation related to the cost of shelter and the prices of used cars is decidedly lower. This time last year apartment rents were rising 14%, now, as of June, they are flat. An interesting chart below shows that big inflation surprises, once both a headline and headache for markets, are dissipating. Finally, online prices continue to exercise deflationary pressures.



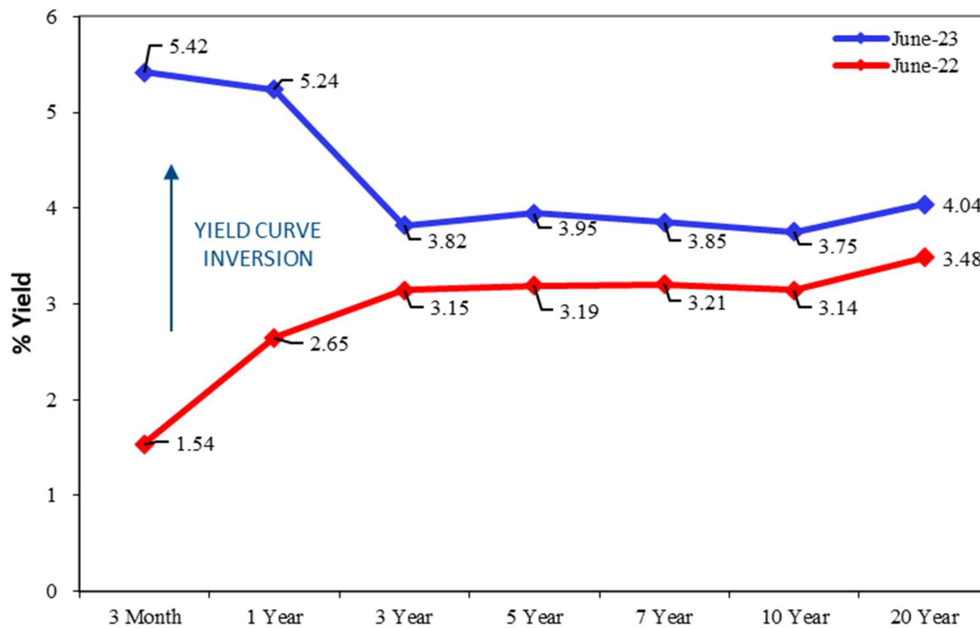






Interest Rates & Monetary Policy

The Fed skipped an interest rate hike in June but their hawkish tone has made it clear that they will implement another hike of 25 basis points in July. That increase is baked into market expectations. Moreover, there are hints among Fed members that there might be more in the future if key elements of core inflation, strong employment and wage growth prove intractable. The second half of 2023 will be key as the Fed's heavy hand with rates intersects with continued economic growth. The lag effects of the Fed's actions, however, are already being felt by consumers and businesses and represent a headwind to growth. Time will tell whether their hawkish stance in the face of a clearly slowing economy will lead to the widely predicted recession or if we escape with a soft landing that allows rates and inflation to decline while employment and profits remain relatively strong, leading the way to a recovery from the retrenchment.



We believe the first half of 2023 marked a period where investors began to anticipate that the Fed is close to the end of the rate hike cycle. The second half of 2023 feels like the measure of the market will depend on

how difficult the Fed wants to make things before they eventually reverse course and cut rates. The current posture of the Fed projects a "higher for longer" interest rate strategy. This inclination is not unexpected given that it fumbled the front end of the inflation scare, calling it transitory, and maintaining an expansionary policy when the ravages of inflation were already clear and troubling. Remember, on Labor Day 2021, the Fed was projecting there would be one Fed rate hike in the next 12 months.

It is noted that the Fed has never cut rates until the fed funds rate is above the rate of inflation. Only recently has the fed funds rate climbed above or in parity of the rate of inflation. But that is a worthy data point to track. This delicate dance of maintaining a hawkish stance on rates as parts of the economy weaken due to the lag effect of higher rates and contractionary monetary policy will play out in the second half of 2023. Only time will tell how severe the economic weakness.

Commercial Real Estate

Commercial real estate as an asset class looks troubled. We thought it worth covering in this commentary because commercial real estate is a very large asset class ($5 trillion in debt related to the asset class) and the problems don't look like something that will go away soon. And it represents a vital part of the economy – middle market banks are closely linked to the health of commercial real estate. Covid sent workers home and many companies have learned to operate remotely with their employees. As a result, there are large swaths of empty commercial real estate throughout the country. As the charts shows, commercial real estate is currently 20% vacant nationally, 25% in Houston and Dallas, 23% in Chicago, 26% in New Jersey and 16% in New York. There does not appear to be an easy way out of this conundrum; we do not see the trend reversing in any reasonable timeframe.

Ranking	Market	Total Vacancy (SF)	Total Vacancy (%)
1	New York	75.8M	16.1%
2	Washington, D.C.	74.0M	20.8%
3	Chicago	63.2M	23.5%
4	Dallas	53.5M	25.0%
5	Houston	49.3M	25.6%
6	Los Angeles	47.1M	24.1%
7	New Jersey	43.3M	25.8%
8	Atlanta	38.1M	21.6%
9	Boston	31.8M	19.1%
10	Philadelphia	27.8M	18.8%
	United States	**962.5M**	**20.2%**

Moreover, the downstream impact of higher vacancies, lower asset valuations, and potential bankruptcies is a troubling sign for middle market commercial banks. Middle market and smaller regional banks have higher concentrations of commercial real estate loans in their portfolios. Write-offs, bankruptcies, and asset deterioration are inevitable at a time when customer deposits have been leaving for higher yielding money market funds. It is not a recipe for flourishing growth.

Second Half 2023

The first half of the year was unexpectedly positive for the equity market. History has shown that a positive first half, more often than not, leads to a positive second half. While the economy has been resilient thus far and survived an unprecedented tightening by the Fed, it would be premature to dismiss the still looming effects of the fastest rate hike cycle in history. There are many early signs that the economy is beginning to slow: decreased bank loans, cooling inflation, unemployment claims, etc. We know that, historically, monetary policies work with a long lag time, up to a year and a half. We are currently only 8 months out from the initial yield curve inversion and we are just starting to see signs of a slowing economy. Has the Fed's draconian tightening worked? Did it go too far too fast? Will the rate hike pause remain? And will corporate earnings surprise to the upside or at least meet expectations? These are factors that will affect how the second half of this year wraps up. We believe our clients are well invested for a challenging environment that presents opportunity for the strongest and best positioned.

POSITIVE	NEGATIVE
• Inflation Cooling Down	• European War
• Debt Ceiling Resolution	• Hawkish Central Bankers
• Expected Fed Pause	• Geopolitical Tension with China
• Labor Market Cooling	• M2 Money Supply Growth Negative/Monetary Tightening Lag
• Positive Earnings	• Economic Slowdown Recessionary Signal
• AI Technology Innovation	• US National Debt at Record High Level ($32T), Greater than Nominal GDP