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Late June 2023: Large Caps Soar, 2 yr & 5 yr Treasuries Yield Highest in 3 months. US seems to have the best outlook but value/smaller companies could lead the next market move due to their undervaluation vs. large cap/tech stocks.

After the Fed's pause on rate increases in June, policymakers see two more hikes this year, and cuts are "a couple of years out" as inflation risks remain, Jerome Powell said. Bloomberg 6/14/2023 Bonds may not be a favorable option for a few years, but the value and smaller stock sectors look like they continue to have the best opportunity for gains in the next few years.

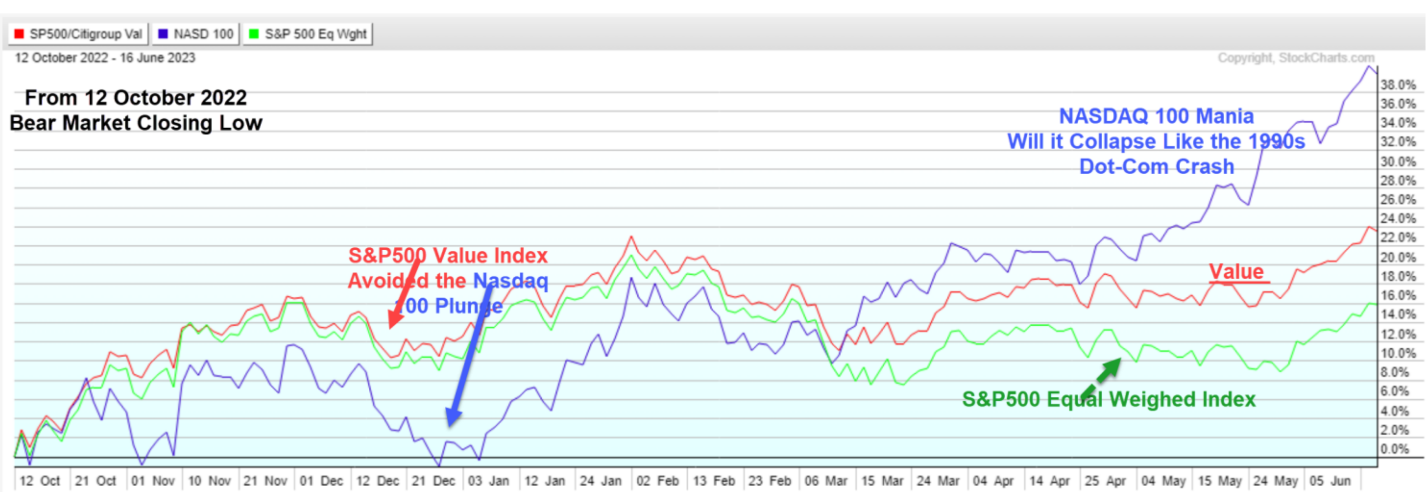
Bonds may continue to lose value as interest rate rise but might become a good potential option in 2024 or 2025. The Morningstar US 10+ Yr. Treasury Bond index lost 29.4% in 2022 Morningstar

Higher interest rates may not just come from Fed tightening, but as Marketwatch reports, "The debt-ceiling deal may spark a new worry: Who will buy the deluge of Treasury bills? Now that the US debt-ceiling fight is finally resolved, the Treasury is expected to unleash a flood of bill issuance to help refill its coffers, run low by the protracted standoff in Washington, DC over the government's borrowing limit. According to an estimate from BofA Global strategists, new bill issuance could reach about $1.4 trillion through the end of 2023, with roughly $1 trillion flooding the market before the end of August."

Some fixed annuities provide high-interest rates for 3-5 years and may be worth considering.

As in previous newsletters, I continue to recommend staying with US investments. Investors that hold large-cap tech stocks may wish to consider repositioning a substantial portion into the value or smaller company sectors due to far lower relative historical valuations vs. the soaring valuations of large caps and AI-related companies. As a reminder, high interest rates tend to decrease the value of growth stocks, since hoped-for future earnings growth is discounted to present value – higher rates lower the discounted value – other factors being equal.

CHART Large Caps, for the last few months, have defied the gravity of higher rates due to what some are calling the AI – Artificial Intelligence - Mania. US stock returns year-to-date have been dominated by mega-cap technology and AI-related stocks. Meanwhile, the rest of the stock market is languishing. The equal-weighted S&P 500, which weights each of the 500 stocks equally rather than by market capitalization, is up much less in the current market.



Favorable Economic and Market Outlook. While there is concern about the high valuations of the mega-caps that soared in the last few months, there are also expectations that the market gains will spread to more reasonably valued stocks, such as the value and smaller cap sectors.

The University of Michigan's survey's preliminary reading on the Index of consumer sentiment came in at a four-month high. Reuters 6/16/2023

The Commerce Department showed that retail sales rose 0.3% from April to May. Economists had been expecting a decline in sales for the month. Last month's increase pointed to a still-resilient economy. APNews 6/15/2023

The Biden massive programs to bring manufacturing jobs home to America and historic investments in infrastructure, clean energy, and education mostly survived the debt ceiling agreement. They provide enormous growth potential in various sectors. A concern is finding enough workers to fill all the new jobs as they are created.

Phoenix has been selected as one of five Workforce Hubs that support critical industries, alongside Columbus, Baltimore, Augusta, and Pittsburgh. The administration will partner with local officials and community leaders to invest in the Phoenix area's semiconductor, optical cable, mineral, and battery manufacturing sectors.

Tempe has been selected as one of 16 cities to participate in the President's third initiative, the Good Jobs, Great Cities Academy. The Academy will develop city-led solutions to upskill and reskill workers for high-demand jobs, in partnership with the National League of Cities. Chamber Business News - a project of the Arizona Chamber Foundation

The US may be the most robust market. While many foreign equity market valuations are much lower than in the US, there is a good reason for the lower valuations. Generally, the US seems to be among the stronger global economies, with lower inflation than many countries. While not avoiding globally rising food and energy costs, and while GDP growth has weakened, it is still growing.

In Asia, Goldman Sachs became the latest Wall Street bank to downgrade its growth forecast for China, as the world's second-largest economy stutters and loses momentum after its coronavirus reopening. CNBC 6/18/2023

"Britain's Economic Malaise" Highlights 6/16/2023 Financial Times
The UK economy is suffering a nasty bout of stagflation, and the prospects appear poor. With no growth in output since last July and inflationary pressures intensifying as wage growth increases, almost no one is satisfied with how the economy is working.

The latest UK inflation data shows core inflation rising to 6.8%, with average wages growing at a near-record rate. These convinced traders that the Bank of England would need to tighten the screws further because rapidly rising wages were not compatible with a target rate of 2 percent inflation.

The UK has had the strong demand seen in the US that has led to labour shortages, while also experiencing the blow from high energy prices that the rest of Europe has faced from the Ukraine war.

Christine Lagarde, European Central Bank president, also warned that inflation would stay "too high for too long" across the eurozone as she raised interest rates for the eighth consecutive time and presented new forecasts showing higher inflation and slower growth than previously expected. Central banks in Australia and Canada also restarted their policy tightening this month.

Europe has fallen behind America, and the gap is growing 6/19/2023 Financial Times.
The US economy is now considerably richer and more dynamic than the EU or Britain — and the gap is growing. That will have an impact well beyond relative living standards. Europe's dependence on the US for technology, energy, capital, and military protection is steadily undermining any EU aspirations for "strategic autonomy."

Natural Gas Continues to Rise as it Targets Higher Prices Jun 16, 2023, FX Empire and FXStreet highlights.

Upside momentum continues as natural gas ends the week at the highest weekly closing price since February. Natural Gas price rises on supply concerns – especially in Europe – due to forecasts of hotter weather and supply outages at key fields in Norway, despite storage figures being unusually high for this time of year, according to a report in the Financial Times.

The FT article cites a pick-up in Asian demand and more supply disruptions to the remaining Russian pipeline gas flows as further factors supporting natural gas prices.

Data from the Permian Basin in the US showed an increase in production to a record historical high compared to the previous year, according to a report by the Energy Information Administration.

Oil producer Apache to halt North Sea drilling due to UK's windfall tax

Apache Corp, the operator of the Forties oilfield for the past 20 years, will halt all drilling in the North Sea because of the UK government's increasingly costly and burdensome tax and regulatory regime.

Forties is one of the largest and oldest oilfields in the UK North Sea, making up part of the oil supply that underpins the Brent crude oil benchmark contract. Financial Times 6/9/2023

US May Inflation Data Signals More Fed Hikes While headline CPI slowed to a 4% rate – the slowest annualized rate for headline CPI in more than two years, the core CPI (which the Fed watches more closely, that excludes food and energy) is still at 5.3% - much above the Fed's 2% target.

On 6/13, when the CPI report was issued, 2 yr & 5 yr treasury yields increased to the highest level since March, and the average 30-year mortgage rate rose to 6.98%. Mortgage News Daily

The lower headline CPI reflected the significant drop in gas prices (-20%) that is not expected to continue, as excess US production is cut back (especially in natural gas) and OPEC cuts its oil output to offset recent price declines. CNN: "Falling gas prices are a big reason inflation cooled from a year ago."

According to US Energy Information Admin (EIA) 6/7/2023, natural gas production is down due to a 75% decline in the Henry Hub price compared to its August 2022 peak. EIA predicts gas will increase to almost \$2.90/MMBtu in 2nd half of 2023, up from the May average of \$2.15. And increase another 30% in 2024.

WTI Oil, as of 6/13/2023, is down about 40% in the last year to \$69.42/bbl. EIA says, "Following the OPEC+ announcement on June 4 to extend crude oil production cuts through 2024, we expect upward pressure on crude oil prices, notably in late-2023 and early-2024."

Food companies continue to raise prices, even as their input costs fall, to boost margins. And they have signaled their intention to continue.

"Higher interest rates haven't stopped, especially in the big food industry, from raising consumer prices despite reporting billions in extra net earnings and over a trillion dollars in new giveaways to wealthy investors," said Liz Zelnick, director of economic security and corporate power at Accountable. US Marketwatch 6/14/2023

Forbes Headline: Will The Artificial Intelligence Mania Sink Stocks?

"Is AI all hype, and does this tiny sliver of stocks driving stock market returns spell doom for stocks at some point? To answer the second part of the question: While many recall the technology stock boom of the late 1990s that led to an ugly peak-to-trough decline of almost 50% in the S&P 500, the gains do sometimes broaden to other stocks.

"Artificial intelligence is not a fad. It has the chance to be the most significant technological development since the internet. AI has the opportunity to increase productivity across the economy, which is immensely valuable. The real question is the pace and extent of the productivity improvement, which remains unknown.

"As seen during the internet stock bubble of the late 1990s, even a revolutionary innovation that changed the world can be overdone. AI-related stocks have risen at a blistering pace, and the valuation of the mega-cap subset has returned to a significant premium to the market. These signs indicate that caution should be taken when wading into the AI investment waters."

Marketwatch had a similar headline: "**Megacap tech stocks out of control**?

According to James Penny, the chief investment officer of TAM Asset Management, the current mood is reminiscent of the early days of the tech bubble that burst in 2000 and wiped more than 70% off the Nasdaq. "Companies that even mention the word AI in their earnings are seeing boosts to their share price, and that smells very much like the dot-com era," Penny said in an interview. Bloomberg 6/13/2023

AI Tech Stocks Are Vastly Over-Extended The notion that a potential reversal in the Fed policy back to easing mode would help to fuel the technology sector again appears to be broadly misguided. If interest rates were to be significantly lowered again, it would likely occur in a difficult macroeconomic environment where the fundamentals of tech companies would also be under severe pressure. It is worth mentioning that their overall earnings have already started to contract.

From our perspective, corporations' capital costs are expected to continue to increase for the foreseeable future. This should result in continued margin pressure, making it increasingly challenging to justify today's highly inflated valuations.

Investors seem to value businesses as if we are on the cusp of another decade of robust growth and low-cost capital. We vehemently disagree with this perspective. Furthermore, the conventional thought that the market has already factored in the potential risks of a significant economic downturn contradicts the balance of evidence across our arsenal of macro and fundamental indicators. Crescat Capital in Seeking Alpha 6/11/2023

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