

Investment Report 2Q2023

Global stocks rose in the quarter, with developed markets, particularly the United States, leading the way, while emerging market equities trailed. AI (Artificial Intelligence) enthusiasm has lifted technology stocks. Although the US Federal Reserve chose to remain on hold in June, major central banks boosted interest rates over the time. Government bond rates increased, implying that prices declined. The S&P 500 concluded the second quarter and first half of 2023 at a 14-month high, and most major stock indices posted solid gains in the second quarter, thanks to a pause in the Fed's rate hike campaign, stronger-than-expected corporate earnings (particularly in the tech sector), and a relatively drama-free debt ceiling resolution.

Following the March collapses of Silicon Valley Bank and Signature Bank, markets began the second quarter still reeling from the regional bank crisis, and investors began the month of April apprehensive of contagion risks. Those fears were generally unfounded, as regional banks remained steady for the majority of the month. This stability allowed investors to refocus on corporate profits, and the results were substantially better than expected, with 78% of S&P 500 businesses reporting better-than-expected Q1 earnings, a figure that was much higher than the 66% long-term average. Furthermore, 75% of reporting firms outperformed sales projections for the first quarter, which is substantially above the long-term average. That excellent corporate performance was a pleasing sight for investors, and when combined with broad macroeconomic calm, allowed equities to rise consistently for the most of April. However, after an uninspiring earnings release, fears over First Republic Bank's solvency weighed on markets late in the month, and the S&P 500 fell until the end of April to close with a slight gain.

On May 1st, fears of a First Republic Bank failure became reality when the bank was seized by authorities and the FDIC was named receiver. However, JPMorgan announced the same day that it was acquiring the bank from the FDIC, which helped to alleviate market concerns about financial contagion risks. The Federal Reserve also helped to divert investors from the failure of the First Republic, as the Fed raised rates at the May 2nd FOMC meeting, but changed language in the statement to indicate that rate rises would be paused at the following meeting. However, because investors anticipated the shift, it failed to spark a substantial increase in markets. Instead, the tech sector aided the S&P 500's rise in mid-May, thanks to an explosion of investor and financial media interest in Artificial Intelligence (AI), highlighted by a big surge in Nvidia (NVDA) following a solid earnings report. However, like in April, volatility increased near the close of the month. This time, it was due to a lack of action on extending the US debt limit and mounting worries of a debt ceiling violation and possibly US debt default. However, on May 28th, Speaker McCarthy and President Biden agreed to a two-year debt limit extension, which was signed into law a few days later, averting a financial disaster. The S&P 500 concluded May slightly higher.

The stock market rise began in early June, supported by many potentially favourable factors, with the debt ceiling cleared, a Fed halt in rate hikes predicted, and sustained stability in regional banks. First, inflation fell to its lowest level in two years, according to the Consumer Price Index (CPI). Second, economic indicators remained remarkably robust, easing concerns about a near-term recession. Finally, in mid-June, the Federal Reserve verified market predictions by stopping rate rises, which fueled a wide stock surge that saw the S&P 500 break past 4,400 and reach its highest level since April 2022.

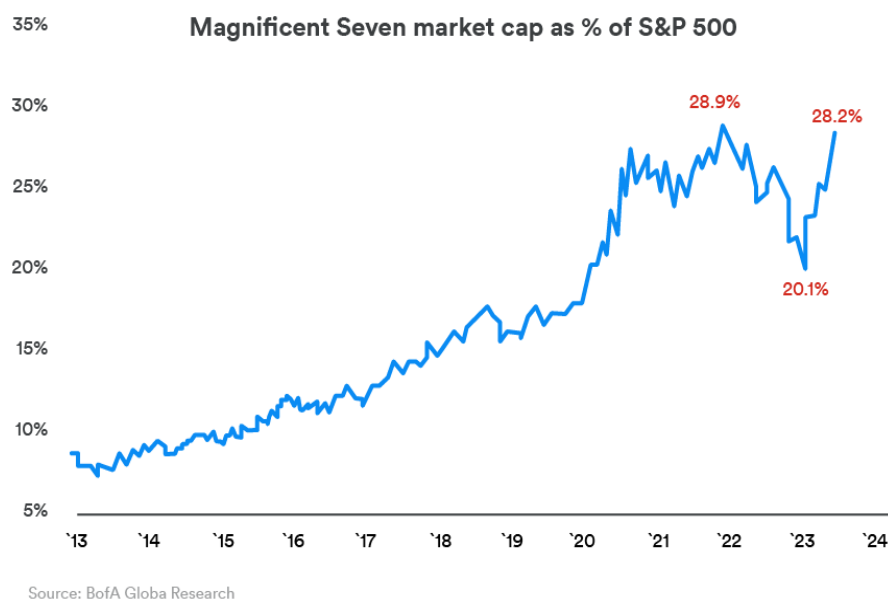
Despite conflicting economic statistics, political turbulence in Russia, and hawkish language from global central bankers in the last two weeks of the month, the S&P 500 concluded June with robust gains. Markets were impressively resilient in the second quarter and throughout the first half of 2023, as better-than-expected earnings, expectations for less aggressive central bank rate hikes, more evidence of a "soft" economic landing, and relative stability in regional banks propelled the S&P 500 to a 14-month high.

Second Quarter Performance Review

Investors headed into the second quarter on high alert for a recession and expecting the Fed to lower rates shortly. At the conclusion of the quarter, there was still no sign of an economic slump, inflation remained stubborn, and the Fed was anticipated to hold rates higher for longer.

The tech sector's outperformance in the second quarter of 2023 was accelerated, as "AI" euphoria propelled numerous mega-cap tech firms considerably higher. These high gains led to big rallies in the tech-focused Nasdaq and, to a lesser extent, the S&P 500, as the tech sector is the index's most heavily weighted sector. Similarly, to the first quarter, the less-tech-focused Russell 2000 and Dow Industrials saw lower-but-still-positive quarterly results.

There were considerable differences in market performance. The "Magnificent Seven" were responsible for the majority of the surge in equities, while the remainder of the market was flat on balance. Changes in expectations for Fed policy sent rate-sensitive bonds marginally down in the bond market. The S&P 500 index's performance is presently the most concentrated it has been since the covid-19 days. Seven of the largest components — Apple, Microsoft, Alphabet's Google, Amazon, Nvidia, Tesla, and Meta, or the "Magnificent Seven" — have increased by 40 to 180 percent this year, compared to the remaining 493 firms, whose aggregate performance has been practically flat.



Large caps beat small caps in terms of market capitalization, as they did in the first quarter of 2023. Concerns about regional banks and increasing loan rates continued to weigh on small caps, since smaller firms have historically relied more on finance to maintain operations and generate expansion.

In terms of investing strategy, growth easily beat value in the second quarter, continuing the significant shift that began in 2022. The aforementioned "AI" enthusiasm benefitted tech-heavy growth funds. Value funds, which have a higher exposure in financials and industrials, outperformed growth funds, as the

performance of non-tech sectors more accurately represented the broader economic reality of mainly stable but unspectacular economic development.

Eight of the 11 S&P 500 sectors concluded the second quarter with positive results. The Consumer Discretionary, Technology, and Communication Services sectors outperformed in the second quarter, as they did in the first. Many mega-cap tech firms, including Amazon (AMZN), Apple (AAPL), Alphabet (GOOGL), Meta Platforms (META), and Nvidia (NVDA), led the advances in those three sectors, which easily beat the remaining eight S&P 500 sectors. Industrials, financials, and materials have all seen modest increases in the last three months, owing to increased confidence about a "soft" economic landing.

In terms of laggards, typical defensive sectors like as Consumer Staples and Utilities have decreased marginally over the last three months as investors have shifted to sectors that will benefit from stronger-than-expected economic growth. Energy also had a little negative return in the second quarter, owing to lower oil prices.

US Equity Indexes	Q2 Return	YTD
S&P 500	10.32%	16.89%
DJ Industrial Average	5.28%	4.94%
NASDAQ 100	17.33%	39.35%
S&P MidCap 400	6.70%	8.84%
Russell 2000	7.24%	8.09%

Source: YCharts

Internationally, foreign markets lagged the S&P 500, owing primarily to a lack of large-cap "AI" exposed stocks in major foreign indices, combined with late-quarter concerns about the EU economy and the pace of Bank of England rate hikes, though foreign markets ended the second quarter with a modestly positive return. Due to a lack of strong economic stimulus in China, which impacted on emerging markets late in the quarter, foreign developed markets outperformed developing markets.

International Equity Indexes	Q2 Return	YTD
MSCI EAFE TR USD (Foreign Developed)	3.63%	12.13%
MSCI EM TR USD (Emerging Markets)	1.50%	5.10%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	3.13%	9.86%

Source: YCharts

Overview

Total returns (net) % – to end June 2023

Equities	3 months			12 months		
	USD	EUR	GBP	USD	EUR	GBP
MSCI World	6.8	6.4	3.9	18.5	13.6	13.2
MSCI World Value	3.0	2.6	0.2	10.7	6.0	5.7
MSCI World Growth	10.4	10.0	7.4	26.4	21.1	20.7
MSCI World Smaller Companies	3.2	2.8	0.4	12.9	8.2	7.9
MSCI Emerging Markets	0.9	0.5	-1.9	1.7	-2.5	-2.8
MSCI AC Asia ex Japan	-1.3	-1.7	-4.0	-1.2	-5.3	-5.6
S&P500	8.7	8.3	5.8	19.6	14.6	14.2
MSCI EMU	3.2	2.7	0.3	29.5	24.1	23.7
FTSE Europe ex UK	3.4	3.0	0.6	25.3	20.0	19.6
FTSE All-Share	2.4	1.9	-0.5	12.9	8.2	7.9
TOPIX*	5.4	4.9	2.5	18.1	13.2	12.9

Moving on to fixed income markets, the major bond benchmark (Bloomberg Barclays US Aggregate Bond Index) generated a slightly negative return for the second quarter of 2023, as the strong economy and the prospect of a near-term stop to Fed rate rises prompted investors to pursue riskier assets.

In the second quarter, shorter-duration bonds outperformed longer-duration bonds, as bond investors priced in a near-term end to the Fed's rate hike campaign, while optimism about economic growth caused investors to exit the safety of longer-dated fixed income. In the corporate bond market, lower-quality but higher-yielding "junk" bonds increased moderately in the second quarter, while higher-rated, investment-grade debt increased very slightly. That performance disparity represented investor confidence about the economy, which led to greater risk-taking in exchange for a better return.

US Bond Indexes	Q2 Return	YTD
BBgBarc US Agg Bond	-0.38%	2.09%
BBgBarc US T-Bill 1-3 Mon	1.23%	2.33%
ICE US T-Bond 7-10 Year	-1.32%	1.62%
BBgBarc US MBS (Mortgage-backed)	-0.41%	1.87%
BBgBarc Municipal	0.04%	2.67%
BBgBarc US Corporate Invest Grade	0.40%	3.21%
BBgBarc US Corporate High Yield	2.60%	5.38%

Source: YCharts

Commodities

The prolonged global economic slump continues to exert negative pressure on commodities markets. Despite the fact that global inflation has begun to decline, price pressures remain historically high. Consumers and companies are constrained by high pricing and growing borrowing rates. Consumer spending on goods and services and slow manufacturing activity, along with lower B2B demand and

capital investment growth, are expected to restrict demand for energy, metal, and food commodities this year, limiting price rise.

Commodities suffered minor losses in the second quarter, with most key commodities falling during the previous three months. Despite a surprise production reduction from Saudi Arabia and an uptick in geopolitical tensions in Russia, oil prices fell somewhat as concerns about future economic growth and oversupply weighed on the market. Meanwhile, gold produced a somewhat negative return as inflation fell but the dollar did not fall significantly.

In the second quarter, the S&P GSCI Index performed poorly. The worst-performing industries were industrial metals and energy, while livestock prices climbed in the quarter. Zinc, nickel, and aluminum prices were all much lower in the quarter. Crude oil, Brent crude, heating oil, and gas oil all fell in price, but natural gas and unleaded gasoline prices rose somewhat. In agriculture, dramatically higher cocoa and soybean prices failed to compensate for price losses in coffee, sugar, and maize. Wheat and Kansas wheat both finished the month in the black. Both gold and silver finished the month in the red in precious metals.

Commodity Indexes	Q2 Return	YTD
S&P GSCI (Broad-Based Commodities)	-1.45%	-7.54%
S&P GSCI Crude Oil	-5.21%	-12.40%
GLD Gold Price	-3.08%	5.23%

Source: YCharts/Koyfin.com

Commodity	Price Trends	Upside risks	Downside risks
Energy	Energy Price Index Mar 2020-Jul 2023 2010=100 	Higher demand from Asian countries, particularly China	Lower global demand amid economic slowdown
		Supply cuts by OPEC+	Ramped-up adoption of renewables and energy efficiency
		Difficulties with gas storage refilling in Europe	Mandatory energy demand reduction
		Unfavourable weather (limiting output or boosting demand)	Resilient production output, successfully reshuffled trade flows
Food	Food Price Index Mar 2020-Jul 2023 2010=100 	Extreme weather events, including drought, heatwaves and floods	Weaker consumer demand, as high inflation hits affordability
		Stronger-than-expected rebound in demand from China	Higher supply on higher yields, planted area and favourable weather
		Constrained supply from Ukraine	Elimination of export restrictions
		Volatility in prices of energy and other inputs	Improving affordability of fertilisers
Metals	Metals Price Index Mar 2020-Jul 2023 2010=100 	Accelerated growth in China	Recession in the USA
		Supply disruptions in Latin America	Slowdown in construction industry
		Elimination of Russia from export markets	Higher interest rates and weaker B2B investment growth
		US dollar depreciation	Oversupply of metals

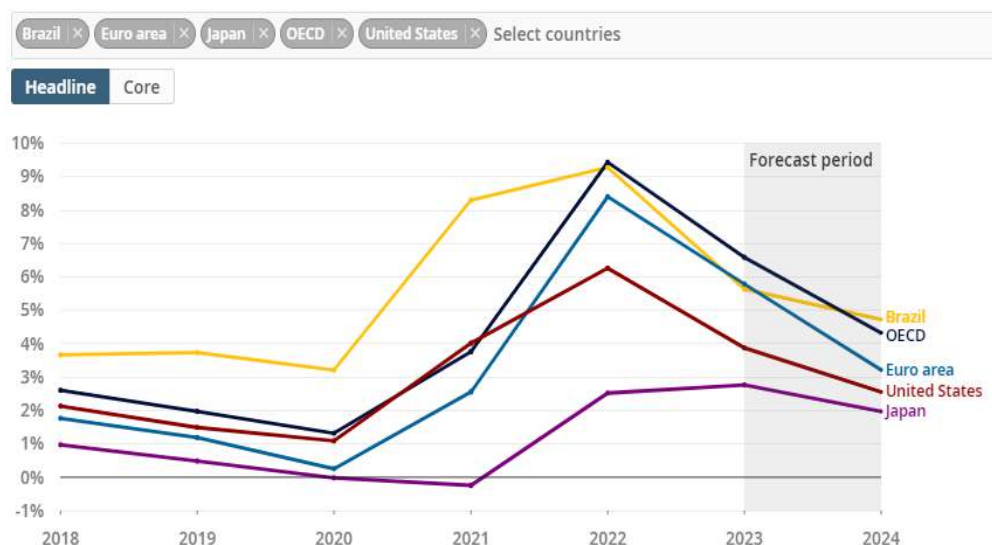
Inflation

Inflation has begun to ease from multi-decade highs recorded in several nations following Russia's full-fledged invasion of Ukraine. The global economy is showing indications of progress, but the recovery is

still fragile, with considerable downside risks. Lower energy costs are contributing to lower headline inflation and easing stresses on household budgets, while China's earlier-than-expected reopening has boosted global business. However, core inflation is persistent, and the impact of increased interest rates is spreading across the economy. In most economies, headline inflation has declined in recent months due to a drop in energy costs, even while food and service prices have continued to climb significantly. Core inflation continues to be persistently high.

Headline inflation has started to fall, but core remains persistent

%, year-over-year




Note: Headline inflation concerns all commodities, services, and goods. Core inflation is headline inflation excluding food and energy. OECD inflation aggregate relies on different country-level definitions of inflation.
Source: [OECD Economic Outlook, June 2023](#).

Hedge Funds

As per HFR, total global hedge fund capital reached \$3.95 trillion by the end of the second quarter of 2023, representing a quarterly growth of more than \$60 billion. In the second quarter, investors put \$3.6 billion into global hedge funds, contributing to the industry's asset growth. The industry attracted \$12.64 billion in the first half of the year. Investors redeemed \$55.4 billion from funds last year, resulting in a positive net money inflow this year. Capital flocked to major hedge funds with assets in excess of \$5 billion. Smaller businesses saw an outflow. Furthermore, by the end of the second quarter, the investible HFRI 500 Fund-Weighted Composite index has gained 2.2% year to date, led by directional equity hedging and event-driven strategies. Both of these techniques "navigated surging risks" in the first quarter, with banking and inflation concerns receding in the second quarter. According to the research, the techniques were also bolstered by the current growth in technology and AI exposures. Total equity hedge capital increased by an estimated \$29.4 billion to \$1.14 trillion in the second quarter of 2023, as robust performance-based gains were supplemented by an expected \$2.8 billion in new investor capital. Fundamental value funds led asset rises in equity hedge sub-strategy assets, which increased \$16.5 billion in the second quarter on

robust performance and net asset inflows of an estimated \$2 billion. The investible HFRI 500 Equity Hedge index gained 4.3% year to date through the second quarter of 2023, leading all key strategy indexes.

Single manager hedge funds

Benchmark name	Jun-23	May-23	2023 YTD	12-month	3-year annualized	12-month trend
Hedge funds	2.40	-0.26	6.06	8.46	10.13	
HF - Event driven strategies	3.34	-1.51	2.97	5.93	11.25	
HF - Equity strategies	3.16	-0.03	6.64	9.89	9.88	
HF - Relative value strategies	1.46	0.09	3.97	7.18	6.64	
HF - Multi-strategy	1.43	-0.22	3.28	5.46	7.67	
HF - Macro strategies	0.86	0.30	1.85	3.73	8.16	
HF - Credit strategies	0.93	0.10	3.38	6.47	4.92	
Activist	3.32	-0.09	6.29	8.78	11.56	
Discretionary	2.68	0.07	5.91	8.44	9.24	
Systematic	2.50	-0.40	5.79	6.40	11.33	
Volatility	1.95	-0.10	4.85	7.18	9.14	
HF - North America	3.63	-0.27	6.89	9.94	11.52	
HF - Emerging markets	3.25	1.51	6.13	11.26	7.20	
HF - APAC	2.80	-0.82	4.13	5.74	8.27	
HF - Developed markets	1.47	0.16	5.02	6.52	7.00	
HF - Europe	0.86	-0.83	3.96	6.04	6.18	
HF - JPY	4.80	0.74	10.64	11.72	8.83	
HF - BRL	4.07	3.20	7.60	14.40	6.92	
HF - USD	2.69	-0.75	6.57	8.53	11.11	
HF - EUR	1.38	-0.03	4.76	5.56	6.27	
HF - GBP	1.38	-0.49	2.39	3.01	4.51	
HF - Emerging (less than \$100mn)	2.65	-0.02	6.70	8.96	10.71	
HF - Large (more than \$1bn)	2.46	-0.07	6.72	10.31	9.44	
HF - Small (\$100mn-499mn)	2.34	-0.01	5.26	8.95	9.09	
HF - Medium (\$500mn-999mn)	1.79	0.19	4.81	7.85	9.36	

Global Bonds

Market volatility fell significantly in the second quarter of 2023. Government bond rates were rising again, albeit there was some variance, with the UK and Australia underperforming due to higher-than-expected inflation and a stronger willingness on the part of central banks to battle inflation. With the exception of the Bank of Japan, all major central banks raised interest rates during the quarter. After more than a year of straight rate rises, the Fed was the first to halt in June, leaving rates at 5% to 5.25%.

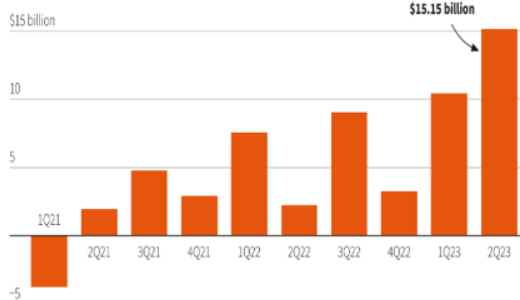
Convertible bonds, as measured by the Refinitiv Global Focus Index, returned 5% in Q2. Convertibles benefited from the tailwinds offered by the robust performance of "big tech" equities supported by the AI story. However, the universe of convertibles lacks some of the big-hitter tech firms, making it harder to fully participate in the high market increases. The main market was particularly busy, with new convertibles worth US\$22 billion entering the market.

In the second quarter of this year, global investors poured a record amount of money into European sovereign bond funds, drawn in by high yields and the potential of interest rate reduction by the European Central Bank next year. According to financial data provider EPFR, European sovereign bond funds received \$15.15 billion in inflows from April to June, up from \$10.44 billion in the previous quarter, which was a record at the time. Global government bond yields have risen as central banks raised interest rates to combat inflation, making fixed income more appealing after years of dismal returns. The yield on

Germany's 10-year government bond, the eurozone's benchmark, was under -0.3% just two years ago and was trading at 2.44% on Friday. The comparable in Italy is roughly 4.14%.

Investors snap up European government debt

Quarterly flows into European sovereign bond funds



Source: EPFR | Reuters, July 14, 2023 | By Harry Robertson

	3 months			12 months		
	USD	EUR	GBP	USD	EUR	GBP
Government bonds						
JPM GBI US All Mats	-1.3	-1.7	-4.0	-1.9	-6.0	-6.2
JPM GBI UK All Mats	-3.1	-3.5	-5.7	-10.9	-14.6	-14.9
JPM GBI Japan All Mats**	-7.6	-8.0	-10.1	-5.9	-9.9	-10.1
JPM GBI Germany All Traded	0.1	-0.3	-2.6	-1.7	-5.8	-6.1
Corporate bonds						
BofA ML Global Broad Market Corporate	0.1	-0.3	-2.7	1.9	-2.3	-2.7
BofA ML US Corporate Master	-0.2	-0.6	-2.9	1.4	-2.8	-3.1
BofA ML EMU Corporate ex T1 (5-10Y)	1.0	0.6	-1.8	4.2	-0.1	-0.4
BofA ML £ Non-Gilts	-0.6	-1.0	-3.4	-2.7	-6.8	-7.1
Non-investment grade bonds						
BofA ML Global High Yield	1.6	1.2	-1.2	9.7	5.1	4.8
BofA ML Euro High Yield	0.4	0.0	-2.3	4.4	0.0	-0.3

Source: Thomson Reuters DataStream. Local currency returns in Q2 2023: *14.5%, **0.4%.

Past performance is not a guide to future performance and may not be repeated.

Performance across regions

US

US equities finished the quarter higher, with the majority of the gains occurring in June. The gain occurred amid easing inflation and indicators that the US economy is holding up despite rising interest rates. An adjustment to Q1 GDP growth suggested a 2% (annualized) increase, far higher than the earlier estimate of 1.3% growth. In May, the Federal Reserve (Fed) increased interest rates by 25 basis points (bps). However, it did not raise rates in June, opting for what economists call a "hawkish pause." The "dot plot" of rate estimates showed two more rate increases in 2023. In the United States, inflation (as measured by CPI) fell to 0.1% month on month in May, down from 0.4% in April, as energy prices continued to fall. This reduced the annual rate to 4.0%, which was lower than the 4.1% expected. The economy as a whole is still doing well. The US unemployment rate rose to 3.7% in May from 3.4% in April, a larger-than-expected increase, although the labor market remained historically tight.

UK

UK equities fell over the quarter. The large UK-quoted diversified energy and basic materials groups were the most significant detractors amid broad-based weakness in commodity prices and concerns over the outlook for the Chinese economy. Sterling strength also weighed on these resources sectors, as it did other significant US dollar earners such as consumer staples. A number of domestically focused areas of the market also underperformed as the Bank of England (BoE) raised rates twice – in May and June. The 0.5 percentage points (pp) increase in June represented a reacceleration in rate hikes after an initial decision to slow the pace in March to 0.25 pp increments.

Japan

The strong momentum for Japanese shares accelerated in June and the TOIPIX Total Return index rose by 14.4% in local terms for Q2. The Japanese yen weakness also continued and it hit the levels of 188 yen and 144 yen against sterling and the US dollar respectively in June. This pulled down foreign currency denominated returns from the Japanese equity market. In June, the Nikkei achieved its highest level in 33 years, surpassing 33,700 yen. This has been fueled in part by persistent buying from foreign investors since April. Furthermore, the improvements have occurred amid continuous expectations of corporate governance changes and structural developments in Japan's macroeconomic environment. Yen depreciation and gains in the US market aided the Japanese equities market's risk-on mentality. Despite the fact that market values, such as the price-to-earnings ratio, have reached a reasonable level, there appears to be room for upward earnings revisions in the coming months, backed by yen depreciation.

Asia (ex Japan)

Asia ex Japan stocks performed poorly in the second quarter. China, Malaysia, and Thailand had the worst-performing index markets, while India, South Korea, and Taiwan saw gains. Chinese shares fell substantially in the second quarter as the country's economic recovery began to moderate following its reopening following the Covid-19 crisis. Following interest rate hikes in the United States and Europe, factory output in China has begun to stagnate due to weak consumer spending and export demand. Hong Kong share prices declined in the quarter as the Chinese economy slowed, lowering investor confidence toward Hong Kong equities. Shares in India rose sharply, backed by foreign inflows and consistent profitability, as good economic statistics strengthened investor confidence in the country. Taiwanese stocks rose, led by increases in technology companies as investors rushed to acquire AI-related stocks. Investor confidence for AI-related firms lifted South Korean share prices, which closed the second quarter solidly in positive territory. The Philippines and Singapore closed the quarter in the red, while Indonesia gained somewhat.

As we enter the third quarter of 2023, the outlook for stocks and bonds is undoubtedly the most positive it has been since late 2021, with inflation at a two-year low, economic growth and the labor market remaining impressively resilient, the Fed temporarily pausing its historic rate hike campaign, the debt ceiling extension resolved, and no significant contagion from earlier this year's regional bank failures. To summarize, there have certainly been good macro changes in 2023 that have aided the stock market's recovery. However, it is vital to note that the economy and markets continue to face a wide range of dangers.