Aptus Quarterly Market Update – Q2 2023

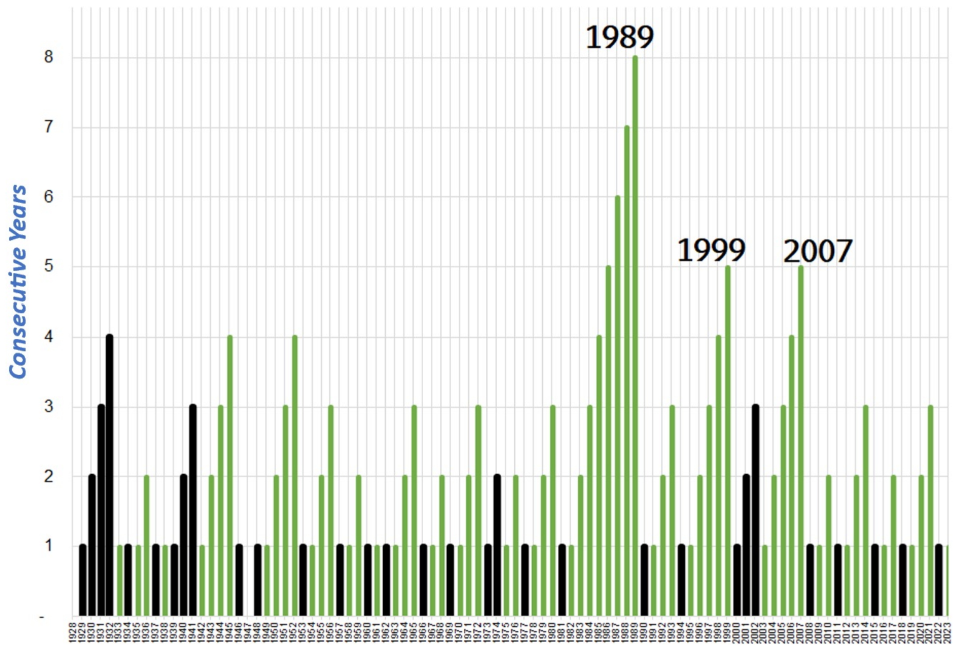
A Market in Review – Q2 2023

Weak Market Breadth Leading the Market: The banking fears in Q1 faded into an AI FOMO trades in Q2. That is why this quarter's rally was highlighted by a lack of market breadth leading the S&P 500 higher. Year-to-date, 86% of the market's returns has been contributed from the 7 largest companies, deemed "The Magnificent 7". History has shown that when market breadth is this weak, it is not a precursor to presage poor future returns. In fact, there's no clear directional clue. So, while the superlative sounds interesting, history has yet to provide a clear trading signal.

EPS Estimates May Help Explain Equity Market Strength In 1H23: One way to interpret the recent market performance is that earnings per share ("EPS") expectations have been moving higher, so the equity markets are moving higher, but institutions just don't believe it, so they are hiding in the largest, most liquid, profitable names they can. This one reason for the lack of market breadth.

Market Sentiment was All About "Immaculate Disinflation": During the quarter, market participants believed in a narrative of falling inflation, stable growth called "Immaculate Disinflation", given the strong labor market.

S&P 500, Consecutive UP Years (Green) and Consecutive DOWN Years (Black)
1928 to now (2023 = YTD)



Source: Brent Donnelly, Data as of 6/27/23

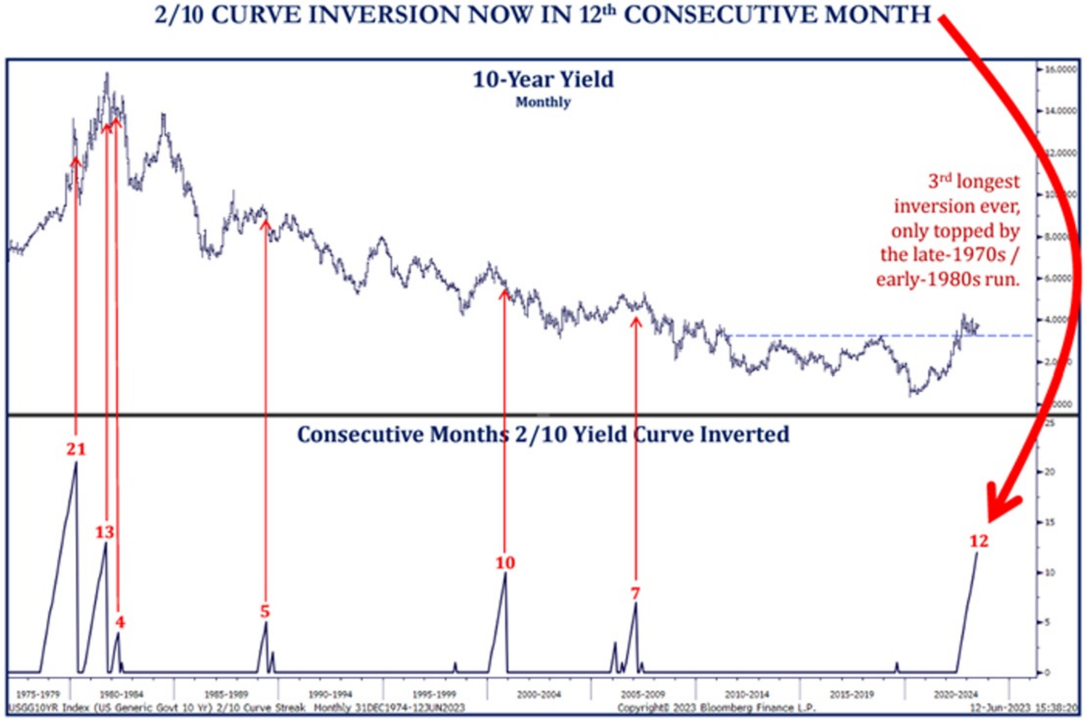
	1M	QTD	YTD	1-YR	3-YR	5-YR	10-YR
S&P 500	4.87%	6.97%	14.97%	14.18%	15.10%	12.08%	12.61%
NASDAQ	4.85%	11.14%	30.08%	18.71%	12.49%	13.79%	16.09%
Dow Jones Industrial	3.21%	2.52%	3.47%	10.27%	12.95%	9.42%	11.01%
Russell 2000	5.84%	2.97%	5.78%	6.00%	11.66%	3.78%	7.98%
MSCI EAFE	3.16%	1.79%	10.64%	14.87%	9.13%	4.81%	5.89%
MSCI EM	4.27%	1.40%	5.47%	0.13%	2.70%	1.70%	3.59%
U.S. Barclays Agg.	-0.14%	-0.63%	2.32%	0.29%	-3.90%	0.80%	1.55%
Investment Grade Bonds	0.40%	-0.69%	3.75%	2.36%	-4.14%	1.94%	2.91%
High Yield Bonds	1.13%	0.67%	4.34%	5.86%	2.24%	2.71%	3.78%

Source: Bloomberg. Data as of 6/27/2023. Returns include Dividends. Returns over 1YR are Annualized.

The Fundamental Bond Backdrop

What is the Yield Curve Telling Us?

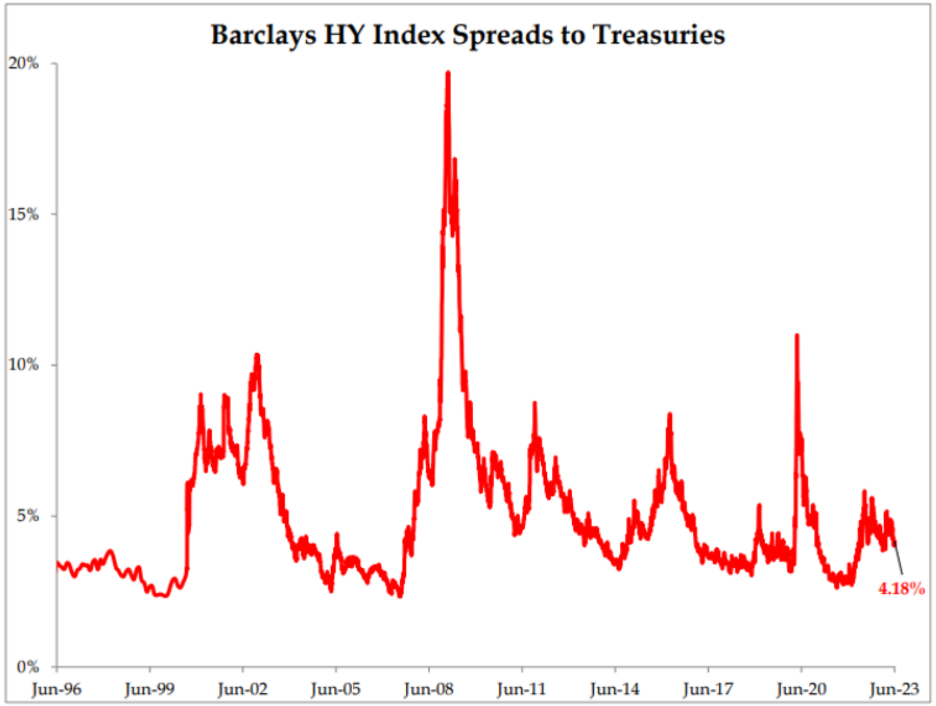
2/10 CURVE INVERSION NOW IN 12th CONSECUTIVE MONTH



Source: Strategas, Data as of 6/27/23

What Are Credit Spreads Telling Us?

SPREADS NOW 150 BPS BELOW THEIR 2022 HIGHS



Source: Strategas, Data as of 6/27/23

	1M	QTD	YTD	1-YR	2-YR
U.S. Aggregate	-0.14%	-0.63%	2.32%	0.29%	-5.44%
U.S. Investment Grade Bonds	0.40%	-0.69%	3.75%	2.36%	-7.31%
U.S. High Yield Bonds	1.13%	0.67%	4.34%	5.86%	-2.69%
iShares 20+ Year Treasury Bond	0.44%	-2.25%	4.96%	-4.91%	-12.84%
International Bond Index	0.10%	0.61%	3.58%	2.08%	-3.72%
U.S. Treasury TIPS	-0.14%	-0.63%	1.54%	-0.15%	0.71%

Source: Bloomberg. Data as of 6/27/2023. Returns include Dividends. Returns over 1YR are Annualized.

The Health of the Consumer

Market invests In the CHANGE in the near term, and the LEVEL in the long term.

The Positive – The absolute *level* of U.S. Household Net Worth Remains Strong Showing the Strength of the Consumer:

- Consumer balance sheets are well positioned to deal with an adverse shock or continued inflation. Household assets rose by $3.1T in Q1 '23, driven by gains in financial assets.
- On the liability side, the share of household debt balances that were current (rather than late) was 97.4%, which is close to an all-time high showing that debt-service & financials obligation ratios are both below pre-COVID levels.

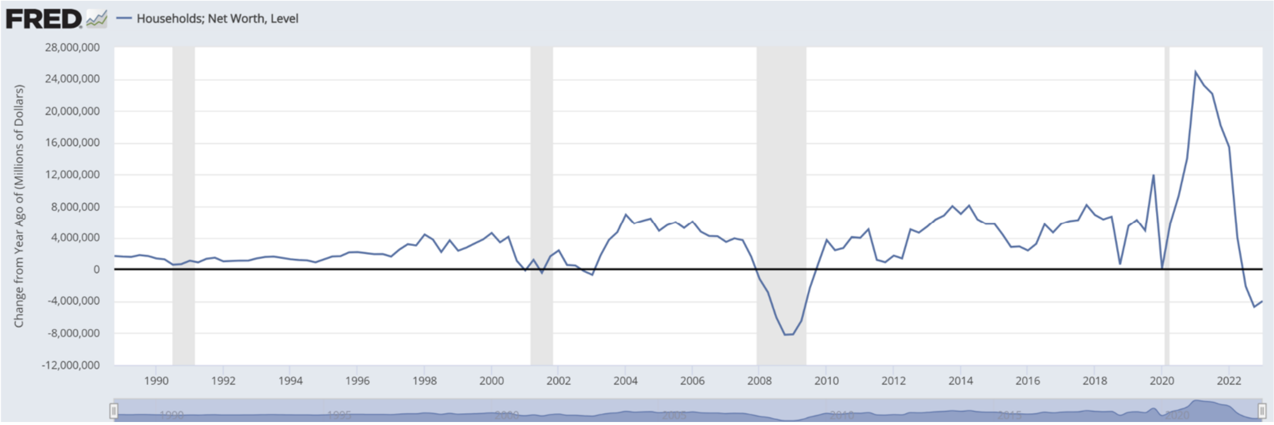
U.S. Household Net Worth ($T)

	Current Q1 2023	Peak Q1 2022	Since High Change (%)	Q1 2020	COVID 15-QTR Change (%)	Q1 2013	10-YR Change (%)
Total Assets	**$ 168.5**	$ 171.2	-1.62%	$ 127.1	32.54%	$ 81.6	106.45%
Deposits	**$ 17.8**	$ 18.3	-2.73%	$ 13.9	28.06%	$ 9.5	87.96%
Total Stock Inv.	**$ 42.1**	$ 47.3	-10.99%	$ 26.5	58.87%	$ 18.2	131.83%
Other Fin'l Assets	**$ 54.4**	$ 51.5	5.69%	$ 46.1	18.03%	$ 34.8	56.53%
Real Estate	**$ 41.2**	$ 41.7	-1.20%	$ 30.6	34.64%	$ 19.0	116.84%
Other Non-Fin'l Assets	**$ 13.0**	$ 12.5	4.02%	$ 10.0	29.50%	$ 7.6	71.30%
Less: Total Liabilities	**$ 19.6**	$ 18.6	5.15%	$ 16.6	18.07%	$ 13.9	41.31%
Total Net Worth	**$ 148.9**	$ 152.6	-2.44%	$ 110.5	34.71%	$ 67.7	119.78%

Source: Federal Reserve, Data as of 6/27/23

The Negative - On the Other Side of the Equation, Monthly Comps are Becoming More Difficult:

- One consideration to your theory is the long track record of net worth's resiliency. Interestingly, the current y/y decline is the second biggest decline in 30+ years. This chart suggests less that resiliency of net worth avoids recession, but rather that these numbers are recessionary.
- As we all know, investors need to look through the windshield and recognize the potential hurdles for consumer spending in the future: a labor market slowdown, resumption of student loan payments, and increased debt-servicing costs due to interest rates.



Source: Federal Reserve, FRED Charts, Data as of 6/27/23

The GOOD / The BAD / The UGLY

The Good

The U.S. Consumer Continues to be Resilient

We believe the aggregate consumer is flush with cash, and once pent-up demand can safely be unleashed, the U.S. economy can continue being resilient. The average U.S. Household is worth 15% more. Consumer balance sheets are well fortified and flush with cash.

Labor Market Remains VERY Resilient

There has never been a recession that did not witness a material increase in the unemployment rate, which remains “stubbornly” below 4%. Though, the labor market does appear to be slowly weakening, it has remained very resilient, which has allowed consumers to continue to spend capital, as wage growth remains high.

The Bad

Inflation is Persistent, Though Peaking?

The magnitude of the policy actions used to counteract deflation may, in the end, be hugely inflationary. Higher-than-expected inflation tends to be a major headwind to equity valuations, but it appears that inflation has peaked for now. For markets, how the Fed chooses to address inflation is as important as the inflation itself. The battle isn’t over, as services and wage inflation continue to be “sticky”.

Fed Policy Collateral Damage

The yield curve officially inverted in ’22 creating speculation of a recession. This means caution in communication by the Fed to avoid the mistakes of the Yellen Fed and the “stop-and-go” policy from the ’70s. The Fed’s number one goal is to anchor inflation, even if it puts the economy into a recession. With this, there may be some collateral damage in parts of the speculative market, as we’ve already seen a few in the banking sector.

The Ugly

Inflation Transitioning to Growth Frustration

Earnings expectations for the S&P 500 have only come down 9.1% in ‘23. Anecdotally, margins continue to compress at the corporate level, but have not yet been represented in overall analyst’s future expectations. We believe that if earnings were to significantly drop, which they tend to fall ~20% during a recession, the market could follow, as lower inflation could mean lower earnings.

Risk of a Recession:

An inverted yield curve has preceded almost every recession, though it has difficulty on properly calling the timing. The yield curve is the most inverted it's been during this cycle. If consumer spending starts to slow, the economy could witness a stagflationary environment where inflation is structural, growth is slowing, and unemployment increases. Not to mention, it appears that Central Banks are simply hiking until labor markets start to weaken.

Asset Allocation Woes

Asset Allocation Decisions Become More Difficult During Periods on Inflation:

Many Investors Were Caught Offsides:

- The Market entered '23 with a lot of pessimism on the market and it's future path of returns, which should not be a surprise, given that the 60/40 portfolio had its worst year since 1937.

It Pays to be a Rational Optimist:

- Pessimism about the long-term does not align in any way with a historic worldview. Investors can choose to believe that right now is the beginning of the end, but that is a bet against all of human history and against human nature itself. As has always been the case, progress occurs against an inevitable backdrop of catastrophe. Always has, always will. Invariably, you can always find what you go looking for and your investment results will probably mimic that worldview.

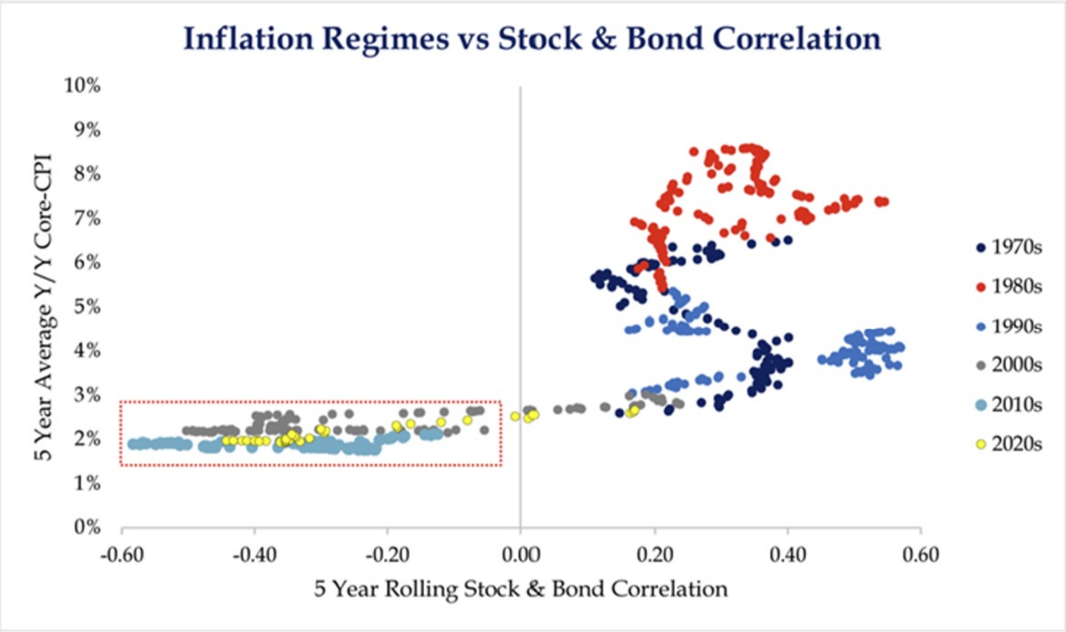
Decade	Yield +	Earnings Growth +	Valuation Change =	Annual Returns
1900s	3.9%	4.7%	0.9%	9.5%
1920s	4.2%	2.0%	-2.9%	3.4%
1920s	3.7%	5.6%	4.6%	13.9%
1930s	3.1%	-5.7%	1.6%	-1.0%
1940s	4.2%	9.9%	-6.4%	7.8%
1950s	4.1%	3.9%	10.1%	18.1%
1960s	3.1%	5.5%	-1.2%	7.3%
1970s	3.4%	9.9%	-8.0%	5.3%
1980s	3.4%	4.4%	8.6%	16.4%
1990s	1.7%	7.7%	8.2%	17.6%
2000s	1.5%	0.6%	-2.9%	-0.8%
2010s	1.9%	10.6%	0.7%	13.3%
2020s	1.5%	11.1%	-5.1%	7.6%
Avg. Contribution to Return	3.1%	5.4%	0.6%	9.1%
% Contribution to Return	33.6%	59.4%	7.0%	100.0%

Source: Aptus Capital, John Bogle & Robert Shiller, Data as of 6/27/23

Portfolio Volatility as Correlations Rise:

- Historically, negative stock/bond correlations have coincided with low inflation regimes and vice versa. We're mindful of the disinflationary impulse from a probable credit contraction due to stress in the U.S. banking system but we remain of the view that inflation will be above the Fed's target (i.e., > 2.0%) for longer than expected.

- So, although there are certainly catalysts for disinflation in the near-term, over the long-term we believe inflation will be stickier than what the consensus expects creating an environment where risk parity correlations could be positive.



Source: Strategas, Data as of 6/27/23

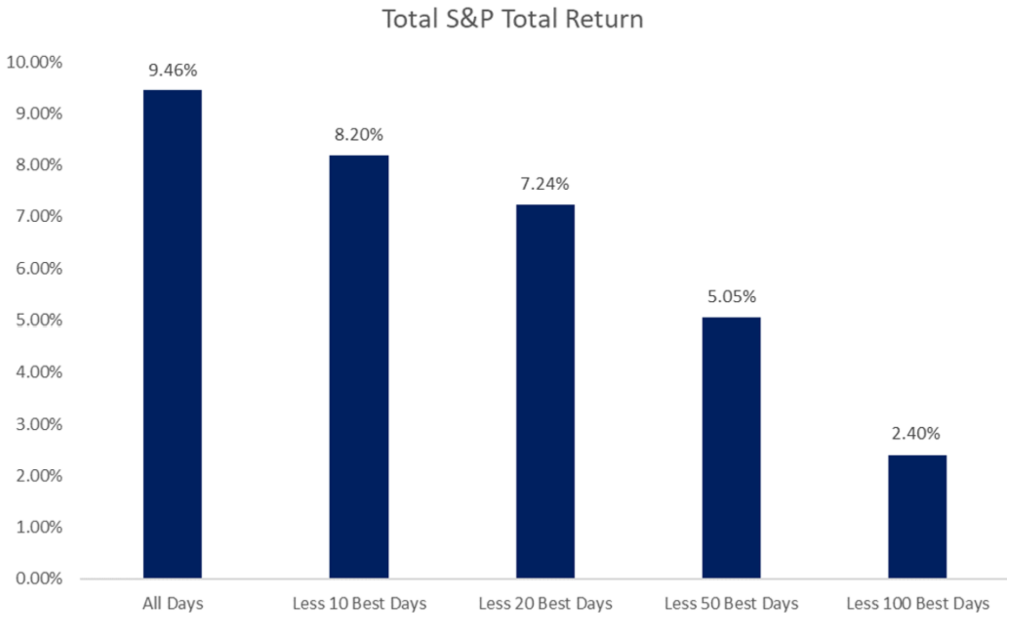
Consistent Behavior Breeds Winners

Failure to Stay Invested:

- *It Pays to Stay Invested* - The US stock market has been resilient through its history. Stocks routinely recovered from short-term crisis events to move higher over longer time periods.

- *Timing the Market* - By trying to predict the best time to buy and sell, you may miss the markets biggest gains. Attempting to guess short-term swings make it very difficult to produce consistent results. The best method for loss avoidance is to expand your time horizon.

- *Behavior Gap* - We have found the shorter time frame you choose the more apt you are to get whiplash and trade excessively. This behavior challenge often leads to emotions driving decisions over your goals.



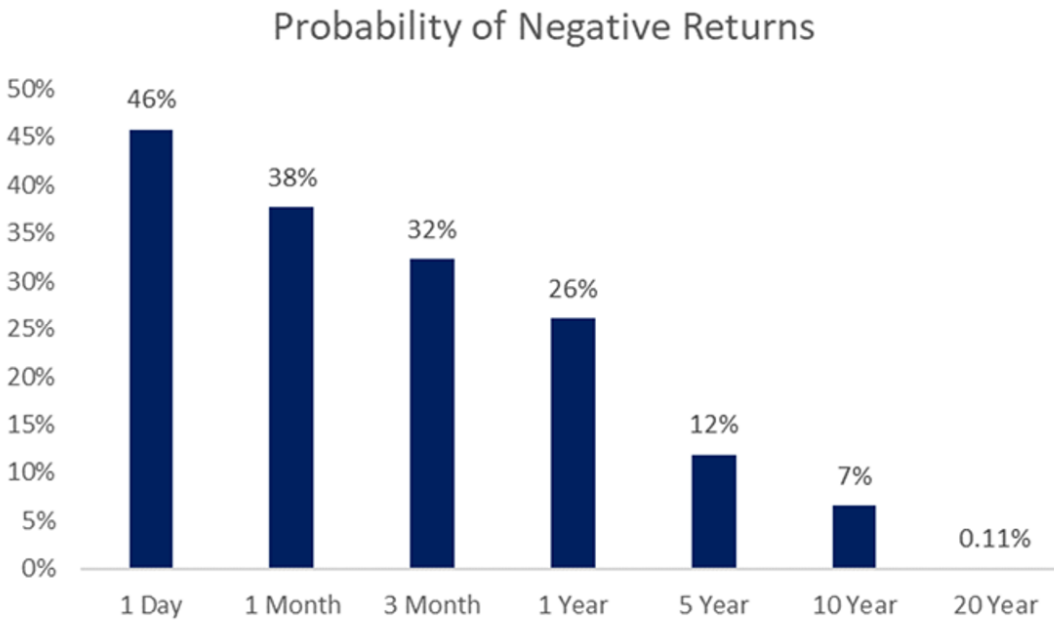
Source: Aptus Capital, Data as of 6/27/23

Remember to Expand Your Time Horizon:

- No one ever knows that the market is going to do – especially on a daily basis – we know that volatility tends to breed more volatility – whether it's up or down.

- In our view, investors also tend to focus too much on the short-term "noise" in the market. There is usually great deal of variability in the day-to-day, with different economic, geopolitical, and company-specific news constantly moving markets.

- We believe the best method for loss avoidance is to expand your time horizon.



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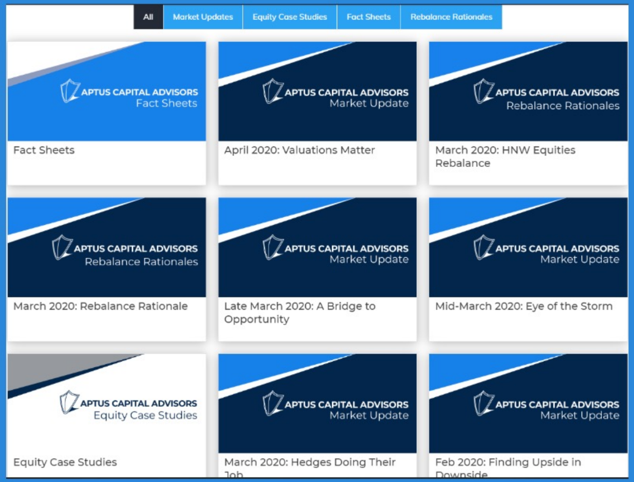
Additional Resources



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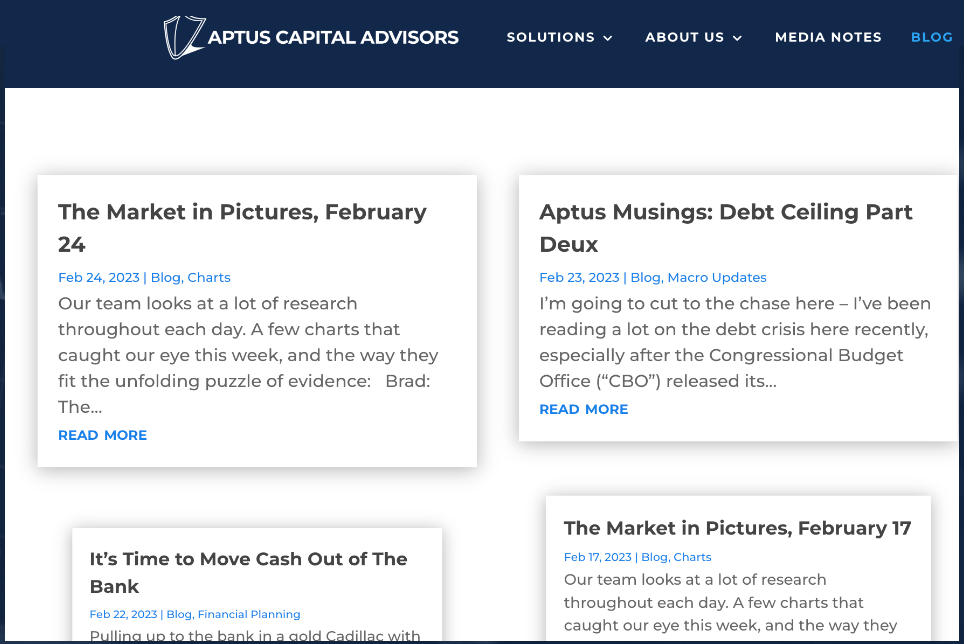

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The Dow Jones Industrial Average is the most widely used indicator of the overall condition of the stock market, a price-weighted average of 30 actively traded blue chip stocks, primarily industrials. The 30 stocks are chosen by the editors of the Wall Street Journal (which is published by Dow Jones & Company), a practice that dates back+A70 to the beginning of the century. The Dow is computed using a priceweighted indexing system, rather than the more common market cap-weighted indexing system.

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The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

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