AMI Quarterly Commentary

Growth Through Stability

Q2 ▪ 2023

Capital Market Outlook

Equities continued to rally in Q2, with the S&P 500 gaining 8.74%. The Technology-heavy Nasdaq 100 was also up substantially at 15% and finished the first half of 2023 up almost 40%, the best first half performance since that index was introduced in 1985. Investors were enthusiastic about an economy that seems to be holding up relatively well with hopes that a recession can be avoided. Excitement about Artificial Intelligence (AI) and the potential for increased Tech spending was also a key catalyst in the quarter. The market gains have been very narrowly focused and is unsustainable in our view and while we remain positive on the longer-term potential for equities, we see near-term risk to stocks after such breathtaking gains since the market low early in Q4 of 2022.

Enthusiasm over AI and the possible uses of this technology in a variety of applications drove much of the rally in Q2. AI is not new, but the release of the latest version of ChatGPT in March drove a wave of interest in the potential for this technology. In addition, Nvidia's earnings report in May added to this excitement, with investors speculating that companies building out AI platforms would drive substantial technology spending that would be a boon to semiconductor companies. We share some of the optimism surrounding the potential for AI, although we remain disciplined and do not want to get too caught up in the early hype.

The Federal Reserve increased interest rates by 25bps in May, with the range now at 5-5.25%. The Fed then took the unusual step of pausing in June, which sparked optimism that the tightening cycle was nearing an end. Indeed, the Fed has never paused and then restarted its tightening cycle again in history, however, inflation remains well above the Fed's target and Fed commentary suggests that most Fed members see two more rate hikes as necessary. The previous hikes are still working through the economy as there is always a lag, and in our view the Fed is risking going too far with additional hikes this year. Rate cuts seem highly unlikely any time before 2025 unless there is a severe weakening in the economy.

The U.S. economy has remained remarkably resilient in the face of the unprecedented tightening cycle over the past year, but some cracks are beginning to appear. The Jobs report for June was slightly below expectations, with the economy adding 209k jobs versus the 240k estimate. But wage gains remained strong, up 4.4% y/y, and the report was widely viewed as providing support for the Fed to continue tightening. Inflation has certainly cooled, with the Consumer Price Index (CPI) data ex-Food and Energy for June coming in at 4.8%, below the 5% expectation, and continuing a consistent downward trend since late last year. Personal Consumption Expenditure (PCE) data, the Fed's preferred measure of inflation, was 3.8% in May, the smallest increase in more than two years. However, PCE reflects consumer spending, which is a large driver of GDP growth. Consumer credit utilization is increasing, and the resumption of student loan payments in the Fall will be another headwind. There are other signs of a cooling economy, especially in the manufacturing sector, where PMI data for June fell to the lowest level in three years, the eighth consecutive month of contraction, which is the longest streak since 2009.

AMI
ASSET MANAGEMENT

Capital Market Outlook

Looking forward, we remain optimistic on equity markets for the long term but we see some near-term risk following such a strong rally in the first half of the year. While we share the optimism surrounding the potential for artificial intelligence, it is too early to know exactly how this technology will drive efficiency and who will be the winners and losers. The Fed has made it clear that the economy is still too hot despite the pause in June, and will continue to work to bring down inflation, even if that results in a faltering economy in the second half. We see a mild recession as likely but as always, we continue to focus on managing risk by constructing portfolios of high-quality businesses that we believe will perform well regardless of the economic backdrop.

Disclosures

The views expressed in this Quarterly Commentary reflect the opinion of AMI Asset Management, a registered investment adviser, and are subject to change without notice in reaction to shifting market, economic or political conditions. The information provided here is for general informational purposes only and should not be considered an individualized recommendation or personalized investment advice.

Certain information was obtained from third party sources, which we believe to be reliable but not guaranteed. This content was created as of the specific date indicated and reflects AMI's views as of that date. Supporting documentation for any claims or statistical information is available upon request.

Past performance is no guarantee of future results. Forecasts contained herein are for illustrative purposes only, may be based upon proprietary research and are developed through analysis of historical public data. The policy analysis provided does not constitute and should not be interpreted as an endorsement of any political party.

All investments carry a certain degree of risk, including possible loss of principal, and there is no assurance that an investment will provide positive performance over any period of time. It is important to review investment objectives, risk tolerance, tax liability, and liquidity needs before choosing a suitable investment style or manager.
The S&P 500® index is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

If at any time your current financial situation, investment needs or objectives change, please notify your portfolio manager promptly. A copy of our ADV Part 2 is included with your quarterly reports. You may call or write us to obtain the latest copy of our Proxy Voting Policies and Procedures and/or Privacy Notice.

Point of Contact: Matthew Humiston· 424-320-4002 · matt@amiassetmanagement.com

10866 Wilshire Blvd, Ste. 770, Los Angeles, CA 90024 · 424-320-4000 · www.amiassetmanagement.com