MARKET OBSERVATIONS
JUNE 2023

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Onward

Investors spend much time on anticipated events, the potential outcomes, and implications for portfolio strategy. When assessment leads to high conviction, strategy is shifted before an event. Often, however, potential outcomes and implications either are so varied or uncertain as to forestall action. The event then is experienced, outcomes are assessed, and attention moves to the next set of events. An important activity is determining whether an event marks a turning point or indicates more of the same awaits. A review of some recent events can provide perspective for moving onward to economic activity and investing ahead.

PERSPECTIVE

Much media attention was given in recent weeks to the political debate over raising the U.S. debt ceiling. Most focus was placed on the downside risk for markets and economies from a potential default on U.S. debt payments in the absence of a new debt ceiling. Many believed a crisis would be avoided and, indeed, it was. The price paid, however, was an onward march of annual fiscal deficits well into the future. Over the next decade, annual deficits are projected above the historical average year-by-year. Chart I shows the long-term picture of the U.S. for whom running annual deficits has been more the rule than the exception, 81 of the last 94 years. Deficit spending is not a crisis, until it is.

A cumulative loss of -20% or more generally is considered a bear market for broad stock indexes. As shown in Table I for the S&P 500 index, 11 bear markets have occurred in the past 66 years. They have varied widely, but on average the duration has been 14 months and the magnitude has been -35%. The current uncertainty is whether the latest bear market in fact has ended. The index has gained about +19% from the low of last October, but it has yet to surpass the previous high. To do so would indicate a move onward to a new bull market. Certainly, individual stocks can be found either remaining in a bear market or already having entered a new bull market. For now, the overall stock market has weathered higher interest rates but is facing a headwind of declining earnings as the bear versus bull debate continues.

Recession – past, present or future? The overall trend of U.S. real economic growth remains highly uncertain. As shown in Chart II, a recession may have occurred "technically" in the first half of 2022. At this time, a technical recession is the consensus forecast for the second half of this year. This timing is important as stock market lows tend to occur amidst a recession. If a recession already has occurred, the odds are higher that the bear market for stocks has ended. If a recession is just at hand or yet ahead, the risk of a further stock market decline is higher. At this time, conviction is not high for either scenario.

INVESTMENT IMPLICATIONS

While the stock market is not the economy, major economic factors, especially interest rates and earnings, are important determinants of market levels. It is not just a recession itself but the coincidental trends in these factors at times of recession that help determine if the onward trend of stock prices is higher or lower. When either outcome is feasible, a prudent course is to avoid portfolio extremes of excessive over- or under-allocations among primary market sectors. A more aggressive posture is warranted when onward clearly is upward.

CHART I

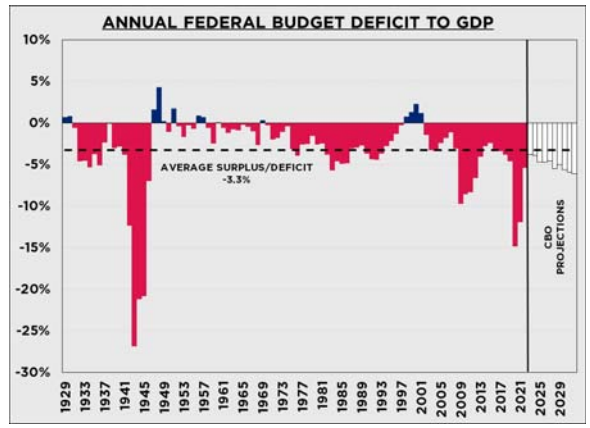
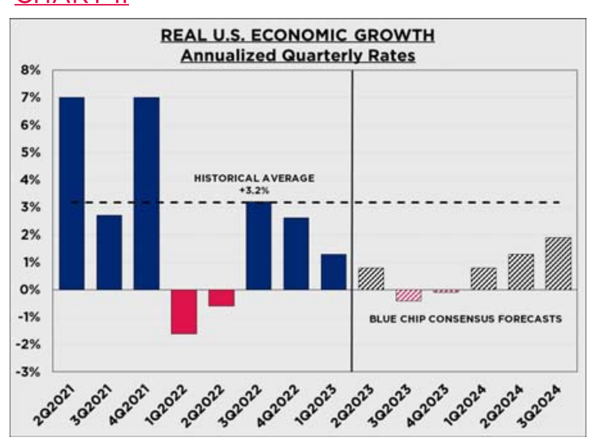


TABLE I

S&P 500 BEAR MARKETS

Period	Duration (Months)	Magnitude
1956 - 1957	14	-22%
1961 - 1962	6	-28%
1966	7	-22%
1968 - 1970	17	-36%
1973 - 1974	20	-48%
1980 - 1982	20	-27%
1987	3	-34%
2000 - 2002	30	-49%
2007 - 2009	16	-57%
2020	1	-34%
2022 - 2023	16	-25%

CHART II



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