J.W. Burns & Company
Investment Counsel
Quarterly Update - July 2023

A Pleasant Surprise In The Face Of Pessimism

"The nice part about being a pessimist is that you are constantly being either proven right or pleasantly surprised." - *George Will*

Dear Clients and Friends,

At the midpoint of the 2023 calendar year, stocks are doing very well. The S&P 500 Index is up 16.8%, international stocks as measured by the MSCI EAFE Index are up 12.5%, and the Lipper Balanced Index is up 7.6%.

It should be noted that the equity market's largesse was not spread around evenly. Driving a significant portion of the S&P 500's gains were the "magnificent seven," the mega-cap technology stocks such as Microsoft, Apple, Amazon, Google, etc.

In fact, the blue chip Dow Jones Industrial Average was up "only" 4.03% and the S&P 500 Equal Weight Index was up 6.9% - respectable returns for half the year, but a sizeable spread between market averages, nonetheless.

As you have solid positions in many of these premiere growth stocks, we were able to generate strong absolute returns.

In our January and April client letters, I outlined the rational for our bullish stance on equities. Specifically, I believed that the extreme bearish sentiment following 2022's sharp market decline was overdone, giving us a contrarian bullish signal for stocks. I quoted legendary investor John Templeton who famously said: "Bull markets are born on pessimism." With both retail and institutional cash levels still very high, I believe there is enough pessimism and ample liquidity to drive stocks higher in the back half of 2023.

"While there remain pockets of sticky inflation, the trajectory is positive, and the Federal Reserve is near the end of this rate hiking cycle. This is bullish for stocks."

Another part of our bullish thesis at the beginning of 2023 was that the economic backdrop was slowly turning favorable towards stocks. Specifically, we were confident that the inflation rate would continue to decline – which it has. The Consumer Price Index (CPI) came down to 3.0% in June which marked the 12th consecutive monthly decline following a peak of 9.1% in July of 2022. While there remain pockets of sticky inflation, the trajectory is positive, and the Federal Reserve is near the end of this rate hiking cycle. This is bullish for stocks.

The overwhelming consensus amongst economists at the beginning of this year was that the economy was heading for a recession. Thus far, that has failed to play out. Consumer spending is strong, the job market remains tight, and corporate profits have held up much better than expected. Additionally, the potential banking crisis in March, which led to two of the largest bank failures in U.S. history, has not spread throughout the financial system as

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many feared. Indeed, the stock market's first half of 2023 has been propelled more by what didn't happen than what did.[1]

To be sure, the full impact of the Federal Reserve's ten consecutive interest rate hikes has not yet been felt by the economy. The U.S. economy did in fact slow in the first half of the year and most leading economic indicators are down over the past 14 months. GDP has also slowed from 3.2% to 2% over the last three quarters. So, investors face the challenge of reconciling higher equity values with the anticipation of weaker economic data.[2]

It is our view that markets have already priced in a mild recession and are looking at stronger corporate earnings out into 2024. That is our base case and, obviously, if the economy goes into a deeper than expected recession, stocks will fall. However, barring a sudden economic downturn, we believe there is enough strength in the economy and ample investor liquidity that should support further stock market gains in the second half of this year.

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It should be noted that there is still about $500 billion in excess savings that can be tapped into by consumers. In fact, the average American now has nearly 10-15% more in their bank accounts compared to four years ago, and consumer sentiment recently spiked to its highest level in 18 months.[3] Also, regarding the higher cash levels I mentioned earlier, there is $5.5 trillion on the sidelines in money market funds – some of which will find its way into equities. See below.

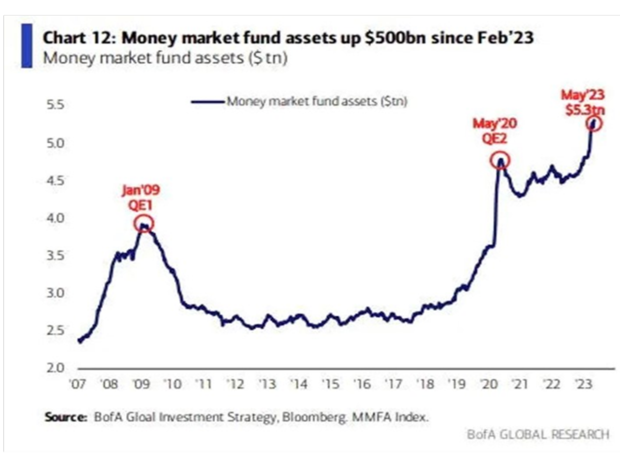


Chart 12: Money market fund assets up $500bn since Feb'23

Source: BofA Gloal Investment Strategy, Bloomberg, MMFA Index.

As I write this, second quarter earnings results are being reported and I like what I see from your portfolio companies – a number of earnings beats, and raises to forward guidance. I will temper my enthusiasm by saying that there are many reports yet to come in! Nevertheless, while the broad market averages will likely achieve more modest gains in the second half of 2023, the market's direction is decidedly up.

Let's move on to your questions.

Q: Is Artificial Intelligence a truly investable theme or simply hype that is creating an investment bubble?

A: In our view, Artificial Intelligence is the real deal and is poised to have far-reaching impacts on our economy and society.

The potential of AI to drive a productivity boom across all business sectors and improve efficiency in various aspects of life is genuinely exciting. However, it's important to acknowledge that we are still in the early stages of AI development, where the technology remains relatively expensive and challenging to implement.

As of now, our investment focus in AI is primarily directed towards established giants in the field, such as Microsoft (MSFT), Apple (AAPL), Google (GOOG), and the broad-based Nasdaq 100 ETF (QQQ).

Over time, the stocks and sectors that will capitalize on the transformative power of AI will broaden well beyond the technology industry. Just as the advent of the internet has had profound effects on the speed and availability of information, AI will have an analogous effect on the processing of information. It is hard to overstate this.[4]

On the whole, I believe AI will be a positive for consumers, the economy, and the stock market. It is certainly going to make companies more profitable over the long term.

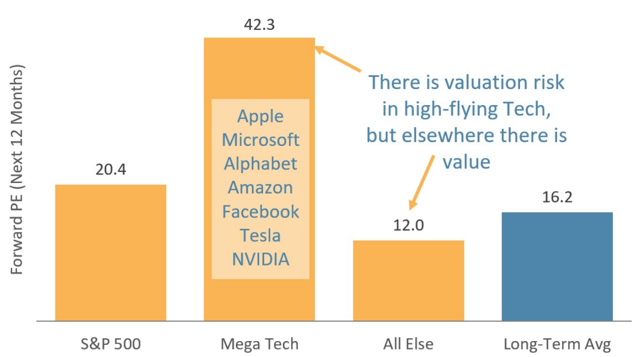
And our lives more interesting.

Q: Considering the stock market's strong performance through the first half of 2023, do you think stocks are overvalued?

A: Yes and no.

Currently, the S&P 500 index is selling at 20.4x forward earnings, indeed above historical levels. However, that price-to-earnings multiple can be misleading, as the aforementioned "magnificent seven" mega-cap technology stocks are selling at elevated P/Es, arguably for good reason.

In fact, if you take out just those seven stocks, the broad-market indices sell at around 14x forward earnings. Considering the 10-year average price to earnings ratio for the S&P 500 is 15 to 16x earnings, I don't believe you can say the overall market is overvalued.



Source: Factset

So, I think it is fair to say that while the market may be fully valued when you take into account the exceptional performance of the mega-cap tech names, there remain undervalued areas of the market with opportunities in many stocks and sectors to play catch up.

Finally, keep in mind, through June 30, the Nasdaq remains 14% off its previous peak on 11/19/2021, and small-cap stocks overall are still in a bear market, down around 20% from their last peak on 11/8/2021.[5]

In summary, for the first six months of this year, stocks have surprised just about everyone – pleasantly, I may add. Thus far in July, stocks continue to perform smartly, but I do think we should expect a pull back or even a correction in the near future.

On the whole, however, the economic resilience and ample levels of liquidity should provide a ballast for modest stock gains in the second half of the year.
As the old Wall Street saying goes: "Bears may sound smarter, but the bulls make the money."

I remain bullish.

Thank you for your continued confidence and enjoy the rest of your summer!

Best Wishes,

Jim

James C. Burns, CFA
President & Chief Investment Officer

P.S. As some of our local clients may have seen on the Syracuse news, our own Drew Derrenbacker (pictured right) personally volunteered and then completed a 102 -hole golf marathon to raise money for the United Way of CNY. Teeing off at 4:30 in the morning, on a rainy day, spanning 12 hours and over 22 miles, Drew completed this impressive feat on foot – no golf carts allowed. In just a single day, Drew and his playing partner raised nearly $19,000 to benefit the United Way.

Crazy!

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For those who don't know, Drew represents J.W. Burns & Company on the Board of Directors of the United Way of Central New York. It is well known that JWB gives back to our local community and Drew is carrying on this tradition.

J.W. BURNS & COMPANY, INC.

INVESTMENT COUNSEL
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1 - Bloomberg, "Markets are Propelled by What Hasn't Happened,", 07/17/23

2 - The Conference Board – 06/22/23, Bureau of Economic Analysis - 06/29/23

3 - Washington Post, "Americans have more in the bank than before the pandemic," 07/19/23

4 - Royce Investment Partners, "Bullish for the Long Run," 07/07/23

5 - Royce Investment Partners, "2Q23 Small-Cap Recap," 07/03/23