FINANCIAL SENSE

	LAST MONTH	LAST 3 MONTHS	YTD
S & P 500 Index	6.61%	8.74%	16.89%
Russell Midcap Index	8.34%	4.76%	9.01%
Russell 2000 Index	8.13%	5.21%	8.09%
Dow Jones Industrial Average	4.68%	3.97%	4.94%
Morgan Stanley EAFE Index	4.55%	2.95%	11.67%
DJ US Real Estate Index	5.76%	2.43%	4.04%
S&P Commodity Index	4.39%	-7.54%	-2.73%
Barclays Aggregate Bond Index	-0.36%	-0.84%	2.09%

INDEX RETURNS

Large-Cap Domestic Growth stocks have been on fire in the first half of this year. The top 10 stocks in the S&P 500 now make up 31.7% of the overall market capitalization of the index. The P/E ratio of those 10 stocks has jumped to more than 29 times earnings while the remaining 490 stocks have a P/E ratio of 17.8 times earnings. Overall, the S&P 500 is now up 16.89% on the year thanks to the big guys. Mid-cap stocks are up 9% and small-cap stocks are up 8%. Commodities are down 2.73% on the year.

International stocks cooled off a bit in the second quarter but were still positive. The MSCI EAFE Index is up 11.67% on the year led by Italy, the Netherlands, and Spain which are all up around 20%. The MSCI Emerging Markets Index is up 4.89% thanks to the 26% return for Mexico.

Bonds were quiet in the second quarter as investors try to figure out what the Federal Reserve is doing. Global Bonds have fared better as they are up 3.81% on the year versus only 2.09% for Domestic Bonds.

ECONOMIC REVIEW AND OUTLOOK

The economy is continuing to grow. First quarter GDP grew at a 2.0% annualized rate. Estimates for the second quarter are in the 1-2% range. The economy is continuing to grow despite the drag from higher interest rates. While the manufacturing sector has been in contraction territory for quite a while, the service sector continues to expand. Restaurants, hotels, and air travel have remained resilient. It is important to remember that the service sector represents roughly 70% of our economic output.

There has been a lot of talk about an official recession in 2023. While it is still possible, we think it is becoming less likely to occur this year. Although the yield curve is flashing a recessionary signal, most cyclical sectors are not at extremes. Residential investment as a percentage of GDP is below average, car sales are at long-term averages, and business inventories are relatively low.

The Leading Economic Index declined 0.7% in May to 106.7 following a 0.6% decline in April. Industrial Production dropped 0.2% in May to 103.0. The Capacity Utilization rate (which measures how much slack is in the economy) moved down to 79.6 percent.

Non-farm payrolls rose by 209,000 in May and the unemployment rate remained at 3.6%. Weekly unemployment claims were 248,000 for the week ending July 1, 2023. This was an increase of 12,000 from the previous week

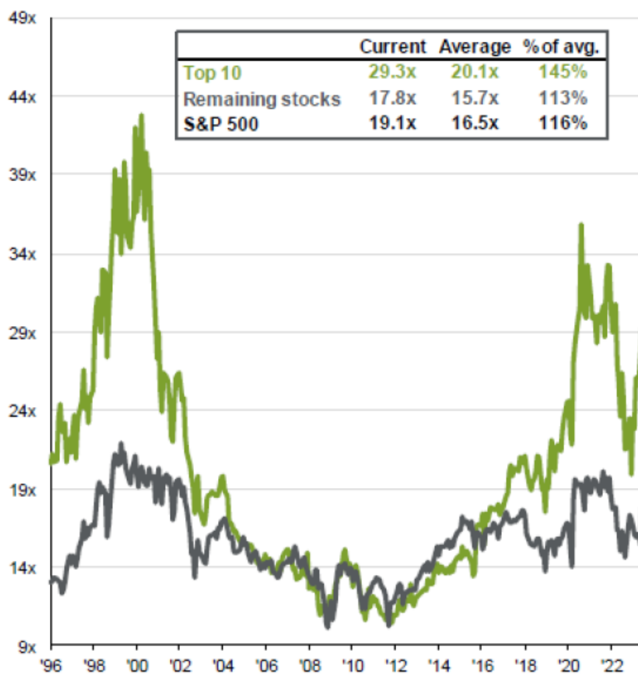
and the 4-week moving average is at 253,250. There are still 10.1 million job openings in the U.S. Job layoffs have remained stable while the number of individuals quitting their jobs has dropped. In 2018, we had roughly 7 million job openings, which was a record. While we have dropped from 12 million openings to 10 million, we are still 3 million higher than just 5 years ago.

Manufacturing decreased to 46.0% on the ISM PMI index in June. This was a drop of 0.9% from May. This index has now been in contraction territory for seven straight months. The New Orders Index came in at 45.6% which was up 3% from the prior month. The ISM Services index was at 53.9% in June. This was 3.6% higher than June. This index has now expanded for six straight months. The Business Activity Index came in at 59.2% which was a 7.7% increase from May. New Orders for the service sector came in at 55.5%, up 2.6%.

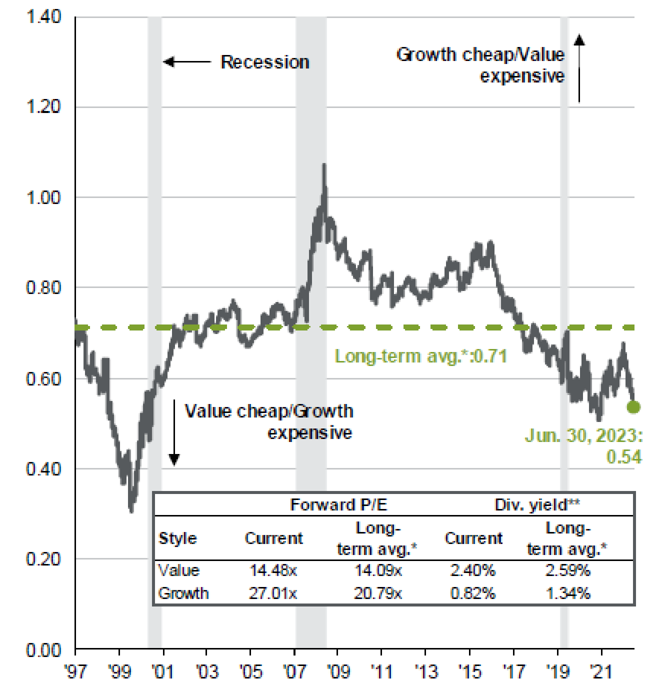
The JPM Global Manufacturing PMI was at 52.1 in June which was a drop of 2.3% from May. The Euro area is positive at 50.3 but is clearly slowing. France moved into contraction territory at 47.3. Emerging Economies are showing strength with a PMI of 55.6 led by India's 61.6 reading.

EQUITY AND BOND MARKETS

Domestic equities are off to a great start in 2023. The top 10 stocks in the S&P 500 now make up 31% of the overall weighting. The top 5 stocks are AAPL, MSFT, AMZN, NVDA, and GOOG. The surge in these top tier stocks has caused an imbalance in valuations. The top 10 stocks have a P/E ratio of around 29 times earnings, while the remaining stocks have a P/E ratio of 17.8.



	Current	Average	% of avg.
Top 10	29.3x	20.1x	145%
Remaining stocks	17.8x	15.7x	113%
S&P 500	19.1x	16.5x	116%



Style	Forward P/E Current	Forward P/E Long-term avg.*	Div. yield** Current	Div. yield** Long-term avg.*
Value	14.48x	14.09x	2.40%	2.59%
Growth	27.01x	20.79x	0.82%	1.34%

Value stocks have a forward P/E ratio of around 14 times earnings, while growth is now up to 27. While we strive to maintain a balanced and diversified portfolio, it is becoming clear that value oriented stocks look very attractive at these levels and growth stocks are starting to look expensive. It is important to rebalance during market environments that lead to one asset class outperforming significantly in a short amount of time.

The good news is that international equities continue to look attractive. Japan is trading well below its long-term average P/E level, as well as most of Europe and China. After a 14-year outperformance by U.S. stocks, we think the pendulum could swing back in favor of international stocks over the next few years. The Dollar could also come under pressure in the next year or so, which would provide an additional tailwind for international equities.

In terms of the bond market, we believe the Federal Reserve is close to the end of their rate hike cycle. If that holds true, this could be a good time to buy bonds, locking in higher long-term yields.

PORTFOLIO MANAGEMENT

The Investment Committee has been quite pleased with the overall performance of our portfolios. Our domestic equities are off to a great start primarily due to significant outperformance in the large-cap growth space. We have been rebalancing to bring our exposure back in line with intended targets after such an impressive run to start the year. This should allow us to take advantage of any move on the value side of the portfolio.

Our fixed income allocation is also performing quite well so far this year. We are adding duration to our bonds as we believe that the Federal Reserve is near the end of their rate hike cycle. If this happens, we could continue to see relatively strong returns from the fixed income side of the portfolio.

We design our portfolios to have an asset allocation strategy that provides optimal diversification and performance. Over a short time-horizon, this type of diversified portfolio can decline in value. However, if we keep a long-term perspective and ignore short-term volatility, the probability of achieving our desired returns significantly increases. Remember, “Time in the Market” is more important than “Timing the Market”.

FINANCIAL PLANNING

SECURE Act 2.0, passed in December 2022, implemented a variety of changes around retirement plans. See our 1st quarter newsletter for a few quick highlights. Quite a few of these changes take effect in 2024 and beyond. Today we are going to focus on the changes related to Roth retirement contributions. This affects contributions into 401(k)s, 403(b)s, 401(a)s, and basically any qualified employer sponsored account.

As a quick refresher, Roth retirement contributions are made with after-tax dollars. This means the contributions do not reduce your taxable wages in the year they are made. Roth funds grow tax-free inside of the retirement plan and are withdrawn tax and penalty free once you are over age 59 ½. You are electing to pay the income tax on the money today, to avoid paying the income tax in the future.

Roth retirement accounts will also be exempt from future Required Minimum Distributions (RMDs). The RMD age for pre-tax retirement accounts is 73 (or 75 if born in 1960 or later).

Beginning in 2024, if your salary is above $145,000 per year, your catch-up 401(k) and/or 403(b) contributions MUST be made as Roth contributions. Catch-up contributions apply if you age 50+. The 2023 amount is $7,500. This amount can change every year based upon inflation.

If this change will impact you in 2024, this begs the question: should you change all your retirement contributions to Roth?

Like all financial planning questions, it is entirely dependent upon each individual or family situation. In general, if you believe your income tax bracket (or the income tax bracket of your retirement account beneficiaries), will be higher in the future than today, Roth contributions may make sense. For other individuals and families, especially those already in the highest tax bracket, it might not be beneficial to change all pre-tax contributions to Roth.

If you are a business owner who sponsors a retirement plan, you may need to amend your retirement plan document to be prepared for these changes. If you do not already offer Roth contributions as an option in your plan, any employee (including yourself!) earning more than $145,000 annually will no longer be able to make catch-up contributions.

Along those lines, employer contributions into employee retirement accounts can now be made as Roth contributions. Previously, employer contributions could only be made with pre-tax dollars. The employer is still able to deduct Roth contributions made for employees. The employee picks up the tax on the Roth contributions the year they are made.

We recommend reaching out to your third-party plan administrator to confirm that your retirement plan is set up appropriately for the changes under the SECURE Act 2.0.

COMPANY NEWS

The Galecki team kicked off Summer enjoying a night at the Fort Wayne TinCaps ballpark. Our team enjoyed spending time together with our families, eating great food, chasing around the young kids, and narrowly avoiding a well-hit foul ball.

This summer we are looking forward to a few more team building activities including a cook-out at Brady McArdle's house and an Escape Room! We are grateful to our team for all playing vital roles to ensure Galecki continues to earn the trust and confidence of all our clients.

Have a safe and fun-filled rest of the Summer!

- Galecki Financial Management Investment Committee

If you would like to schedule an appointment with a Certified Financial Planner™ Professional, please visit www.galecki.com