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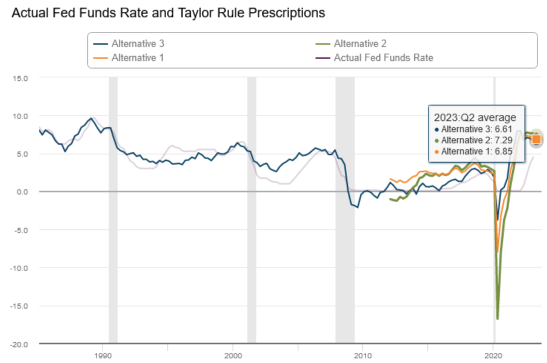
Investment Committee Meeting Summary

June 2023

Macro Environment and Current Conditions

The Committee reviewed ***inflation*** data, which remains central to evaluating the current economic conditions. May's Producer Price Index (PPI) came negative and lower than anticipated. ***Supply-side reliefs and real-time rent declines*** should exert ***downward pressure*** on inflation. Conversely, an exceptionally ***tight labor market*** may contribute to the ***persistence of service inflation***. The unemployment rate, at 3.7%, is one of the lowest since 1970. The three-month median wage growth stands at a robust 6%.

The resilience of the economy in the face of a high inflation and rapidly rising interest rate environment can be reconciled by referencing ***the Taylor rule***. Had the Fed followed the Taylor rule prescriptions, it would have started raising the federal funds rate in 2021Q2 and brought it to above 6.6% by now. In contrast, the upper limit of the federal funds rate is at 5.25%. This indicates that the monetary policy is still ***accommodative*** rather than restrictive, resulting in loose financial conditions.



Factor Rotations and Investment Landscape

The stock market went through ***four distinct phases*** so far this year. ***January*** was a risk-on month characterized by significant outperformance of high beta stocks, along with a pickup in small-cap stocks. Investors were hoping for a Fed pivot after inflation peaked. But the sentiment was instantly damped by a blowout jobs report released in ***early February***. Hiking all the way to a recession suddenly looked more likely than not. Both segments that did well in the preceding month started to underperform. In ***March***, the regional bank crisis came as another surprise, prompting a flight to quality, with large-caps and high-quality stocks prevailing. As the banking sector stabilized and recession concerns eased, the performance of quality stocks leveled off, while high beta stocks have resumed their rally since ***mid-May***.

Guidance Change - 10% to Growth

The Committee reduced the Value bet in April, returned to a style-neutral posture in May, and this month made a further shift of 10% towards Growth. ***The Style Guidance is now 40% Value - 60% Growth***. The Committee's decision was based on several considerations.

- ***Qualitatively***, the outperformance of value stocks in 2022 can be primarily attributed to a ***repricing of duration***, which had a negative impact on growth stocks. As inflation and rates peak, this environment is changing.
- ***Fundamentally***, as noted in the March Committee Summary, despite value stocks' outperformance last year, their ***earnings*** have been declining relative to those of growth stocks.
- ***Technically***, the ***trends*** favoring growth stocks started in February and broadened out in March. This month mid-cap stocks have reverted to a neutral stance, but large- and small-caps continue to see strong growth trends.

Nevertheless, more growth bets entail higher risks at this moment. Due to the early signs of mid-caps' style-neutralization, narrow breadth among growth stocks, and lofty valuations of top-performing names, the Committee has chosen a cautious, data-driven approach for further changes in its style guidance.

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