Argent Capital Management LLC

RE: **INVESTMENT COMMENTARY FOR PERIOD ENDING JUNE 30, 2023**

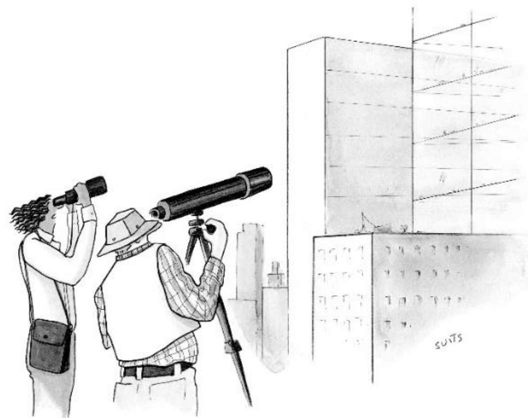
FROM: **ARGENT CAPITAL MANAGEMENT**

DATE: **JULY 20, 2023**

"Capitalism without failure is like religion without sin. It doesn't work."
- Allan Meltzer, Historian for the Federal Reserve

If we had known that the first half of 2023 would contain a few of the biggest bank failures in U.S. history along with the astounding collapse of military control in Russia, we might have been more worried about the stock market in January. If there is one thing stock markets hate, it is failure and uncertainty. Instead, markets quickly shrugged off both events, resulting in a particularly strong June and a nicely positive first half for virtually all stock market participants. At Argent, we are quite pleased with how it all turned out.

Now, as we move to the second half of the year, investors are wrestling with three interrelated investment concerns: inflation, interest rates and the potential for a recession. Inflation first exploded in the Fall of 2021 so, after spending several months in denial, the Federal Reserve pivoted from its accommodative stance to begin an unprecedented string of ten consecutive interest rate increases. The Fed did not take a breather from this until just last month, when it said it wanted to *better assess* the implications of the tightening done to-date.



"Yep, a rare gray-suited office worker."

Interest rate increases are typically made by the Fed to slow an economy to keep inflation in check, and the increases historically take a year or two to have full impact. Fortunately, current tightening is working, as inflation *has* declined over the past year, but more gradually than desired. After rising above nine percent a year ago, inflation has dropped to half that level today, but still well above the Fed's two percent target level. Numerous indicators point to the declining inflation momentum continuing, although the Fed remains hawkish and has suggested that another few interest rate hikes are likely later this year.

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While the economy is slowing under the pressure of higher interest rates, there are a few signs of a recession in the near term. Nonetheless, unemployment claims are low, but rising; banks are generally healthy, but loan volumes have diminished, and industrial manufacturing is okay, but has slowed. Additionally, corporate profits, while hanging in there, have softened. Perhaps the most significant omen is the inverted yield curve. Why is that particularly important? Because an inverted yield curve occurs when short-term interest rates rise above longer-term interest rates and is as sure a sign for a future recession as we move further into 2023 and 2024.

An inverted yield curve, however, only predicts a recession; it reveals nothing about the *severity* of a recession. If a recession does come later this year or in 2024, most believe it will be of the milder variety. Time, of course, will tell, but that makes sense to us.

"Any chance of an upgrade to a flight that's on time?"

As mentioned, global stock indices were positive in the first half, and the S&P 500 Index, a proxy for large U.S. stock performance, was up a strong 16.9 percent. It was a first half, however, in which investors were laser-focused on a relatively few big U.S. behemoths – Apple, Microsoft, Google, Amazon, NVIDIA, Meta (Facebook) and Tesla. These seven companies produced over eighty percent of the S&P 500 Index total gain over the past six months. The rest were up, on average, but not by a lot, yet these seven alone added *three trillion* dollars of market cap to their valuations. Remarkable.

We started this commentary with a quote on failure, and how it is an unpleasant but necessary by-product of capitalism. The occasional failure of a business allows better-managed companies to emerge and excel. We have nothing specific to suggest, but we can see a lot of reasons other "failures" might occur over the next six to twelve months. Interest rates are up, there are a lot of commercial office buildings without enough tenants, and we still have a war in Europe and troubles with China. Thus, we will be happy to hold recent gains for a time. As we move farther into 2023 and 2024, we also know the tea leaves tell us we may well have a recession. Nonetheless, markets tend to perform in the most unexpected ways, and at the most unexpected times, as we saw again in the first half of 2023. As Peter Lynch once said, "The real key to making money in stocks is not to get scared out of them."

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