PALOS

CONTENTS

Weekly Commentary

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Is this a Bull Market?

The stock market barometer that's most followed by investors is the Standard & Poor's 500 Index (SPX), or for short, the S&P 500. Launched in 1957 by rating agency Standard and Poor's, the index is comprised of a "basket" of 500 U.S.-traded public companies with a market capitalization of at least US$ 12.7 billion. The index includes familiar names like Apple, Microsoft, Amazon, Alphabet (Google) and Meta (Facebook). Each of the 11 primary sectors is assigned a "weighting" with the Information Technology sector having the largest at roughly 28%, followed by Healthcare (14%), Financials (12%), and Consumer Discretionary (10%). The smallest of the 11 sectors, with each weighted at under 3%, include Utilities, Real Estate and Materials.

Investors and industry pundits often classify markets as being in either a "Bull market" or "Bear market". Bull markets are characterized by an extended period of rising prices that's fueled by rising optimism, rising corporate profits, growth in GDP, strong consumer spending, and low unemployment. Bull and bear markets can occur in stocks, bonds, commodities and currencies. Often accompanied by increases in optimism, greed, and speculation (a bull), or a weakening economy, fear, and falling confidence (a bear), they are virtually impossible to predict and are identifiable in hindsight only.

As a rule of thumb, an increase of 20% from a recent low will mark the "technical" beginning of a new bull market whereas a fall of 20% from a top would mark the start of a new bear. On June 8, the SPX closed the trading day at 4,490, confirming a 20.04% rise from the most recent low of 3,577 established on October 12, 2022. Therefore, based on the technical parameters of the definition of a bull market, a new bull began on June 8. As of Friday's close (June 19), the SPX is higher by 23.3% from the October 12 low, further confirming a change in trend, albeit theoretical, from bear market to bull market.

The SPX is not alone. The tech heavy NASDAQ 100 Stock Index (NDX), which bottomed on October 14, 2022, entered a technical bull market territory in late March and as of Friday was higher by 41.1%; an undisputable bull. However, we should recall that the NDX fell in tandem with the "high flying" tech sector and saw a drawdown of roughly 35% between November 2021 and the October 2022 low. The NDX has yet to recapture its all-time high. The story in Canada is a bit different. Following a similar pattern by establishing a recent low on October 12, the S&P/TSX Composite Index (TSX) has not risen the requisite 20% which would signal a new bull market. Recent weakness in the energy, materials and financials sectors has reigned in optimism at home.

While some markets have entered bull market territory, many prognosticators and pundits are maintaining their bearish commentary. This is understandable. Persistent high inflation, hawkish central banks continuing with a policy

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of raising interest rates, and geopolitical issues have reined in optimism. In fact, a select universe of technology-related stocks has driven market indices higher. These companies, who have been labelled the "Magnificent Seven", include industry-leading Artificial Intelligence (AI) chip maker Nvidia, META Platforms (formerly Facebook), Apple, Amazon, Microsoft, and Alphabet (formerly Google). Recently, it was reported that these seven companies, whose stock prices are being driven higher by the enthusiasm surrounding the AI craze, are singlehandedly driving the SPX and NDX higher.

The divergence between the "Magnificent Seven" and the rest of the market has some concerned that the technical bull market is nothing more than a bear market in sheep's clothing! Since the SPX is a cap-weighted index, as the prices of these seven stocks increase, their dominance in the index also increases with the result being a potential case of the "tail wagging the dog". In our view, one of two potential scenarios will play out; either the rest of the pack joins in the rally which would extend the bullish move, or the current leadership group either takes a pause or reverts to bear mode.

As we have stated countless times, we are not prognosticators or forecasters. Our mandate is to responsibly protect investment portfolios by managing risk, rebalancing portfolios accordingly and continuously searching for new investment opportunities. However, we admit we are encouraged by the recent bullish activity. Without a doubt, indicators are suggesting that the battle against inflation, which will take months to see results, is being won. In addition, the pandemic is behind us, supply chains are normalizing, earnings remain robust, employment is showing few signs of weakness and consumers continue to spend. These are hardly bearish undertones.

In closing, we remind ourselves that bear markets always transition to bull markets in due time. Markets "topped out" in late 2021 and we witnessed one of the worst years in decades as virtually all asset classes saw price declines in 2022. Investor sentiment remains excessively pessimistic, money continues to flow to safe havens and allocations to equities are significantly underweight. On the bright side, inflation numbers are coming down, the price action in stocks is clearly signaling higher, and the recent spate of earnings bettered expectations. We are cautiously optimistic that the worst is behind us and better times lie ahead. Only time will tell.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$8.33	3.40%
Palos Equity Income Fund - RRSP	PAL101	$6.67	2.78%
Palos WP Growth Fund - RRSP	PAL213	$11.36	-8.84%
Palos-Mitchell Alpha Fund [3]	PAL300	$9.71	19.89%
S&P TSX Composite (Total Return with dividends reinvested)			4.60%
S&P 500 (Total Return with dividends reinvested)			15.77%
S&P TSX Venture (Total Return with dividends reinvested)			7.72%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			3.76%
Canadian Government 10-Year			3.35%
Crude Oil Spot			US $71.78
Gold Spot			US $1,958.40
US Gov't10-Year/Moody BAA Corp. Spread			202 bps
USD/CAD Exchange Rate Spot			US $0.7576

[1] *Period ending June 16th, 2023. Data extracted from Bloomberg*
[2] *Fund is priced annually*
[3] *Fund is priced weekly on Tuesdays*

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