"Optimism often sounds like a sales pitch, pessimism sounds like someone trying to help you."
- Morgan Housel

As 2023 began, there were plenty of reasons to be pessimistic: inflation was still uncomfortably high, with central bankers promising no end to their rate-hiking campaigns; almost all asset prices were being bludgeoned by the spike in rates; the economically important US housing sector was in a deep freeze; the long predicted recession was to arrive at any moment; stocks were limping out of a plunge that had passed the bear market threshold just weeks before; and, for good measure, the year began with a banking crisis south of the border. It's no wonder that most of the big strategy shops forecast that the S&P 500 would finish the year flat at best.

Trouble is, through the opening six months of 2023 the S&P has risen by as much as it would in a very strong *full* year and the NASDAQ Index has posted its best first half … *ever*. What's also notable is that many of the predictions on which the bearish case was built have failed to materialize. Yes, we recently got another rate hike in Canada and the US Federal Reserve has forcefully reaffirmed that it's not done tightening, but many of the underlying drivers of consumer inflation have receded significantly and both the bond and equity markets seem to be taking note. For example, shelter is the largest component of CPI and, though this measure is still running at a 9% year-over-year rate by the US government's calculations, several private measures paint a much different picture. Rents monitored by Apartment List, for instance, show a semi-annual *decline* of 0.6% to the end of June and if the gap between these measures begins to close, headline inflation

and the probability of additional rate hikes could dissipate rapidly.

Housing in the US is still challenged by higher mortgage costs and an accompanying lack of listings, but the industry has managed its way through and expected layoffs haven't materialized. In fact, the homebuilder subset of the S&P is up by more than a third so far this year, another outcome which was not likely on the bingo cards of many forecasters six months ago! *(In DM US Equity, we own DR Horton Inc. and TopBuild Corp. which have returned 37% and 70%, respectively, so far in 2023)*

As for recession, many remain adamant that it's still on its way, though it's difficult to imagine that we'll go into a steep slide anytime soon. In June, a slew of data was released in the US which appeared to be anything but recessionary: durable goods orders, business investment activity, new home sales, home prices, consumer confidence, and initial jobless claims all came in more favourably than expected, while first quarter GDP was revised upward by nearly 1%. As an example of how things are faring beneath the surface, the chart below shows construction spending by US manufacturers over the past two decades, a figure which has more than doubled in the past year alone. This activity is undoubtedly being helped by the push to "reshore" supply chains – *and some may argue that the move away from Chinese production will carry its own negative implications in the long run* – but it's difficult to square this level of business capital deployment with a near-term recessionary backdrop.

Construction by Manufacturers in US

$200 billion

Seasonally adjusted annual rate

2002   2023
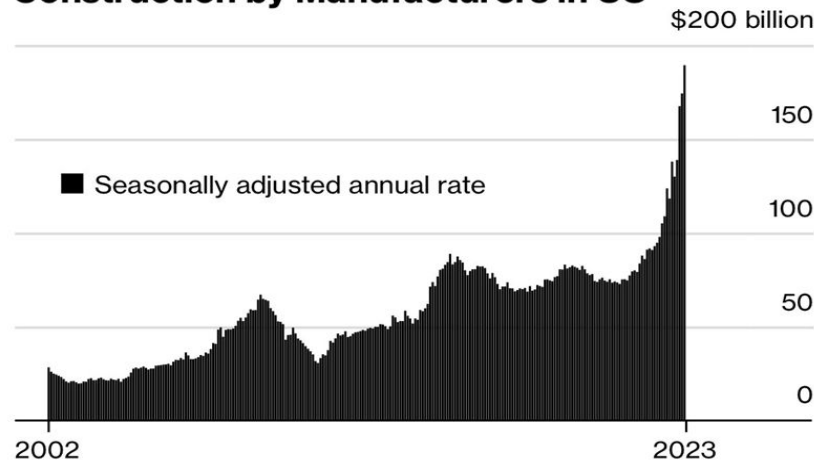
Source: *US Census Bureau*

Of course, the "not as bad as predicted" story described above only goes so far and doesn't explain the entirety of the market surge. The introduction of artificial intelligence into the public consciousness in Q1, first via Microsoft's collaboration with OpenAI to create ChatGPT and then with the release of Alphabet's Bard chatbot, led to talk of potential productivity gains similar to or in excess of those that followed the adoption of the mainframe computer, the desktop PC, the internet, and mobile telephony. This put a charge in the tech sector and provided a significant contribution to the NASDAQ's record start to the year, as strategists and investors contemplated and quantified a new source of long-term profit growth. *(Microsoft and Alphabet have returned 43% and 36%, respectively, for DM portfolios so far this year)*

Since 1928, the broad stock market has risen about three out of every four years and fallen by 20% or more every six or so years. Predicting a market decline in any given session is always a low probability position, and even more so when stocks have suffered through a bear market just weeks before. With equities rallying now, sentiment improving, and the economy showing no sign of a significant slowdown, where does it leave the many who staked out bearish positions at the start of the year? Do they double down on their negative outlooks and hope that things take a sudden turn for the worse? Or do they throw in the towel and chalk up the missed opportunity of recent months to the cost of doing business? That's a tough call and one which we're very happy not to be facing!

As we look ahead to the balance of the year, the unusually long list of incorrect predictions made since the onset of covid-19 have only reaffirmed our conviction that the forecast game is one which we have no interest in playing. We're naturally pleased to have been fully invested in 2023 (as we always are) and equally glad that our equity team was patient with names that struggled for parts of last year, but which have made outsized contributions to performance through the past two quarters. We've recently made select equity trades to reallocate some gains toward better valued areas of our mandates and have increased our bond duration to crystallize the relative outperformance we generated over the past 18 months by being meaningfully shorter than the benchmark. With these changes, we feel confident in the positioning of DM portfolios, but will undoubtedly make further adjustments as conditions unfold.

Have a great summer!