GIA PARTNERS

2nd Quarter 2023

Highlights

- **Interest rates increased and spreads narrowed as the bank crisis faded and the Fed tightened further. Our portfolios outperformed as credit markets recovered.**
- **The economy was surprisingly resilient following 500 b.p. of rate hikes, the bank crisis, and a disappointing Chinese reopening. Another rate hike is now likely in July.**
- **The world became enthralled with A.I. after last fall's public release of ChatGPT. Enthusiasm over the prospects boosted tech stocks, and also raised concerns over its implications and adoption.**

Markets

GIA	Average Quality	Returns (%) 2Q23 Gross	2Q23 Net	12 Months Gross	12 Months Net
Core Plus Composite	**(A)**	**0.04**	**-0.05**	**1.55**	**1.20**
Global Investment Grade Composite	**(A-)**	**0.13**	**0.03**	**1.86**	**1.46**
Global Credit Plus Composite	**(BBB+)**	**0.75**	**0.63**	**3.21**	**2.69**
High Yield Composite	**(BB-)**	**1.64**	**1.50**	**9.18**	**8.58**
Emerging Market Corporate Debt Composite	**(BB+)**	**2.12**	**1.96**	**6.74**	**6.10**
Benchmark Bonds					
Bloomberg U.S. Agg. Index	(AA+)	-0.84		-0.94	
Treasury	(AAA)	-1.38		-2.13	
Corporate	(A-)	-0.29		1.55	
Mortgage	(AAA)	-0.64		-1.52	
Government/Credit	(AA)	-0.93		-0.70	
ICE BofA U.S. Corporate & Yankees	(A-)	-0.23		1.33	
ICE BofA U.S. Corporate	(A-)	-0.21		1.41	
ICE BofA U.S. High Yield	(B+)	1.63		8.87	
ICE BofA EM Corporate Plus	(BBB)	0.58		3.68	
ICE BofA Global Gov't ex-US	(AA-)	-0.56		-3.51	
JPM Emerging Markets EMBI GD	(BB+)	2.19		7.39	
JPM CEMBI Broad Diversified	(BBB-)	1.37		5.66	
JPM GBI-EM Global Diversified	(BBB+)	2.51		11.38	
Benchmark Equities					
S&P 500	NA	8.30		17.57	
Nasdaq Composite	NA	12.81		25.02	
Russell 2000	NA	4.79		10.58	
MSCI EAFE	NA	1.87		15.46	
MSCI Europe	NA	1.38		18.34	
MSCI Japan	NA	6.16		15.50	
MSCI Emerging Markets Equity	NA	-0.08		-1.12	

* Please refer to the respective factsheets for the long-term composite and benchmark returns for each strategy.

Markets

The second quarter started with a simmering banking crisis depressing investor sentiment and a central bank trying to balance between a teetering financial system and a resolute commitment to fighting inflation. After aiding in the closure of two banks on March 10, the Fed raised the Fed Funds rate on March 22. Oddly, equity markets remained relatively calm while bonds rallied in a flight to safety. Nervousness persisted until JP Morgan acquired First Republic on May 1. Ultimately, the banking system endured and predictions of a damaging side effect to the economy did not materialize. Instead, the Fed proceeded with another rate hike on May 3 (to 5.0% lower bound) and the pillars of recent economic strength, labor markets and services, demonstrated ongoing resilience. While bonds faded from their April highs, equity markets enjoyed an excellent quarter. As of June 30, 2023, the S&P 500 returned 8.72% (including dividends), the Nasdaq 13.03%, European equities 3.11%, and emerging markets lagged at 0.85%. It is interesting to observe that despite widespread expectations of recession, global equity markets have recovered meaningfully this year and are not decisively below their 2021 closes. Bonds, meanwhile, recovered marginally from year-end 2022, but suffered another negative return quarter as the fear-based improvement reversed. For the quarter, the Bloomberg U.S. Aggregate Index returned -0.84% with U.S. treasuries down -1.38%, corporates down -0.21%, and securitized sectors losing -0.64%. In another unusual result given forecasts, the U.S. high yield market outperformed with a positive 1.63% return.

Investment grade credit posted strong relative returns as spreads narrowed and longer-term yields increased less than short-term yields. For the quarter, the investment grade corporate bond index, the ICE BofA U.S. Corporate Index (C0A0), was down -0.21%, although the sector remained positive 3.23% year-to-date. Corporate bonds generated 131 b.p. of duration adjusted excess returns for the quarter and 156 b.p. year-to-date as the U.S. treasury index (G0Q0) returned -1.41% and 1.63% over the same periods. Corporate option adjusted spreads (OAS) narrowed 12 b.p. to 132 b.p., while the yield to worst of the index increased from 5.24% to 5.55%. Investment grade issuance recovered mid-quarter as the bank crisis faded and investor demand was robust. For the quarter, issuance totaled a healthy $388.6 billion, which compared favorably to last year's $333.1 billion second quarter. Year-to-date issuance totaled $896.8 billion surpassing last year's first half by over $52 billion.

The high yield market enjoyed a strong quarter despite the move higher in rates and expectations of economic deterioration. The ICE BofA U.S High Yield Index (H0A0) was up 1.63% for the quarter and a healthy 5.42% year-to-date. At quarter-end the spread to worst for the sector was narrower by 48 b.p. from 474 b.p. to 426 b.p. as bank-induced fears receded. Although the high yield market has modest exposure to banks (0.74%), the sector was boosted by the riskiest securities. By rating, quarterly returns were: BB 0.78%, B 1.84%, and CCC 4.73%. The rise in treasury yields increased the yield-to-worst for the sector from 8.31% to 8.55%. In an unlikely development given the market backdrop, retail investors added $3.6 billion to high yield funds during the quarter. The inflow put a small dent into the previous quarter's $14.8 billion and 2022's near-$50 billion outflow. During the quarter, there were $9.97 billion in bond defaults and distressed exchanges. The default rate including distressed exchanges rose to 2.71% from 1.91% at the end of the first quarter (1.64% not including distressed exchanges) which remained well below the historical average of 3.2%. The new issue market showed signs of life completing $55.1 billion in transactions, the best quarterly total since the fourth quarter of 2021. Year-to-date issuance reached $95.6 billion, exceeding last year's first half by nearly $25 billion.

Like other credit sectors, emerging markets had a decent quarter despite global geopolitical friction and disappointing economic data from China. Latin America showed resilience with better-than-expected growth and some success fighting inflation. Other significant countries that showed improvement included India and Ukraine. Going forward the sector will likely depend on better performance in China, as the U.S. and Europe continue their central bank driven battle with inflation. The JPM Emerging Market Bond Index – Global Diversified (EMBIGD), a dollar denominated sovereign index, was up 2.19% for the quarter and 4.09% year-to-date. The JPM Corporate Emerging Markets Broad Diversified Index (CEMBI BD) increased 1.37% during the quarter and 3.64% over the six months. The JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index, gained 2.51% for the quarter and 7.79% for the first half of the year.

Economy

The most prescient observation in this quarter's discussion was how difficult it has been to forecast economic activity. Accepting we are not alone, the conversation highlighted the incongruity in the performance of certain industries with returns in equity markets. As an example, transportation companies continue to experience tariff and volume reductions, consistent with deterioration in the ISM manufacturing data, yet many stocks have gains for the year and improvements in the most recent quarter. Furthermore, airline and hotel prices declined in June despite healthy booking pronouncements from companies in those industries.

Economists have also been whipsawed by data that usually serves as a reliable indicator of future activity. The second quarter began with an unresolved regional bank crisis that prefaced a decline in bank lending and tighter financial conditions. A dearth in loan demand, perhaps in anticipation of slowing economic conditions, enabled many banks to attend to their liquidity concerns without threatening the quality of their loan book. In another unexpected development, home sales, which declined in 2022 with the spike in mortgage rates, experienced a revival during 2023 due to pent-up demand and light supply. The economy's resiliency has been hard to explain, although it may be that behavioral changes associated with the pandemic are lifting activity in unexpected ways. While often noted in economic commentary, accumulated consumer and corporate savings may be playing a larger role than originally envisioned.

The Fed raised rates in May and paused in June, completing an unprecedentedly quick 500 b.p. tightening in fourteen months. Perhaps unhappy with the markets' reaction, the pause was accompanied by a stern warning that future hikes would likely be necessary. Sure enough, data released through early July suggest the Central Bank will indeed hike rates again in July. We believe, given the clear downward thrust of most indicators, that hike will be the last.

Economic activity abroad has also been hard to forecast. China's widely touted pandemic reopening turned into a dud as consumers held back their savings and the government was timid with stimulus. While that economy is still likely to contribute meaningfully to global growth during the second half of the year, geopolitical concerns may dampen the impact of their recovery on the rest of the world. In the meantime, Europe escaped a winter recession due to warmer than expected weather and ultimately manageable energy demand. Like the U.S., Europe experienced a jump in services activity we believe will likely last through the summer and help sustain modest growth for the region as the European Central Bank completes its hiking cycle.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the U.S. economy growing about 1.0% to 1.5% at an annual rate in 3Q and 4Q, 2023. Data released during the second quarter generally exceeded expectations confirming consumption remains robust, especially in services. Momentum in industries vulnerable to higher rates, like housing and autos, suggests the Fed's desired economic decline will be slower and less damaging than previously expected. In addition, resilience in employment and wages indicates consumption can keep the economy growing, even if at a slower pace. PROBABILITY 60%

2. A second scenario has the economy slowing to a rate of 0.0% to -0.5% at an annual rate during the next six months. In this scenario, the Fed's rate hikes continue into September with economic conditions worsening at a rapid pace. Lending becomes more restrictive, and consumers pause their purchases of higher ticket items. In addition, services demand softens, and unemployment rises putting a dent into consumer confidence. PROBABILITY 25%

3. A third scenario has the economy expanding at the same or even stronger pace of 2.0% to 2.5% at an annual rate during the next six months. In this scenario, personal consumption remains robust aided by low unemployment and reasonable wage growth. In a "Goldilocks-like" manner, inflation remains contained because the "artificial" pressure on prices (war related shortages and lingering supply chain disruptions) clears up removing rationale for Fed's dogged insistence on additional tightening. PROBABILITY 15%

Market Outlook

The Fed paused rate increases at its June 14 meeting after a relentless 500 b.p. of tightening over the previous 14 months. Over that same period, inflation peaked above 9.0% and then dropped to about 3.0%. The unemployment rate moved from about 3.7% to 3.6%. Average hourly earnings moved from about 5.9% to 4.4% (YOY), barely exceeding the inflation rate in June 2023 for the first time during the hiking cycle. While economic activity appears to be weakening, the Fed is expected to tighten further. Additional hikes will likely drag the economy into recession in 2024. The move higher in rates across the longer end of the yield curve will likely peak near current levels (4.0% 10-year) with the curve inversion getting wider for a brief period. Credit spreads are relatively tight reflective of solid creditworthiness ahead of a slower growth period. It is likely spreads will widen slightly or remain rangebound as the outcome for the economy becomes clearer.

The portfolios benefited from an overweight to credit. While creditworthiness remains strong, credit spreads are not "cheap" considering the economic context. We anticipate retaining relatively modest exposure to high yield and emerging markets while maintaining near-benchmark weights in investment grade credit and exposure to investment grade emerging markets to supplement the yield. We also anticipate increasing exposure to mortgage-backed securities as the sector looks compelling relative to investment grade credit. Since we keep the portfolios duration neutral, we will manage curve exposure through security selection in our higher quality holdings.

July 15, 2023

Important Information

GIA Partners, LLC ("GIA") is an SEC registered investment adviser.

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Index Definitions

Bloomberg U.S. Aggregate Index
The Bloomberg U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Bloomberg U.S. Treasury Index
This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Bloomberg U.S. Government/Credit Index
The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Bloomberg U.S. Corporate Index
This index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers. (Future Ticker: I02765US)

Bloomberg U.S. Mortgage Backed Securities Index
This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

ICE BofA U.S. Corporate & Yankees Index
The ICE BofA U.S. Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

ICE BofA U.S. Corporate Index
The ICE BofA U.S. Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

ICE BofA U.S. High Yield Index
The ICE BofA U.S. High Yield Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

ICE BofA US Emerging Markets Corporate Plus Index (EMUB)
The ICE BofA US Emerging Markets Corporate Plus Index is a subset of The ICE BofA Emerging Markets Corporate Plus Index including all securities denominated in US dollars.

ICE BofA Global Government Excluding the U.S. Index (N0G1)
The ICE BofA Global Government Excluding the U.S. Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency. N0G1 excludes U.S. government bonds.

Emerging Markets Bond Index Global Diversified (EMBI® Global Diversified):
The EMBI Global Diversified is a uniquely-weighted version of the EMBI Global. It limits the weights of those index countries with larger debt stocks by only including specified portions of these countries' eligible current face amounts of debt outstanding. The countries covered in the EMBI Global Diversified are identical to those covered by the EMBI Global.

JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI Broad Diversified)
The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. The CEMBI Broad Diversified limits the weights of those index countries with larger corporate debt stocks by only including a specified portion of these countries' eligible current face amounts of debt outstanding.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)
The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

S&P 500 Index
An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index
An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI Europe Index
The index is a free-float weighted equity index measuring the performance of Europe Developed Markets.

MSCI Japan Index
The index is a free-float weighted equity JPY index.

MSCI Emerging Markets Equity

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.