MEDALLION
WEALTH MANAGEMENT

May 2023 Market Commentary

With a Little Help from my Friends

What would you think if I sang out of tune?
Would you stand up and walk out on me?
Lend me your ears and I'll sing you a song
And I'll try not to sing out of key
Oh, I get by with a little help from my friends
Mm, I get high with a little help from my friends
Mm, gonna try with a little help from my friends

The Beatles - https://www.youtube.com/watch?v=0C58ttB2-Qg

I consider myself a very fortunate man. I've been blessed to find a career that I enjoy enough that it's almost not work, and maybe even more importantly, I've been doing it long enough that I can choose who I want to work with. I've been able to choose to work with friends.

In the early years of our careers we often take the best job offered, sometimes the only job offered. Often times that means tolerating some less than desirable colleagues. We struggle through those years by adapting, outlasting, or moving on. All the while learning much about ourselves and others, and more importantly learning what type of people we want to surround ourselves with.

A few years ago, I was approached by a couple of old colleagues from my days at National City Bank, with a proposition to join them as a co-portfolio manager at Medallion Wealth Management. The arrangement was very attractive, because it offered me both a flexible work environment and the intellectual challenge I desired. What I didn't fully appreciate at the time, was that I'd also have the pleasure of working with one of the best portfolio managers and persons I've met over my long career, Jim Schrott.

After nearly 40 years in the business, Jim retired last month. I'll miss him dearly, but I know that there is no way for him to actually retire from watching the markets, so I'm looking forward to many more years of buying him lunch to pick his brains. Congratulations James, and enjoy some much deserved time off my friend!

One of Jim's best traits is his humility, he liked to quote Humphrey Neill, ***"Don't confuse brains with a bull market."*** Which brings us to today's markets. As of the end of April, the S&P 500 is up a very respectable 9.18% year-to-date, and is up about 20% from its October 2022 lows. So while this rally makes us all look really smart, we shouldn't lose site of the fact that just showing up did most of the work.

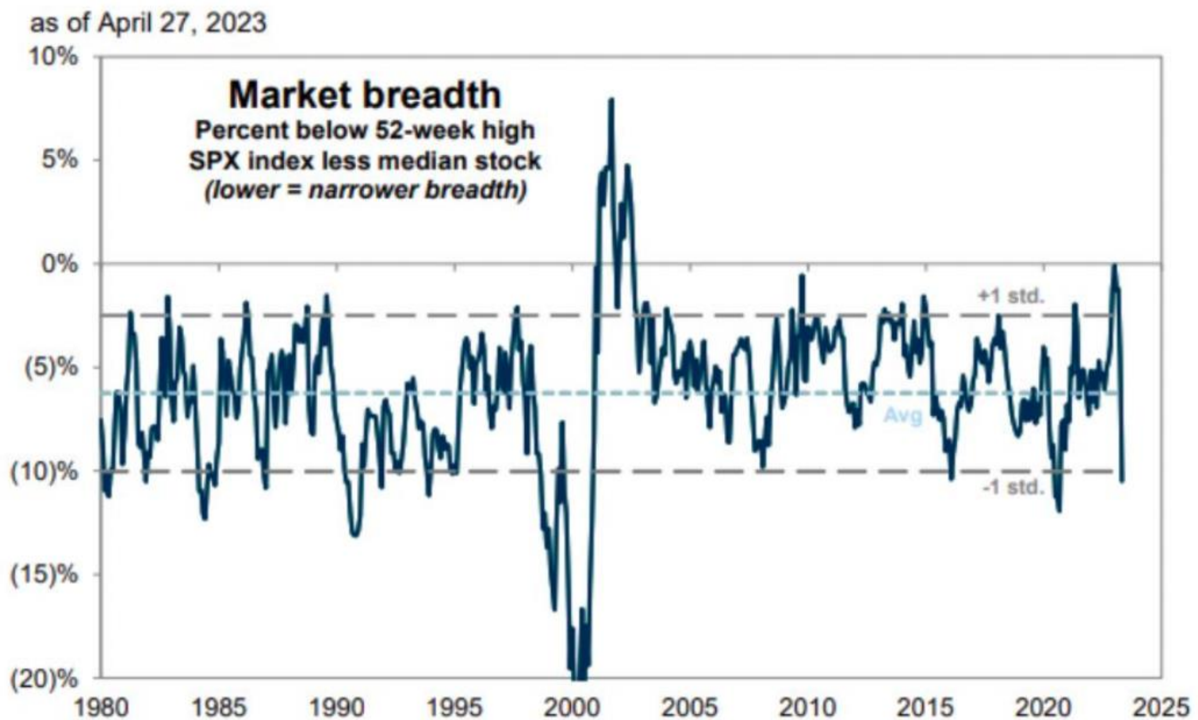
What should give us some pause about the true strength of this market, is its incredibly narrow leadership. The top 10 stocks in the S&P 500 by market cap now account for nearly 30% of the markets weight, and have accounted for about 80% of the markets year-to-date gains. Narrow leadership like this is often a sign of market weakness, not strength.

The first chart below from Bespoke Research shows how much the infamous FAANG+ stocks have surged this year. An average gain of 39% versus just 2% for the rest of the S&P 500.

FAANG+ Stocks Contributions to S&P 500 YTD Performance

Ticker	Company Name	Sector	Market Cap (bn USD)	YTD % Chg	S&P 500 Contribution Index Points	S&P 500 Contribution % of Move
AAPL	Apple	Technology	2,664.57	30.34	70.06	21.27
MSFT	Microsoft	Technology	2,266.56	27.12	58.03	17.62
NVDA	NVIDIA	Technology	672.48	87.97	38.16	11.59
META	Meta Platforms	Comm. Svcs.	611.37	97.32	31.35	9.52
AMZN	Amazon.com	Cons. Discret.	1,125.35	25.46	22.76	6.91
TSLA	Tesla	Cons. Discret.	507.72	33.34	13.01	3.95
GOOGL	Alphabet (Class A)	Comm. Svcs.	1,371.00	20.19	12.74	3.87
GOOG	Alphabet (Class B)	Comm. Svcs.	1,371.00	20.51	11.48	3.49
AMD	Advanced Micro Devices	Technology	140.73	34.88	4.35	1.32
NFLX	Netflix	Comm. Svcs.	144.85	13.12	2.03	0.62
		FAANG+ Stocks	9,504.63	39.03	263.97	80.15
		Rest of S&P 500	27,266.14	2.22	65.39	19.85

These next two charts from Goldman Sachs show what happens when market breadth becomes as narrow as it is today.



Episode	12-month change in breadth	S&P 500 Forward returns 1m	3m	6m	12m	Drawdown to trough 1m	3m	6m	12m
March-82	(5.5)pp	4 %	(1)%	8 %	37 %	0 %	(4)%	(9)%	(9)%
October-83	(5.1)	2	(0)	(2)	2	(1)	(1)	(6)	(10)
November-86	(5.2)	(3)	14	16	(8)	(3)	(3)	(3)	(10)
April-90	(6.2)	9	8	(8)	13	0	0	(11)	(11)
June-98	(5.6)	(1)	(10)	8	21	(1)	(16)	(16)	(16)
August-02	(10.1)	(11)	2	(8)	10	(11)	(15)	(15)	(15)
January-08	(5.8)	(3)	1	(8)	(40)	(4)	(8)	(12)	(45)
November-15	(7.1)	(2)	(7)	1	6	(4)	(12)	(12)	(12)
July-20	(5.3)	7	(0)	14	34	0	(1)	(1)	(1)
Median episode	**(5.6)pp**	**(1)%**	**(0)%**	**1 %**	**10 %**	**(1)%**	**(4)%**	**(11)%**	**(11)%**
April-23	**(5.8)pp**								
Overall median since '80	**0.0 pp**	**1 %**	**3 %**	**5 %**	**12 %**	**(2)%**	**(3)%**	**(4)%**	**(5)%**

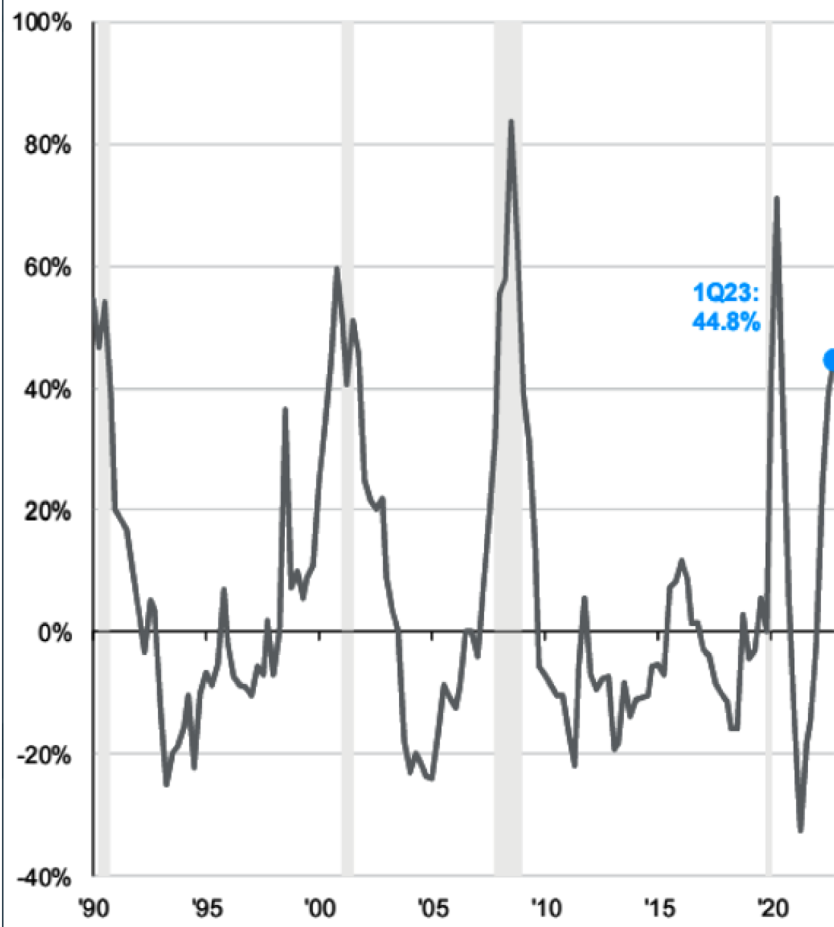
The above table shows that whenever market breadth narrows by more than one standard deviation the subsequent market returns over the next six months have averaged about 1%, and there has been an average drawdown of about 11%.

In summary, narrow market leadership isn't necessarily a harbinger of doom, but it does generally presage more muted future returns.

Last month I wrote about **"The Madness of Crowds"** as it relates to our recent bank failures. I stated that regional banks will continue to be under pressure from rising Fed Funds rates and that the larger (quasi-government) banks will be asked to step in and consolidate the industry.

As I write this today, the news is breaking that JP Morgan is going to take over First Republic Bank, which lost $100 billion in deposits during the first quarter. This is the second largest bank failure of all time; Silicon Valley Bank and Signature Bank are now the third and fourth largest. Washington Mutual's 2008 collapse is the largest. Fun fact: there have been 511 bank failures between 2009 and 2022 with total assets of $339 billion. The three failures in the last two months had total assets of $548 billion.

I'm not overly worried about these bank failures and subsequent bailouts, but they are another very visible sign that all is not well with our economy. When banks are feeling stressed, they generally will tighten lending standards, which obviously leads to economic growth slowing.

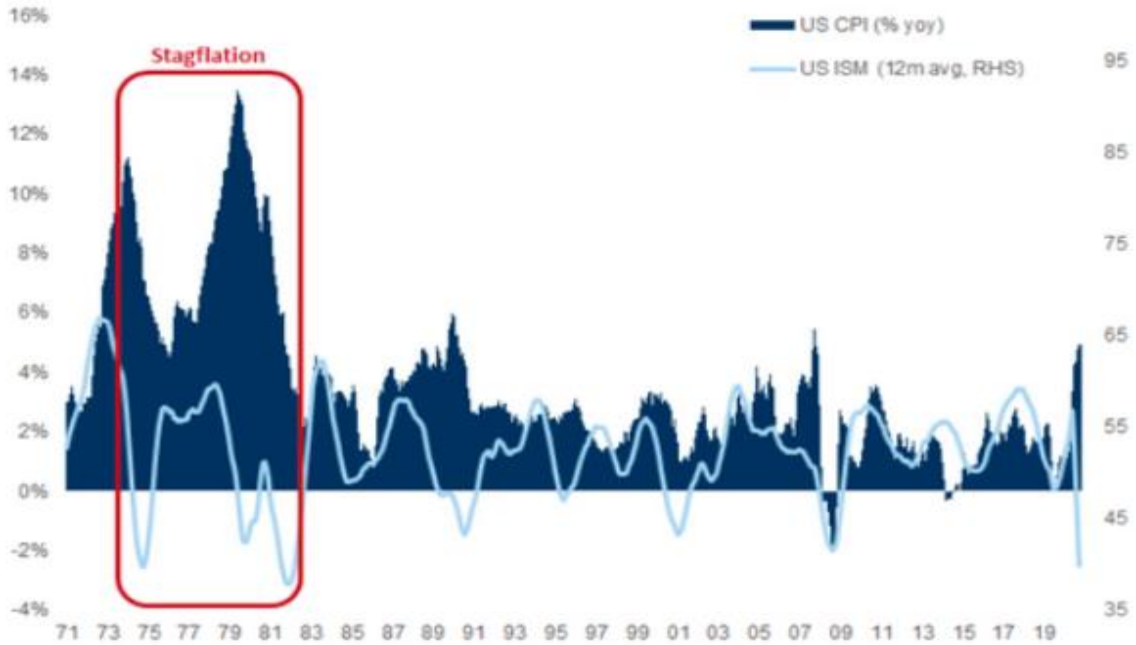


So, we have very clear signs that there is stress in our financial system and right on cue first quarter GDP growth comes in at only 1.1%. But we still have a fairly tight labor market, relatively healthy consumer spending, and stubbornly high inflation. To paraphrase Forrest Gump, ***"I may not be a smart man, but I know what stagflation is."***

Yes, the Fed is stuck in a tough spot (of their own making), faced with raising rates to battle inflation, while staring into the eyes of an economic slowdown/recession.

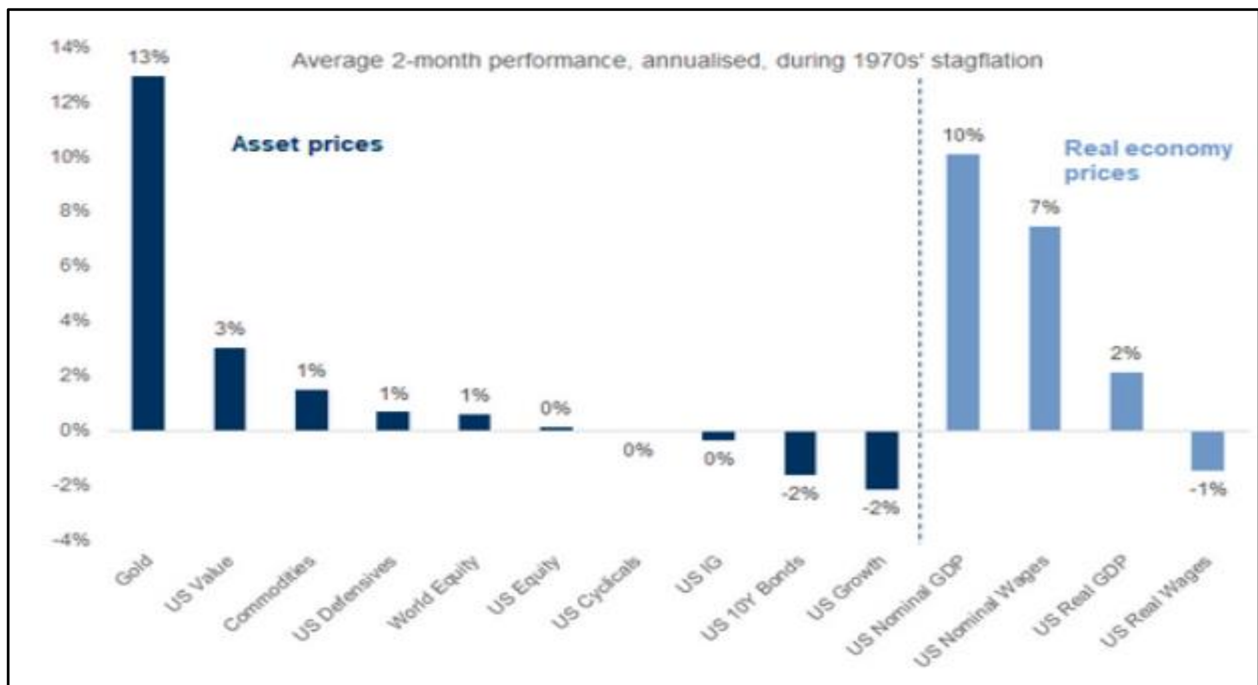
For those of you not old enough to remember what stagflation looks like, our friends at Goldman Sachs have put together the following graphics. They said that the economy was in stagflation from the first quarter of 1974 to the fourth quarter of 1982. It was a period of high inflation and very muted economic growth.

Exhibit 1: The US economy was in stagflation from Q1 1974 to Q4 1982



Source: Datastream, Haver Analytics, Goldman Sachs Global Investment Research

As far as what assets performed best in this environment, the chart below shows that Gold and Commodities did well, while the overall U.S. stock market had an inflation-adjusted return of 0%. Bonds did poorly as interest rates rose.



What should investors take from this little walk down memory lane? Well, history in financial markets tends to rhyme, not repeat. Every environment has a multitude of differences but we can probably make some relevant assumptions.

- Real inflation-adjusted returns are going to be lower than historical averages as long as inflation is high and economic growth is low.
- Real hard assets; like gold, real estate, and commodities will probably be more resilient.
- Companies able to grow organically, without relying purely on inflation, will be sought after.

So, in summary, we've had a really nice run off of the October lows. We're now faced with clear signs of financial stress and slowing economic growth. Cash and bonds offer decent risk-adjusted returns. We should continue to be risk adverse, and remember… ***we'll get by with a little help from our friends.***

As always, be careful out there.

Chris Wiles, CFA

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