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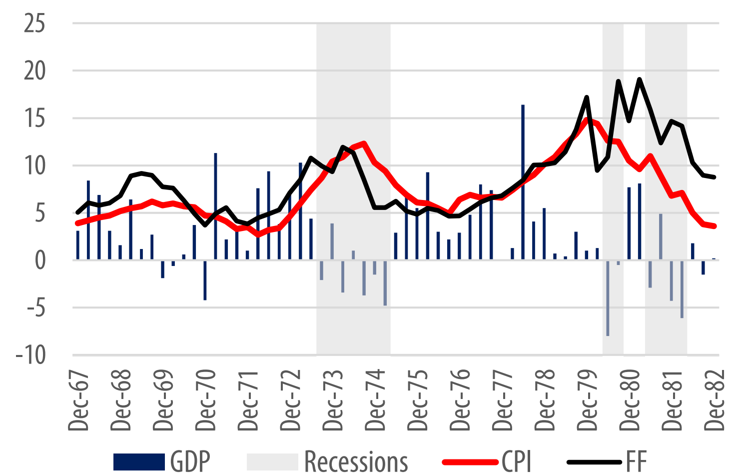
In the second quarter of 2023, U.S. stocks were the place to be invested. Investors grabbed hold of the narrative that the Federal Reserve (the "Fed") has quelled inflation, the U.S. economy will not experience a recession or if there is a recession, it will be mild and there will be a quick and decisive pivot back to an easy money economy. Perhaps the Fed's incredibly aggressive rate hikes have clawed back some of the credibility it lost during the "inflation is transitory" period. With risk aversion set aside, and the artificial intelligence (AI) frenzy in full swing, investors seem to be emboldened by positive signals from Gross Domestic Product (GDP), housing and jobs data even though these indicators tend to be lagging and not leading. There are potential warning signs of challenging times to come. Among them are continued hawkish language from the Fed that rates will remain high for a long time, a steeply inverted yield curve the likes of which has not been seen in 40 years, the Fed Fund's rate now exceeding headline Consumer Price Index (CPI), and the first ever sustained period of negative money supply growth.

Inflation has been THE central investment theme of the past two years. While the Fed was reluctant to start, the speed and magnitude of rate ascension has surprised many, partially because there was a concern that an economy so used to 0% rates and hyper-accommodative monetary policy would be fragile and unable to handle such a shock. Employment has remained strong in the face of rapidly tightening financial conditions and stocks have all but recovered from the bear market of 2022. However, there is a line of thinking that while the Fed appears to have won the inflation battle as of today, it is illusionary, and the war is far from over. As first articulated by Milton Friedman and often repeated by current Fed officials, "There is much evidence that monetary changes have their effect only after a considerable lag and over a long period and that the lag is rather variable." In other words, it takes time for rate hikes to impact the economy and how much time is uncertain. Could the bank failures of the first quarter of 2023 be just a warning shot across the proverbial economic bow, a tremor preceding the coming quake? After all, it has only been 15 months since the first rate hike.

Figure 1 Price Changes (%)



Source: Bloomberg.

The inflationary backdrop and the Fed's response today have some similarities to the 1970s and early 1980s. During that period, high inflation was met with an aggressive rate policy only to have the economy plunged into a steep recession approximately 18 months after the initial rate increase. The Fed responded by quickly lowering rates to stimulate growth. Inflation stormed back, thus requiring even more aggressive tightening resulting in two more recessions, all of which unfolded over roughly a 10-year period (Figure 1). Today, markets do not appear to be pricing in a significant probability of repeating this path and instead are indicating that there will be a "Goldilocks" outcome. While the 2020s may not exactly follow the path of the 1970s, ignoring the rate/inflation/growth dynamics of the last period of high inflation and aggressive Fed policy may prove to be one, if not the largest, risk to investor's portfolios, in our opinion.

The Fed raised the Fed Funds Target Rate (FF) only once during the second quarter, a 25 basis point (bps) hike in May and then paused their rate increasing cycle in June. The Fed Funds rate now sits at 5.00% - 5.25%. The CPI Year-over-Year (YoY), reported in June, came in at 4.0%, CPI Month-over-Month (MoM) registered at 0.1%, helped by falling energy prices. CPI ex-food and energy was 5.3.% YoY and 0.4% MoM, respectively. The Producer Price Index for final demand (PPI) YoY, reported in June, came in at 1.1% and the PPI MoM was -0.3%. The inflationary outlook has slowly turned the corner though the Fed has remained hawkish in its tone. U.S. 3-month T-bills ended the quarter at 5.30%. Prior to this quarter, the last time rates hit this level was January 2001.

Alternative Investments ("alternatives") had a solid quarter, with positive returns in 9 of 10 categories. None of the categories kept pace with the torrid pace of U.S equities but were more in line with the return of global equity markets. The average underperformance versus the S&P 500 Index was -718 bps. Nine of 10 categories outperformed the Bloomberg U.S. Aggregate Bond Index for the quarter. On average, there was +241 bps of outperformance. Managed futures was the best performing category (+3.69%). Other notable gainers were hedged equity (+2.97%), real estate (+2.43%), and macro (+2.02%). Commodities (-2.56%) was the worst performing category (See Figure 2 and Figure 3 on the next page).

References to specific companies or securities should not be construed as a recommendation to buy or sell any such security, nor should they be assumed profitable.

All charts shown herein are for illustrative purposes only and not indicative of any investment. The performance illustrations exclude the effects of taxes and brokerage commissions or other expenses incurred when investing. ***Past performance is not indicative of future results*** *and there can be no assurance past trends will continue in the future. An investor cannot invest directly in an index. See last page for definitions of asset class indexes and other terms discussed herein.*

Figure 2 Alternative Performance

	Q2 2023	YTD 2023
Hedged Equity	2.97%	5.55%
Event Driven	1.59%	2.99%
Equity Market Neutral	1.45%	2.23%
Real Estate	2.43%	4.04%
Commodities	-2.56%	-7.79%
Distressed/Restructuring	1.85%	2.75%
Volatility Arbitrage	0.88%	0.79%
Credit Arbitrage	1.36%	4.17%
Macro	2.02%	-0.47%
Managed Futures	3.69%	-0.21%

Source: Bloomberg, data as of 6/30/23.

Figure 3 Alternative Performance (Over/Under) vs S&P 500 Index

	Q2 2023
Hedged Equity	-5.77%
Event Driven	-7.16%
Equity Market Neutral	-7.29%
Real Estate	-6.31%
Commodities	-11.30%
Distressed/Restructuring	-6.89%
Volatility Arbitrage	-7.87%
Credit Arbitrage	-7.39%
Macro	-6.72%
Managed Futures	-5.05%

Source: Bloomberg, data as of 6/30/23.

Traditionally, managed futures and macro strategies are viewed as having lower correlations to equities because they are diversified across a variety of markets and often employ shorting as part of their approach. Strategies that had lower two-year correlations to U.S. equities (less than 0.60), on average, underperformed those strategies that had a higher correlation with U.S. equities. The spread was -107 bps (Figure 4). Real asset returns were mixed. Broad commodities fell on concerns of slower growth, a faltering China reopening, and a hawkish Fed. Real estate was up on solid housing data and shrugged off rising mortgage rates, poor housing affordability and commercial real estate concerns. Gold fell sharply in sympathy with the broader commodity market as the risk-on sentiment took hold and rising real rates likely served as a headwind (Figure 5).

Figure 4 Correlations (2yr) & Returns

	S&P 500 Index	Q2 2023
Hedged Equity	0.88	2.97%
Event Driven	0.77	1.59%
Equity Market Neutral	0.13	1.45%
Real Estate	0.88	2.43%
Commodities	0.34	-2.56%
Distressed/Restructuring	0.68	1.85%
Volatility Arbitrage	-0.30	0.88%
Credit Arbitrage	0.46	1.36%
Macro	-0.15	2.02%
Managed Futures	-0.38	3.69%
Lower Correlation Avg TR (≤0.60)		1.14%
Higher Correlation Avg TR (>0.60)		2.21%

Source: Bloomberg, data as of 6/30/23. Correlation of monthly returns over 24 months.

Figure 5 Real Assets

	Q2 2023	YTD 2023
Real Estate	2.43%	4.04%
Commodities	-2.56%	-7.79%
Gold	-2.54%	5.23%
Average	-0.89%	0.49%

Source: Bloomberg, data as of 6/30/23.

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Cryptocurrencies had significant crosscurrents battling each other during the quarter. There were an estimated $300MM in losses for the quarter due to hacks and fraud bringing the estimated total for 2023 to around $700MM. The Securities and Exchange Commission (SEC) filed separate lawsuits against cryptocurrency exchanges, Bittrex, Binance, and Coinbase. While each case is unique, we believe the core driver seems to be the desire to bring cryptocurrencies, their trading and relevant exchanges, under the SEC's regulatory umbrella. At nearly the same time, the world's largest asset manager filed for a Bitcoin ETF that would hold digital Bitcoin and not futures. Previously, all non-futures-based Bitcoin ETFs have been turned down by the SEC. The filing seems to have signaled to the market, that despite the turmoil and ongoing SEC actions, this asset manager sees a path to market. The Bloomberg Galaxy Crypto Index was down -2.08% and the bellwether Bitcoin was up +7.03%, likely on optimism that the ETF filing would ultimately succeed and stoke demand. Ethereum, Ripple, and Litecoin posted mixed performance, +6.01%, -12.56%, +19.74%, respectively (Figure 6).

Returns for major asset classes were generally positive in the second quarter of 2023. U.S. equities (+8.74%) moved sharply higher, led by strong movement among MegaCap Tech shares. International developed, real estate, high yield bonds and emerging markets were all positive (+2.95%, +2.43%, +1.60%, +0.90%, respectively). Commodities (-2.56%) and U.S. Treasuries (-2.38%) struggled as the Fed continued to articulate a strategy of higher rates in place for longer and inflationary data continued its trend lower. We believe confidence that the Fed would thread the needle with respect to managing inflation while not creating a recession seems to be taking hold and the regional banking crisis of the first quarter of 2023 seems to have been long forgotten. Prices, as measured by the CPI, moved higher but the rate of inflation continued to trend lower (4.0% down from a high of 9.1% in 2022), helped in part by significantly lower energy prices. The yield curve pushed further into inversion reaching levels not seen since the 1980s. An inverted yield curve is financially restrictive and has often preceded a significant economic slowdown or recession. Real yields out to five years moved into positive territory and real yields further out the curve were near zero and look positioned to move into positive territory soon (Figure 8). For much of the 2010s, real yields were deeply negative and therefore extremely accommodative. Now that real yields are moving to what would be considered a more restrictive stance, along with other tightening measures such as higher absolute rates, negative money supply growth, and a declining Fed balance sheet (an aspirational goal of the Fed), the impact on the economy and financial markets could be significant, though stocks do not appear to be pricing in much concern, in our opinion.

Alternatives have historically provided significant diversification benefits when paired with a portfolio of traditional assets, in addition to both competitive absolute returns and attractive risk-adjusted returns. **Please Note: Alternative investments may employ complex strategies, have unique investment, and risk characteristics that may not be appropriate for all investors.**

Figure 6 Cryptocurrency Returns

	Q2 2023	YTD 2023
BB Galaxy Crypto Index	-2.08%	56.36%
Bitcoin	7.03%	83.75%
Ethereum	6.01%	60.67%
XRP (Ripple Dig.Asst)	-12.56%	39.21%
Litecoin	19.74%	52.89%

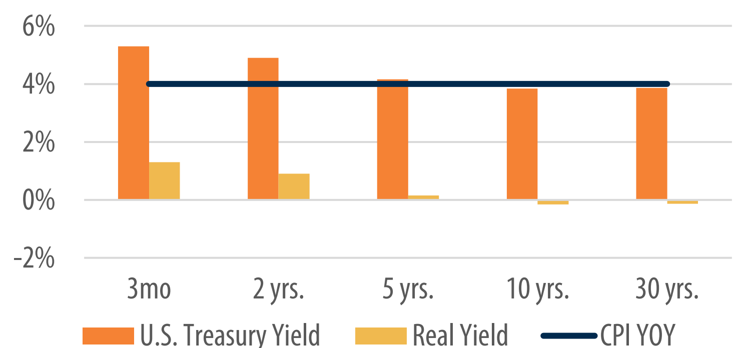
Source: Bloomberg, data as of 6/30/23.

Figure 7 Asset Class Returns

	Q2 2023	YTD 2023
U.S. Equities	8.74%	16.89%
International Developed	2.95%	11.67%
Emerging Markets	0.90%	4.89%
U.S. Treasury	-2.38%	3.99%
Real Estate	2.43%	4.04%
Commodities	-2.56%	-7.79%
High Yield Bonds	1.60%	5.46%
U.S. Aggregate Bonds	-0.84%	2.09%
Bitcoin	7.03%	83.75%
U.S. Dollar	0.40%	-0.59%

Source: Bloomberg, data as of 6/30/23.

Figure 8 U.S. Treasury Yield Curve and CPI



Source: Bloomberg, data as of 6/30/23.

Definitions

10-Yr Treasury: Yield of U.S. Treasury securities maturing in approximately 10 years.

30-Yr Mortgage Rate: is a fixed interest rate home loan that will be paid off completely in 30 years if you make every payment as scheduled.

Aggregate Bonds: The Bloomberg US Aggregate Bond Index is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

Bear Market: When a market experiences prolonged price declines typically 20% amid widespread peccimism and negative investor sentiment.

Beta: A measure of price variability relative to the market.

Binance: A cryptocurrency exchange, operating the world's biggest bitcoin exchange and altcoin crypto exchange in the world by volume.

Bitcoin: A digital currency using encryption techniques created for use in peer-to-peer online transactions Introduced in 2008 by a person or group using the name Satoshi Nakamoto.

Bittrex: a cryptocurrency blockchain platform exchange founded in 2014. It provides the widest selection of cryptocurrencies in the United States along with fast trade execution and dependable digital wallets.

Bloomberg Galaxy Crypto Index (BGCI): The BGCI is designed to measure the performance of the largest cryptocurrencies traded in USD.

Coinbase: An online platform for buying, selling, transferring, and storing cryptocurrency.

Commodities: The Bloomberg Commodity Index is made up of exchange-traded futures on physical commodities and represents 20 commodities, which are weighted to account for economic significance and market liquidity.

Consumer Price Index (CPI): A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them. Changes in the CPI are used to assess price changes associated with the cost of living.

Correlation: A statistical measure that quantifies the extent to which two or more data series fluctuate together. Values run from -1.0 to +1.0.

Credit Arbitrage: Hedge Fund Research HFRI Event-Driven Credit Arbitrage Index. Credit Arbitrage strategies employ an investment process designed to isolate attractive opportunities in corporate fixed-income securities; these include both senior and subordinated claims as well as bank debt and other outstanding obligations, structuring positions with little of no broad credit market exposure. These may also contain a limited exposure to government, sovereign, equity, convertible or other obligations but the focus of the strategy is primarily on fixed corporate obligations and other securities are held as component of positions within these structures.

Cryptocurrency: A digital or virtual currency that is secured by cryptography, which makes it nearly impossible to counterfeit or double-spend.

Distressed/Restructuring: Hedge Fund Research HFRI Event-Driven Distressed/Restructuring Total Index. Distressed/ Restructuring strategies employ an investment process focused on corporate fixed-income instruments, primarily on corporate credit instruments of companies trading at significant discounts to their value at issuance or obliged (par value) at maturity as a result of either formal bankruptcy proceeding or financial market perception of near term proceedings.

Emerging Markets: The MSCI Emerging Markets Index captures large and mid cap representation across Emerging Markets (EM) countries. The index covers 85% of the free float-adjusted market capitalization in each country.

Equity Market Neutral: Hedge Fund Research HFRI Equity Hedge Equity Market Neutral Index. Equity Market Neutral strategies employ sophisticated quantitative techniques of analyzing price data to ascertain information about future price movement and relationships between securities, select securities for purchase and sale. Equity Market Neutral Strategies typically maintain characteristic net equity market exposure no greater than 10% long or short.

Ethereum: Ethereum is a platform that offers programming code of any decentralized application. It has been linked to payment style transactions. Ether is the cryptocurrency issued through open-source code executed on thousands of nodes.

Event Driven: Hedge Fund Research HFRI Event-Driven (Total) Index. Investment Managers who maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments.

Gold: The return of the gold spot price as quoted as U.S. dollars per Troy Ounce.

Gross Domestic Product (GDP): Is the monetary value of all finished goods and services made within a country during a specific period.

Inflation is the decline of purchasing power of a given currency over **time.**

Hedged Equity: Hedge Fund Research HFRI Equity Hedge (Total) Index. Investment Managers who maintain positions both long (positions that are owned) and short (positions that are owed) in primarily equity and equity derivative securities. Hedged Equity managers would typically maintain at least 50%, and may in some cases be substantially entirely invested in equities, both long and short.

High-Yield Bonds: The Bloomberg US High Yield Very Liquid Index (VLI) is a component of the US Corporate High Yield Index that is designed to track a more liquid component of the USD-denominated, high yield, fixed-rate corporate bond market. The US High Yield VLI uses the same eligibility criteria as the US Corporate High Yield Index, but includes only the three largest bonds from each issuer that have a min amount outstanding of USD500mn and less than five years from issue date.

International Developed: The MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. The index is a free-float weighted equity index.

Inverted Yield Curve: An unusual state in which longer-term bonds have a lower yield than short-term debt instruments.

JOLTS: The Job Openings and Labor Turnover Survey produces data on job openings, hires and separations.

Litecoin: A peer-to-peer cryptocurrency and open source software project similar to Bitcoin, Litecoin uses blockchain technology to process transactions. Litecoin, referred to as an alt-coin can process blocks faster than Bitcoin, uses a different mining algorithm and has larger supply.

Macro: Hedge Fund Research HFRI Macro (Total) Index. Investment Managers which trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed-income, hard currency and commodity markets.

Managed Futures: BarclayHedge US Managed Futures Industry Top 50 (BTop 50) Index. The Index seeks to replicate the overall composition of the managed futures industry with regard to trading style and overall market exposure.

Monetary Policy: Is the tool used by central banks to influence the money supply, and with it, the economy at large.

Money Supply: Is the entire stock of a nation's currency and other liquid instruments that is in circulation at a given time.

Month-over-Month (MoM): is a calculation that helps compare growth over the previous month and automatically negates the effect of seasonality.

Real Estate: The Dow Jones US Real Estate Index is designed to track the performance of real estate investment trusts (REITs) & other companies that invest directly or indirectly in real estate through development, management or ownership, including property agencies.

Real Yield: or Real Interest Rate has been adjusted to remove the effects of inflation to reflect the real cost of funds to the borrower and the real yield to the lender or to an investor.

Recession: Is a significant decline in economic activity that lasts longer than a few months.

Ripple: Known as XRP, Ripple is a cryptocurrency that can be used on open source distributed ledger created by the company Ripple. It is built upon the principles of blockchain as an on-demand option for faster cross border payments.

Securities and Exchange Commission (SEC): A government agency created by Congress to regulate the securities markets and protect investors.

U.S. Equities: The S&P 500 Index. An unmanaged index of 500 stocks (currently 505) used to measure large-cap U.S. stock market performance.

U.S. 30-Yr Treasury Yield: Yield of U.S. Treasury securities maturing in approximately 30 years.

U.S. Dollar: The U.S. Dollar Index (USDX) indicates the general international value of the U.S. dollar. The USDX does this by averaging the exchange rates between the USD and major world currencies. The ICE US computes this by using the rates supplied by some 500 banks.

U.S. Treasury: The ICE U.S. Treasury 20+ Years Bond Index is part of a series of indices intended to assess U.S. Treasury issued debt. Only U.S. dollar denominated, fixed-rate securities with minimum term to maturity greater than twenty years are included.

Year-over-Year (YoY): is a calculation that helps compare growth over the previous 12 months and automatically negates the effect of seasonality.

Volatility Arbitrage: Hedge Fund Research HFRI Relative Value Volatility Index. Volatility strategies trade volatility as an asset class, employing arbitrage, directional, market neutral or a mix of types of strategies, and include exposures which can be long, short, neutral or variable to the direction of implied volatility, and can include both listed and unlisted instruments. Directional volatility strategies maintain exposure to the direction of implied volatility of a particular asset or, more generally, to the trend of implied volatility in broader asset classes. Arbitrage strategies employ an investment process designed to isolate opportunities between the price of multiple options or instruments. Volatility arbitrage positions typically maintain characteristic sensitivities to levels of implied and realized volatility, levels of interest rates and the valuation of the issuer's equity, among other more general market and idiosyncratic sensitivities.

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