Economic and Market Overview

Second Quarter 2023

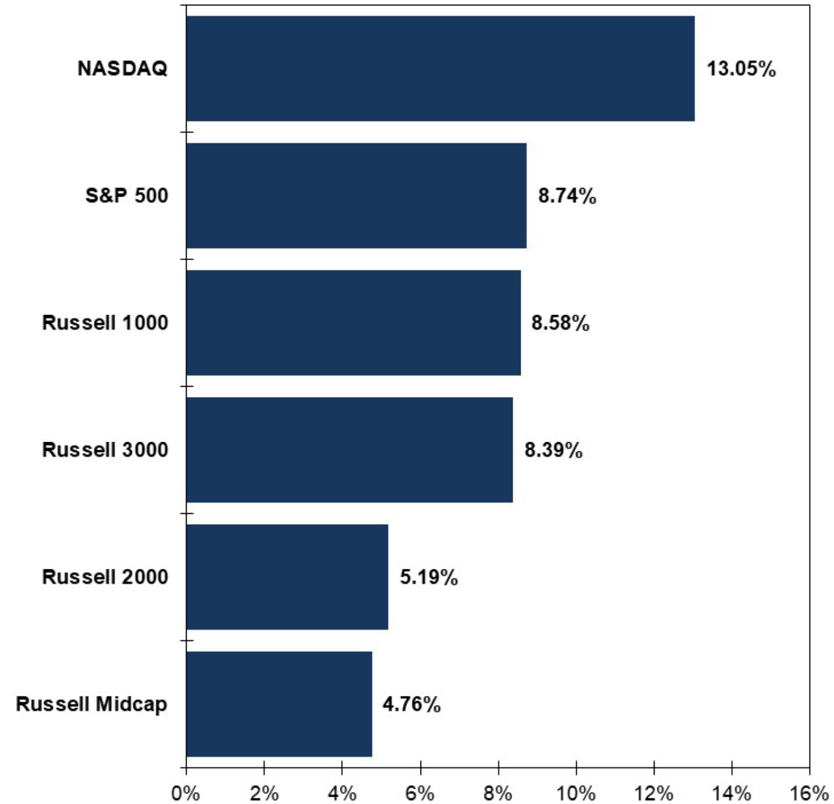
Building a Lifelong Partnership

The Economy

U.S. economic growth slowed in the first quarter of 2023, and the current environment sets up the possibility of weak growth for the remainder of the year. Even though growth was positive for the third consecutive quarter, the rate of growth has declined in each of the past two quarters as the economy grapples with still-elevated inflation and the rising interest rate environment initiated by the Federal Open Market Committee (FOMC) to subdue the inflation. The third estimate of first quarter 2023 real GDP from the Bureau of Economic Analysis was an annualized increase of 2.0%, higher than the prior estimate but lower than the 2.6% increase in the first quarter. The labor market remained resilient throughout the quarter. The June employment report showed that employers added 209,000 jobs for the month, and that the unemployment rate was 3.6%. The FOMC, in its continuing effort to tame inflation, raised its federal funds rate target range by 0.25% in the quarter, to 5.00% to 5.25%, from a range of 4.75% to 5.00%.

Broad Market Index Returns

Second Quarter 2023



Source: Bloomberg

Highlights and Perspectives

GROSS DOMESTIC PRODUCT (GDP)

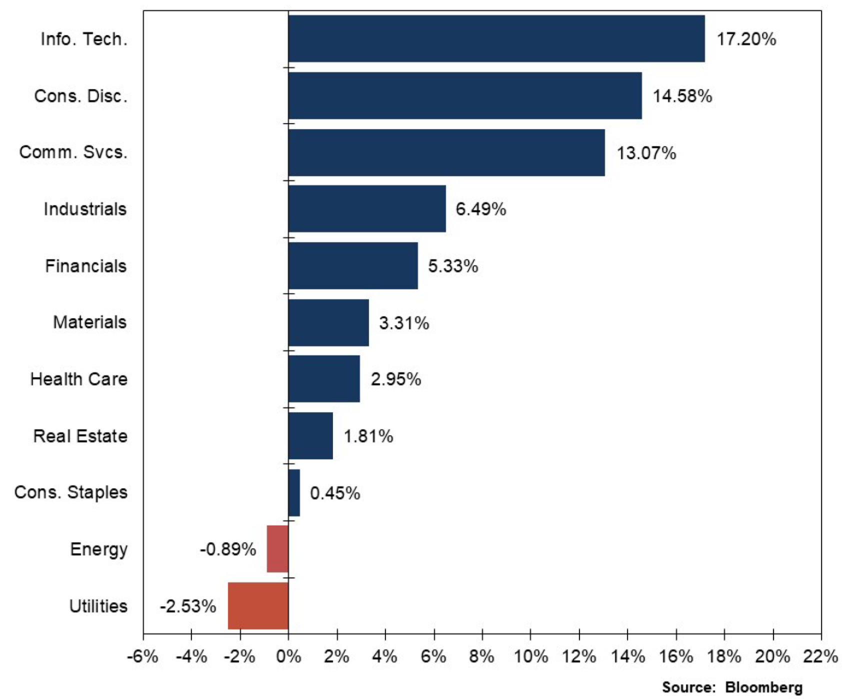
In the latest data available, the Bureau of Economic Analysis released the third estimate of the first quarter 2023 real GDP, a seasonally adjusted annualized rise of 2.0%, modestly higher than the prior estimate, but a decline from the 2.6% increase in the prior quarter. Slower growth is a trend that economists anticipate will continue for the rest of the year as the economy deals with elevated inflation and significantly higher interest rates. Primary drivers of the economy's gains in the quarter were consumer spending, nonresidential business investment, and government spending. Inventories were a significant drag on growth during the quarter. Corporate profits declined by 5.1% (not annualized) during the quarter after falling by 2% in the prior period. Inflation expectations were in line with the prior quarter, but remain elevated.

HOUSING

The housing market continued to bear the weight of elevated mortgage rates, but signs of life have appeared as new construction ramps up. Sales of existing homes rose very slightly in May (most recent data available) to an annualized rate of 4.3 million units, up 0.2% from the prior month but still down 20% from last year. Sale prices of existing homes fell 3.1% compared to May 2022. The number of existing homes for sale remains constrained as homeowners with low mortgage rates are disincentivized to sell and take on a pricier mortgage. On the other hand, homebuilders are slowly gaining confidence and increasing construction. New single-family housing starts jumped 18.5% in May, and sales of new homes jumped for the third month straight, rising 12.2% to an annualized rate of 763,000 units. At the end of May, newly constructed homes made up 31% of all homes for sale, far above the historical average of 10-15%, illustrating how few existing properties are currently available.

U.S Equity Market Returns by Major Sector

(GICS Sectors in S&P 500, Second Quarter 2Q23)



EMPLOYMENT

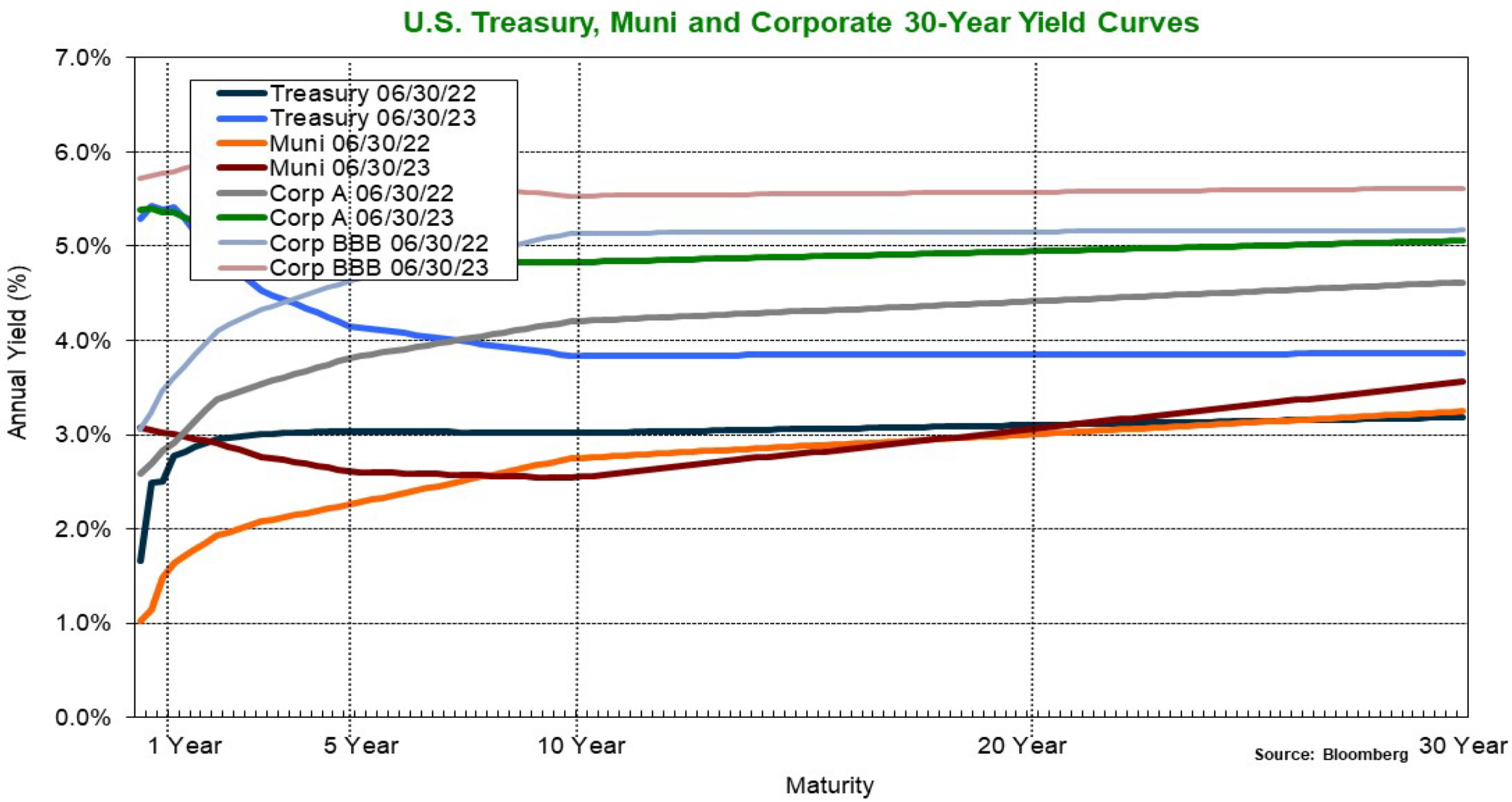
The June employment report showed a significant deceleration in hiring, but the labor market remains tight after substantial gains in the second quarter. Employers added 209,000 jobs in June, below expectations, and job numbers from previous months were revised lower. Still, the economy added an average of 244,000 per month in the second quarter, remaining robust. Wage growth continues to be an inflationary concern as wages rose 0.4% in June and 4.4% over the past year, a tick higher than 0.3% and 4.3% in May. The unemployment rate fell a tick in June to 3.6%, and the labor force participation rate was flat at 62.6%.

FEDERAL RESERVE POLICY

The FOMC raised the federal funds rate target range once during the quarter - at its May meeting – to a range of 5.00%-5.25% from 4.75%-5.00%. As many Fed-watchers had anticipated, the FOMC opted to pause interest rate hikes at its June meeting. It was the first time since January 2022 that the committee did not raise the target range for the federal funds rate – a span of 10 consecutive increases. Inflation remains elevated but much lower than in the prior three quarters. However, the FOMC is not declaring victory yet, as it promises to remain vigilant in reining in price growth. FOMC chairman Jay Powell said the goal of the pause is to enable the economy to adapt and allow the committee to determine next steps.

INTEREST RATES

Fixed income securities' prices were generally lower (and yields higher) during the quarter, as the bond market continued to grapple with high inflation and the FOMC's attempts to keep it under control through higher interest rates. After raising the federal funds target rate once during the quarter, the FOMC paused its increases to let the economy adjust and to determine the committee's next steps. Despite not raising rates in June, the FOMC is widely expected to resume its increases again at its meeting in late July. The committee expects the fed funds rate to end the year at 5.63%, approximately 0.50% higher than current levels. The committee indicated that the fed funds rate is nearing its terminal target, but analysts warn that conditions can change very quickly, forcing the FOMC to continue to raise rates.



The Treasury yield curve remained inverted, similar to the end of the first quarter, but shifted higher. Yields on the very short-term maturities of up to one year rose up to 70 basis points, while yields in the intermediate- and long-term segments of the curve rose between 15 and 50 basis points. By the end of the quarter, the yield on the benchmark 10-year US Treasury note was higher, ending at 3.84%, compared to 3.47% on March 31.

The yield on the 10-year Treasury began the quarter trending in no particular direction, but began to climb around April. It then trended higher for the next two weeks until it peaked at 3.80% on May 26, after which it remained in a fairly tight range into the end of the quarter. Against this backdrop, the yield on the 3-month Treasury Bill settled at 5.30% at the end of the quarter, higher by 55 basis points from the previous quarter. The yield on the 5-year Treasury Note ended the quarter at 4.16%, compared to 3.58% on March 31, the yield on the 10-year Treasury Note settled at 3.84%, compared to 3.47% over the same period. The yield on the 30-year Treasury Bond was somewhat higher, ending the period at 3.86%, compared to its beginning level of 3.65%.

Total returns on fixed income securities were once again largely negative during the quarter, offsetting gains from the first quarter. The Bloomberg Treasury 5-7 Yr. Index declined by 1.6% for the quarter. The Bloomberg US Credit Corporate 5-10 Yr. Index shed 0.5% during the three months. High yield securities, which often follow the performance of equities, were slightly higher, posting a gain of 1.8%. Municipals were little changed in the quarter, as the Bloomberg Municipal Bond Index declined by 0.1%. Prices of non-US fixed income securities posted losses in the quarter, as the Bloomberg Global Aggregate ex-US Index fell 2.2%. Emerging markets bonds were higher, with the JPM EMBI Global Index adding 1.5%.

EQUITIES

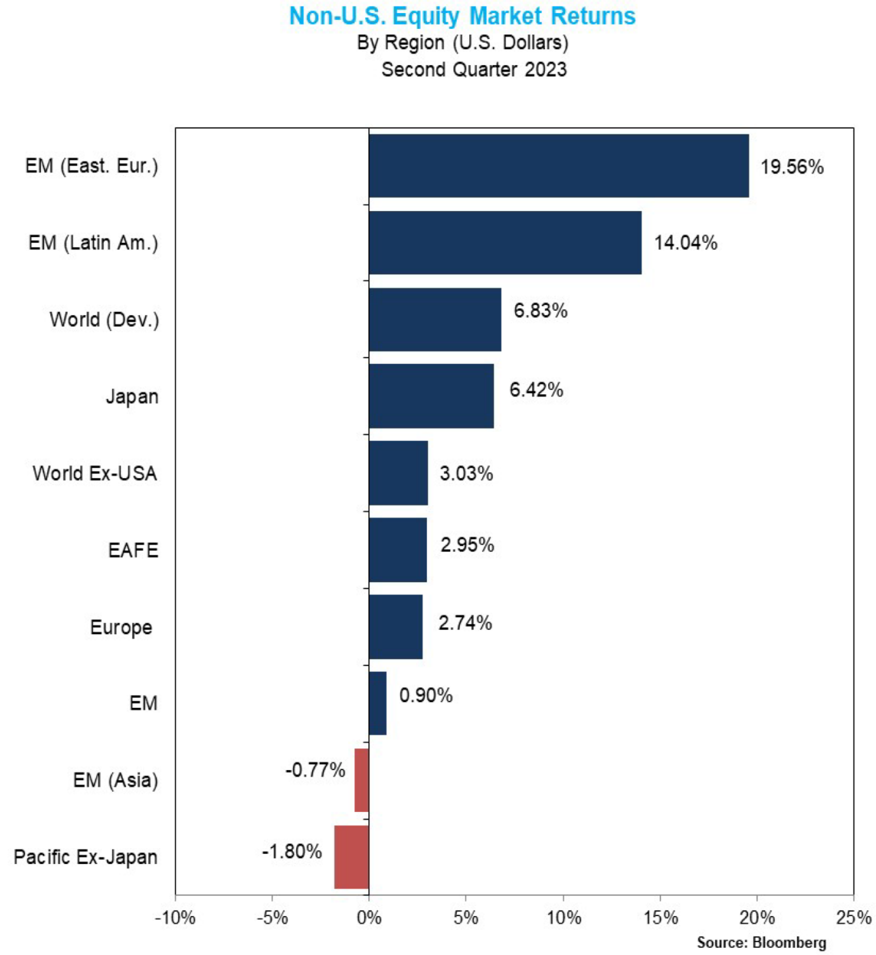
Stock prices were mostly higher in the quarter following the first quarter's mixed results. The economy's resiliency has surprised many investors and analysts, and the strength in stock prices seems to be suggesting that the US economy may avert a recession. For the first several weeks of the quarter the S&P 500 remained in a relatively narrow trading range. The index then began to trend higher in the latter part of May when investors began to believe the FOMC would pause its rate increase program, and topped out in mid-June. When the quarter ended, the S&P 500 Index had advanced 8.7%.

Return dispersion was wide across the 11 primary economic sectors, with many of the worst performers from 2022 generating the best returns this year, and vice versa; with certain sectors advancing more than 17%, while others declined more than 2%. Information Technology, Consumer Discretionary, and Communications Services were the strongest performers on a relative basis, generating returns of +17.2%, +14.6%, and +13.1%, respectively. The Utilities, Energy, and Consumer Staples sectors were the poorest relative performers, posting returns of -2.5%, -0.9%, and +0.5%, respectively.

The Russell 1000 Index of large capitalization stocks generated an 8.6% total return. Within the large cap segment, value stocks again significantly underperformed growth stocks, by a total of more than 800 basis points. Small cap stocks, as represented by the Russell 2000 Index, underperformed large caps, and finished the quarter with a total return of 5.2%. Small cap value underperformed small cap growth. The NASDAQ Composite, dominated by information technology stocks, finished the quarter with a strong gain of 13.1%. The Dow Jones Industrial Average of 30 large industrial companies posted a modest gain of 4.0%.

Real Estate Investment Trusts (REITs) were higher during the quarter, with the DJ US Select REIT Index up 2.9%. Commodities posted slight losses, with the Bloomberg Commodity Index declining by 2.6%.

International stocks generated positive results during the quarter. The MSCI ACWI Ex-USA Index, which measures performance of world markets outside the US, advanced by 2.4%. MSCI EAFE Index of Developed Market Stocks was higher by 3.0%. Most regions saw positive returns for the quarter. Eastern Europe was the strongest performer on a relative basis, with a return of 20%. China was the poorest relative performer, declining 9.7%. Emerging markets stocks were slightly higher, as the MSCI Emerging Markets Index rose by 0.9%.



Outlook

The global economy is having difficulty finding its footing. Having survived the tumult caused by the pandemic, the economy is now being buffeted by tighter monetary policy enacted by central banks as they attempt to bring down still-elevated inflation. Economists anticipate that global GDP growth will slow to an estimated 2.2% in 2023, below the 3% rate of 2022. At this point, economists are divided on growth prospects going forward, with many maintaining that recession is on the horizon while others acknowledge that economies have remained resilient and may continue to grow. Inflation continues to be stubbornly high, and though the rate has eased from its peak, the FOMC is expected to resume interest rate increases again in July. FOMC policymakers estimate the target fed funds rate will end 2023 at 5.63% before declining in 2024. The situation in areas outside of the US is also murky. Europe seems to have also averted a recession, and sentiment in the euro zone and the UK is beginning to trend higher. China's growth has also accelerated after it abandoned its zero-COVID policy, but its economy has a heavy reliance on the property market, which has shown signs of stress over the past year. In terms of equities, the rise in stock prices this quarter was not entirely expected, and indicates that investors may be anticipating a better earnings environment going forward.

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INDEX OVERVIEW

The **Dow or DJIA** (Dow Jones Industrial Average) is an unmanaged index of 30 common stocks comprising 30 actively traded blue chip stocks, primarily industrials, and assumes reinvestment of dividends. The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **S&P 500 Index** is an unmanaged index comprising 500 widely held securities considered to be representative of the stock market in general. The **DJ US Select REIT Index** is a subset of the Dow Jones Americas Select RESI and includes only REITs and REIT-like securities (The Dow Jones US Select Real Estate Securities Index (RESI) represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the US). The **Bloomberg Commodity Index** is a broadly diversified commodity price index that tracks prices of futures contracts on physical commodities on the commodity market, and is designed to minimize concentration in any one commodity or sector. The **MSCI EAFE Index** is recognized as the preeminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia, and the Far East. 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. The **MSCI ACWI Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indices comprising 23 developed and 23 emerging markets country indices. The **MSCI Emerging Markets (EM) Eastern Europe Index** captures large and mid cap representation across four emerging markets (the Czech Republic, Hungary, Poland, and Russia) countries in Eastern Europe. With 52 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in each country. The **MSCI EM (Emerging Markets) Latin America Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of emerging markets in Latin America. The **MSCI ACWI Ex-US Index** is a market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI) and designed to provide a broad measure of stock performance throughout the world, with the exception of US-based companies. The **MSCI China Index** captures large and mid cap representation across China H shares, B shares, Red chips, and P chips covering about 85% of this China equity universe. The **Bloomberg Barclays Municipal Bond Index** is an unmanaged index comprising investment-grade, fixed-rate municipal securities representative of the tax-exempt bond market in general. The **Bloomberg Barclays Global Aggregate ex-US Index** is a market-capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most US-traded investment-grade bonds are represented. Municipal bonds and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The Index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in the US. The **Bloomberg Barclays US 5-10 Year Corporate Bond Index** measures the investment return of US dollar-denominated, investment-grade, fixed-rate, taxable securities issued by industrial, utility, and financial companies, with maturities between 5 and 10 years. Treasury securities, mortgage-backed securities (MBS), foreign bonds, government agency bonds, and corporate bonds are some of the categories included in the Index. The **Bloomberg Barclays Capital US 5-7 Year Treasury Bond Index** is a market-capitalization-weighted index, and includes Treasury bonds issued by the US with a time to maturity of at least 5 years, but no more than 7 years. The **Russell 1000 Index** is a market-capitalization-weighted benchmark index made up of the 1000 largest US companies in the Russell 3000 Index (which comprises the 3000 largest US companies). The **Russell 2000 Index** is an unmanaged index considered representative of small cap stocks. The **Russell 3000 Index** is an unmanaged index considered to be representative of the US stock market, and measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The **Russell Midcap Index** is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The **Housing Market Index** (HMI) is based on a monthly survey of **NAHB** members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months, as well as the traffic of prospective buyers of new homes. The **JPMorgan Emerging Market Bond Index** (EMBI Global) tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the JPMorgan EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million. The **CBOE Volatility Index** (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index.

DEFINITIONS

The **Federal Open Market Committee** (FOMC) is the monetary policymaking body of the Federal Reserve System. The **federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **European Central Bank** (ECB) is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power, and thus price stability, in the euro area. The euro area comprises the 19 European Union countries that have introduced the euro since 1999. The **Gross Domestic Product** (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. The **Bureau of Labor Statistics** (BLS) is a unit of the United States Department of Labor. It is the principal fact-finding agency for the US government in the broad field of labor economics and statistics, and serves as a principal agency of the US Federal Statistical System. The **Bureau of Economic Analysis** (BEA) is an agency in the US Department of Commerce that provides important economic statistics, including the gross domestic product of the US. It is a governmental statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the American public, the US Congress, other Federal agencies, state and local governments, business, and labor representatives. The **PCE (Personal Consumption Expenditure) Index of Prices** is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data, including US Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures, and is essentially a measure of goods and services targeted towards and consumed by individuals. Sector performance is represented by the **Global Industry Classification Standard** (GICS) sectors, developed by Standard & Poor's and MSCI Barra.

Octavia Wealth Advisors
9999 Carver Road, Suite 130
Cincinnati, OH 45242
T: 513.762.7701, F: 513.762.7741