ACROPOLIS®
INVESTMENT MANAGEMENT

PORTFOLIO INSIGHTS

July 2023: Volume 22, Issue 3 // David Ott, Editor

In this Issue:

Contact us:

P | (888) 882-0072 (Toll Free)
| (636) 449-4900 (St. Louis)
F | (888) 453-1266 (Toll Free)
| (636) 778-2400 (St. Louis)
E | info@acrinv.com
A | 14567 North Outer Forty, Ste. 200,
St. Louis, MO 63017

Acropolis was born from a simple idea:

In an industry where high quality, objective advice is hard to come by, we make a difference by putting the client's interests above our own.

STOCKS HIGH-FIVE INVESTORS

Markets have a way of surprising investors. At the outset of 2023, for example, the median year-end estimate for the S&P 500 was 4,000, as forecast by the 17 most prominent Wall Street strategists and compiled by Bloomberg.

That price target implies a total return of about 5.75 percent for the year when you include the dividend yield. However, the S&P 500 is up 16.9 percent so far this year – almost triple the estimates and only halfway through.

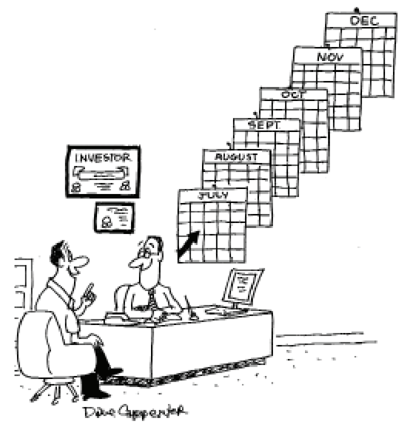
A good amount of the outsized returns this year are because of the recent infatuation with stocks related to artificial intelligence, or AI.

About three-quarters of this year's gain can be attributed to about a dozen stocks, and they're all effectively technology firms.

Although it's impossible to sort out precisely, the other gains probably are due to improved sentiment about corporate profits and the economy.

Last quarter, profits fell by slightly more than one percent, which isn't terrific, but their expectations were even worse.

The economy is also faring better than expected, with positive economic surprises in housing, the industrial sector, the labor market, and retail.



"I like your optimism for the rest of this year."

Most forecasters are still calling for a recession, but it's been "postponed" until next year, and the idea of a "soft landing" is increasingly discussed as a viable outcome.

Of course, as noted at the top, markets have a way of surprising investors. Last year at this time, pundits emphasized how the first six months of 2022 were the worst first half of the year on record.

What did the market do in the second half of the year? It rose by two percent in the second half of the year and almost 20 percent in the following 12 months.

The unpredictable nature of markets is a source of caution, optimism, and, all too often, surprise.

> “The more we value things outside of our control, the less control we have.”
>
> *- Marcus Aurelius, Last Roman Emperor*

STOCK MARKET SUMMARY

By David Ott

All the major stock indexes enjoyed positive results in the second quarter, and the S&P 500 enjoyed the most substantial gains as investors fell in love with companies related to artificial intelligence, or AI.

There is no better poster child for this than Nvidia, which uses hardware and software to develop AI. The stock jumped 52.3 percent in the second quarter and is now up 189.5 percent for the year. As a result, it is the fourth largest stock in the world by market capitalization, which exceeds $1 trillion.

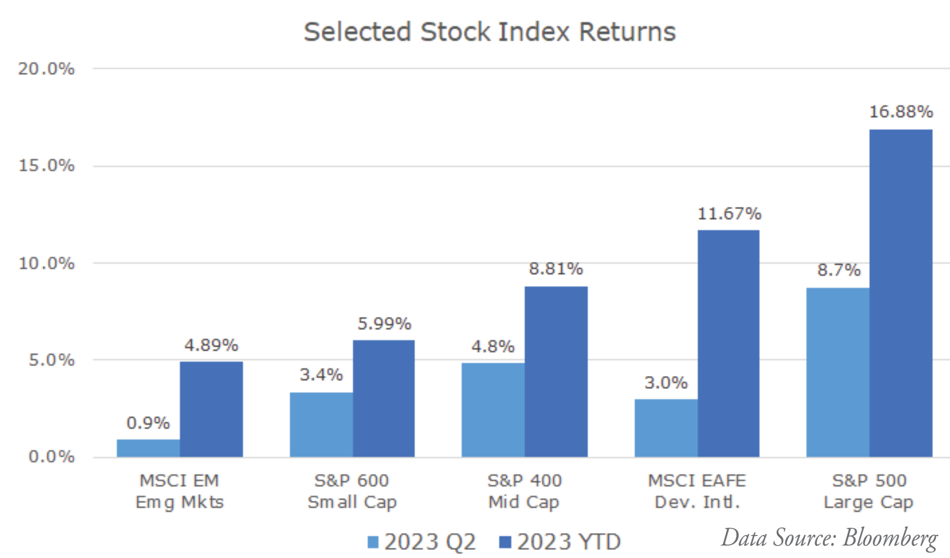
Nvidia’s performance alone was worth 1.1 percent of the 8.7 percent gain in the third quarter; about three-quarters of the S&P 500’s performance comes from about a dozen stocks.

Furthermore, almost all of those stocks fall into what we often think of as technology stocks. The technology sector was responsible for about half of the market performance, but the other two sectors that made up most of the performance have a lot of tech stocks. Amazon and Tesla, for example, are technically consumer discretionary stocks, even though we think of them as technology. The same applies to Meta and Netflix, which are officially in the communications sector.

Technology stocks are up 42.1 percent for the year, communications are up 35.6 percent, and consumer discretionary stocks gained 32.3 percent. Although industrials and materials are up mid-single digits, five sectors are down for the year.

As a result, growth stocks are outperforming value stocks this year, with the S&P 500 Growth Index up 21.2 percent and the S&P 500 Value Index up 12.1 percent.

Growth dramatically underperformed value last year, which meant that momentum indexes switched their holdings to value stocks at the end of the year and missed the rally. The S&P 500 Momentum index is flat for the year, despite the substantial gains in growth and value stocks, which is classically known as a ‘whipsaw.’



Data Source: Bloomberg

BOND MARKET REVIEW

By Ryan Craft, CFA

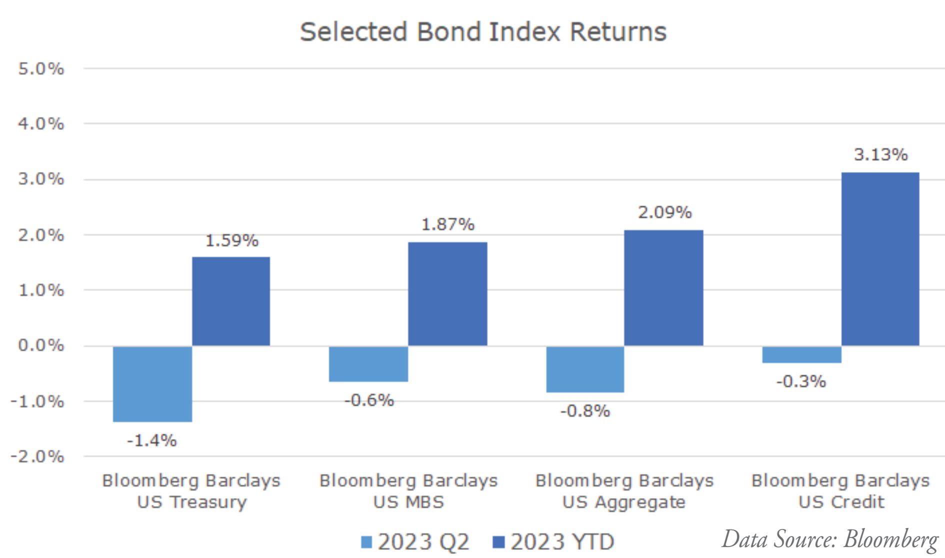
For the first time in over a year, volatility in the bond market began to normalize. Yields remained relatively stable throughout the second quarter before rising slightly in June. For the quarter, interest rates rose about 50 bps across the yield curve while credit spreads compressed. Safe Treasury bonds performed the worst of all major bond sectors, while credit-related securities performed the best.

The Federal Reserve continued to push short-term rates higher as inflation remained higher than its long-term target of two percent. The overnight Fed Funds rate was raised by 25 bps to 5.2 percent. At the June meeting, the Fed decided to take a break for the first time in this cycle and kept rates unchanged. While employment has remained robust, some production gauges have begun to slow this year. Inflation has been decelerating yet remains too high.

The market expects the Fed to hike rates again in July by 25 bps, which will be the peak for this hiking cycle. The yield curve has become extremely inverted, with long-term yields stuck around four percent yet short-term bills earnings at 5.5 percent. This spread is the most inverted the yield curve has been since 1981.

An inverted yield curve is a sign of a very tight monetary policy. Every time the curve has inverted, a recession has followed within a year, so many expect the US economy to enter a recession shortly. However, economic activity has remained relatively strong despite the steep inversion. This tightening cycle has slowed the economy and inflation longer than many expected. The Fed may have to push rates higher than expected to get the inflation genie back in the bottle, or it could just be that there is a longer lag in feeling the effects of the monetary policy compared to past periods due to the excess liquidity present. This is the dilemma that the Fed is currently facing.

The good news for bond investors is that bond yields remain attractive. Earning a five percent yield on a safe asset looks very attractive and provides a nice cushion for any additional yield increases in the future.



Data Source: Bloomberg

“The more we know, the more we realize there is to know.”

- Dr. Jennifer Anne Doudna
American Biochemist

UNDERSTANDING STOCK BUYBACKS

By David Ott

"It ain't what they call you, it's what you answer to."

- W. C. Fields
American Actor & Comedian

Companies' capital decisions aren't usually very controversial: paying down debt, paying a cash dividend, or upgrading facilities.

Stock buybacks, however, are another story: they generate a lot of controversy. Before getting into the debate, let me take a minute to describe a buyback.

When companies have extra capital, they sometimes "buy back" their own stock in the open market (hence the name buyback).

When a company buys back its shares, it reduces the number of shares outstanding, which increases the ownership percentage of the remaining shareholders. It also increases the earnings per share because the same profits get distributed across fewer shares.

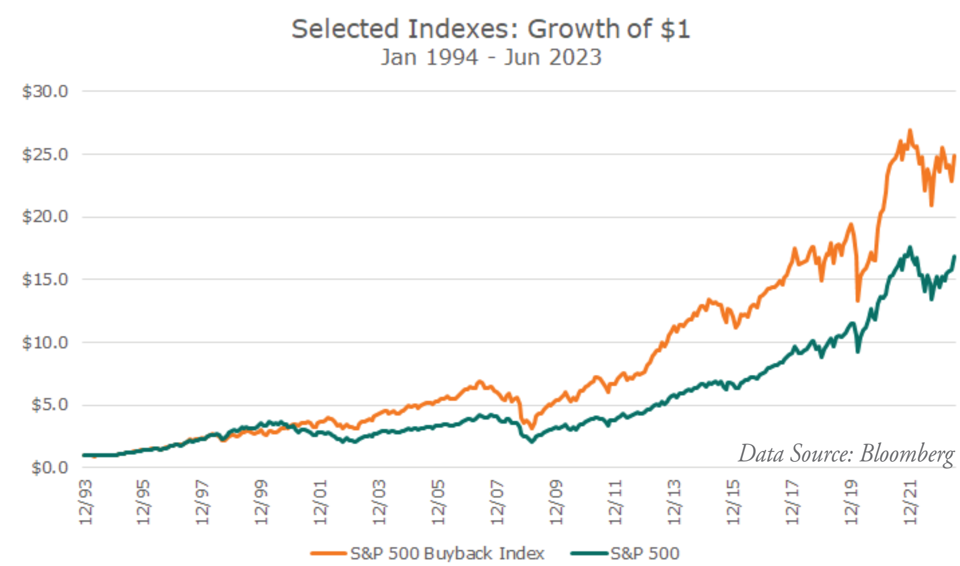
That hardly seems controversial, but critics argue that buybacks boost a company's stock in the short term at the expense of long-term investment.

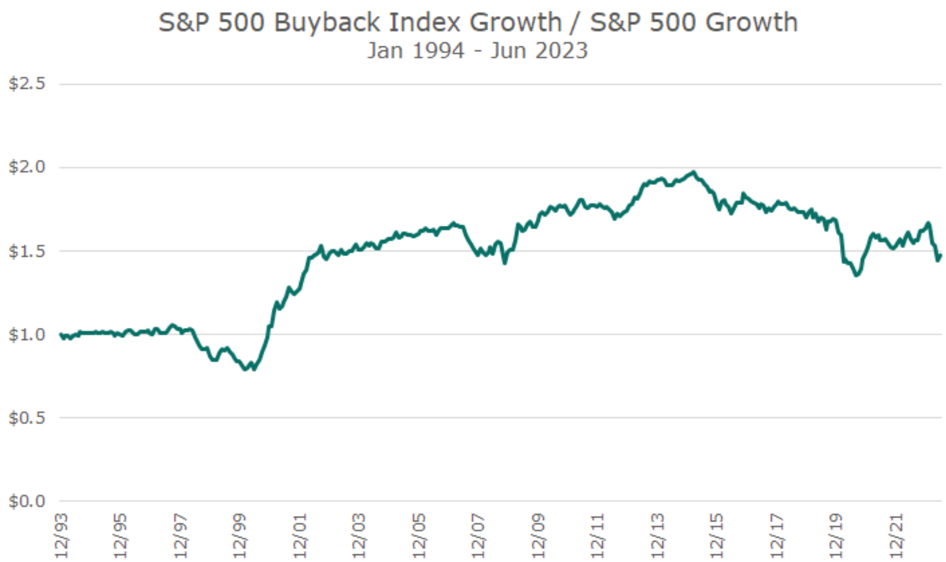
In other words, a management team that is compensated based on the share price over the next year might opt for a buyback even if the company might be better off in the long run if it puts more money into research and development or employee training.

But that's also true with cash dividends, which hardly generate much heat. The difference here often boils down to politics. Proponents of buybacks like them because they are a tax-efficient way to return cash to shareholders because, until recently, buybacks weren't taxed.

That also makes buybacks unpopular with critics, who say that companies are cheating the government out of tax revenue that they would pay with dividends.

Personally, I'm okay with buybacks because I want companies to return capital to shareholders, and I prefer less taxes to more. I don't want to debate tax policy, but I always thought dividends were unfairly taxed because the company pays tax on the profits,





and then shareholders have to pay tax when the profits are distributed to the shareholders.

I also think some of the critiques of buybacks are true, but for every example of harmful use of buybacks (I'm looking at you, General Electric), I think there are good examples too.

At the same time, I don't think investing more heavily in companies buying back their stock leads to excess returns.

I analyzed the S&P 500 Buyback index, which equally weights the 100 stocks in the S&P 500 with the largest stock buyback programs.

The annualized return for the S&P 500 Buyback Index has been 11.5 percent since its inception in 1994, which is 1.5 percent better than the S&P 500's 10.0 percent annualized return over the same period. The two indexes are shown on the opposite page.

Whenever I compare two indexes, I always look at the growth of the index I'm interested in (the buyback index in this case) compared to the growth of the benchmark index. This method strips out the overall market performance and allows me to more closely evaluate the excess return of the index I'm interested in.

By removing the market's impact, we can see four distinct phases for the outperformance of the buyback index. The first phase, in the 1990s, shows the results were essentially the same. The buyback index underperformed slightly in the late 1990s, but that led to the second phase when there was a sharp period of outperformance of the buyback index that lasted for two years.

The buyback index steadily outperforms until about 2014, reversing course and underperforming until recently. You can say that all of the outperformance occurred in a two-year period about 20 years ago, which is hardly a compelling investment case.

Perhaps not surprisingly, there is no remarkable return associated with buybacks - most of the excess return occurred in a brief period decades ago or can be explained by common factors like value and quality.

"Before anything else, preparation is the key to success."

- Alexander Graham Bell, American Engineer & Inventor

“Nothing is a waste of time if you use the experience wisely.”

- Auguste Rodin, French Sculptor

INSIDE THE ECONOMY: INFLATION

By: David Ott

At this time last year, the Consumer Price Index (CPI) registered an 8.6 percent increase over the previous year, and it was unclear where it might stop.

Although we wouldn't know it for some time, the next month's reading would be the highest at 9.1 percent, and the headline rate would begin steadily decelerating to four percent, where it stood as of May 31st, our most current reading.

While that is undoubtedly good news, it is far too soon to say that we've ‘broken the back’ of inflation.

The first issue is that the core inflation rate isn't decelerating as fast as the headline rate. The core rate excludes food and energy prices because they are so volatile.

When inflation rises, and I mention the core rate, people get frustrated because they can easily remember a recent trip to the gas station or grocery store where they had to pay unreasonably high prices.

But, as we see in the chart below, the headline rate is more volatile, starting below the core rate, rising well above the core rate, and falling below it again.

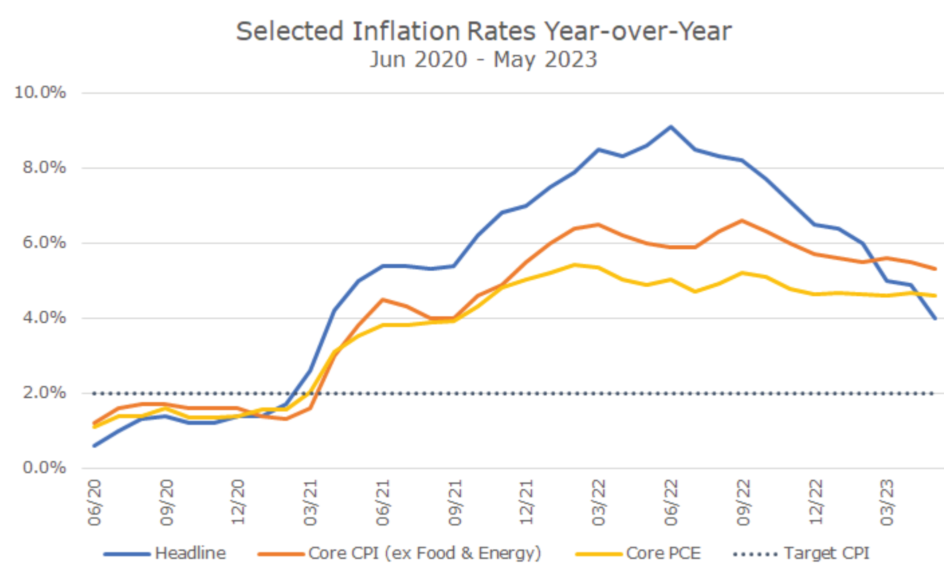
The core rate does a better job of explaining the overall level of inflation, which is why it deserves our focus.

The core rate is now higher than the headline rate by more than a whole percentage point and stands at 5.3 percent as of May.

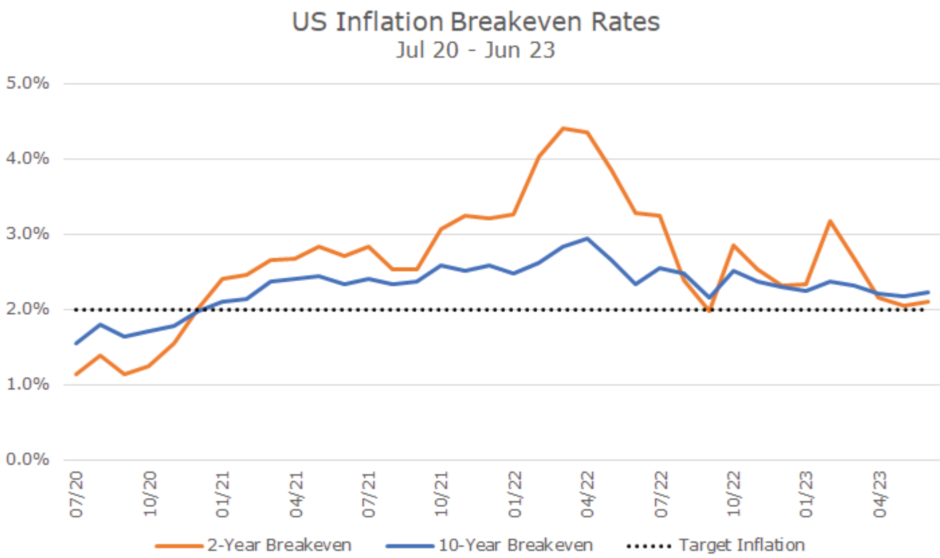
The second issue is that the core rate isn't decelerating very quickly. It peaked at a much lower rate, 6.6 percent, in September.

If core CPI decelerated at the same pace as it has since it peaked, it would take nearly two years to reach the Federal Reserve's two percent target inflation rate.

That leads to the third issue, which is that the Fed is less concerned about a two percent target for CPI as they are



Data Source: Bloomberg



about a two percent target for their preferred inflation rate, known as the Personal Consumption Expenditure (PCE).

PCE differs from CPI because it measures all inflation, not just the inflation consumers face. For example, a lot of healthcare inflation isn't captured in CPI because consumers don't pay for healthcare directly.

The PCE peaked earlier than CPI last February at 5.4 percent. Since then, it's decelerated too and was 4.6 percent as of May. That's more than double the Fed target of two percent, and if it continued to decelerate at this pace, it would take four years to get to the Fed's target.

There is evidence that the inflation rate will continue to drop because the housing data is significantly lagged and isn't fully reflected in the data.

That's partly why the bond market believes inflation will return to the two percent target in the short run. The chart above shows those expectations by comparing the yields on standard Treasury notes and Inflation-Protected Treasury securities (TIPs).

The difference is called a 'breakeven' and indicates the market view of inflation over various time frames. The chart above shows the breakeven rate for the two-year and 10-year maturities.

You can see that inflation expectations rose above the two percent rate when inflation was rampant but have cooled down to the target levels.

As a result, the Fed decided to pause its interest rate hiking campaign but also strongly indicated that another hike or two is likely.

The Fed governors are in a challenging position. They don't want to be like Arthur Burns, who let inflation run out of control in the 1970s.

They want to be like his successor, Paul Volker, who successfully broke inflation, but they want to do it without enduring the two recessions that Volker's policies brought on—no easy task.

"Wealth is the slave of the wise man and the master of a fool."

- Seneca the Younger
Roman Philosopher

Major Indexes	2023 YTD
Dow Jones	4.94%
S&P 500	16.88%
S&P 400 Mid-Cap	8.81%
S&P 600 Small-Cap	5.99%
MSCI EAFE (Intl)	11.67%
MSCI Emerging Mkt	4.89%

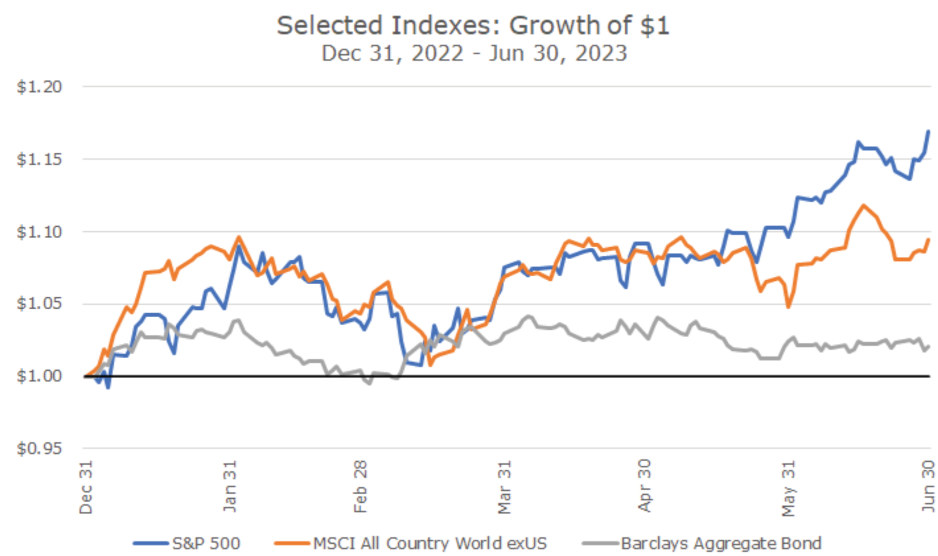
Equity Styles	2023 YTD
S&P 500 Growth	21.24%
S&P 500 Value	12.13%
S&P 500 Quality	15.72%
S&P 500 Momentum	-0.09%

S&P Sectors	2023 YTD
Basic Materials	7.74%
Communications	36.24%
Consumer Discretion.	32.97%
Consumer Staples	1.28%
Energy	-5.55%
Financials	-0.53%
Healthcare	-1.48%
Industrials	10.19%
REITs	3.72%
Technology	42.77%
Utilities	-5.69%

Interest Rates	2023 Q2
Fed Funds	5.25%
Prime Rate	8.25%
3-mo. Treasuries	5.30%
2-yr. Treasuries	4.90%
5-yr. Treasuries	4.16%
10-yr. Treasuries	3.84%

All Data as of 06/30/23

THE BIG PICTURE



FAST FACTS: TRILLIONS

12: The number of zeros in a trillion: 1,000,000,000,000. It's equal to 1,000 billion or 100,000 million.

5: The number of stocks with a market value of over $1 trillion. The largest stock is famously valued at over $3 trillion, and the second largest is valued at more than $2 trillion. The ten largest stocks in the S&P 500 are worth $12 trillion. The Wilshire 5,000, which attempts to capture the value of all publicly traded US stocks, is valued at $42.3 trillion.

$25.5 trillion: The size of the US economy in 2022, as measured by Gross Domestic Product (GDP). The "Buffett Indicator" measures the stock market's value to the size of GDP and currently stands at 1.65x, higher than the long-term average of about 1.0x.

$31.5 trillion: As long as we're discussing unfathomably large numbers, the total federal debt outstanding is $31.5 trillion at the end of the first quarter and about 10x the size of the most expensive US stock.

Notice to Clients

Please remember to contact ACROPOLIS® Investment Management, LLC if there are any material changes to your financial situation or investment objectives or if you wish to impose, add or modify any reasonable restrictions to our investment management services. A copy of our current written disclosure statement as set forth on Part II of Form ADV continues to remain available for your review upon request.

Legal Disclaimer