COLONIAL TRUST COMPANY
EST 1913

3RD QUARTER
2023

COLONIAL TRUST *Quarterly*

IN THIS ISSUE

REVIEW OF THE 2ND QUARTER'S RETURNS

THE EQUITY MARKET'S RESILIENCE CONTINUED IN THE SECOND QUARTER, WITH THE S&P 500 RETURNING 8.8% FOR THE QUARTER AFTER POSTING A 7.5% RETURN IN THE FIRST QUARTER.

The outperformance of the tech-heavy Nasdaq Composite index also continued. The Nasdaq returned 13.1% for the quarter, putting the year-to-date return for the index at 32.3%. This marks the best first half for the Nasdaq since 1986, according to Dow Jones Market Data. The Dow Jones Industrial Average lagged other large cap indices, posting a 4.0% return for the quarter and returning 4.9% year-to-date.

For the quarter, the small cap Russell 2000 index returned 5.4%. While major domestic indices were strong, international markets were muted. The developed market index, MSCI EAFE, returned 3.2% and the MSCI Emerging Markets Index turned positive on the last day, posting a 1.0% return.

The bond market, as measured by the Bloomberg Aggregate Bond index, was negative, down 0.8%. We began the quarter with low bond yields, coming off the banking issues in March. During the quarter, economic data was largely better than expected and put upward pressure on bond yields, causing this negative performance. April began with fears that banking failures would lead the Fed to pivot and begin cutting rates. Economic strength and continued inflationary pressures have reversed those forecasts. The Fed raised rates in their June meeting and the market now expects two more 0.25% rate hikes this year. This caused the benchmark 10yr Treasury yield to increase from 3.47% on 3/31/23 to 3.82% on June 30th.

MARY KATHERINE ANDERSON
Client Service Coordinator

IN THE SPOTLIGHT

Mary Katherine (Wise) Anderson joined the Colonial Trust Spartanburg office in July 2021. Before joining Colonial, Mary Katherine worked as Client Specialist in the BB&T/Truist Wealth office in Greenville. She has led the transition to our new Black Diamond Portfolio Management system. Since Carolyn's retirement, Mary Katherine has taken a greater role in assisting Lorie Barton. She takes great pride in helping our clients succeed financially.

Mary Katherine grew up in Spartanburg, and lives in town with her husband Joe. She is a graduate of Furman University. Mary Katherine and Joe are members of Westminster Presbyterian Church. She enjoys traveling, yoga, and needlepoint.

ECONOMIC REPORT

ECONOMISTS AND MARKET PARTICIPANTS HAVE BEEN ON HEIGHTENED ALERT FOR A RECESSION FOR OVER A YEAR.

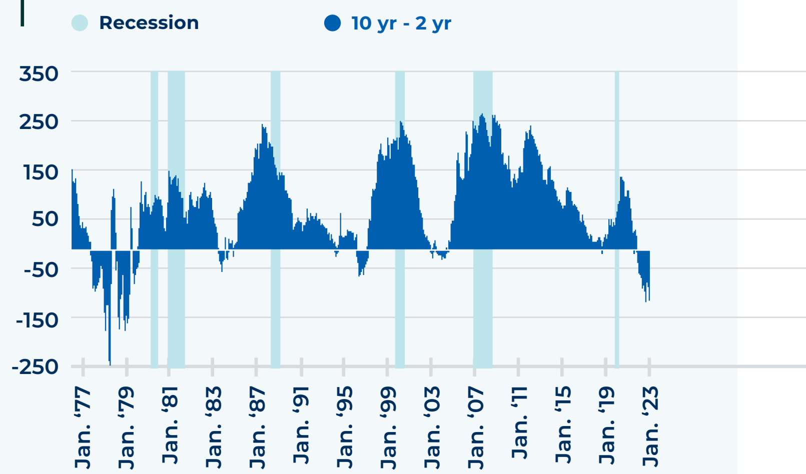
The probability of recession compiled from a Bloomberg survey of 58 economists has been above 50% since October and 65% since December. We ran a search on Google at quarter-end for "The Recession that never came" and found 110 million results in 0.46 seconds. Economists have been puzzled by divergent signals from economic data and are trying to tease out relevant information from lagging, coincident, and leading economic indicators.

The yield curve is likely the most cited recession indicator, with a yield curve inversion signaling a recession is on the horizon. A curve inversion occurs when short-term yields are higher than long-term yields, suggesting the market believes the Fed is raising short-term rates too high and will push the economy into recession and curtail demand for credit in the future. There are several ways to measure the curve, but the two most cited are the 3-month Treasury to 10-year Treasury and the 2-year Treasury to 10-year Treasury. The 10yr-3mth yield inverted in November and the quarter ended with the 3mth Treasury yield 1.5% higher than 10yr yields. The 10yr-2yr yield has been negative since July 2022 and the 2yr is currently 1.05% higher than 10yr yields. The last time the 10yr-2yr yield was as negative was the early 1980s.

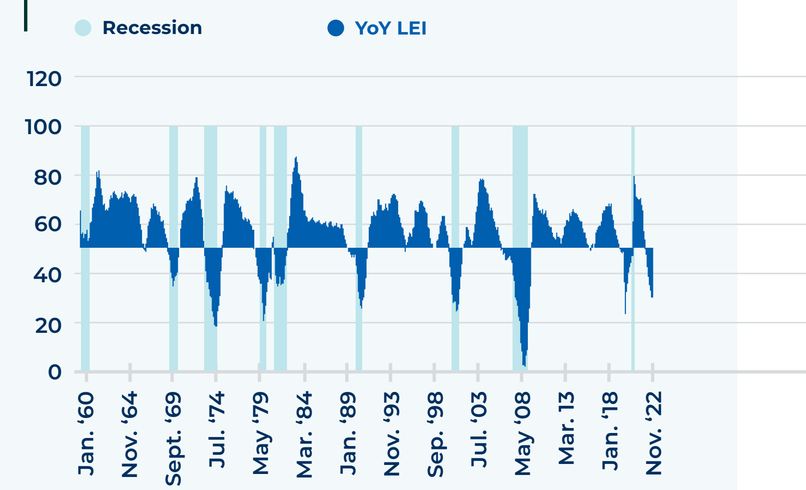
WHILE CURVE INVERSIONS HAVE PRECEDED PREVIOUS RECESSIONS, THE LEAD TIME CAN VARY.

The Conference Board publishes an index of leading economic indicators (LEI), which uses ten different economic indicators to assess the direction of the economy. The year-over-year change in the LEI turned negative in July 2022. This index dates to 1960 and has never been so deeply negative without a recession. The notable weakness in the LEI is in new manufacturing orders and consumer expectations for business conditions.

10YR-2YR CURVE



YOY CHANGE IN LEI

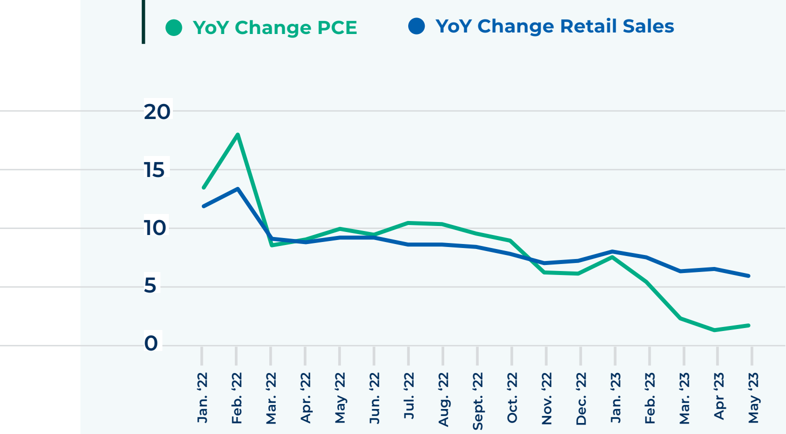


These two tried and true recessionary indicators have been flashing warning signs for over a year but the US economy continues to surprise to the upside. This has caused economists to push back their forecasts for a recession. When 2023 began, the Bloomberg Survey of economists forecast weak GDP growth in 1Q and a decline in the middle of the year. This week, 1Q GDP growth was revised higher to 2.0% and the consensus for 2Q was 1.2%, while the Atlanta Fed GDPNow Forecast is

2.2%. The full year projections from Bloomberg increased from 0.3% in January to 1.3% today. Economists and market participants remain concerned that the recession may come but continue to postpone its inception.

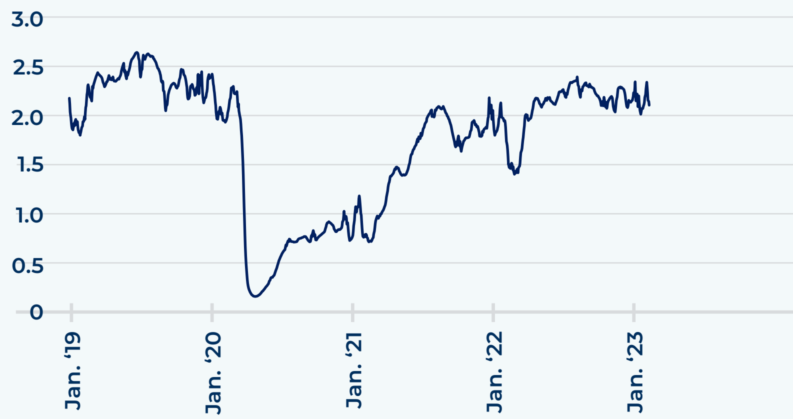
The economic strength continues to be led by the consumer, with employment remaining strong. Job growth remains robust, with 1.57 million jobs created in the first five months of the year. The unemployment rate rose in May to 3.7% from 3.4% but did so because more people entered the workforce. Wage growth outpaced inflation on a year-over-year basis in May for the first time since March 2021. Nominal personal income growth year-over-year has been 5.5% in each of the last three months. When the US consumer is working and seeing wage gains, they reliably spend. Measures of consumer spending have slowed from the reopening levels of 2021 and 2022 but remain positive.

CONSUMER SPENDING



The annual growth rate of retail sales has slowed from 7.4% in January to 1.6% in May. This is partially explained by the base effects of double-digit growth in retail sales of 2022. Personal consumption expenditures (PCE) is a broader measure of consumer spending that includes services. PCE growth moderated as well, but not to the extent of retail sales, falling from 8.1% in January to 6.0% in May. The divergence in these measures is due to changing consumer preferences towards services, entertainment, and travel. We have all seen packed restaurants, hotels, and airports in 2023, providing anecdotal evidence of this shift. Our experience is echoed by TSA checkpoint data, which shows that passenger levels have returned to 2019 levels.

TSA TRAVELERS - 7DAY AVERAGE (MILLIONS)



DURING THE QUARTER, THE NEW HOME MARKET SHOWED SIGNS OF A REBOUND.

Demand for homes remains depressed versus 2020 and 2021 levels when low mortgage rates fueled outsized demand. However, demand has bounced from the year-end lows and home sales are up 8.5% from December through May. Most existing homeowners have mortgage rates below 3.5% and are "locked" into their home. For that reason, existing home sales are up only 6.7% over that period, while new home sales are up 20%. With much of the inventory effectively "off the market" home builders are bringing new supply to meet this rebound in demand. New home construction creates more economic activity than selling an existing home, allowing housing to be additive to growth, reversing its large drag on growth in 2022.

This leaves us with macro-economic indicators signaling recession and a strong, employed consumer who seems not to be participating in the slowdown. This dichotomy is well-captured in the National Federation of

Independent Businesses (NFIB) Optimism Index. This survey asks businesses a set of ten questions regarding their outlook for the economy. The most recent survey reading was 89.4, which is below the 90.9 reading in April 2020 – during the lockdowns. However, the two questions about employment have readings above the overall index since 2021. The readings for Job Openings and Plans to Hire have diverged from the other eight questions by a degree never seen in the 40-year history of the index. This is echoed in the job openings report (JOLTs) from the BLS. The April JOLTs report showed 10.1 million job openings in the country, which is 1.7 jobs for every unemployed person. Unemployment claims rose during the quarter, with the 4wk moving average up 8.3% during the quarter to 258,000. During the last three recessions, excluding COVID, unemployment claims were between 350,000 and 400,000 when the recession began.

WE BELIEVE THE ECONOMY CAN CONTINUE TO GROW AND FORESTALL A RECESSION AS LONG AS EMPLOYMENT REMAINS STRONG.

A change in employment could be caused by several factors, including higher inflation and a hawkish Fed. CPI headline inflation has fallen from 9.1% in June 2022 to 4.0% in May, with moderation in prices for goods, energy, and food. However, services inflation remains sticky, forcing the Fed to continue their hawkish policy. After ten consecutive rate hikes brought the Fed Funds rate from zero to 5.25%, the Fed paused in their June meeting. Chair Powell has been crystal clear the Fed was not done with rate hikes and has guided the market to expect two more ¼ point hikes this year. This would bring the rate to 5.5%-5.75% and we expect the Fed to maintain that level of rates into 2024. This would further slow the economy in the second half of the year.

Another risk to the economy and the consumer is the resumption of student loan payments in September after a three-year hiatus of those monthly payments. This could affect 40 million borrowers and a study by Goldman Sachs and the Treasury estimates this will be approximately $84 billion annually of spending power that will be allocated to debt service. Wall Street retail analysts estimate this could reduce retail sales between 1%-2% at a time when annual retail sales growth is 1.6%. This reduction in spending may cause a reduction in hiring and possibly layoffs for retailers and providers of discretionary services.

For the economy to move into recession, we would need to see these factors result in widespread job loss. It has been our contention that we would see a reduction in job openings before we see mass layoffs. Employers faced tremendous difficulty hiring when the economy reopened post-COVID and they will seek to prevent a repeat of that misadventure. However, if inflation persists, the Fed tightens too much, or a student loan induced retail-pullback occurs, it is possible we would see a reduction in both job openings and employment levels. As it stands today, we have not seen demonstrable evidence that higher rates are causing broad-based weakness in employment. To the contrary, the market and the Fed have been surprised by the resilience of the consumer and the labor market.

At some point the US economy will enter a recession and the inverted yield curve and falling LEI will have preceded the recession. But currently, it looks like we will stretch the length of time between these signals and the economic weakness they portend.

MARKET OUTLOOK INTO THE BACK HALF OF 2023

AS MENTIONED ABOVE, THE INTEREST RATE MARKETS REBOUNDED FROM THE MARCH LOWS AND MOVED HIGHER ACROSS THE YIELD CURVE.

The short-end of the curve moved more sharply than longer-term yields, with the 1mth T-Bill rate up by 0.61%. The Fed has been clear in its communication that it intends to continue to raise rates to reduce inflation and has brought the bond market to the point of believing that is the case. We expect the yield curve will remain inverted for the foreseeable future and that rates will remain at these levels or slightly higher. The strong economic growth is pressuring the Fed to remain hawkish and establish a floor on rates for the intermediate term. It would take pronounced weakness in the economic data and rapidly falling inflation to cause the Fed to reverse course.
On the positive side, as the banking crisis gets further behind us and the economy continues to perform well, we are seeing the spread for corporate borrowers over Treasuries fall. The measure of BAA borrowers' 10yr premium over 10yr Treasury yields has fallen from 2.35% in March to 1.83% as the quarter ended. Additionally, the ICE BofA Move Index, which measures volatility in the treasury market has fallen from 199 in March to 113 at quarter-end. This paints a picture of improved bond market functioning, even with higher rates.

	1 mth	3 mth	6 mth	1 yr	2 yr	5 yr	10 yr	30 yr
3/31/2023	4.532%	4.75%	4.88%	4.62%	4.03%	3.58%	3.47%	3.65%
6/30/2023	5.141%	5.30%	5.44%	5.41%	4.88%	4.13%	3.82%	3.85%
Change	0.61%	0.55%	0.56%	0.79%	0.85%	0.56%	0.35%	0.20%

The equity market performance in 2023 has not been uniform. The financial press has been littered with stories about the narrowness of this rally. Apple, Microsoft, Nvidia, Amazon, and Meta have been responsible for most of the S&P 500's gains this year. In fact, the quarter ended with the market capitalization of Apple crossing $3tn, which puts it on par with the GDP of France, the world's 7th largest economy. These mega-cap tech stocks have seen a phenomenal first half of the year, but in the third quarter we expect to begin to see strength in other market sectors. This would be a continuation of June's returns, where consumer discretionary, industrials, materials, energy, and financials outperformed the technology sector. This indicates the rally is beginning to broaden beyond a handful of mega cap growth stocks.

THE DIVERGENCE BETWEEN THE S&P 500 AND THE S&P 500 EQUAL-WEIGHTED INDEX CONTINUED IN THE QUARTER, WITH THE LATTER RETURNING 3.0% COMPARED TO 8.8% FOR THE CAP-WEIGHTED INDEX.

However, for the month of June, the equal-weighted index returned 5.9% while the S&P 500 returned 5.6%. This also points to a broadening of the rally. Another measure of market breadth is the percentage of companies trading above their 200-day moving average price. At the end of May, 41.5% of companies in the S&P 500 were trading above this measure. During June, this increased to 64.9%.

The shift in leadership towards more cyclical sectors, June's out-performance of the equal-weighted S&P against the market weight index, and the increasing number of S&P 500 companies trading above their 200-day moving averages point to a healthy market, less dependent on a few large cap companies.

	June	2Q Returns	YTD Returns
Energy	6.93%	-1.12%	-5.41%
Materials	11.01%	3.25%	7.67%
Industrials	11.26%	6.50%	10.16%
Consumer Discretionary	12.23%	13.78%	32.14%
Consumer Staples	2.79%	-0.01%	-0.68%
Healthcare	4.26%	2.95%	-1.52%
Financials	6.62%	5.33%	-0.50%
Technology	6.05%	15.37%	40.32%
Utilities	1.61%	-2.54%	-5.74%
Real Estate	5.59%	1.81%	3.77%
Communication Services	4.73%	12.45%	36.20%

As we begin the second half of the year, the direction of equities will likely be a function of the direction of earnings. Estimates for 2023 earnings growth have been falling for over a year as higher interest rates and lower profit margins dampened growth forecasts. In the first quarter, results exceeded analysts' forecasts with 76.6% of the S&P 500 companies posting results higher than expected. Additionally, the consensus from managements' guidance has been things are not deteriorating, but rather are stabilizing. This has led Wall Street estimates to stabilize after 12 months of reducing expectations. In the spring of 2022, Wall Street expected 2023 earnings growth to be 26.4% and these reductions in estimates have brought growth forecasts to 10.4%.

DURING MARKET CYCLES, ANALYSTS OFTEN BECOME TOO OPTIMISTIC IN THEIR EXPECTATIONS, WHICH ARE THEN CALLED INTO QUESTION, USUALLY BY OTHER ECONOMIC FACTORS – LIKE HIGHER INTEREST RATES.

Estimates are then quickly reduced to reflect this new reality, which often becomes too pessimistic. Typically, with the last downgrade to earnings estimates, companies report things are not as bad as expected and Wall Street ceases reducing expectations and begins to raise estimates for growth. We may indeed be starting this process for this cycle.

Valuation ratios of the market have increased with this rally, with the forward P/E ratio of the index ending the quarter at 19.2x, up from approximately 15.0x at the October lows. The forward P/E for the median stock in the S&P 500 is lower at 16.8x. Both measures are above their 40-year average metrics, but the premium for median stock is 9%, versus a 21% premium for the broad market. As we have discussed, much of the year-to-date results have been driven by mega cap returns, although June may foster new leadership. The forward P/E of the S&P 500 without Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla is 16.5x and is below the levels seen in 2020-2022. The forward P/E of those eight stocks is 31.0x and accounts for the uptick in valuations in 2023.

As we begin the second half of 2023, we expect market leadership to continue to broaden out and include companies that lagged the returns of these large tech companies in the first half. It appears earnings estimates have bottomed out and the economy, while slowing, is proving more resilient than initially thought. While we expect the Fed to raise another 0.25%-0.50% in 2023, we believe the economy can continue to grow with tight labor markets supporting employment and consumer spending. With that backdrop, the market is beginning to appreciate the potential of companies not solely in the artificial intelligence or cloud computing industry. We don't expect the incredible results of many of these mega cap names to repeat in the second half, but rather for broader participation within the equity markets. This would be a sign of a healthy market and a signal the worst may be behind us in terms of the impacts from inflation and tighter monetary policy.

WE HOPE THAT OUR CLIENTS AND FRIENDS ENJOYED THEIR JULY 4TH WITH FAMILY AND FRIENDS.

It is always an opportunity to remember and be thankful for the blessings we all enjoy in our wonderful country. With all its flaws, the US remains the place where we want to live, work, and raise our families. It reminds us that we are thankful for our clients and friends and take seriously the responsibility you have bestowed upon us as partners in your financial journey. As always, if you have any questions, please do not hesitate to reach out to your team here at Colonial.

SUMMER PLANNING

In between the summer swim meets, family beach trips, once-in-a-lifetime trips, and elective procedures, we wanted to offer a small checklist to make sure that your financial household is in order.

1. **INSURANCE:** While you are checking on what kind of insurance coverage you need for your vacation rental car, check also what personal insurance policies you have in place. Do you have umbrella coverage? How much time is remaining on your term life insurance policies? What is the accumulated cash in your permanent insurance? Is it time for a check-in?

2. **ESTATE PLANNING DOCUMENTS :** As you are preparing for that trip abroad, make sure you know who is on your health care power of attorney? Don't have one? It may be time to put one in place. While you are at it, make sure that your revocable trust is funded and that you don't have any stale beneficiaries in your will or rev trust.

3. **CPA:** Hopefully you made your June 15th quarterly payment timely. While we are managing cash for the September 15th payment, we want to remind you that this is the time of year to contemplate searching for a new tax preparer if you are unhappy with yours. In between tax deadlines when things are slower is the time for a proper intake meeting. This can ensure that you get the attention and planning that you may need, rather than contemplating a change when you get your tax forms at the beginning of the year.

4. **ROTH CONVERSIONS:** While we are on the topic of planning, now that we are halfway through the year is a good time to start taking a look at how your income is stacking up for this year. Are you retiring part-way through? This might be a good opportunity to contemplate a Roth conversion.

5. **QCDS:** While we are on the topic of income, have you taken your RMD this year? If not, thinking about whether gifting from your IRA can make sense for your financial situation may be another tax savvy thing to do while you are hiding from those hot summer rays outside.

6. **FINANCIAL PLANNING:** While things are moving at a slower pace during the summer months, take the opportunity to update your financial plan. 65% of Americans do not have a financial plan, and when asked why, 20% of those said that it was too time consuming.

OUR LEADERSHIP

H. Walter Barre

Bert D. Barre, CFA

Barry D. Wynn

Camp R. Wynn, CFA

Henry E. Batts III, AWMA®

Charles W. Clementson

James C. Fiske, CFP®

Jamison W. Hinds, JD

Karen H. Longhurst, ATFA, CTFA

Pamela G. McCauley

Ansley J. Mitcham

Kathryn A. Smith, CPA/PFS, CFP®

Lorie L. Barton

W. Charlton Wieters, CTFA

Matt Van Name, CFP®, CRPS®, AIF®

Jordan R. Taylor, CPA

LOCATIONS

SPARTANBURG

359 S. Pine St.
Spartanburg, SC 29302

864.582.3356

GREENVILLE

101 E Washington St.,
Suite 200
Greenville, SC 29601

864.370.0737

COLUMBIA

6 Calendar Ct.,
Suite 1
Columbia, SC 29206

803.782.7646

CHARLESTON

578 East Bay St.,
Suite B
Charleston, SC 29403

843.577.0444

COLONIALTRUST.COM