

MARKET COMMENTARY

A NEW BULL MARKET?



The S&P 500 is up 8.8% for the year through May 25. So, we should start celebrating a *bull market*, right? But look deeper, and a different picture emerges. Take away the top ten, mostly technology, names, and the market return falls to zero. Moreover, those ten stocks performed horribly last year, with an average decline of 43%. The average stock in the broader market, defined as the largest 3,000 stocks in the United States, is also flat for the year. Such narrow leadership is not what we expect in a full-bore bull market.

STUMBLING BLOCK

The market hit a stumbling block in March. That month, we saw some prominent regional banks fail, followed by debt ceiling worries. The short-lived “junk” rally of January and February, which saw low-quality stocks jump 8%, came to a screeching halt.

Since early March, the highest-quality stocks found ample buyers, while the lowest-quality stocks came under the most selling pressure. Here is the performance of the WCA Quality Indices¹ from March 1, 2023, to May 25, 2023:

• WCA “A” Quality	+0.9%
• WCA “B” Quality	-2.9%
• WCA “C” Quality	-7.6%
• WCA “D” Quality	-8.2%
• WCA “F” Quality	-10.9%

As you can see, when stress emerged, higher quality companies with low debt, profitable assets, and steady businesses did the best. And we should not be surprised. It makes perfect sense that such companies, the most durable, flexible, and predictable ones, would shine in the face of uncertainty.


PAIN AMONG HIGH YIELD STOCKS

What did not work? The highest dividend-yielding companies, which also tend to earn the lowest WCA Quality grades, stumbled badly after regional bank troubles. The Dow Jones Select Dividend Index, based almost entirely on dividend yield, was down 9%, in line with the “D” and “F” quality companies. Once again, the highest-yielding stocks and the lowest-quality stocks proved to be highly correlated.

The S&P 500’s 8.8% year-to-date return, dominated by a bounce in a handful of popular stocks, offers scant evidence of a robust bull market. Such a market would involve greater participation spread across a wider array of stocks. Moreover, the fact that investors are flocking to the highest ground speaks to continued investor caution.

¹ Note: The WCA Quality Grade indices are proprietary quantitative indices focused on fundamentals. Indices are for informational purposes only and do not reflect the performance of any actual WCA investment strategy. From 2000-2022, we analyzed and ranked the top 1,000 U.S. companies based on debt, profitability, and business consistency. Rankings were organized into five categories ranging from “A” to “F”, with “A” receiving the highest quality designation and “F” the lowest. Each grade category formed an equally-weighted, annually reconstituted index with then-available data (to avert lookback bias).

CONCLUSION



Although the S&P 500 is up for the year, we should remain mindful of risk. As the last several weeks have again proven, unforeseen events have hurt the weakest, highest-yielding, lowest-quality companies. By contrast, the highest quality companies with most solid balance sheets, most consistent businesses, and most profitable assets provided far better shelter from the storm.

And if the market rallies from here, and we do begin a new bull market, we expect high-quality companies to go along for the ride.

In the meantime, we will stick to our knitting, focused first on the most critical issues: quality and value.

WCA Fundamental Conditions Barometer Description: We regularly assess changes in fundamental conditions to help guide near-term asset allocation decisions. The analysis incorporates approximately 30 forward-looking indicators in categories ranging from Credit and Capital Markets to U.S. Economic Conditions and Foreign Conditions. From each category of data, we create three diffusion-style sub-indices that measure the trends in the underlying data. Sustained improvement that is spread across a wide variety of observations will produce index readings above 50 (potentially favoring stocks), while readings below 50 would indicate potential deterioration (potentially favoring bonds). The WCA Fundamental Conditions Index combines the three underlying categories into a single summary measure. This measure can be thought of as a “barometer” for changes in fundamental conditions.

Index Descriptions: WCA Quality Indices are based on Washington Crossing Advisors’ quantitative analysis of firms along three dimensions: asset profitability, consistency, and leverage. Higher quality companies are defined as those which fall in the top quintile of largest-cap U.S. companies and tend to have higher average profitability, greater than normal consistency, and low leverage. Lower quality companies are defined as those which fall in the lowest quintile based on the same criteria. Indices are reconstituted annually, continuously rebalanced, and presented on a total return basis, as calculated by Bloomberg. Indices are unmanaged and do not represent performance of any actual portfolio or portfolio strategy offered by Washington Crossing Advisors, LLC.

Standard & Poor’s 500 Index (S&P 500) is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market. S&P 500 Growth Index and S&P 500 Value Indices are designed to provide a comprehensive measure of global equity growth and value performance. **S&P High Beta Total Return Index** is designed to measure the performance of the constituents of the S&P 500 that are most sensitive to changes in market returns.

S&P Low Beta Total Return Index is designed to measure the performance of the constituents of the S&P 500 that are least sensitive to changes in market returns.

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