DECATUR CAPITAL
MANAGEMENT INC.

Decatur View – Second Quarter 2023 Update

The second quarter was positive for equity markets with the S&P 500 providing 10.3% return for the quarter. This brings the year to date, through June 30th to 16.9%.

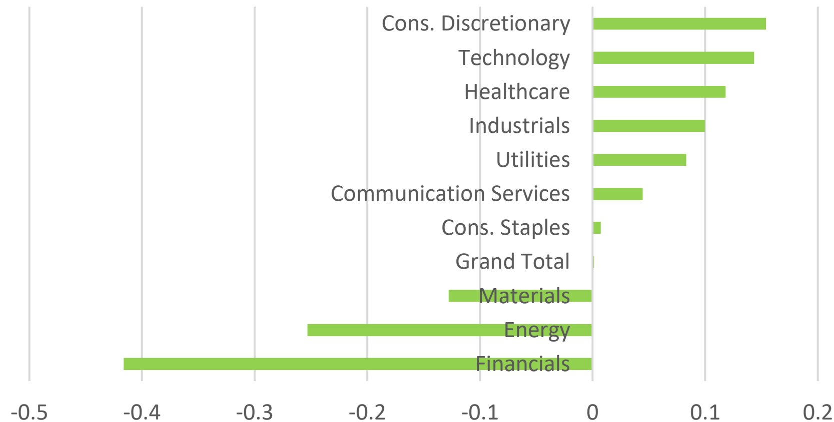
We have identified four drivers that are impacting markets in 2023. The drivers, in order of significance, are: 1) earnings expectations 2.) the Federal Reserve controlling inflation, 3) isolated regional bank weakness, and 4) global threats.

Based on the four market drivers, we are optimistic on the capital markets.

Earnings Revisions

Chart 3 shows the average US net earnings revisions normalized which provides a measure of market sentiment on the direction of earnings. The net analysts' revisions measure the number of analysts that are making positive changes to their earnings estimates compared to the number of analysts that are making negative changes to their estimates scaled by the number of analysts. We normalized these values to measure the distance from the market net earnings revisions.

Chart 1: US 1 Year EPS Net Earnings Revisions Normalized, June 30, 2023



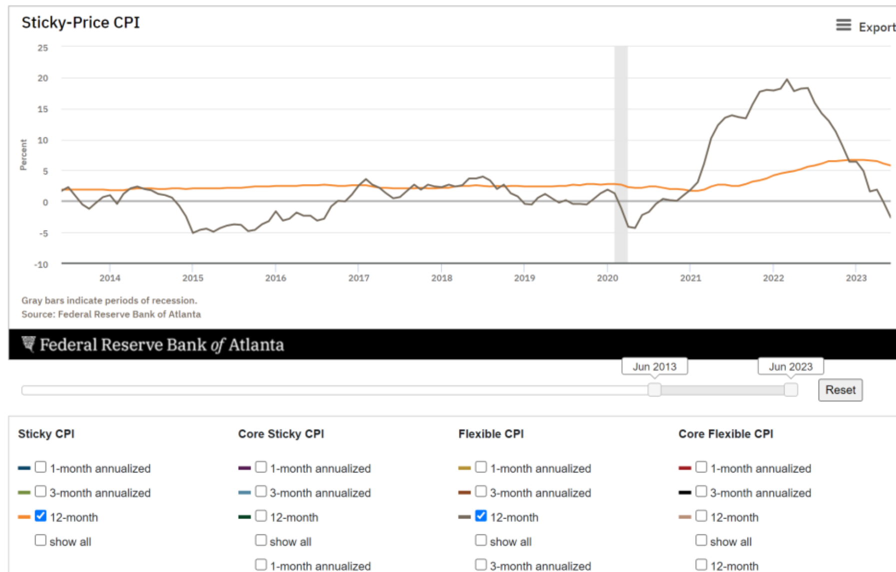
Source: Decatur Capital Management, Zacks Investment Research

Due to the banks reduced earnings, the financial sector's net earnings revisions are the most negative relative to the rest of the market. Consumer Discretionary has the most positive net earnings revisions. We are adding to our exposure in consumer discretionary, with a focus on luxury brands. Also, we continue to overweight technology stocks that are benefiting from the artificial intelligence tailwinds.

The Federal Reserve and Inflation

Federal Reserve (Fed) will remain resolute in controlling inflation. Chart 2 shows the two aspects of inflation: the sticky and flexible consumer price index. The orange line represents the sticky price CPI, which as the name implies is hard to get rid of and sticks around, such as rents and medical care. The grey line represents the flexible CPI. The flexible CPI includes those costs that may rocket upward as inflation builds but are more easily controlled by the Fed, such as hotel rooms costs, entertainment tickets and eating out.

Chart 2: Sticky and Flexible CPI



The Fed paused increasing interest rates during the June 2023 meeting to evaluate the impact of earlier hikes on the economy. Both the sticky CPI, 5.8%, and flexible CPI, -2.6%, are trending downward, which means that the Fed's hikes are working to control inflation.

We believe that the majority of the Fed's rate hikes are behind us, but we are forecasting a few more hikes in 2023. For our fixed income clients, we continue to employ maturity ladders that will benefit as yields increase with the Federal Reserve's future rate hikes.

Isolated Bank Failures

The regional banking scare fueled by the collapse of Silicon Valley Bank was front and center at the beginning of the quarter. Chart 3 illustrates your investment of $10,000 in the

regional bank ETF, (IAT) at the beginning of the year. By May 2023, your investment would have dropped to $6,272, a decline of 37%. Currently, the regional banks are recovering and moving up to $7,207; but still a loss on that initial investment of 28%!

Chart 3: Impact of Bank Failures on Regional Bank Returns

The Hypothetical Growth of $10,000 chart reflects a hypothetical $10,000 investment and assumes reinvestment of dividends and capital gains. Fund expenses, including management fees and other expenses were deducted.

The performance quoted represents past performance and does not guarantee future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more or less than the original cost. Current performance may be lower or higher than the performance quoted, and numbers may reflect small variances due to rounding. Standardized performance and performance data current to the most recent month end may be found in the Performance section.

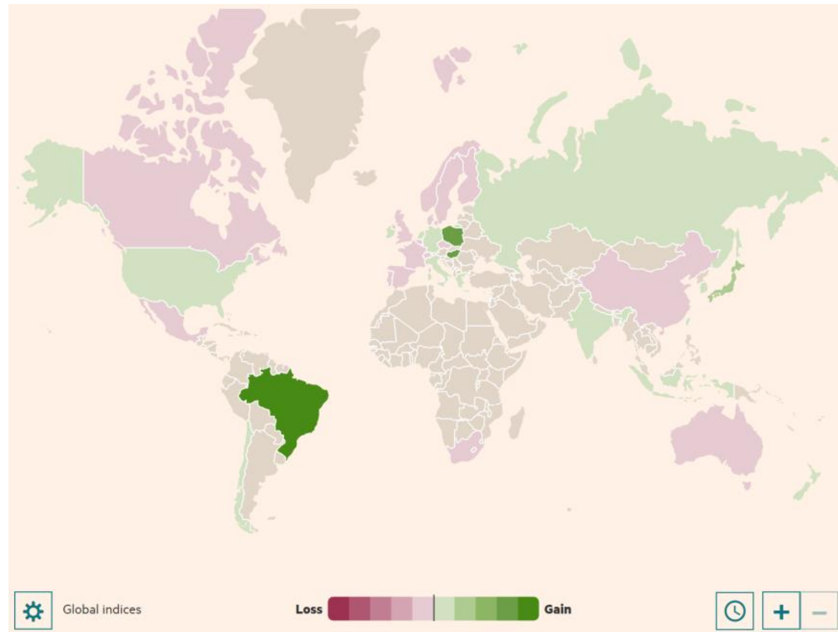
At the end of first quarter, we forecasted that the bank closures would not have a contagion effect on the rest of the banking industry. However, the negative market sentiment carried the regional banks down as a group. During second quarter, we reduced our overall exposure to regional banks. In the short term, our outlook for the banking industry is that earnings will be lower which may be a headwind for future price appreciation.

We continue to hold several banks in our quality dividend portfolio. The portfolio's regional banks are in the top half of profitability among financial firms, with return on equity of 12% or higher and providing 4% or higher dividend yields. We believe that individual stock selection should provide better results than buying a broad regional bank fund.

Global Threats

At the beginning of the year, we were concerned with the Russia-Ukraine War and China's impact on global markets. The Russia-Ukraine War appears to be moving into a stalemate with no immediate resolution at hand. In addition, China and the U.S. have toned down the saber rattling. During the month of July, Treasury Secretary, Janet Yellen, visited China to meet with officials on various economic issues. Global markets are rallying based on the reopening in Asia and the global movement of manufacturing facilities closer to domestic markets.

Chart 4: Global 2nd Quarter Stock Return Map



https://markets.ft.com/data/world

Chart 4 shows the relative global performance during the quarter. We are forecasting positive market trends will continue into the second half of the year. In our All Country World excluding the U.S., we continue to overweight Latin America, Canada, and we are increasing our exposure to Asia.

We realize that there could be risks that we simply cannot plan for. Some events that fall into this category include the popping of a financial bubble, such as the Silicon Valley Bank failure. We address these risks by staying true to our investment discipline. We continue to focus on companies that will survive catastrophic events based on the company's leadership and competitive advantage. So, sticking to our mantra of profitability, expectations of stable or growing earnings, and valuation is how we manage these unknown risks.

Note: Returns are measured in U.S. dollars net of fees. Decatur Capital Management, Inc. (DCM) is a registered investment advisor specializing in quantitative growth oriented investment management. The benchmark is the S&P 500 which is designed to measure the large cap firms within the U.S. The benchmark is market cap weighted. DCM claims compliance with the Global Investment Performance Standards (GIPS). To receive a list of composite descriptions of DCM and/or presentation that complies with the GIPS standards, contact Ralph J. Bryant, CPA at (404) 270-9838 or ralphb@decaturcapital.com or write to DCM, 520 W. Ponce De Leon Avenue, Suite 793, Decatur, GA 30030.