

July 28, 2023

Dear PCM Clients and Friends:

As we enjoy summer and begin the last half of 2023, inflation is hitting a two-year low, economic growth remains impressively resilient, the Fed will now likely pause its historic rate hiking campaign, the debt ceiling extension was resolved, and there have not been further significant regional bank failures. These improvements in the broad economic outlook have been reflected in both stock and bond prices so far this year, as the S&P 500 hit the best levels since last April.

Midyear, the economy has not yet felt the full impact of the Fed's historically aggressive hike campaign. Though there have now been 11 rate increases and rates are at their highest level since 2001, it takes time for these interest rate increases and other changes in monetary policy to affect the economy. A year ago, the recession fear, "will we or won't we" in 2023 was the current upfront negative investment issue. We should now all expect the resilient economy to slow more as we move into the second half of 2023 and 2024. Last year slowing was considered "bad." Today moderate slowing is considered warranted and good.

Clearly, the Fed's aggressive tightening, along with natural "free market" forces correcting the Covid-related supply imbalances, has brought the 2022 inflation spikes down. The year-over-year CPI has fallen from over 9% in 2022 to 4% in less than a year's time; yet, this is far above the Fed's 2% target. This decrease in the rate of change, along with receding price pressures, is positive. Is inflation "whipped?" Probably not. For investors, what is important for now is that the Fed appears to feel it has done enough to step back, watch the data, and see if what they have done to date, with time lags, is sufficient. The next year should be less about further Fed tightening and more about holding and keeping rates high. Today's rates will stay high and should be considered a return to more "normal" rates.

This past quarter investor sentiment turned suddenly, and intensely, optimistic. Just three months ago in April we wrote how the percentage of consumers expecting lower stock prices was in the longest streak since 1987; with the only longer streak at the time of the 2008 Financial Crisis. Now, in one quarter, there has been an important change in investor sentiment. The CNN Fear/Greed Index ended the second quarter at "Extreme Greed" levels, while the American Association for Individual Investors (AAII) Bullish/Bearish Sentiment Index hit the most bullish level since November 2021. This past week the Dow Jones Industrial Average finished a 13-days-in-a row up streak, which is the first time it has done this since 1987. Six months ago, in our October letter, we wrote that we wanted to see the market "get some legs" and start going up. It has done that. Now this market strength should continue to broaden with more stocks completing bases and beginning or continuing to rise.

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INVESTMENT MANAGEMENT

While we are happy with the market's performance; we want to remain vigilant. We continue to see a market where many companies will continue to prosper; while others, due to a slowing economy or poor management team execution, will falter and need to be replaced.

THE MARKET SCOREBOARD

The S&P 500 ended the second quarter and first half of 2023 at a 14-month high and most major stock indices logged solid gains in the second quarter. The tech-focused and market cap-weighted NASDAQ Composite had an exceptional quarter as "AI" enthusiasm drove several mega-cap tech stocks sharply higher. The less-tech-focused Russell 2000 and Dow Industrials logged more modest, but still solidly positive, quarterly returns.

Indexes	% Return YTD 2023	% Return Q2 2023	% Return Q1 2023
NASDAQ Composite	31.73	12.81	16.77
S&P 500 Total Return	16.80	8.74	7.50
Wilshire 5000	15.58	8.10	6.92
NYSE Composite	4.55	3.26	1.26
Dow Jones Industrial Average	3.80	3.41	0.38

The second quarter began with markets still in the throes of the regional bank crisis following the March failures of Silicon Valley Bank and Signature Bank, and investors started the month of April wary of contagion risks. In late April and May, corporate earnings results

were much better than feared as 78% of S&P 500 companies reported better-than-expected Q1 earnings, a number solidly above the 66% long-term average. Additionally, 75% of reporting companies beat revenue estimates for the first quarter, also well above the long-term average. That solid performance, coupled with general macroeconomic calm, was welcomed by investors. Not welcomed, in May, was a looming U.S. debt default, which caused the markets to consolidate until a debt ceiling agreement was reached and was signed into law at May's month end, avoiding a financial calamity.

By market capitalization, large caps outperformed small caps, as they did in the first quarter of 2023.

On a sector level, 8 of the 11 S&P 500 sectors finished the second quarter with positive returns.

Continuing first quarter's trend, the Consumer Discretionary, Technology, and Communication Services sectors were the best performers for the quarter, handily outperforming the other eight S&P 500 sectors.

The surge in a few mega-cap tech stocks, Amazon, Apple, Alphabet, Meta Platforms (Facebook), Microsoft, Nvidia and Tesla drove the gains in those three sectors and the markets. These 7 companies equal around 30% of the S&P 500's market cap and accounted for most of this quarter's and the YTD's gain in the S&P 500 and NASDAQ

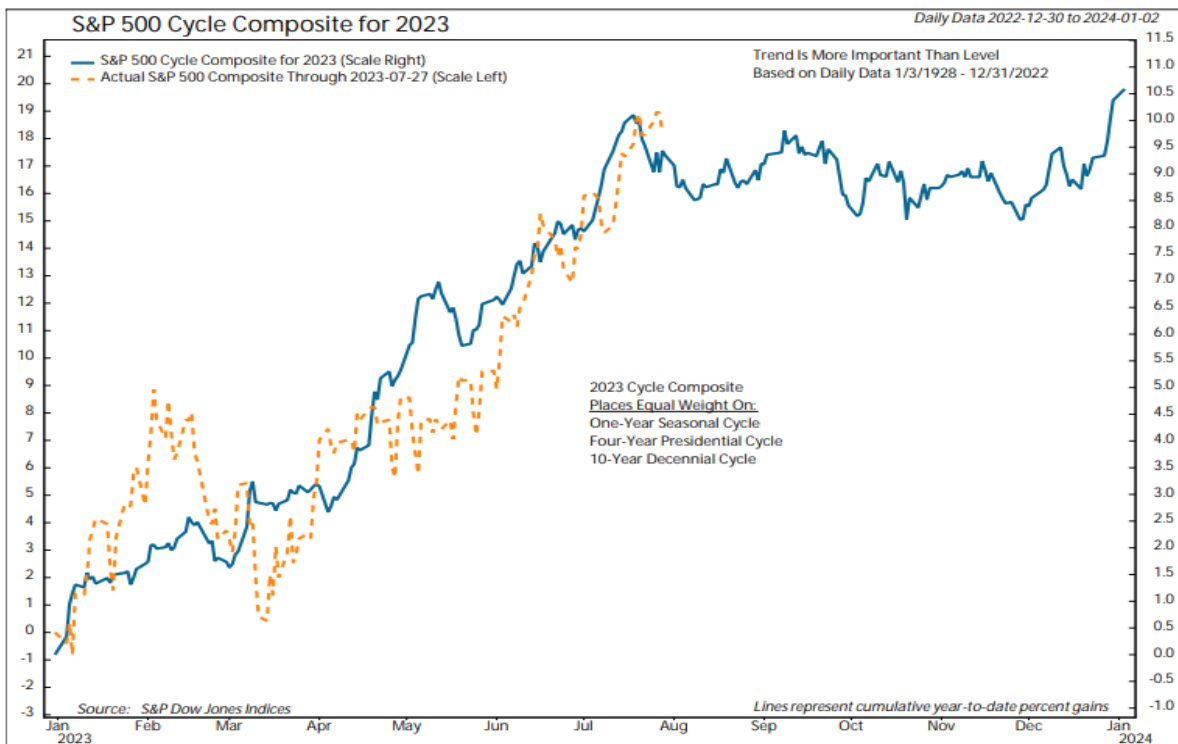
indexes. Of the other 493 S&P companies, around 25% beat the index, 23% were up less than 10%, and 35% of the companies in the S&P 500 were down or unchanged this quarter.

In sum, the markets were impressively resilient, but extremely narrow and focused on a select few companies during the second quarter and throughout the first half of 2023; as better-than-feared earnings, expectations for less aggressive central bank rate hikes, more evidence of a “soft” economic landing, relative stability in the regional banks, a debt ceiling agreement and improving consumer confidence quelled investors’ fears.

STOCK MARKET OBSERVATIONS

The outlook for stocks remains positive; though, at this time, at the mid-point of the year and in the middle in the third year of the four-year Presidential Cycle, the pre-election year, we should now expect the markets to pause and consolidate their gains off the major bottom formed at the end of last year in the off presidential-year election bottom.

We included in our last letter, on page 4, the Ned Davis Four-Year Presidential Chart which graphically shows a market guide for the next several years of this political cycle and its effects on the markets. The Presidential Cycle predicts a trading range market beginning about now as the rhetoric and uncertainty of the elections begins to gear up. As in the past, this uncertainty will last until the uncertainty of the elections is removed. The market traditionally moves higher regardless of the election outcome and continues strong after the election in a “honeymoon” rally until mid-year 2025.



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We find it extremely interesting that so far this year the Ned Davis 2023 S&P 500 Cycle Composite, which we include here at the bottom of the previous page, has been an accurate guide. The Composite is a combination of three historical patterns: the one-year seasonal cycle, the four-year presidential cycle, and the ten-year cycle. The 2023 NDR Cycle Composite in the chart is the blue line and calls for a strong first half of the year, which occurred, until about now and then a trading range for the last half of the year. The S&P 500 actual market composite is in orange, is updated through July 27, and shows how the S&P has tracked the composite YTD. The orange S&P line also clearly shows the February/March 7.75% correction in the S&P 500 which began on February 2 and ended on March 13. This is the only greater than 5% correction so far this year. Every year 5% corrections come along every 84 days on average (3 or 4 a year). Each year also typically has one 10% correction.

In our April letter, we wrote that there was continued “significant upside for the averages if they just returned to the top of their recent trading ranges and old highs.” For the Dow this was an approximate further 10% gain and for the smaller companies in the Russell 2000 index this was a gain of 15% to its trading range. This has now happened and is positive. The Dow, the S&P, the Transports, and the NASDAQ have all reached and exceeded the top of their previous 12-months trading ranges and are also approaching their past years’ highs. The smaller company Russell index has now also reached the area of its 12-month highs; but is still quite a distance away from its old high.

When several averages reach and exceed a previous high together it brings to mind Dow Theory which is an investment theory or methodology written about by Charles Dow in the late 1800s in a series of editorials in the Wall Street Journal, which he co-founded. Charles Dow was also one of the founders of the Dow Jones Industrial Average in 1896. The thought behind Dow Theory is that the economy can only experience meaningful and sustainable long-term growth when both the industrial sector and the transportation sector (formerly known as the “rail sector”) are both rising together. Dow found through historical study that when the two sectors were in unison the economy was expanding, and if one of the major sectors reversed or trended lower versus the other, an economic contraction was always looming ahead. Interestingly, today our economy is much more than just manufacturing (industry) and railroads (transportation). For instance, it is technology companies who are the major component of the NASDAQ.

Dow Theory recently turned bullish during the second week of July when the Dow Industrials closed above its early December high of 34,430, confirming the late January new high in the Dow Transports.

The fact that the Dow, the Transports, the S&P, and the NASDAQ have all moved up together above recent new highs is encouraging and is a message that at this time the long-term health of the economy and the markets is good. The markets should remain positive for some time until one or more of these averages diverges from the others.

We want to thank you for your confidence in us during the past several years.

We are always available to talk or meet with you to discuss any specific investments or just have a general review of your account. If you have any questions, please give us a call. Or call in and ask to schedule a time to talk or meet in person.

Sincerely,

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A man and woman had been married for more than 60 years. They had shared everything. They had talked about everything. They had kept no secrets from each other, except that the little old woman had a shoebox in the top of her closet that she had cautioned her husband never to open or ask her about it.

For all those years, he had never thought about the box, but one day, the little old woman got very sick and the doctor said she would not recover.

In trying to sort out their affairs, the little old man took down the shoebox and took it to his wife's bedside.

She agreed that it was time that he should know what was in the box. When he opened it, he found two crocheted dolls and a stack of money totaling \$95,000.

He asked her about the contents. "When we were to be married," she said, "my grandmother told me the secret of a happy marriage was to never argue. She told me that if I ever got angry with you, I should just keep quiet and crochet a doll."

The little old man was so moved; he had to fight back tears. Only two precious dolls were in the box. She had only been angry with him two times in all those years of living and loving. He almost burst with happiness.

"Honey," he said, "that explains the dolls, but what about all this money? Where did it come from?"

"Oh," she said. "That's the money I made from selling the dolls."

An out-of-towner drove his car into a ditch in a remote area. Luckily, a local farmer came to help with his big strong horse named Buddy. He hitched Buddy up to the car and yelled, "Pull, Nellie, pull!" Buddy did not move. Then the farmer hollered, "Pull, Buster, pull!" Buddy did not respond.

Once more the farmer commanded, "Pull, Coco, pull!" Nothing. Then the farmer nonchalantly said, "Pull, Buddy, pull!" And the horse easily dragged the car out of the ditch. The motorist was most appreciative and very curious. He asked the farmer why he called his horse by the wrong name three times. The farmer said, "Oh, Buddy is blind and if he thought he was the only one pulling, he wouldn't even try!"

An elderly woman had just returned to her home from an evening at a church service when she was startled by an intruder in her home. As she caught the man in the act of robbing her of her valuables, she yelled, "Stop! ACTS 2:38!" (Repent and be baptized, in the name of the Lord, so that your sins may be forgiven).

The burglar stopped in his tracks. The woman calmly called the police and explained what she had done. As the officer cuffed the man to take him in, he asked the burglar, "Why did you just stand there? All the old lady did was yell a scripture at you."

"Scripture?" replied the burglar, "She said she had an axe and two 38's!"

One day a florist went to a barber for a haircut. After the cut, he asked about his bill, and the barber replied, "I cannot accept money from you, I'm doing community service this week." The florist was pleased and left the shop.

When the barber went to open his shop the next morning, there was a thank you card and a dozen roses waiting for him at his door.

Later, a policeman comes in for a haircut, and when he tries to pay his bill, the barber again replied, "I cannot accept money from you, I'm doing community service this week." The policeman was happy and left the shop.

The next morning when the barber went to open, there was a thank you card and a dozen donuts waiting for him at his door.

Then a politician came in for a haircut, and when he went to pay his bill, the barber again replied, "I cannot accept money from you, I am doing community service this week." The politician was very happy and left the shop.

The next morning when the barber went to open, there were a dozen politicians lined up waiting for a free haircut.

Recently, I was asked by a funeral director to play my bagpipes at a graveside service for a homeless man. He had no family or friends, so the service was to be at a pauper's cemetery in the Kentucky backcountry.

As I was not familiar with the backwoods, I got lost and being a typical man, I didn't stop for directions. I finally arrived an hour late and saw the funeral guy had evidently gone and the hearse was nowhere in sight. There were only the diggers and crew left and they were eating lunch.

I felt badly and apologized to the men for being late. I went to the side of the grave and looked down. The concrete vault lid was already in place. I didn't know what else to do, so I started to play. The workers put down their lunches and began to gather around. I played out my heart and soul for this man with no family and friends.

And as I played 'Amazing Grace,' the workers began to weep. They wept, I wept, we all wept together. When I finished, I packed up my bagpipes and started for my car.

Though my head hung low, my heart was full. As I opened the door to my car, I heard one of the workers say, "I never seen nothing like that before, and I've been putting in septic tanks for twenty years."

The barber's client looked depressed, so the barber told him, "Cheer up. I knew a guy who owed \$5,000 he couldn't pay. He drove his vehicle to the edge of a cliff, where he sat for over an hour. A group of concerned citizens heard about his problem and passed a hat around. Relieved, the man pulled back from the cliff's edge." "Incredible," said the client. "Who were these kind people?" "The passengers on the bus."

Senior texting codes:

ATD: At the doctor's

BFF: Best friend fell

BTW: Bring the wheelchair

CUATSC: See you at the senior center

DWI: Driving while incontinent

FWIW: Forgot where I was

GGPBL: Gotta go pacemaker battery low

LMDO: Laughing my dentures out

LOL: Living on Lipitor

WAITT: Who am I talking to?

GGLKI: Gotta go laxative kicking in

If dogs sent letters to God:

Dear God: Why do humans smell the flowers, but seldom, if ever, smell one another?

Dear God: When I get to heaven, can I sit on your couch, or is it the same old story?

Dear God: Why are there cars named after the jaguar, cougar, mustang, colt, stingray, etc., but not after dogs? How often do you see a cougar riding around? We dogs love a nice ride! Would it be so hard to rename the Chrysler Eagle to Chrysler Beagle?

Dear God: Are there mailmen in Heaven? If there are, will I have to apologize?

Dear God: Here is my list of things I will try to remember to be a good dog: I will not eat the cats' food before they eat it or after they throw it up. The diaper pail is not a cookie jar. The sofa is not a face towel. The garbage collector is not stealing our stuff. I will not play tug-of-war with Dad's underwear when he is on the toilet. Sticking my nose into someone's crotch is not an acceptable way of saying hello. I must shake the rainwater out of my fur before entering the house. I will not come in from outside and immediately drag my butt across the carpet. I will not sit in the middle of the living room and lick my crotch when company is over.

