



Nia Impact Capital Market Commentary Q2 2023

Economic Trends and Themes

2023 has been a year of continued volatility in the markets. Despite the many highs and lows, driven by interest rate hikes as well as rising inflation, with much of the global economy in flux, the markets have generally experienced a positive and upward trend. The continued fear of a predicted recession, in combination with the Federal Reserve's interest rate hikes aimed at controlling inflation contributed to volatility. Domestically in the US, concerns arose due to the inverted yield curve, indicating additional stresses in the economy.

Inflation and Economic Growth

Looking at the second quarter, the overall economic indicators suggested a slight cooling of inflation (currently at 4%, still higher than the Federal Reserve's targets), yet we have reason to believe inflation may remain elevated. The economy also experienced a slight slowdown as many investors monitored economic indicators such as housing and consumer spending to assess the impact of these measures on economic growth. Despite some solid earnings reports from medium and small banks in the first quarter, the banking sector as a whole continued to face ongoing challenges in April. This was partly attributed to loan officers tightening lending standards, which could further contribute to an economic slowdown.

Large Cap Tech and AI Stocks Drive Performance

Throughout the second quarter, a small number of large tech company stocks kept rising in price. These large cap technology stocks performed particularly well throughout April and May. Despite the U.S. debt ceiling crisis posing a risk, traders seemed to overlook that issue in April. Progress toward raising the debt ceiling before the end of May seemed to have prevented a more significant sell-off.

During the first quarter of the year, the majority of the gains in the S&P 500 and the NASDAQ Composite were driven by seven stocks out of 500. This trend continued through May, with a dramatic spread between large cap (S&P 500) and small cap (Russell 2000), and between tech (NASDAQ Composite) and non-tech stocks. The performance of these large



cap tech and AI companies stood out particularly when compared to the equal weighted S&P 500 index.

Market Dynamics: Concerns and Opportunities with AI

Important to note is that extreme market shifts like these where stock prices rise dramatically may not accurately reflect a company's long-term value and potential. This situation reminds us of the dot com boom when stock market activity did not perfectly predict the internet's long-term winners and losers. Looking back, we can now see the overly optimistic investments made during the era. However, the dot com boom did signal the transformative power of the internet to change our lives and our world.

The AI boom is following a similar pattern, and we can already see how AI innovations will significantly impact our lives and our world. While thoroughly evaluating companies based on their financial outlooks, core business models, and products providing solutions with positive impact, most of the current AI companies do not satisfy Nia investment criteria, which include a focus on gender inclusivity, and demonstrated positive impact.

We are clear that wider adoption of AI can enhance efficiencies within Nia portfolio companies. At the same time, we are gravely concerned about the inherent biases, including gender, racial, and socio-economic biases stemming from a lack of diversity within AI development teams. Relying solely on historical data and models presents risks and obstacles in solving many of our societal problems. Ethics, intellectual property, and data privacy also need careful attention. Nia continues to advocate for diversity of thought and background in the development of AI, and at all leadership tables.

These past few months have brought disruption across the economy, marking a new era with the adoption of AI. Amidst these changes, we remain focused on our investment themes addressing the needs of people and the planet. We maintain discipline and optimism throughout this investment cycle.

Federal Reserve's Monetary Policy

In its latest meeting, the Federal Reserve took a cautious approach, opting to pause rate hikes instead of raising rates as expected. The decision was driven by mixed signals from economic data, leaving uncertainty about whether the economy is heading towards a recession and if further rate increases are necessary to combat inflationary pressures. The



guidance provided indicated there is a high likelihood of two additional 0.25% rate increases, suggesting a prolonged period of higher interest rates.

Macro Indicators

The recent macroeconomic indicators showed a combination of positive and concerning trends. The Consumer Price Index (CPI) and Personal Consumption Expenditures (PCE) indicated slightly declining inflation, providing some relief to investors and policymakers. However, the labor market remains robust, with initial jobless claims surprisingly low and payroll increases exceeding expectations. On the flip side, US GDP growth has slowed, and the threat of a global recession continues to loom, as several international markets experience economic contractions or near-recessionary conditions. Additional concerns as far as geopolitical risks include Russia's ongoing aggression as well as the increasing tension between China and the US.

Housing Market and Input Costs

The housing market experienced a surge in new home sales, largely attributed to limited supply. Home builders' shift towards offering more affordable homes has helped offset supply constraints and higher mortgage costs. Additionally, input cost pressures have eased, as many material inputs like wood and transportation costs have come down significantly compared to 2021 pricing.

Yield Curve Inversion and Recession Concerns

The yield curve inversion, a reliable predictor of recessions, has persisted and is currently at levels not seen since the 1980s. This inversion drives concerns about the long-term (10-year) outlook with many investors remaining wary of global economic conditions.

Equity Market Performance

The equity market benchmarks have shown positive momentum year-to-date, although the trend of a few dominant stocks driving the entire market continued through June. Big tech and AI sectors were the primary drivers of market performance, contributing significantly to the market's gains. However, we saw a stark disparity in performance between the top



10 performing stocks in the tech sector and other benchmarks with varying levels of exposure to large-cap tech stocks.

Market Outlook

As we move forward, we are closely monitoring the Federal Reserve's actions, particularly with the possibility of two additional rate increases. Concerns over a global recession remain. The housing market's resilience, accompanied by pay and income increases, may offer some support to bolster the broader economy. However, the concentration of market gains in a narrow range of tech stocks underscores the importance of diversification in investment strategies to navigate potential market volatility.

The views and observations shared here are those of Nia Impact Capital and are subject to change.