MARKET COMMENTARY

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At the beginning of the year, we made the assertion that low expectations are the equity market's best friend. As we mark the midpoint of 2023, this declaration continues to hold.

Following a universally disappointing 2022, investors feared and even expected stubbornly high inflation, higher interest rates, and eventually an economic recession. Market strategists were generally bearish, with even the most optimistic scenarios calling for mid-single-digit returns for the year. Institutional and retail investors built their cash positions to defend against this pessimistic outlook and to take advantage of the most compelling interest rates seen in decades.

Against this dour backdrop, the equity markets surged to some of their best first-half returns in decades. The Nasdaq® index had its best start since 1983. Apple officially became the first $3 trillion company. Even the beaten-up cryptocurrency markets rebounded, with Bitcoin surging more than 80 percent.

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There were still plenty of obstacles for investors to traverse. In fact, some of the aforementioned concerns did come to fruition. In particular, a remarkably resilient labor market is helping to keep inflation stubbornly high and forcing the Federal Reserve to continue their hawkish posture of hiking interest rates. We also witnessed some unexpected macro events, including the regional banking crisis and the political theater surrounding the debt-ceiling negotiations. Until June, the market's advance was primarily attributable to a handful of very large technology companies. Bears repeatedly questioned the legitimacy of this market advance due to the narrow market leadership.

Fortunately, fundamentally positive developments more than offset investors' worries to propel the indices higher. The mainstreaming of generative Artificial Intelligence (AI) was the most discussed catalyst since the development of the internet itself. AI created excitement over the nearly endless possibilities for its deployment. Though perhaps not as exciting as the artificial intelligence movement, corporate profits continue to beat lowered investor expectations as businesses remain remarkably sturdy while operating in an uncertain global environment. Lastly, hope has been renewed that the Fed may actually be able to orchestrate the elusive soft economic landing, whereby the U.S. economy avoids a recession during a time of rapid interest rate increases.

The first half of 2023 should serve as a reminder of the perils of attempting to time the market or even anticipating how market participants may react to certain events. Instead, we believe investing in fundamentally sound businesses possessing management teams with a long-term orientation and the ability to adapt to changing market conditions is of paramount importance.

While Riverbridge does invest in some of the AI pioneers, history suggests the enduring long-term winners will be the companies harnessing and incorporating the power of AI within their existing businesses. We witnessed this phenomenon play out during the development of the world wide web in the late 1990s. Wall Street gave attention to and drove up the valuations of some early internet providers and enablers. Many of those companies did not survive, despite the undisputed success of the web. The true winners from the era were the more staid companies that incorporated the power of the internet into their business with online ordering, customer account access, etc. It will not surprise us if much of the long-term value created by AI is captured by companies garnering little attention today.

The Riverbridge investment team continues to position our portfolios behind companies we believe are poised to respond and adapt to opportunities like AI and challenges like restrictive monetary policy. Management teams that have cultivated strategic customer relationships and a business model that can sustain internally financed growth have a chance to build enduring earnings power no matter the economic environment.