# Equity Intelligence Report

June 2023

GAMMA INVESTMENT CONSULTING

## Gamma Equity Model Highlights

- **The S&P 500 and Nasdaq Models remained neutral (in cash) for June**. Despite last month's 10.6% jump in tech stocks, the outlook for the overall market remains bearish. Contracting liquidity, declining earnings, overvaluation, and spreading signs of economic weakness are keeping the Model out of the market.

- **Energy remained the top sector for June despite the rally in technology stocks last month.** Materials and Healthcare were the only other sectors with positive expected returns for June. Despite the strength in technology stocks, the sector remains extremely overvalued.

- **Sempra (formerly Sempra Energy, SRE) and WEC Energy (WEC) were added to our recommended portfolio for June.** The Gamma Company Model maintained long positions in all the current holdings as their expected returns remained above the average for the stocks in the S&P 500. Two of the current holdings (Henry Schein, ONEOKE) struggled last month, but both continue to have high expected returns that are in the top 10% of all the S&P 500 stocks.

- **The Gold Model covered its long position and went neutral for June.** The prospect of additional interest rate hikes knocked the Model out of its previous long position. Despite this, both gold and gold mining shares reman substantially undervalued, which makes the sector an attractive long-term buy.

## I. A Few Comments on the Debt Ceiling Increase

Washington is engaging in a round of self-congratulation at passing a $4 trillion increase in the debt ceiling. Let's do a quick post mortem to see if anything good came from this.

Both parties are arguing that they prevented a "catastrophic" default that would have plunged the economy into "the worst recession since the Great Depression." Hmmm. Let's deal with the default issue first. Let's be extremely clear on this point. There was effectively zero chance that the Federal government would default on principal or interest payments. Why? Three reasons. First, the debt ceiling only applies to issuance of NET NEW DEBT. The government could issue new debt to replace any maturing debt. No default on principal could occur because the maturing debt would be replaced by new debt. Second, the rise in interest rates since early 2022 has already added at least $130 billion to the government's interest expense. A default would further increase the cost of borrowing by increasing the perceived risk of holding U.S. debt - something that the Treasury cannot afford given the prospect of multi-trillion-dollar budget deficits as far as the eye can see. Third, the Federal government is obligated to make payments. The 14th Amendment states that "the validity of the public debt of the United States, authorized by law, …. shall not be questioned."

The government has more than enough tax revenues to make these payments indefinitely. In fact, tax revenues in 2022 reached an all-time high so the problem is not having enough money (Chart 1). While it's true that the government might have to lay off workers or reduce discretionary payments (gasp), the Constitution is clear on ensuring that U.S. debt is paid. The Biden Administration might have tried to force the Republicans' hand by threatening to delay scheduled interest and principal payments, but that would have immediately landed in the Supreme Court. The Court would almost certainly have ruled that debt payments take precedent over other discretionary government spending.

Now that we've addressed the political hysterics, let's discuss whether the debt ceiling increase actually accomplishes anything of value. To summarize, the Republicans get an essentially unenforceable agreement to cap

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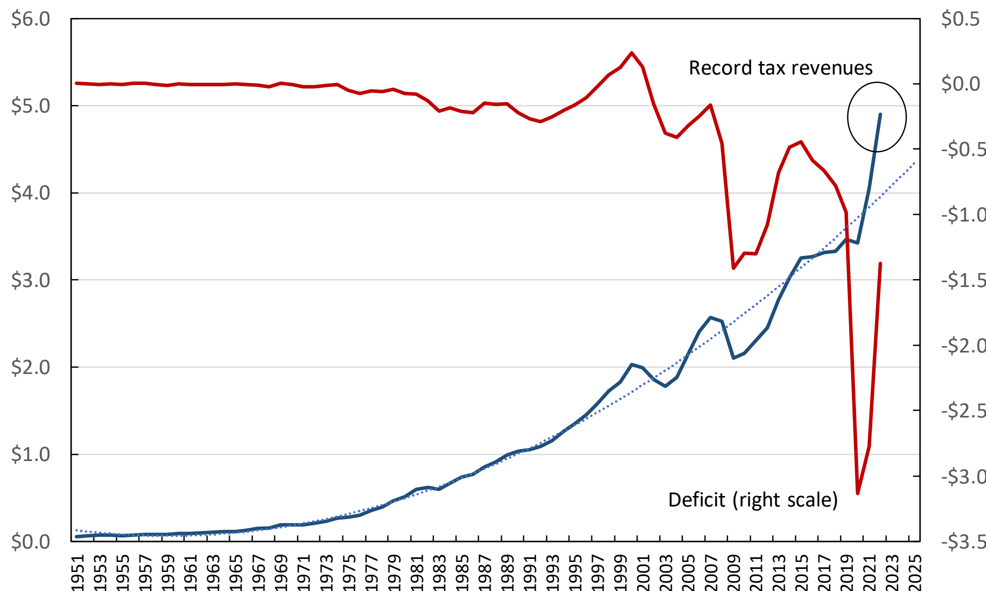
spending for the next two years and a "whopping" net $12 billion in spending cuts from the "temporary" $2.4 trillion orgy of Covid spending. The Democrats get to finance $4 trillion of additional spending through new debt (added to the $31 trillion already outstanding), preserve all of the $1.2 trillion crony subsidies that make up the so-called Inflation Reduction Act and, wait for it, 87,000 new IRS agents to further harass U.S. taxpayers (though to be fair, this is delayed for a year). Who do you think won this negotiation?

**CHART 1**

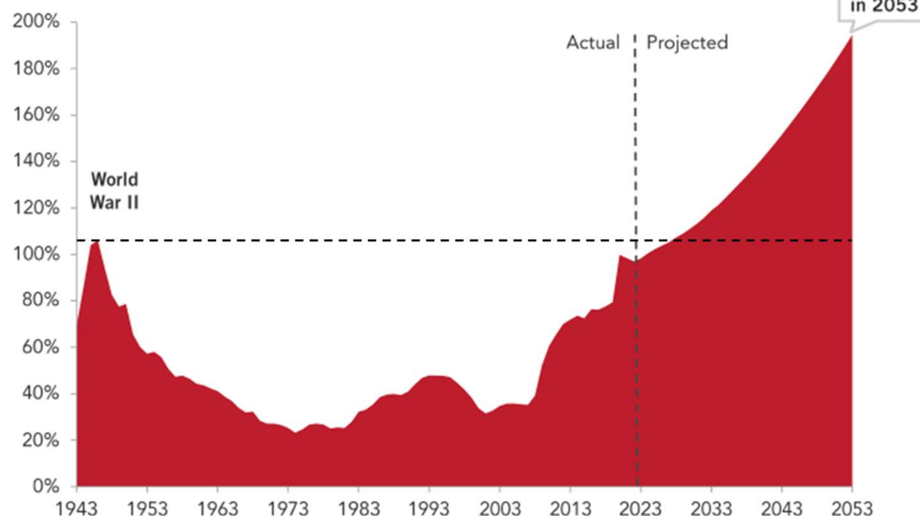
**Federal Tax Revenues vs Deficit (Trillion $)**




Next, let's look at the implications for the economy. First, government spending is completely out of control. Despite tax revenues at record highs, the Congressional Budget Office (CBO) projects annual budget deficits rising steadily over the next 10 years from $1.6 trillion in 2024 to $2.9 trillion in 2033. The CBO projects that the annual budgetary shortfall will not fall below 5 percent of GDP in any year between now and 2033. Total debt held by the public (not counting debt held by the Social Security Trust Fund) is projected to soon top the WW II peak (Chart 2).

**CHART 2**

The national debt will exceed its historic peak in the upcoming decade




SOURCE: Congressional Budget Office, *An Update to the Budget Outlook: 2023 to 2033*, May 2023.
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Second, as the debt accumulates, an increasing share of the federal budget will be allocated just to paying interest on the national debt. In 2022, the federal government spent over $400 billion on interest alone on debt held by the public ($724 billion including Social Security payments). The cost of servicing the national debt will rise steadily both as a percent of GDP and as a percent of the federal budget (Chart 3)

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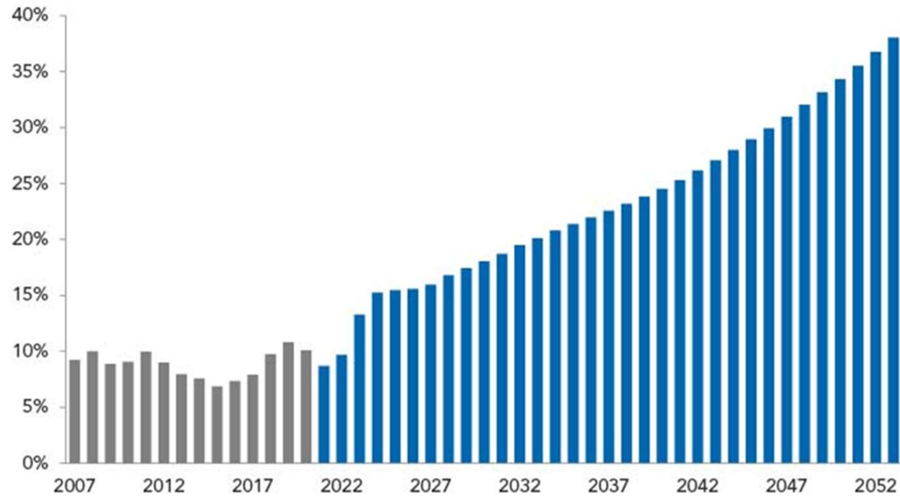
Third, and most importantly, the massive debt being accumulated is rapidly causing real economic growth to slow while at the same time boosting the inflation rate. Recall from Econ 101 that economic growth is a function of labor hours worked, labor productivity (training, education), capital investment (machinery, tools, structures), natural resources (lumber, iron ore, energy, etc,), and technology (ideas, innovation).

**CHART 3**

Net interest costs will account for almost 40 percent of federal revenues by 2053

NET INTEREST (% OF REVENUES)




SOURCE: Congressional Budget Office, *The Budget and Economic Outlook: 2023 to 2033*, February 2023.
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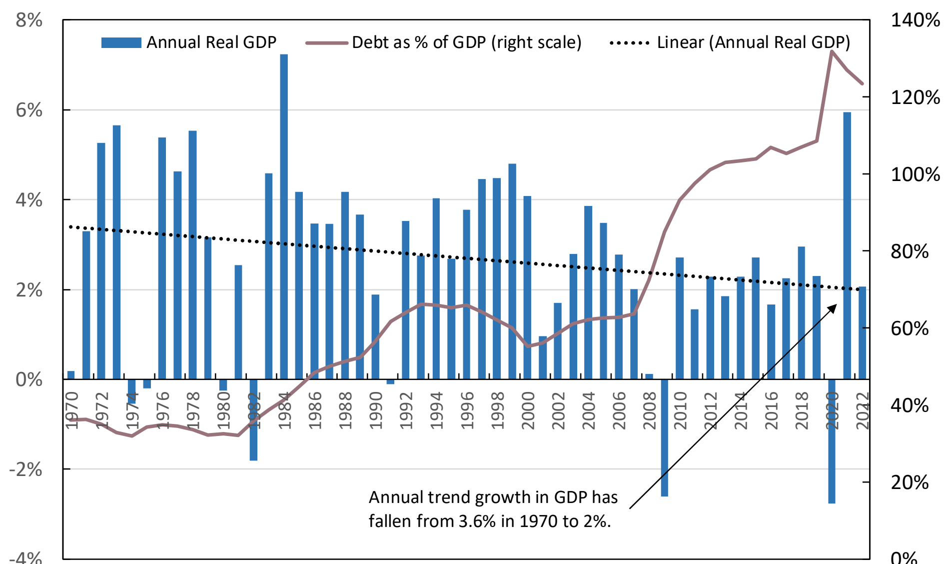
As the deficit increases, more capital is channeled away from productive investment to current consumption and into a bureaucracy whose regulatory burden further reduces economic growth. Chart 4 illustrates the inverse relationship between the federal debt and economic growth.

Trend real economic growth has fallen from a 3.5% annual rate in the 1970's to only 2% since the 2009 recession. Most of the reduction has occurred since debt ballooned from 63% of GDP in 2007 to 103% in 2013. With the debt burden expected to rise steadily, it has set in motion a vicious circle of slower growth which reduces tax revenues at a time when Social Security, Medicare, and Medicaid payments are set to explode higher.

**CHART 4**

**Trend Real GDP Growth vs Federal Debt as % of GDP**




Numerous economists have estimated that the "gap" between expected revenues and spending on these "entitlement" programs could be as high as $150 TRILLION over the next 30 years.

The vast majority of people are not even aware of the impact of slower growth on their standard of living because it occurs over a relatively long time period. Consider a single 25-year-old earning $50,000 a year. If his real (inflation adjusted) earnings grow at the current 2% GDP growth rate, he will earn (in real terms) about $3.1 million over the next 40

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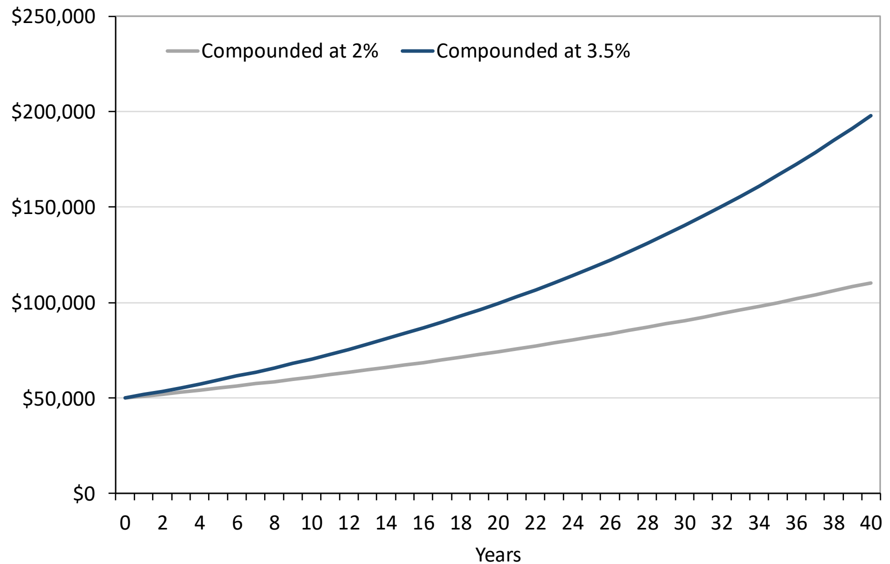
years. That same person whose income grows at the 3.5% average growth between 1950 and 2000 would earn $4.4 million in real terms – an increase of $1.3 million (Chart 5). That is the equivalent of 3.3 houses based on the current median single-family home price!

CHART 5

**Real Value of $50,000**

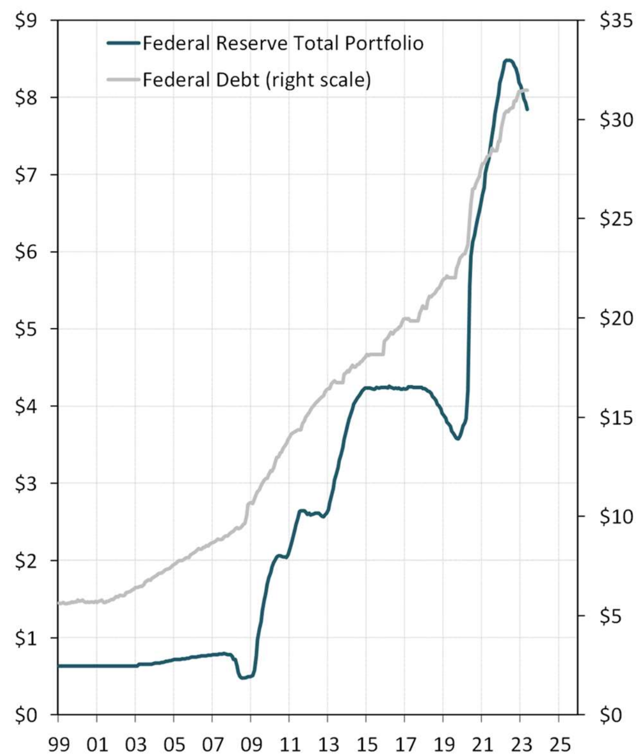



And that's not all. At the lower growth rate, the federal government would receive $300,000 less in tax revenues over that 40-year period based on the current average 13.6% income tax rate. Increasing debt beyond current levels actually reduces tax revenues by slowing growth in real income.

The other implication is a higher inflation rate. While slower trend GDP growth does not necessarily imply higher inflation, the tendency of the Federal Reserve to monetize the Treasury's borrowing with new money creation does. Chart 6 shows the relationship between Fed purchases of Treasury securities and the total amount of debt outstanding. Of the $19.3 trillion in net new borrowing by the federal government since 2009, $4.5 trillion - over 23% - has been purchased by the Federal Reserve. The Fed now owns over a third of the Treasury's debt, all of it paid for with new money creation. The purchase of over $4 trillion in debt since December 2019 was directly responsible for the surge in inflation to a 40 year high of 8.9% in mid-2022.

CHART 6

**Fed Portfolio vs Treasury Debt (Trillion $)**




The Federal Reserve has likely already realized, at least internally, that the magnitude of government borrowing will force them to buy an increasing share of government debt. The implication is that the Fed will have to tolerate a higher inflation rate than the current 2% target rate. Several regional Federal Reserve presidents recently signaled an openness to examining whether 2% (vs 3%) is the right target for the inflation rate. This is likely the first warning to financial markets that 2% inflation will be inconsistent with the amount of government debt that the Fed has to buy with new money in order to prevent major cuts in spending.

The other side effect of the Fed purchasing huge swaths of Treasury debt is the negative impact on the economy and financial markets when the Fed pulls back as a buyer. The Fed's sale of Treasuries in 2008, 2010, 2012, and 2018-2019, and 2022-2023 all triggered slower economic activity and lower stock prices. As a result, fluctuations in the economy and financial markets are increasingly being tied to the Fed's willingness to monetize

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substantial portions of the Treasury's debt. As government debt grows as a percent of GDP, this relationship is likely to become more pronounced and more volatile.

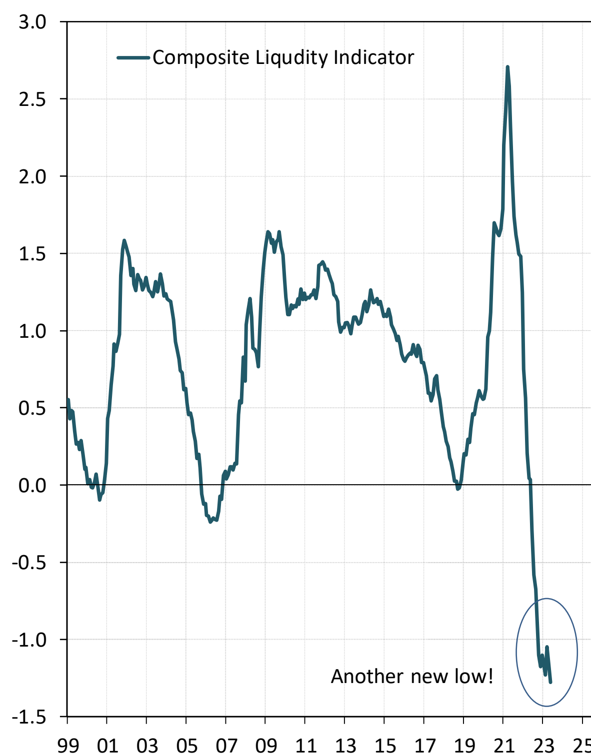
Clearly the "best and the brightest" in government haven't thought this one through. Targeting a 3% inflation rate might reduce the need for politically painful budget cuts. It would also, however, send a message to financial markets that interest rates should be 100 basis points higher because of the higher targeted inflation rate. The Treasury is already being adversely affected by higher interest costs on its borrowing. Higher interest rates since the Fed started tightening in early 2022 have already increased the cost of servicing the Treasury's debt by $130 billion over the CBO's forecasts (Chart 3). Tolerating a higher inflation rate might allow the Fed to buy more Treasuries, but the Treasury would be selling them at a higher yield which would largely offset any benefit from monetizing the debt. Moreover, increased tolerance for higher debt as a percent of GDP would further erode economic growth resulting in even lower tax revenues. Very rarely does trying to fix one stupid action with another stupid action have a good outcome.



## II. Equity Index Outlook

The equity markets continue to hang tough despite the Gamma Liquidity Indicator signaling the most severe liquidity contraction since 1980 (Chart 7). The S&P 500 edged up 0. 3% in May and now stands just -12% below its all-time high. Most of the gains were in a handful of stocks, however, as less than 25% of the S&P 500 stocks were up during the month. Tech stocks were the big performers as the Nasdaq climbed 5.6%. The Technology sector led the way with a 10.6% jump followed by Communication stocks which rose 8.9%. Markets were supported by resolution of the debt ceiling issue and another strong 339,000 increase in May payrolls. Despite this, the Gamma Equity Models for the S&P 500 and the Nasdaq stayed neutral (in cash) for May as the fundamentals remain bearish (Chart 8).

**CHART 7**
**Gamma Liquidity Indicator**




***Positive Factors***

- **Labor Market Remains Robust**. 339,000 jobs were created in May. 850,000 jobs were created over the past three months, pushing the number of payroll-type jobs to a record 156.1 million. The three-month average, which smooths out the month-to-month variability, is still above the average growth rate of the 2012-2019 period despite ten rate hikes since February 2022. Large revisions in the employment numbers over the last three months make the size of these increases somewhat suspect, but it's still clear that the labor market remains solid. As long as people have jobs, consumption – which makes up 68% of GDP – will likely hold up. Also, headline concerns about record highs in auto, student, credit card, and mortgage debt slowing spending may be overstated. It's true that household debt as a percentage of disposable income has jumped from a pandemic low of 75% to about 86%, but that level is comparable to the 2012-2019 average and is way below the 115% peak hit in 2008. The equity market appears focused on the positive impact of consumer spending on earnings rather than the risk that robust job growth will keep pressure on the Fed to hike rates further.

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- **Resolution of the Debt Ceiling Increase**. As we discussed above, there was never any real chance that the Federal government would default on its debt. Nevertheless, the uncertainty over limited government shutdowns to conserve cash has been removed. Since markets despise uncertainty, the removal of this issue has helped spur the market's recent strength.
- **A Pause in the Banking Crisis.** After the sale/liquidation of Silicon Valley Bank (SVB), Signature Bank, and First Republic Bank, the regional banking crisis has receded from the headlines. Unrealized losses on securities – mostly Treasury securities and mortgage-backed securities – held by all FDIC-insured commercial banks fell by $102 billion Q1 2023. It was the second quarterly decline in a row, and it left losses 25% below their Q3 2022 high when unrealized losses hit $690 billion. Note that the current losses of $516 billion are still enormous compared to historical norms (Chart 9), they just aren't AS enormous as they were six months ago. As the crisis fades, emergency discount window borrowing has fallen back to its pre-SVB level (Chart 10). This may simply be due to replacing one type of emergency aid with another. As discount widow borrowing has fallen, Bank Term Funding Program (BTFP) lending has climbed to a new high. Under this program, banks can borrow for up to one year by posting as collateral securities valued at "par," not at their current market value. The idea is that this high-quality collateral (Treasuries, MBS) will eventually mature and repay at its par value, thus avoiding the impact of unrealized losses on bank capital and threatening their solvency. High BTFP borrowing suggests that problems continue to simmer below the surface, but the equity market appears happy to ignore them for the time being: out-of-sight, out-of-mind!

CHART 8

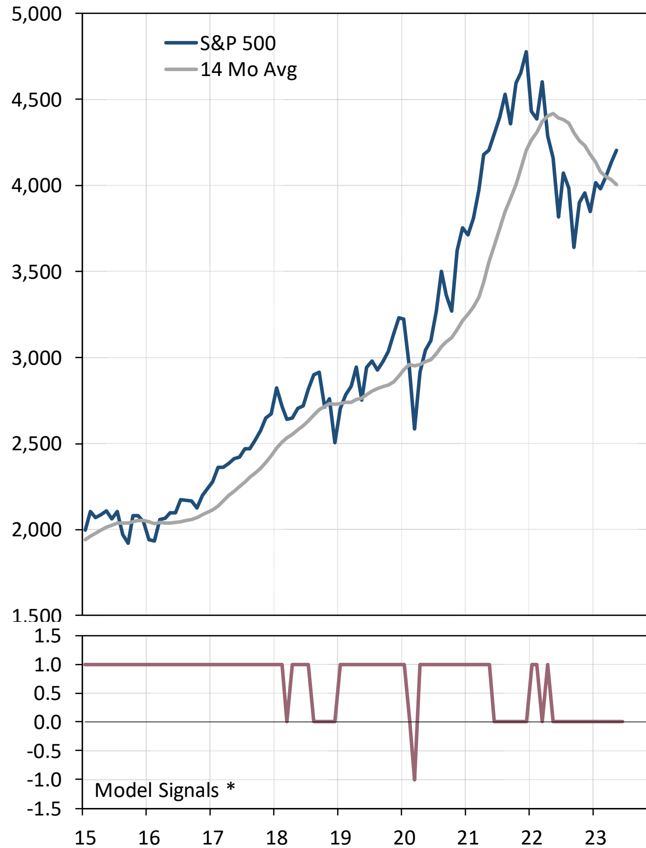



CHART 9

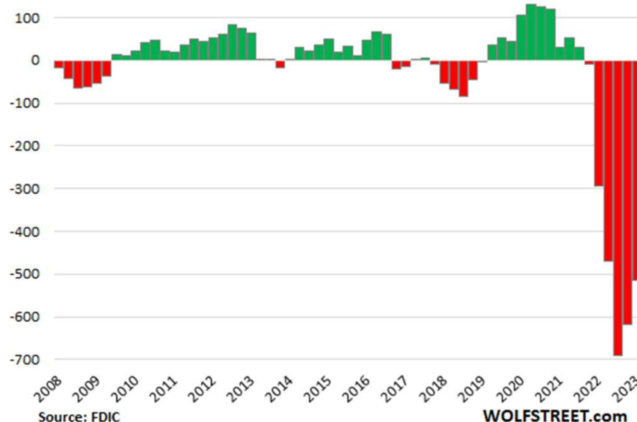
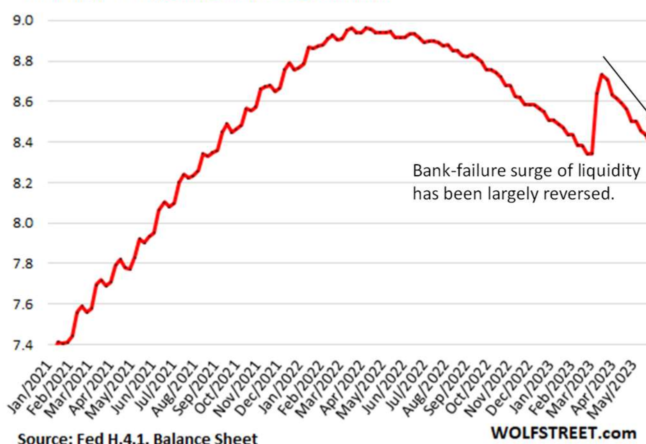



CHART 10

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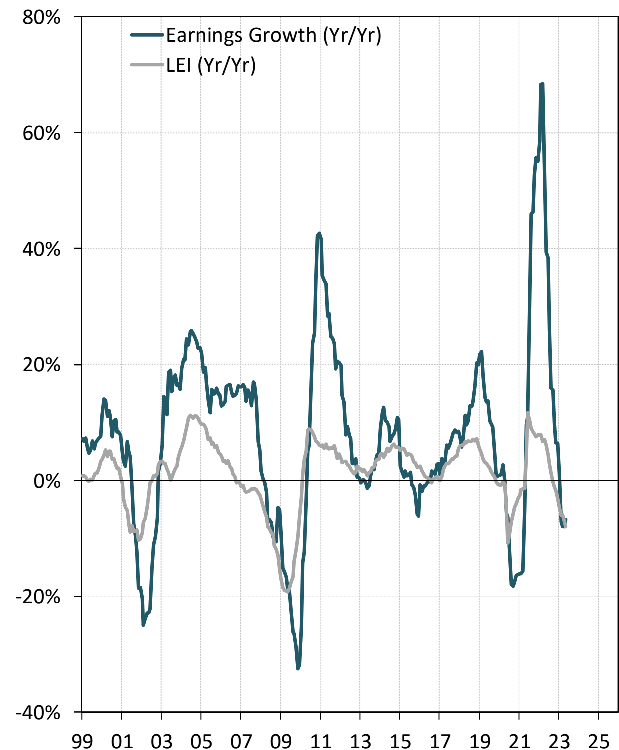
*Neutral Factors*

- **Corporate earnings *may* be bottoming**. 12-month trailing earnings still look awful, but measures for the total U.S. market, S&P 500, and Nasdaq indexes all improved in May. Total earnings for all U.S. stocks were still down -6.8% yr/yr, but this was an improvement from -8.0% the previous month. Earnings momentum (the 12-month change in 12-month earnings growth) also improved to –46.2% from -60.6%. Earnings have historically turned higher about six months after the Index of Leading Economic Indicators bottoms (Chart 11). The Index just put in a new cyclical low of – 8.0% yr/yr in May which suggests that some further short-term deterioration may still be possible. With earnings momentum still negative, it is unlikely that earnings will provide much support for stocks for the balance of the year. It may, however, remove one of the major drags on stock prices over the last year.






*Negative Factors*

- **Core inflation is no longer improving**. Consumer prices excluding food and energy rose 0.4% last month, the fifth consecutive monthly gain of 0.4%. Overall inflation has dropped from an 8.9% yr/yr rate last August to a 5% rate last month. Most of that decrease has occurred due to a 37% drop in energy prices and a 15% decline in food costs. The Gamma Economic Model predicts that at the projected growth rate of the economy, inflation will bottom at a 3.5% annual rate later this year – well short of the Fed's 2% target. Moreover, average hourly earnings rose 0.45% in May from April, the fastest growth rate since November. The three-month average rose by 0.4%, also the fastest rate since November. We previously believed that the Fed's ten rate increases totaling 500 basis points would put a sizeable dent in both economic activity and the core inflation rate. Leading economic indicators still point to a significant slowdown ahead. The persistence of these core numbers, however, is likely to be of growing concern to the Fed.
- **Short-term interest rates continue to rise**. The lack of recent progress in core inflation will keep upward pressure on interest rates (Chart 12). Market expectations previously called for rates to peak with the Fed's May FOMC meeting. Instead, the CME FedWatch Tool currently calls for a pause at the Fed's June meeting followed by another 25 basis points hike in July. Now that the distraction of the debt ceiling increase is out of the way, the Fed may assume a more aggressive stance to try and get inflation solidly under control. Previous comments by Fed officials acknowledge that a sustained improvement is not likely to occur given the current tightness in the labor market. Fed officials are probably frustrated by the disconnect between leading economic indicators and the labor market. The Conference Board's index of leading indicators (LEI) posted its worst one-month drop since June 2020 last month, yet the economy cranked out 339,000 new jobs. The LEI fell 1.2%, the thirteenth monthly decline in a row and a new yr/yr cyclical low. The Fed is clearly hoping that the projected weakness eventually feeds through to the labor market. It's likely they are concerned that a significant slowdown is on its way and that additional tightening(s) will tip the odds in favor a more severe downturn. Each additional month in which wage growth and core inflation continue at a 5%+ rate increases the odds, however, of further rate hikes that would push rates towards their 2000 highs.

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- **<u>The yield curve is becoming even more inverted</u>**. Last month's Fed rate hike caused the 3-30 yield curve to invert to its most extreme level since May 1981 despite an aggressive rise in bond yields due to debt ceiling concerns (Chart 12). The 2-10 curve, which had shown signs of moderating the last several months, also inverted further to 0.72%. **Both curves remain indicative of a very restrictive monetary policy.** Both are likely to contribute to even weaker money growth which has already fallen at the most extreme rate since the 1930's.
- **<u>Every measure of real money growth continues to deteriorate</u>**. Both nominal and real (inflation-adjusted) True Money Supply (TMS) growth continues to crash. Real TMS was down -13.5% yr/yr last month, its largest 12-month decline since March 1981 and the second largest drop yr/yr since WW II (Chart 13). Nominal TMS was down -8.5%. **To put this into perspective, nominal TMS has not fallen this much on an yr/yr basis since the bank failures of the 1930's.** Real M2 was down -9.6% yr/yr. Nominal M2 contracted -4.6%, the first yr/yr decline since the 1930's. All the measures are indicative of a severe contraction in liquidity which is likely to worsen due to an expected further inverting of the yield curves as short-term rates rise. It is highly unlikely that money growth will recover until interest rates have clearly peaked. The only factor preventing this contraction in liquidity from having a more extreme impact on the economy is that it is coming in the face of the record surge in money growth during the Covid pandemic. As we discussed last month, even with the Fed's rate hikes and contraction of it balance sheet, the amount of money per unit of GDP is still 44% higher now than before the pandemic.
- **<u>The Federal Reserve's balance sheet continues to contract</u>**. Even though the Fed injected almost $500 billion in reserves into the banking system in reaction to the flurry of regional bank failures, this occurred against a backdrop of ongoing tightening. Total assets held by the Fed dropped $118 billion for the month and are down $348 billion in the 10 weeks since the peak of the banking crisis. So-called quantitative tightening (QT) continues to be on-track with total assets down $580 billion from their April 2022 high. Chart 6 above shows that divergences

**CHART 12**

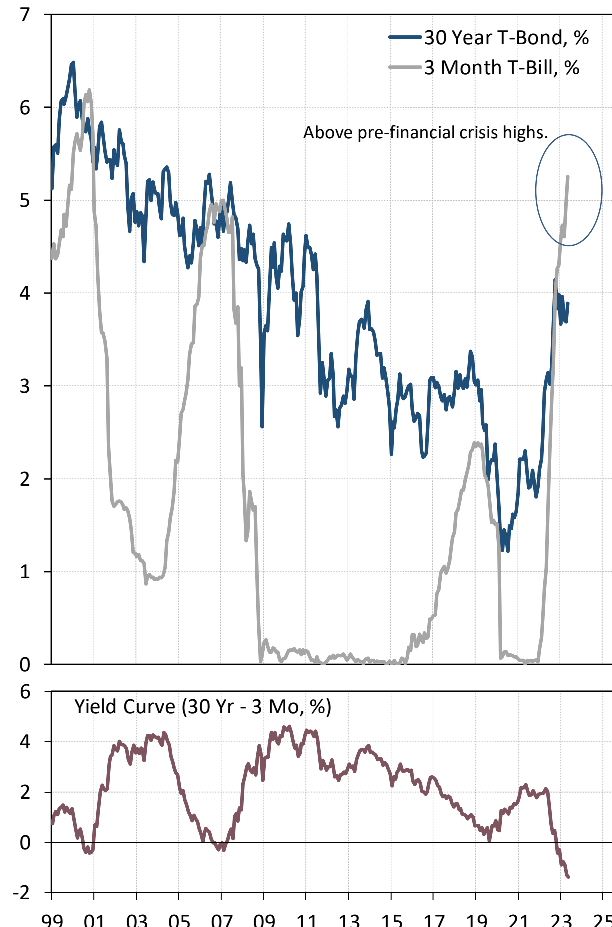
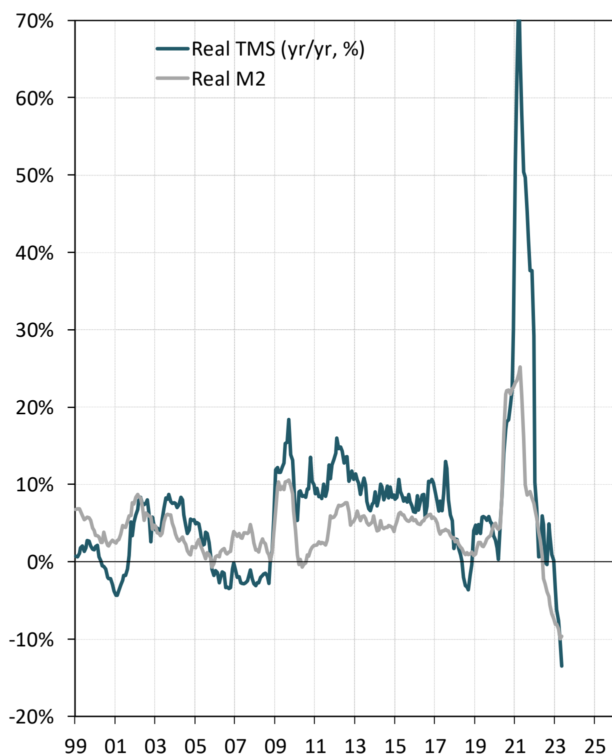



**CHART 13**

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between debt issuance by the Treasury and purchases by the Fed have invariably been accompanied by flat or negative equity performance.

- **Equities remain overvalued**. Last month's stock rally combined with higher short- and long-term rates carried the major indexes further into overvalued territory. The S&P 500 edged up to 21% overvalued from 19% in April (Chart 8). That's now the most extreme overvaluation since June 2021. The Nasdaq, which led the stock rally last month, saw value deteriorate sharply to 38% overvalued (Chart 14). **That pushed overvaluation just short of levels seen before the beginning of the current bear market** and raises the question of how sustainable this rally is in the face of potential additional rate hikes. **As we have repeatedly noted, no recovery from a major bear market low has occurred in the last 60 years when stocks were not at least fairly-valued. On average, new bull markets launched when stocks were 25% undervalued.**
- **Seasonals: Sell in May and go away**? Stocks have a reputation for underperforming during the summer months. The summer months have actually been positive historically, with the S&P 500 averaging a 0.2% monthly gain since 1974. In contrast, the S&P 500 has averaged a 1.2% monthly return in the non-summer months – a 6:1 outperformance ratio. Looking only at those summers when the Fed was tightening, the monthly summer average shows even worse underperformance with an average monthly loss of -0.04%. June has also historically been the fourth weakest month of the year, averaging a 0.7% gain.

CHART 14
USA: NASDAQ Valuation

## III. Equity Sector Outlook

There were few changes in the Sector Model forecasts for June. Energy continuing to hold the top spot (Table 1). Given the negative forecast for the overall market, there were only three sectors with positive expected returns compared to five last month. Energy remained in the top spot with an expected return of 1.13%. The Materials sector moved up into the second spot with a 0.1% expected return. Healthcare remained third on the list, while last month's second pick, Consumer Staples, dipped to fourth. Consumer Discretionary, Real Estate, and Financials remained at the bottom of the list reflecting the prospect of slower growth and potentially higher interest rates. Technology, despite posting a 10.6% gain in May and being up almost 40% for the year was forecasted to decline -0.9% in June.

The relative ranking of the sectors closely reflects the outlook for the overall economy and relative valuation of the different sectors. The recent flurry of bank failures, the number of banks with stretched balance sheets due to unrealized securities losses, and the prospect of additional rate hikes by the Federal Reserve is clearly weighing on the Financials and Real Estate sectors. With Financials down -13% from their January peak, the sector has actually moved into undervalued territory (Table 2). The Gamma Valuation Model shows Financials to be -

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**TABLE 1**

**1 Mo Stock Sector Index Forecasts (%)**

| Sector | Ticker | 1 Mo Forecast | Previous Forecast | Change |
|---|---|---|---|---|
| Energy | XLE | 1.13% | 0.93% | 0.21% |
| Materials | XLB | 0.10% | 0.23% | -0.13% |
| Health Care | XLV | 0.09% | 0.48% | -0.39% |
| Consumer Staples | XLP | -0.09% | 0.55% | -0.63% |
| Utilities | XLU | -0.14% | -0.26% | 0.12% |
| Industrials | XLI | -0.60% | -0.48% | -0.12% |
| Communications Services | XLC | -0.75% | -0.36% | -0.39% |
| Gold Miners | | -0.80% | 0.34% | -1.14% |
| Technology | XLK | -0.90% | -0.43% | -0.48% |
| Real Estate | XLRE | -0.97% | -0.24% | -0.73% |
| Financials | XLF | -1.26% | -0.62% | -0.64% |
| Consumer Discretionary | XLY | -1.71% | -1.36% | -0.35% |

**TABLE 2**

**Sector Valuation**

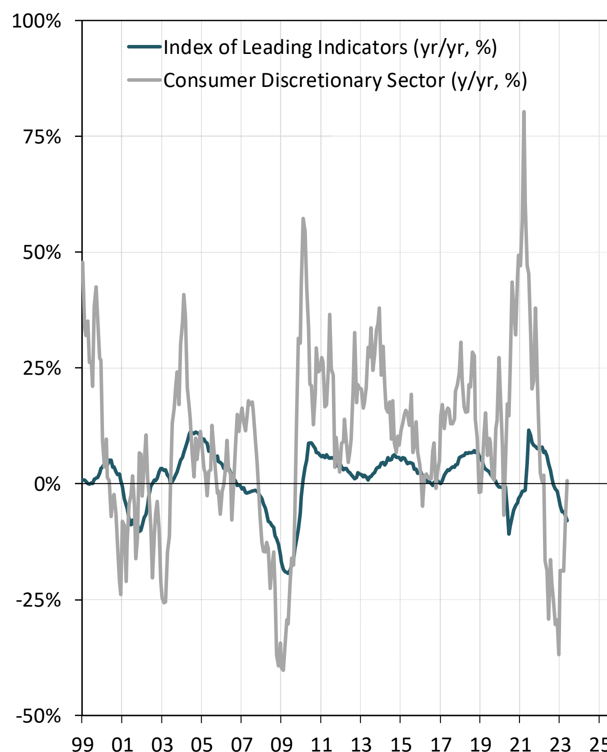
| Sector | Valuation (σ) | Valuation (%) |
|---|---|---|
| Energy | -3.41 | -68% |
| Gold Mining Shares | -1.22 | -36% |
| Financials | -0.63 | -15% |
| Real Estate | -0.50 | -15% |
| Consumer Staples | -0.04 | -1% |
| Materials | +0.21 | +3% |
| Industrials | +0.33 | +7% |
| Health Care | +1.17 | +26% |
| Utilities | +1.66 | +24% |
| Technology | +1.69 | +56% |
| Communication Services | +1.97 | +54% |
| Consumer Discretionary | +2.07 | +51% |

0.6 standard deviations undervalued (about 15%). Real Estate is down -11% from its January high which translates into -0.5 standard deviation undervaluation (also about 15%). This level of undervaluation is likely to provide some protection against another major selloff relative to the overall market given that a great deal of bad news is already priced in.

On the other extreme is Consumer Discretionary which is dead last on the list with an expected loss in June of -1.71%. This sector has held up extremely well given the steady rise in interest rates since early 2022 and the ongoing drumbeat from economists warning of an imminent recession. The sector is up 16% from its December low despite the index of leading indicators being down 13 months in a row and currently sitting at its cyclical low (Chart 15). That can be interpreted in one of two ways. Either 1) the Consumer sector is signaling that the LEI is bottoming and is likely to improve, or 2) the sector is overestimating the odds of a soft landing to the economy. The current valuation for the sector suggests the latter. Consumer Discretionary stocks have the distinction of being the most overvalued sector at +2.07 standard deviations. That translates into 51% overvaluation. Even if the sector correctly anticipates a recovery in economic activity, its extreme overvaluation suggests that it will lag behind the overall market.

**CHART 15**

**Measures of Economic Activity**




In contrast to Consumer Discretionary, the Energy sector continues to be the cheapest by a long shot. The sector is currently -3.41 standard deviations undervalued (68%). The next cheapest sector, Gold Mining shares, comes in a distant second at -1.22 standard deviations. Attractive valuation is the major support for both sectors. Gold shares, in particular, have been buffeted all year by the tug-of-war between very attractive valuation and the expectation of a peak in interest rates being steadily pushed out further into the future. **At 36% undervaluation, we continue to encourage long-term investors to take advantage of weakness in the sector to add to long positions in Gold Mining shares.**

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# IV. Stock Recommendations and Review

The Gamma Company Model starts June with 14 names on our "hold long" list of companies including the latest additions, Sempra (SRE) and WEC Energy (WEC). No companies were removed from last month's list. All the names on the previous list have expected returns above the average for the stocks in the S&P 500. Two in particular, Henry Schein (HSIC) and ONEOKE (OKE), have expected returns in the top 10% of all the S&P 500 stocks despite struggling last month. The total portfolio trailed -3.27% behind the S&P 500 last month, the first underperformance in at least 12 months that was largely due to the lack of tech names.

**TABLE 3**

**GAMMA COMPANY MODEL - Recommended List Performance** — As of: May 31, 2023

| Sector | Ticker | Entry Price | Closing Price 5.31.23 | % Change | Trade Date | S&P 500 % Change | Excess Return |
|---|---|---|---|---|---|---|---|
| Altria Group, Inc. | MO | $47.63 | $44.42 | -6.7% | 12.2.22 | 2.7% | -9.4% |
| Celanese Corp. | CE | $122.12 | $104.02 | -14.8% | 2.6.23 | 1.7% | -16.5% |
| Centene Corp. | CNC | $63.21 | $62.41 | -1.3% | 3.31.23 | 0.0% | -1.3% |
| DaVita Inc. | DVA | $90.36 | $93.67 | 3.7% | 4.28.23 | 0.3% | 3.4% |
| Diamondback Energy, Inc. | FANG | $145.46 | $127.15 | -12.6% | 12.2.22 | 2.7% | -15.3% |
| Henry Schein Inc. | HSIC | $78.31 | $73.90 | -5.6% | 3.1.23 | 5.8% | -11.4% |
| Kroger Co. | KR | $47.57 | $45.33 | -4.7% | 12.2.22 | 2.7% | -7.4% |
| McKesson Corp. | MCK | $313.34 | $390.84 | 24.7% | 6.10.22 | 7.2% | 17.6% |
| ONEOKE Inc. | OKE | $68.20 | $56.66 | -16.9% | 2.6.23 | 1.7% | -18.6% |
| PG&E Corporation | PCG | $17.11 | $16.94 | -1.0% | 4.28.23 | 0.3% | -1.2% |
| Pulte Group | PHM | $57.48 | $66.08 | 15.0% | 2.6.23 | 1.7% | 13.3% |
| Sempra | SRE | $143.53 | $143.53 | 0.0% | 5.31.23 | 0.0% | 0.0% |
| Skywork Solutions Inc. | SWKS | $93.96 | $103.51 | 10.2% | 5.31.23 | 2.7% | 7.5% |
| WEC Energy | WEC | $87.35 | $87.35 | 0.0% | 12.2.22 | 0.0% | 0.0% |

The first new name being added, Sempra (SRE, $143.53), has an expected return of 1.4% for June and is also a member of the top-ranked Energy sector.

- Sempra, formerly Sempra Energy, is an energy holding company with infrastructure investments in the

Source: CNBC

  U.S. and internationally. It operates through four segments: San Diego Gas & Electric Company, Southern California Gas Company, Sempra Texas Utilities, and Sempra Infrastructure.
- Analyst coverage: 17 analysts cover SRE, and the recommendations are 4 strong buys, 6 buys and 7 holds. The price target ranges from $163.00 to $182.00.
- Trades at a Forward P/E (NTM) of 16.3 and pays a dividend with an attractive 3.25% yield.
- SRE has increased its dividend for 19 consecutive years.

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- Sempra updated its full-year 2023 GAAP EPS guidance range of $8.76 to $9.36, affirmed FY 2023 adjusted EPS guidance range of $8.60 to $9.20, and announced its FY 2024 EPS guidance range of $9.10 to $9.80. The company is also affirming its projected long-term EPS growth rate of 6% to 8%.
- The company has an exceptional five-year net income growth rate of 24% (robust net margin and consistent profitability). It benefits from a natural monopoly and it targets segments of the ultra-lucrative SoCal market.

Our second addition is WEC Energy (WEC, $87.35), also an energy company, with an expected June return of 1.4%.

- WEC Energy Group, Inc. is a diversified utility – electric power holding company. The company provides or invests in regulated natural gas and electricity and renewable energy, as well as non-regulated renewable energy. It has four segments: Wisconsin, Illinois, Other States, and Electric Transmission. WEC's energy network consists of 71,000 miles of electricity distribution lines and 51,400 miles of gas delivery lines.
- Analyst coverage: 13 analysts cover WEC and the recommendations are 2 strong buys, 4 buys, and 7 holds. The price target ranges from $96.00 - $111.00.
- Trades at a Forward P/E (NTM) of 19.0 and pays a dividend with a 3.58% yield.
- Dividends have been growing at a 10% annual rate over the last ten years. Increased dividend in January 2023 by 7.2% to an annual rate of $3.12 per share. This marks the 20th consecutive year of higher dividends.
- The company reaffirmed 2023 earnings guidance in the range of $4.58-$4.62 per share. The midpoint of the range, $4.60 per share, is on par with the Zacks Consensus Estimate.
- WEC reported Q1 2023 earnings of $1.61 per share, which beat the Zacks Consensus Estimate of $1.59 by 1.26%. However, EPS declined 10.1% from Q1 2022's figure of $1.79.
- Debt is well covered by earnings which are forecasted to grow for the next three years.
- Recent pressure on the company's stock due to regulatory concerns maybe overblown as it resolved its Wisconsin filings earlier this year.

**Note: in general, we do not like being long ANY stocks at the moment given the negative forecasts from the S&P 500 and Nasdaq Models. The stocks on our recommended list, however, are likely to have the best chance of outperforming the overall market according to our Models.**

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## V. Asset Allocation

Coming next month, we will be adding a new section on asset allocation. That section will provide specific information on how our subscribers can implement the Gamma Model investment recommendations using ETF's, mutual funds, or futures. Our goal is help subscribers replicate the returns of the Gamma Models based on our specific trade instructions using liquid, low-cost investment options. We will also track the performance of these portfolios so investor can decide which strategies best suit their investment goals.



-Karl Chalupa and N. Claude Colabella

Mr. Chalupa is the CIO and Co-Founder of Gamma Investment Consulting and Editor of the Gamma Intelligence Reports. He is also President of Gamma Capital LLC, a quantitative global macro investment firm. Mr. Chalupa developed the Gamma Investment Program used for previously trading the firm's $400 million global macro program. He was previously Director of Risk Management at Titan Advisors LLC, a $4.5 billion alternative investments firm. Mr. Chalupa was also Managing Director of the Currency and Alternative Investment Strategies Groups at State Street Global Advisors (SSGA) where he developed a $9 billion currency overlay program and launched SSGA's first hedge fund based on his Gamma Model. Mr. Chalupa spent 13 years at ABN Amro Bank where he traded interest rate and currency derivatives and was Manager of the Proprietary Trading and Economic Research Desk. He began his career as an economist for the Federal Reserve Bank of Chicago. Mr. Chalupa holds an MA in Economics from Brown University, graduated magna cum laude from Northern Illinois University with BAs in Economics and Political Science, and is Series 3 registered.

Mr. Colabella is the Chief Operating Officer, Co-Founder of Gamma Investment Consulting and Co-Editor of the Gamma Equity Intelligence Report. He was previously Director of Communications and Investor Relations at Titan Advisors, LLC, a $4.5 billion alternative assets solutions firm. Mr. Colabella has equity research experience with working at Petroleum Research Group, Inc. (Rye, NY), an independent energy equity research boutique and at John S. Herold, Inc., a leading petroleum research and consulting firm. He was a Managing Partner at Alpha Beta Alternative Investments, Inc., an alternative investment boutique that managed Alpha Beta Partners, LP, a multi-strategy "fund of funds". Mr. Colabella holds an MBA in Finance from Duke University, Fuqua School of Business. He graduated magna cum laude from Manhattan College, with a BS BA in Economics and is Series 63 registered.

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# Gamma Equity Model Forecasts for June 2023 (as of 5/31/2023)

**TABLE 1**

**1 MONTH STOCK INDEX MODEL FORECASTS (%)**

| Country | Stock Index | Price | 1 Mo Forecast | Previous Forecast | Position | Trade | Updated |
|---|---|---|---|---|---|---|---|
| USA | S&P 500 | 4,205.52 | 0.00% | 0.00% | Neutral | Hold | 5/31/23 |
| USA | Nadaq | 13,014.26 | 0.00% | 0.00% | Neutral | Hold | 5/31/23 |
| Canada | S&P/TSX 60 | 1,181.89 | 0.00% | 0.00% | Neutral | Hold | 5/31/23 |
| Mexico | IPC | 53,180.80 | 0.00% | 5.43% | Neutral | Cover Long | 5/31/23 |

**TABLE 2**

**1 MONTH STOCK SECTOR MODEL FORECASTS (%)**

| Sector | Ticker | 1 Mo Forecast | Previous Forecast | Updated |
|---|---|---|---|---|
| Energy | XLE | 1.13% | 0.93% | 5/31/23 |
| Materials | XLB | 0.10% | 0.23% | 5/31/23 |
| Health Care | XLV | 0.09% | 0.48% | 5/31/23 |
| Consumer Staples | XLP | -0.09% | 0.55% | 5/31/23 |
| Utilities | XLU | -0.14% | -0.26% | 5/31/23 |
| Industrials | XLI | -0.60% | -0.48% | 5/31/23 |
| Communications Services | XLC | -0.75% | -0.36% | 5/31/23 |
| Gold Miners | --- | -0.80% | 0.34% | 5/31/23 |
| Technology | XLK | -0.90% | -0.43% | 5/31/23 |
| Real Estate | XLRE | -0.97% | -0.24% | 5/31/23 |
| Financials | XLF | -1.26% | -0.62% | 5/31/23 |
| Consumer Discretionary | XLY | -1.71% | -1.36% | 5/31/23 |

**TABLE 3**

**S&P 500: LARGE CAP STOCKS** — **Top 25 Picks Based on Expected Return and Factor Momentum** — **Forecast for: Jun 2023**

**1 Month Company Stock Price Forecasts (%)** — **Updated: May 31, 2023**

| Company | Ticker | Closing Price | 1 Mo Forecast | Previous Forecast | Change | % Off 52 Wk High | Forward P/E | Dividend Yield | Factor Momentum |
|---|---|---|---|---|---|---|---|---|---|
| HEALTHPEAK PROPERTIES | PEAK | $19.96 | 2.55% | 1.49% | 1.06% | -32.8% | 36.83 | 6.01% | Positive |
| NVIDIA | NVDA | $378.34 | 1.78% | 0.63% | 1.14% | 0.0% | 46.49 | 0.04% | Positive |
| FEDERAL REALTY INV.TST. | FRT | $88.20 | 1.59% | 0.25% | 1.35% | -23.3% | 32.11 | 4.90% | Positive |
| L3HARRIS TECHNOLOGIES | LHX | $175.92 | 1.42% | 1.02% | 0.40% | -28.6% | 13.89 | 2.59% | Positive |
| WEC ENERGY GROUP | WEC | $87.35 | 1.39% | 0.09% | 1.30% | -16.9% | 18.26 | 3.57% | Positive |
| SEMPRA | SRE | $143.53 | 1.38% | 0.33% | 1.05% | -13.6% | 15.49 | 3.32% | Positive |
| DOMINION ENERGY | D | $50.28 | 1.36% | 0.56% | 0.80% | -40.3% | 13.00 | 5.31% | Positive |
| MCKESSON | MCK | $390.84 | 1.32% | 1.12% | 0.21% | 0.0% | 14.12 | 0.55% | Positive |
| INTUITIVE SURGICAL | ISRG | $307.84 | 1.32% | 0.02% | 1.30% | 0.0% | 52.32 | 0.00% | Positive |
| GENUINE PARTS | GPC | $148.93 | 1.23% | 0.40% | 0.83% | -18.8% | 16.84 | 2.55% | Positive |
| DUKE ENERGY | DUK | $89.29 | 1.16% | 0.31% | 0.85% | -20.6% | 15.33 | 4.50% | Positive |
| EDISON INTL. | EIX | $67.52 | 1.05% | 0.40% | 0.65% | -8.3% | 13.44 | 4.37% | Positive |
| DOVER | DOV | $133.33 | 1.05% | 0.30% | 0.75% | -12.2% | 14.68 | 1.52% | Positive |
| INSULET | PODD | $274.25 | 1.05% | 0.17% | 0.88% | -14.0% | 156.54 | 0.00% | Positive |
| MICRON TECHNOLOGY | MU | $68.20 | 1.03% | 0.93% | 0.10% | -7.6% | NA | 0.67% | Positive |
| MGM RESORTS INTL. | MGM | $39.29 | 1.00% | 1.00% | 0.00% | -12.5% | 17.01 | 0.03% | Positive |
| EMERSON ELECTRIC | EMR | $77.68 | 0.98% | 0.34% | 0.63% | -19.1% | 17.15 | 2.68% | Positive |
| AMER.ELEC.PWR. | AEP | $83.12 | 0.88% | 0.21% | 0.67% | -18.5% | 15.18 | 3.99% | Positive |
| APPLIED MATS. | AMAT | $133.30 | 0.82% | 0.18% | 0.64% | 0.0% | 18.99 | 0.96% | Positive |
| VERISIGN | VRSN | $223.32 | 0.80% | 0.68% | 0.12% | 0.0% | 30.86 | 0.00% | Positive |
| TRAVELERS COS. | TRV | $169.24 | 0.77% | 0.19% | 0.58% | -11.4% | 11.04 | 2.20% | Positive |
| APTIV | APTV | $88.08 | 0.74% | 0.28% | 0.46% | -24.3% | 18.03 | 0.00% | Positive |
| MONSTER BEVERAGE | MNST | $58.62 | 0.72% | 0.72% | 0.00% | 0.0% | 34.87 | 0.00% | Positive |
| PAYPAL HOLDINGS | PYPL | $61.99 | 0.69% | 0.35% | 0.34% | -33.7% | 11.82 | 0.00% | Positive |
| CIGNA | CI | $247.41 | 0.66% | 0.51% | 0.16% | -25.3% | 9.27 | 1.99% | Positive |

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