FORD WEALTH MANAGEMENT LLC

Independence · Integrity · Insight

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April 12, 2023

"The worst historian has a clearer view of the period he studies than the best of us can hope to form of that in which we live. The obscurest epoch is to-day." -Robert Louis Stevenson

"There's nothing quite as frightening as someone who knows they are right." -Michael Faraday

Fellow Investors:

As we approach summer the key question seems to be "soft or hard?". It is not regarding how we prefer our ice cream, but what kind of recession do we expect from the Federal Reserve's aggressive rate increases. There are opinions for every case and the confidence in which they are expressed only leads us to further discount those sources and views. As we have stated in previous letters, history is interesting and can certainly be learned from, but no situation is exactly like a previous one. If for no other reason, a similar set of circumstances is different because we now have the benefit of prior experience. Like Heisenberg's Uncertainty Principal, we cannot know where something is and how it is changing at the same time. Given that, how do we expect policy makers or economic pundits to be able to tell us how things are changing from where we are? Or even if they have an accurate picture of where we are.

In the first quarter of 2023, we were rewarded with positive returns in both the equity and fixed income markets after the thrashing these markets took in 2022. The S&P 500 gained 7.5% for the quarter after losing 18.1% for 2022. International equities (measured by the MSCI EAFE) did marginally better, gaining 8.6% for the quarter. The only major asset category showing a loss for the quarter was commodities (measured by Bloomberg Commodity Index), a sharp reversal from last year when commodities were the only asset class showing a gain for the year. The Nasdaq Composite outshone the S&P 500 with a 17.62% gain for the quarter, but that came after a loss of 32.5% for all of 2022. The large tech firms which dominate these indices (S&P and Nasdaq) were a driving force for both the decline in 2022 and the rebound in the first quarter.

Interest rates and inflation are on everyone's mind as the Federal Reserve Board continued its rate rising campaign into 2023. Market rates indicate that the Fed has nearly come to the end of its rate increases as both the two-year and the ten-year treasury rates are off their peaks for the quarter. The Fed also softened its language a bit after its last 25 basis points increase. Consensus calls for one, maybe two more Fed rate hikes of 0.25% with some forecasting rate cuts starting as early as later this year. We shall see. The two-year treasury started the year at 4.40% and peaked in early March at 5.05% before finishing the quarter at 4.06%. A year ago, the two-year rate was at 2.28%. The ten-year showed a similar pattern, starting the year at 3.79% and peaking at 4.08% in early March before finishing out the quarter at 3.40%. A year ago, the ten-year was 2.32%. The yield curve is decidedly negative which is frequently cited as a recessionary indicator, but I refer you back to Professor Heisenberg.

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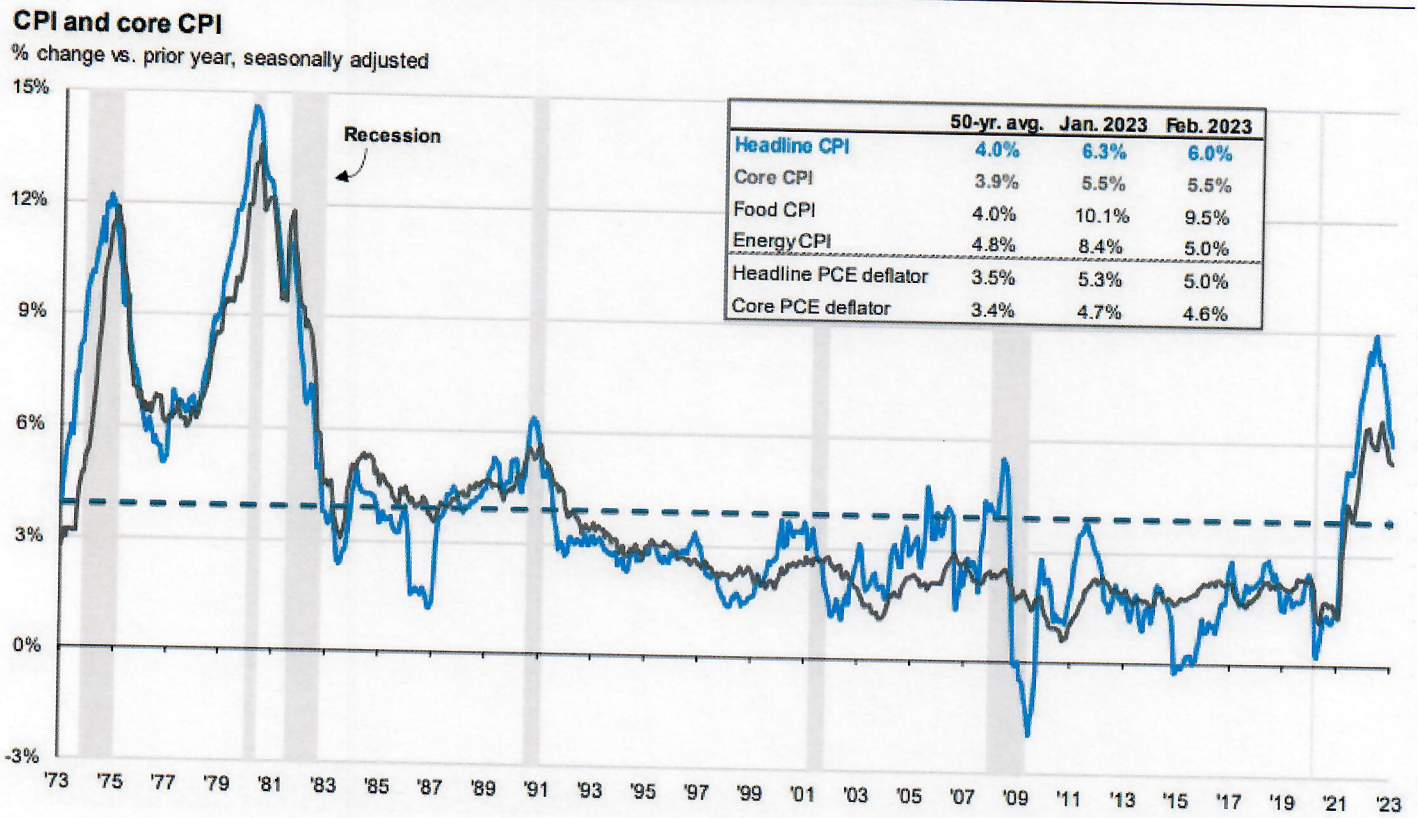

	50-yr. avg.	Jan. 2023	Feb. 2023
Headline CPI	4.0%	6.3%	6.0%
Core CPI	3.9%	5.5%	5.5%
Food CPI	4.0%	10.1%	9.5%
Energy CPI	4.8%	8.4%	5.0%
Headline PCE deflator	3.5%	5.3%	5.0%
Core PCE deflator	3.4%	4.7%	4.6%

Source: BLS, FactSet, J.P. Morgan Asset Management.
CPI used is CPI-U and values shown are % change vs. one year ago. Core CPI is defined as CPI excluding food and energy prices. The Personal Consumption Expenditure (PCE) deflator employs an evolving chain-weighted basket of consumer expenditures instead of the fixed-weight basket used in CPI calculations.
Guide to the Markets – U.S. Data are as of March 31, 2023.

J.P.Morgan
ASSET MANAGEMENT

Inflation has come off its peak but remains elevated and is especially so in the food and energy sectors. The driver of our jump in prices, the growth in the M2 money supply, has continued to marginally contract, down about three percent from its peak a year ago.

It is not necessarily the level of interest rates that is the cause of market dislocation, but the speed at which rates increased to reflect the explosion of inflation and the Fed's moves to combat it once they realized it was not "transitory". The effects of rate changes on bond values are much more familiar to investors after 2022, as the bond sharp upward move in rates resulted in a bond market decline that was nearly as bad as equities. The good news is that our bond portfolios now have a respectable yield, the bad news is we had to realize double-digit losses to get there. Unfortunately, there were a couple of poorly managed banks which learned this lesson by failing.

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Besides the effect on our portfolios, the increase in rates moved through the economy via higher mortgage rates and increasing the cost of capital for business investment. Again, these rates are not historically outrageous, but we have been spoiled by years of abnormally low rates. At one point the 30-year mortgage rate was well below 3.00%. Compare that to rates in the early 1980's. Thanks to lessons learned on the lending side, we are fortunate that the low rates did not result in a residential lending crisis like we had 15 years ago. We cannot say the same for balance sheet management for those banks that failed. The mortgage rate increase did negatively change home affordability for certain real estate markets taking the edge off upward price pressure from a market short of inventory.

The angst for the coming recession seems to be everywhere. Will we have a hard landing or a soft landing? Will we even have a landing (recession) at all? Economic data is always a view in the rearview mirror and as investors we are interested in what is visible through the windshield. Admittedly that is not always easy to interpret, but for believers in efficient markets, the decisions of millions of market participants cancel out the outliers. Perhaps the performance of the first quarter tells us something. Recent data reads indicate slowing and contracting manufacturing activity. The service sector is also slowing but is still growing, just at a slowing rate. Employment gains as measured in new jobs are slowing, but with a 3.5% unemployment rate, it is hard to say that employment is a weak spot. The equity results in the first quarter were driven to a large extent by recovery of big tech, rebounding from being heavily sold in 2022. The consensus seems to reflect (in our opinion) that the future remains bright for big tech's role in our economic future. Inflation and interest rates edging down are also positives, especially in how they are reflected in the values of growth stocks. We do continue to be wary of the concentration in big tech names in the oft cited indices. The top five names in the S&P 500 make up 21.6% of the index and are all tech mega-caps. Those same five names comprise 44.4% of the Nasdaq 100.

There is always a future, and it is always unknown. We continue to be faced with domestic and international questions ranging from economic to political to social. We can guess and speculate, but the most constructive thing for us to do for our future is to participate. We cannot let our human biases take a year like 2022 and keep us from benefiting from what is to come. Steady as she goes.

Sincerely,

Erik Ford

The S&P 500 Index, or the Standard & Poor's 500 Index, is a market-capitalization-weighted index of the 500 largest publicly traded companies in the U.S. It is not an exact list of the top 500 U.S. companies by market capitalization because there are other criteria to be included in the index.

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The Nasdaq Composite Index is a market capitalization-weighted index of more than 3,700 stocks listed on the Nasdaq Stock Exchange. As a broad index heavily weighted toward the important technology sector, the Nasdaq Composite Index has become a staple of financial markets reports.

The Nasdaq 100 Index is a basket of the 100 largest, most actively traded U.S companies listed on the Nasdaq stock exchange. The index includes companies from various industries except for the financial industry, like commercial and investment banks. These non-financial sectors include retail, biotechnology, industrial, technology, health care, and others.

The MSCI EAFE Index serves as a performance benchmark for the major international equity markets and includes companies in 21 countries in Europe, Australasia, and the Far East (East Asia).

The Bloomberg Commodity Index (BCOM) is a broadly diversified commodity price index distributed by Bloomberg Index Services Limited. The index was originally launched in 1998 as the Dow Jones-AIG Commodity Index (DJ-AIGCI) and renamed to Dow Jones-UBS Commodity Index (DJ-UBSCI) in 2009, when UBS acquired the index from AIG.[1][2] On July 1, 2014, the index was rebranded under its current name.

M2 is the U.S. Federal Reserve's estimate of the total money supply including all of the cash people have on hand plus all of the money deposited in checking accounts, savings accounts, and other short-term saving vehicles such as certificates of deposit (CDs).

Index return data from JP Morgan Asset Management and YCharts. Indices mentioned are not managed and cannot be invested in directly.

Treasury yield data from YCharts.

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