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MARKET VIEW QUARTERLY

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Coming off the heels of a dismal year in 2022, markets rebounded in a big way in January. The S&P 500 finished with a gain of just over 6% and the NASDAQ notched its best January performance since 2001. Driving the rally was the declining rate of inflation, which indicated that the Federal Reserve (Fed) could be close to ending its monetary tightening program. However, optimism over the Fed ending rate hikes was quickly squashed with a hotter-than-expected jobs report and a stronger-than-expected increase in the Fed's preferred measure of inflation, which raised concerns that further rate increases may lie ahead. In March, markets received a shock as Silicon Valley Bank and Signature Bank became the 2nd and 3rd largest bank failures in U.S. history. Ultimately, while volatility may persist in the near-term as confidence in the banking sector takes time to fully return, we see opportunities forming in both the equity and fixed income spaces in the months ahead. Almost exactly one year after the start of the Federal Reserve's most aggressive rate-hiking campaign in four decades, the recent bank troubles could potentially mark a turning point in monetary policy. A potential pause in the Fed hiking cycle could spur both equity and bond markets.

DOMESTIC EQUITIES

Most domestic equity markets kicked off the year with a delightful rally, but in March, investors faced a lion in the form of several regional bank failures that whipsawed equity markets. But the arrival of a widely-anticipated, second 0.25% rate hike for the quarter paired with assurances from regulators that the U.S. banking system is "sound and resilient,"[1] assured investors that regional turmoil had been adequately ring-fenced, and markets turned more sanguine – as the old adage goes, out like a lamb. Growth equities, particularly tech stocks, were the star performers, as fears of contagion compelled investors to seek out the cash-rich balance sheets and durable revenue streams of mega-cap tech stocks, pushing their prices higher. The NASDAQ index, serving as a proxy for tech stock, returned +17.05% through Q1, while the banking sector, as represented by the iShares U.S. Regional Banks ETF, retreated (-24.44%), setting up conflicting sector themes domestically. The Russell 1000 Value index returned +1.01% for the first quarter versus +14.37% for the Russell 1000 Growth index while the S&P 500 was up 7.50% As we move past the first quarter, we acknowledge that the volatility introduced by the collapse of three US regional banks worried markets broadly, which temporarily quelled the likelihood of further interest rate hikes. Should this be the end of the Fed's rate hiking campaign, it is valuable to note that in post-pause data going back to the early 1980's, the S&P 500 Index averages over 18% return in the ensuing 12-month period.[2]

INTERNATIONAL EQUITIES

The global economic outlook has not improved much since capping off a difficult 2022 which saw growth slow due to Russia's war in Ukraine and a sharp reduction in China's economic activity due to the government's strict, Zero-Covid policy, as well as the compounding effects of those situations on inflation. Since then, energy and food prices have eased, which has boosted purchasing power, particularly in emerging markets. But central banks, seemingly in lockstep globally, have continued to raise policy interest rates in their fight against inflation. China's reopening since the recent, full repeal of its pandemic-era policy has eased supply-chain issues and increased aggregate demand, positively affecting global economic growth, although turmoil in both the U.S. and European banking sectors has roiled financial markets recently.[3] Despite global economic growth projected to slow - the OECD expects 2.6% growth this year compared to 3.2% in 2022 (although that forecast has improved since November),[4] global equity markets have proven resilient with the MSCI EAFE Index, a benchmark of developed foreign country stocks, improving +8.47% through the first quarter. Emerging market performance, while positive in aggregate as measured by MSCI EM Index, which grew +3.96% through the first three months of the year, has varied quite widely from region to region.[5] But the backdrop is improving despite below-trend growth expectations. China reopening is a significant positive and many are hopeful for an end to Russia's war in Ukraine in the relative near-term. Attractive valuations will continue to tempt investors as the outlook becomes clearer in the coming months.

FIXED INCOME

Bond markets had a decent start to the year following the worst year of performance in fixed income history. With central bank eyes trained on the labor market, a particularly strong jobs report at the end of January sent shudders through bond markets as investors realized the job of fighting inflation was far from done. Further strong economic data trickled in through the month of February, and fixed income gains quickly turned again to losses as yields climbed. The 2-year yield even breached 5% for the first time since 2007.[6] Most monetary tightening cycles continue until something breaks, and in early March the fastest rate rise in history exposed cracks in the regional banking sector with the failures of Silicon Valley Bank, Signature Bank, and Silvergate Bank. With hindsight, the sector at large appears more solid than the initial panic suggested (all three banks were highly concentrated in their depositor bases, largely serving the venture capital, early-stage start-up, and crypto industries, *and* badly mismanaged Treasury portfolios), but bond markets reacted violently in mid-March. In several fitful and precipitous drops, the 2-year yield plunged below 3.8% from over 5% just a week prior.[7] The ICE BofA MOVE Index - a measure of volatility in the bond market - surged to the highest levels since the 2008 financial crisis and surpassed levels recorded during the March 2020 pandemic-related market crash.[8] Chairman Jerome Powell at the March Fed meeting then confirmed the U.S. banking system was "sound and resilient" and still-elevated inflation, though improving, would require some additional monetary tightening.[9] The central bank also raised its benchmark Fed funds rate an additional quarter-percentage point, its ninth consecutive rate hike.[10] The bond-market rally spurred by bank stress has diminished significantly and yields resumed their climb with the understanding that the Fed would now continue its fight against inflation.

ALTERNATIVES

The U.S. Bureau of Labor Statistics calculates that commodities represent close to 40% of the Consumer Price Index (CPI). More specifically, energy represents about 7.5% of the index and food close to 14%. This unpredictability is a key reason economists utilize Core CPI which strips out energy and food prices. By excluding those categories, it gives a better look at underlying inflation trends. Energy prices softened over the quarter, as demonstrated by the DJ Commodity Energy Index -9.74%, when concerns regarding a global slowdown accelerated on news surrounding the banking system failures in March. Gold returned +8.11% for the quarter according to the DJ Commodity Gold Index, benefiting from expectations that the Fed would pause their rate hiking cycle and the US regional bank crisis would drive investors to "safe havens."

REAL ESTATE

Homebuilders are gaining confidence following the third straight monthly increase in builder sentiment according to the National Association of Home Builders/Wells Fargo Housing Market Index.[11] The monthly index rose two points to 44 in March, and while anything below 50 is considered contractionary, this trajectory represents progress in the face of high mortgage rates, high construction costs, and material supply chain disruption. The inventory for existing homes remains stunted as the likelihood of convincing a homeowner to give up their low, fixed-rate, pre-pandemic mortgage for a new one closer to 7% is untenable.[12]

CONCLUSION

Markets wrapped up a volatile but positive first quarter as strength in tech was able to offset weakness in banks. In our view the banking turmoil is simply a crisis of confidence which tends to take time to ease but we continue to believe that there are not yet signs of wide-scale contagion or systemic risk in the U.S. banking system as large banks have solid balance sheets, diversified sources of revenue, and more regulation today than in 2008. We do not believe the US economy is headed for a deep recession because the American consumer is resilient and the recently softening economic data indicates the Federal Reserve's hawkish hand. The best news from the first quarter was that the stock market was positive in January. This is a welcome sign as “since World War II, if the market is up in January, it has continued to rise in the remaining 11 months of the year more than 85% of the time, and the average gain is about 11.5 %. As the old saying, ‘as goes January, so goes the year.”[13]

Economic Definitions

GDP: Gross domestic product (GDP) measures the final market value of all goods and services produced within a country. It is the most frequently used indicator of economic activity. The GDP by expenditure approach measures total final expenditures (at purchasers' prices), including exports less imports. This concept is adjusted for inflation.

Unemployment Rate: The unemployment rate tracks the number of unemployed persons as a percentage of the labor force (the total number of employed plus unemployed). These figures generally come from a household labor force survey.

CPI (headline and core): Consumer prices (CPI) are a measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate.

Housing Starts: Housing (or building) starts track the number of new housing units (or buildings) that have been started during the reference period.

Building Permits: This concept tracks the number of permits that have been issued for new construction, additions to pre-existing structures or major renovations. These statistics are based on the number of construction permits approved

West Texas Intermediate (WTI): West Texas Intermediate (WTI) is crude stream produced in Texas and southern Oklahoma which serves as a reference or "marker" for pricing a number of other crude streams and which is traded in the domestic spot market at Cushing, Oklahoma.

Brent: Brent Crude Oil is a blended crude stream produced in the North Sea region which serves as a reference or "marker" for pricing a number of other crude streams.

Natural Gas: Natural Gas Spot market (natural gas) is a market in which natural gas is bought and sold for immediate or very near-term delivery, usually for a period of 30 days or less. The transaction does not imply a continuing arrangement between the buyer and the seller. A spot market is more likely to develop at a location with numerous pipeline interconnections, thus allowing for a large number of buyers and sellers. The henry hub in southern Louisiana is the best-known spot market for natural gas and is the delivery point for the natural gas futures contract on the New York Mercantile Exchange (NYMEX).

The Federal Reserve System: The central bank of the United States. It performs several general functions to promote the effective operation of the U.S. economy and, more generally, the public interest.

Index Definitions

S&P 500: The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

NASDAQ: The NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

Dow Jones Industrial Average: The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Russell 1000 Value: Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992.

Russell 1000 Growth: Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992.

Russell Mid-Cap: Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index.

Russell 2000: The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization. The real-time value is calculated with a base value of 135.00 as of December 31, 1986. The end-of-day value is calculated with a base value of 100.00 as of December 29, 1978.

iShares U.S. Regional Banks ETF: The iShares U.S. Regional Banks ETF seeks to track the investment results of an index composed of U.S. equities in the regional banks sector

MSCI EAFE: The MSCI EAFE Index is a free-float weighted equity index. The index was developed with a base value of 100 as of December 31, 1969. The MSCI EAFE region covers DM countries in Europe, Australasia, Israel, and the Far East.

MSCI EM: The MSCI EM (Emerging Markets) Index is a free-float weighted equity index that captures large and mid-cap representation across Emerging Markets (EM) countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

Bloomberg Barclays US Agg Bond: The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

Bloomberg Barclays High Yield Corp: The Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded.

DJ Commodity Energy Index: The Dow Jones Commodity Index Energy is designed to track the energy sector through futures contracts.

DJ Commodity Gold Index: The Dow Jones Commodity Index Gold is designed to track the gold market through futures contracts

National Association of Home Builders Confidence Index: The National Association of Home Builders Confidence Index also known as the NAHB/Wells Fargo Housing Market Index (HMI) is based on a monthly survey of NAHB members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months as well as the traffic of prospective buyers of new homes.

Disclosures

Index performance does not reflect the deduction of any fees and expenses, and if deducted, performance would be reduced. Indexes are unmanaged and investors are not able to invest directly into any index. Past performance cannot guarantee future results.

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