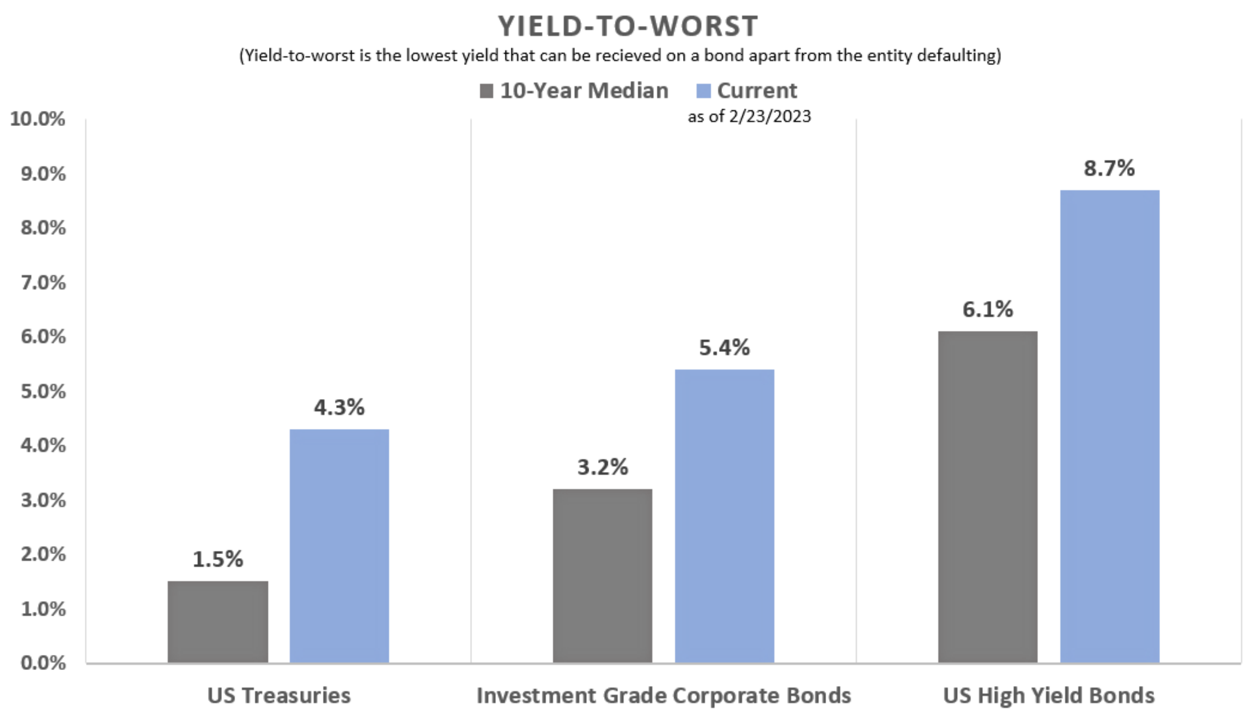
February 2023 Market Commentary
February 27, 2023

Dear Clients,

Market returns in 2022 were definitely ones for the history books…and not in a good way. Going back 100 years, 2022 marked the 7th worst calendar year return for stocks and the worst return ever for bonds[1]. That combination was definitely felt by 401K investors as Fidelity (the largest 401K provider in the country) reported the average 401K balance was down 23% last year[2].

Silver Linings

Entering this year the investment landscape has certainly changed from the year prior. While many of the top investor concerns are still front and center including inflation, geo-political worries, and recessionary fears….the difference is that assets are priced for more attractive returns moving forward, with the most notable changes in the bond markets.



Source: Bloomberg, FactSet, JP Morgan Credit Research, JP Morgan Asset Management. US Treasuries = bloomberg US Treasury Index. Investment Grade Corporate Bonds = Bloomberg US Corp Bond Index. US High Yield Bonds = Bloomberg US Corporate High Yield Bond Index. You cannot invest directly in an index. Chart: Paul R. Ried Financial Group, LLC

The extremely low interest rate policy of the Federal Reserve for the past 10+ years had suppressed bond market returns. Now with the Fed increasing interest rates to levels we have not seen since 2007, prospects for returns going forward for safer assets have increased.

Winners and Losers

As with most policy changes, the Federal Reserve's decision to increase interest rates is not without winners and losers. On the one hand savers look to benefit from higher interest rates on their savings but meanwhile those who are large borrowers or look to take on new debt….the negative impact can be quite significant.

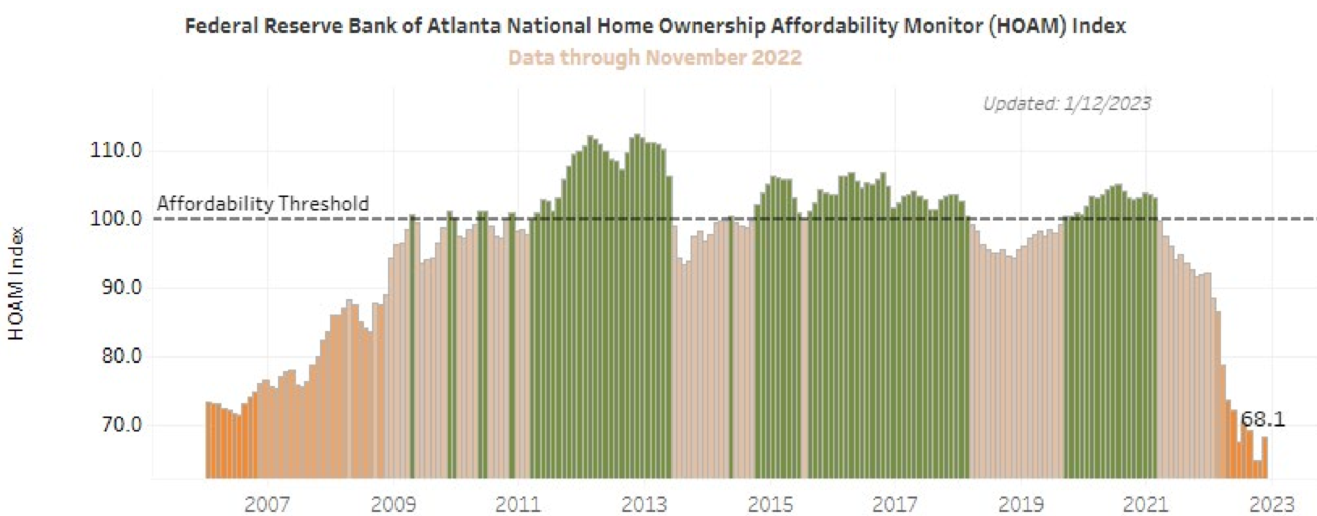
Take homebuyers as an example. Interest rates on a 30-year mortgage have gone from 3.1% at the start of 2022 to 6.5% today[3]. This has dramatically reduced the purchasing power for new home buyers. As a result, existing home sales have fallen 37% since January of last year[4]. But somehow, the fall in demand has not yet affected home prices to the same degree. In fact, existing home prices are actually up 1% over that same timeframe (although prices are down 13% from their peak reached in June last year)[5].

One major factor that might be supporting home prices is that many current homeowners are reluctant to put their homes up for sale, limiting supply. This reluctance is due to the fact that relocating would mean giving up their current mortgage, which is likely in the 3-4% range or lower.

To put this dynamic in context, consider the chart below. It shows the effect on the monthly mortgage payment for a homeowner selling their house valued at $500,000 with the 30-year mortgage rate prevailing at the start of 2022 and buying a home of equal value at today's rate. The result is a monthly payment which is 48% higher. The impact on a 'move-up' buyer is even more dramatic. If they wanted to sell their $500,000 home and buy a home valued 20% more at $600,000, their monthly payment would increase 97%....not accounting for increases in property taxes or insurance.

Home Price	Equity	Mortgage Balance	Interest Rate	Monthly Payment
$500,000	$200,000	$300,000	3.1%	$1,281
$500,000	$200,000	$300,000	6.5%	$1,896
$600,000	$200,000	$400,000	6.5%	$2,528
$700,000	$200,000	$500,000	6.5%	$3,160
$800,000	$200,000	$600,000	6.5%	$3,792
Monthly payment is based on a 30-year Mortgage and only represents principal + interest.				

Usually you would see a correction in housing prices due to increased interest rates. However, it will be interesting to see how this situation unfolds since this rate hike has been so dramatic, leaving many homeowners feeling 'trapped' in their homes. For now, it means that housing affordability remains at historical lows.



While I focused this section on the impact of the Federal Reserve's policy on the real estate market, the effects of higher interest rates will have ripple effects throughout the entire economy, with both winners and losers emerging in different sectors. One area of interest will be the corporate world, where companies that locked in low borrowing costs in previous years will likely benefit, while those needing to renew or take on new debt in the current environment may face challenges. It will be interesting to monitor the long-term effects on companies and their ability to access funds at favorable rates.

Opportunities in Uncertainty

While the investment landscape has undergone significant changes in the past year, it is important to remember that these types of economic changes should inform, but not dictate, a long-term investment strategy. In the construction of a well-diversified long-term portfolio, policy shifts, differing inflationary environments and shifting geo-political landscapes are expected. These things do not necessarily warrant changes to the strategic allocation of your portfolio but instead may bring about shifts within each asset class. This is why we incorporate active managers to adjust or 'tilt' portfolios based on the current opportunities presented in the economy.

We are committed to helping you navigate the ever-changing markets and providing you with the support and guidance you need to achieve your long-term financial objectives. Don't hesitate to reach out to us by phone or email if you have any questions or concerns.

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1 - https://www.cnbc.com/2023/01/07/2022-was-the-worst-ever-year-for-us-bonds-how-to-position-for-2023.html &
https://www.virtus.com/assets/files/6i2/2022_was_one_of_the_worst_years_ever_for_markets_4732.pdf
2 - https://www.cnbc.com/2022/11/17/401k-balances-fell-23percent-year-over-year-due-to-market-volatility-fidelity.html
3 – as of 2/24/23 https://fred.stlouisfed.org/series/MORTGAGE30US/
4- as of Jan 2023 data https://fred.stlouisfed.org/series/HOSMEDUSM052N 5 - https://fred.stlouisfed.org/series/HOSMEDUSM052N