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FIRST QUARTER MARKET REVIEW

It's Not As Bad As It Seems

Investors can be forgiven for being a bit shell shocked by the events in the markets during the last month. After all, a fear of safety regarding deposits led to a bank run that caused two US financial institutions to collapse. Further, interest rate volatility has been extreme during March, rising and falling swiftly as persistently high inflation has battled with banking fears and worries of recession.

The consternation felt from the above situations, however, was not a harbinger of doom for asset prices. In fact, bonds, the S&P 500, and international stocks were all positive in March. Stock performance continues to be led by some of the largest companies in the world, with firms like Microsoft, Amazon, Apple, and Alphabet all rebounding after a difficult 2022. In the bond market, the fears of banking concerns caused interest rates to fall during the month, and as interest rates fall, bond prices rise.

Clearly, not every asset class reacted positively to these issues. Many financial sector stocks faced significant declines, despite business leader's and government official's assurances that deposits are safe and the banking system is on solid footing.

In the current environment, feelings can overwhelm facts. The situation with banks, the persistent nature of inflation, the consistent drum of negative commentary in financial media, and the prospect of recession can all weigh on investor perceptions of what is actually happening with their portfolios. However, it is important to remember the facts:

- Due to interest rate increases, bondholders are generating income from bonds at higher levels now compared to the prior few years. This is great news for savers.
- Unemployment is still near 50-year lows. Jobs remain plentiful and wages are still growing.
- Inflation remains elevated, but readings have decreased from peak levels
- Despite the recent rise in mortgage rates and falling home prices, most homeowners have very low interest rates and higher levels of home equity compared to other cycles

Does this mean we are all clear and there are no concerns? Absolutely not. Investors tend to look to the future and try to estimate what will happen rather than what has already happened. If financial institutions become more conservative in lending because of continued depositor outflow, companies may not be able to grow as anticipated and may have to reduce their staff. If jobs deteriorate while inflation remains elevated, this could lead to significant deterioration of consumer spending (the lifeblood of the US economy). If the Federal Reserve is overaggressive on interest rate increases while economic data deteriorates, the length and severity of a recession could be worse than anticipated. All these issues are possible and could have very negative implications for stocks and bonds.

It is also possible that we have a shallow recession or no recession at all. It is possible that job loss, while never a good thing, remains well below prior recessionary conditions as companies hold on to staff to avoid a future shortage of skilled labor. It is also possible that companies face a short period of earnings decline, but stock markets rally based upon an estimated reacceleration of future growth. If all of this is possible, it is entirely possible that stock markets have already seen their cycle bottom and the recent rise is the beginning of a new prolonged bull market.

It is our opinion that the latter is just as likely, if not more likely, than the former. Stock markets rarely face back-to-back negative declines, with the last occurrence in 2001 and 2002. Further, if we face a relatively short and shallow recession, market participants have widely anticipated this event and could look to growth in 2024 as a catalyst to propel markets higher in the second half of this year.

There is no question that uncertainty remains high, but this is not unique in stock market history. There are always concerns when investing in both stocks and bonds. Stocks will likely also react well before we get an “all clear” from economic data, and investors that wait on the sidelines for a time when there is greater clarity usually end up buying high and selling low. This is precisely why we blend safe assets with growth assets and diversify portfolios. Assets that provide protection allow investors to stay the course during times of uncertainty and reap the benefits of stock market increases that are much more frequent than periods of decline. The best way to properly balance this approach is to invest with a plan that is customized to your objectives, risk tolerance, and time horizon. Lastly, within the bounds of the investment plan, active management that acts prudently during times of excess and opportunistically during times of irrational fear can add value and avoid the pitfalls that can result from acting based on feelings over facts.

Markets By The Numbers					
US Stocks	1m Returns	Last 12m Returns	Bonds	1m Returns	Last 12m Returns
S&P 500 Index	3.67%	-7.73%	Bloomberg Barclays Aggregate Index	2.54%	-4.78%
Dow Jones Index	2.08%	-1.98%			
Nasdaq Composite	6.78%	-13.28%	Interest Rates	Current Rate	Rate 1 yr Ago
Russell 2000 Index (US Small Cap)	-4.78%	-11.61%	2yr US Treasury	4.06%	2.28%
			10yr US Treasury	3.48%	2.32%
International Stocks	1m Returns	Last 12m Returns	Alternatives	1m Returns	Last 12m Returns
MSCI EAFE (Intl Developed)	2.48%	-1.38%	Gold	9.31%	2.84%
MSCI EM (Emerging Markets)	3.03%	-10.70%	U.S. Real Estate	-1.74%	-19.40%

Data as of 3/31/2023. Following Data Sourced from Morningstar: S&P 500 Index represents S&P 500 Total Return, Dow Jones Index represents Dow Jones Industrial Index, Nasdaq Composite represents NASDAQ Composite Total Return, Russell 2000 Index (US Small Cap) represents Russell 2000 Total Return, MSCI EAFE (Intl Developed) represents MSCI EAFE Net Return, MSCI EM (Emerging Markets) represents MSCI EM Net Return, Bloomberg Barclays Aggregate Index represents BBgBarc US Agg Bond Total Return, Gold represents LBMA Gold Price AM USD, U.S. Real Estate represents FTSE Nareit All Equity REITs Total Return. Following Data sourced from Treasury.gov: 2yr US Treasury represents 2yr Treasury Rate, 10yr US Treasury represents 10yr Treasury Rate.