MARKET REVIEW & OUTLOOK

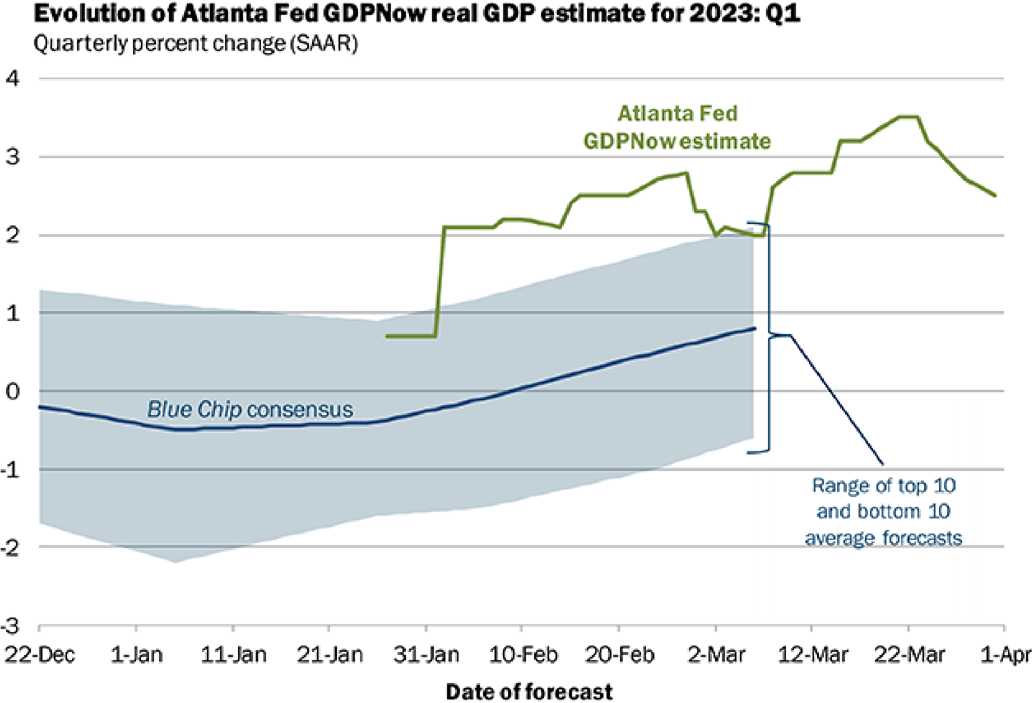
MARCH 2023

KEY TAKEAWAYS

- The Large Cap equity markets temporarily stumbled mid-month on the heels of the failure of Silicon Valley Bank and Signature Bank. However, especially Tech, grabbed the Fed bucks, i.e., bailouts and roared higher for the balance of the month. Small and Mid-Cap U.S. equities, which hold a larger exposure to "smaller" banks, weren't so lucky.
- The bond market saw yields fall most of the month on concerns the bank failures would lead to a recession.
- The economy continues to show strength and inflation seems to have bottomed out and showing signs of reaccelerating.

The U.S. Economy

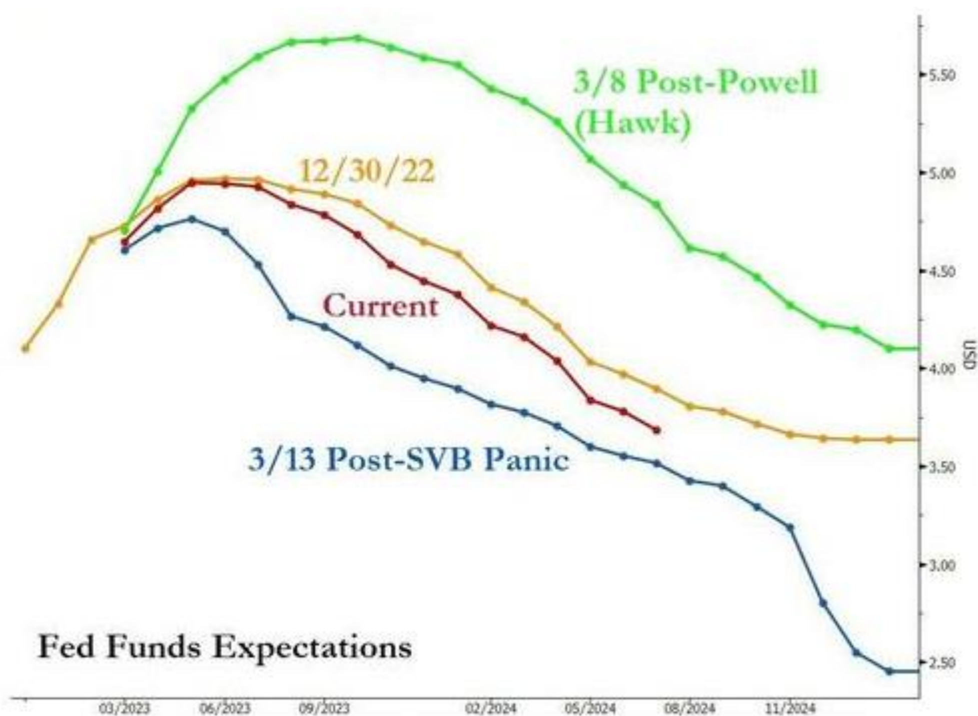
The final look at 4th quarter GDP came in at 2.6%, again weaker than the originally reported +2.9%. The concern remains that the imbedded inflation measure came in stronger than expected at 4.4% vs. the last report of 4.3%. The current estimate for 1st quarter GDP from GDPNow is now around 2.5% while the Blue-Chip consensus has moved up to almost 1%, as shown in the chart below. The Fed is facing firming inflation, a strong economy and now the complications of potential fallout from a couple of relatively large bank failures. The Fed's challenges just keep getting bigger.



Source : https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

Interest rates peaked on the first day of the month and started to back off the +4% yield as the market started to price in concerns of the Fed over tightening policy as Powell continued to talk hawkishly about rates. Then the quickest, maybe, banking crisis in history sparked a flight to quality and concerns of a recession from the tightening financial conditions. The 10-year yield hit its low late in the month at just under 3.30% down from the peak of 4.09% and then stabilized in the 3.50 – 3.60% range. The fear of inflation, then the fear of a banking crisis induced recession caused the market to swing wildly on the path for future Fed funds interest rates, please see the chart below. Simplistically, they were pricing in an additional 100 basis points of hikes by year end as of 3/8, then 100 basis points of rate cuts by year end on 3/13 at the height of the banking crisis and settled about where things were at the end of the year. The decrease in yields created a nice tailwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF gained +2.54% for the month. The U.S. 10-year Treasury bond yield ended the month at 3.49%, reversing last month's increase, and down significantly from February's close of 3.92%.



Source: Bloomberg

Source : https://www.zerohedge.com/markets/eod-2

The Dow Jones Industrial Average increased +1.89%, the S&P 500 rallied +3.51%, and the small cap Russell 2000 dropped -4.98%. The international markets traded in line with the Large Cap U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index climbed +2.76%, and the MSCI Emerging Markets iShares Core ETF Index gained +3.03%.

March was bifurcated by soaring Tech and tanking Banks.

The best performers were…

- Technology: +10.61%
- Communication Services: +6.32%
- Utilities: +4.14%

The worst performers were…

- Financials: -9.99%
- Real Estate: -2.17%
- Materials: -1.43%

Source: https://www.sectorspdr.com/sectorspdr/tools/sector-tracker

Oil Report

The oil market started and finished at relatively the same price, though the previously referred temporary banking crisis fueled a sharp drop in crude prices, spending several days in the $60's on fears of demand destruction. However, the Fed threw some dollars at the problem and the FDIC is rumored to officially insure all deposits, so paper over the current problem, just like always. 😊 The current NYMEX WTI Crude Oil futures settled at $75.70 posting a loss of almost 2% from the prior month close of $77.05 a barrel. The decline in crude oil was again countered with refining constraints and saw RBOB gasoline with a gain of over 1% vs February's close. The current 4-months of range bound trading in Crude oil's price, with the brief excursion south reversed, leaves the market in balance, continuing to await a catalyst to keep prices out of the current range.

The Rest of the Data

The February ISM Manufacturing Index increased modestly to 47.7 from January's reading of 47.4. However, the ISM Services Index modestly decreased to 55.1 in February, basically flat after January's print of 55.2, which was up substantially. The prices paid component for Services eased modestly and remained at elevated levels and Manufacturing prices firmed moving back above 50. Any reading below 50 generally indicates deteriorating conditions and any reading above 50 generally indicates improving conditions. Consumer confidence increased to 104.2 in March, which compares to an upwardly revised figure of 103.4 in February. The unemployment rate rose to 3.6%, and the economy added another strong 311,000 jobs in February, which beat expectations, for the 10th month in a row, of 225,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) eased from last month's pace to 0.4% in February, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index rate further eased to +6.0% on a non-seasonally adjusted basis, which matched expectations. The CPI ex Food and Energy, eased further to 5.5% over the last year, the smallest increase since December 2021. The economy continues to show resilience as does confidence and the job market. We will continue to monitor economic activity along with inflation reports and now bank run concerns and how that may impact Fed policy.

Summary

The markets bifurcated mid-month, with bonds rallying on recession concerns and large cap, especially Tech, rallying on more government bailouts. The Small and Mid-Cap markets with a heavier weighting to the "smaller" banks were hit hard by the bank failures. The economic data showed continued resilience in the face of a 5% increase in the Fed funds rate the past year. The manufacturing sector seems to be stabilizing at modestly contracting levels, and services bounced back strongly. The labor market continues to be strong, even with the Tech industry continuing to cut more job. The hard data currently suggests the Fed, at a minimum must hold the line, as rebound inflation has historically shown to be more difficult to tame. However, financial conditions have tightened with the bank failures by about 2 to 3 "instant" rate hikes, so now include potential fallout from the banking sector in addition to more failures adds another dynamic to a choppy sea for the Fed. You can feel bad for us as we must endure this challenging environment, but don't feel bad for the Fed. They made this mess and now must try to figure a way out, against the many and growing numbers of crosscurrents. The pundits said the Fed would hike until they broke something, was that the previously mentioned bank failures? The large cap equity markets suggest not, but we will have to wait and see. The month of April has no scheduled Fed meetings, but the incoming data and market response will likely be a big driver for the May 3 – 4, Fed meeting.

As always, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. waning growth expectations, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. The markets did bifurcate during the month and the defensive mechanism for Mid-Cap shifted back to Treasury Bill exposure. The tactical allocations for Aggressive Fixed Income and Equity shifted to "risk-on" this week, while Real Estate remains in Floating Rate Treasuries.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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