Stirling Bridge
Wealth Partners, LLC

MARKET COMMENTARY – May 1, 2023

Surfing the Economic Currents.

Three main drivers encouraged investors to buy stocks (some stocks anyway – more on that later) last month. A lack of banks falling like dominoes, cooling inflation reports, and resilient 1Q earnings results from companies in April made for a pleasant reprieve after a challenging March.

Let us begin with a word on banking.

While it is far too early to claim victory, the data coming from the banking sector is approximately what we had expected. Some areas remain in a precarious state, in need of rest and recovery. Other areas continue to operate without interruption as in normal times. It is important to note that the pace of depositor withdrawals has eased. Going forward we still expect a general tightening of credit conditions, especially by smaller banks. We also expect the Fed to remain in intervention mode, ready to open flood gates at further hints of banking stress. Lastly, we also expect no debate on long-term solutions for a banking business model that remains destined for these periodic, and wide, swings.

Inflation.

Any incremental firming of credit standards will play a part in taming inflation. However, absent a widespread crunch, the Fed must remain vigilant to finish the job. In 2021 and 2022, the Federal Reserve fell behind the curve of inflation, being forced to ramp up rates in earnest and at a break-neck pace. This year ought to be different. The headline inflation number remains too high, but the trend is certainly in the right direction – lower. These facts (and the banking hiccups) have allowed the Fed to move at a more measured pace in 2023.

Some commentators expect the Fed to decrease rates later this year. Barring an exogenous shock that causes swift collapse, we don't see such an outcome as likely. The reason for our incredulity is that those prices deemed "sticky" in our economy haven't yet rolled over. This subset of sticky prices (e.g., home insurance, phone bills, rent) is still experiencing inflation and until it has experienced an inflection point, the Fed needs to stay alert.

1246 County Road Q, McClure, OH 43534 P: 419-832-1111
www.stirlingbridgewealthpartners.com F: 419-832-1211

<u>1Q Earnings.</u>

And after slamming the rest of us for more than two years now, inflation is finally gnawing away at even the biggest of corporations. They were able to pass many of the earliest cost increases onto us. But the most recent spate of results coming in confirms there is a limit as to what companies can push through before they begin to experience lost sales.

Thus far in the earnings season, revenues are actually up a small bit when compared to the same time last year, about 2%. The bottom-line results, however, are down a touch, meaning corporate expenses are up more than expanding revenues can cover. A similar way to view the same phenomenon is to take a gander at profit margins. Profit margins across the board are still strong at around 11%. Yet that figure is below those reported in 2018 and 2019 and especially below those juiced-up results amid government funny business and lockdowns when corporations received the equivalent of financial steroids.

The upshot of the three drivers discussed above is that each came in a little better than was feared. Therefore, investors breathed a welcome sigh of relief and committed some capital to "risk" assets. Which brings us to our last tidbit for the day.

<u>Narrow leadership.</u>

Broad-based returns means that a wide set of companies are behaving similarly, driving returns in the same direction. Conversely, narrow returns means that results reported in popular indexes (S&P 500 or NASDAQ) are being driven by very few companies. The nice rebound we've seen thus far in 2023 is narrow, indeed.

Here are some examples to buttress our claim. The market capitalization of the top ten largest stocks relative to the S&P 500 as a whole is now at the 96th percentile. The weighting of the largest two stocks in the index is at the highest at any point in history. A mere six companies (MSFT, GOOGL, AMZN, META, NVDA, & CRM) explain over half the performance of both the S&P and NASDAQ indices. Finally, only 28 stocks explain ALL the market gains YTD.

For some of us those are worrying statistics. But they need not necessarily be worrisome. Viewed correctly, this means that there are many other companies that

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haven't rallied near as much as these hallowed few. It also means that, while it is fine to own many of these titans, it is important to avoid concentrating in them even further. It is why we often own rather boring companies and rather boring industries that simply produce solid results without the glam and sizzle of the technology giants. As we mentioned last month, trees do not grow to the heavens. There will come a day when the performance of these behemoths is overtaken by the rest.

In short, while banking, inflation, and even geopolitical risks remain elevated and we can always retest last year's lows, we continue to see a potential path to recovery.

Stirling Bridge Wealth Partners, LLC is fortunate to count many of you as clients. In the good times and bad, we remain committed to providing customized investment solutions and robust financial planning wrapped in a package of exceptional service. We thank each of you for your dedication to us and for your trust.

Sincerely
Jason Born, CFA
President

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