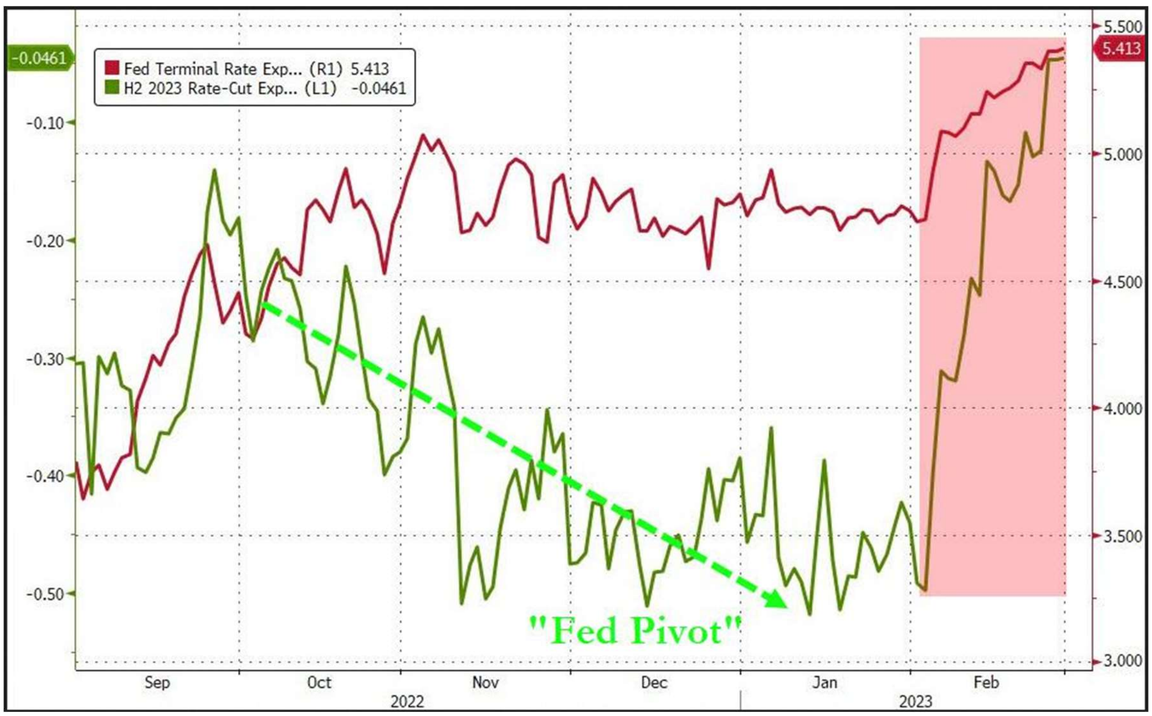
MARKET REVIEW & OUTLOOK

FEBRUARY 2023

KEY TAKEAWAYS

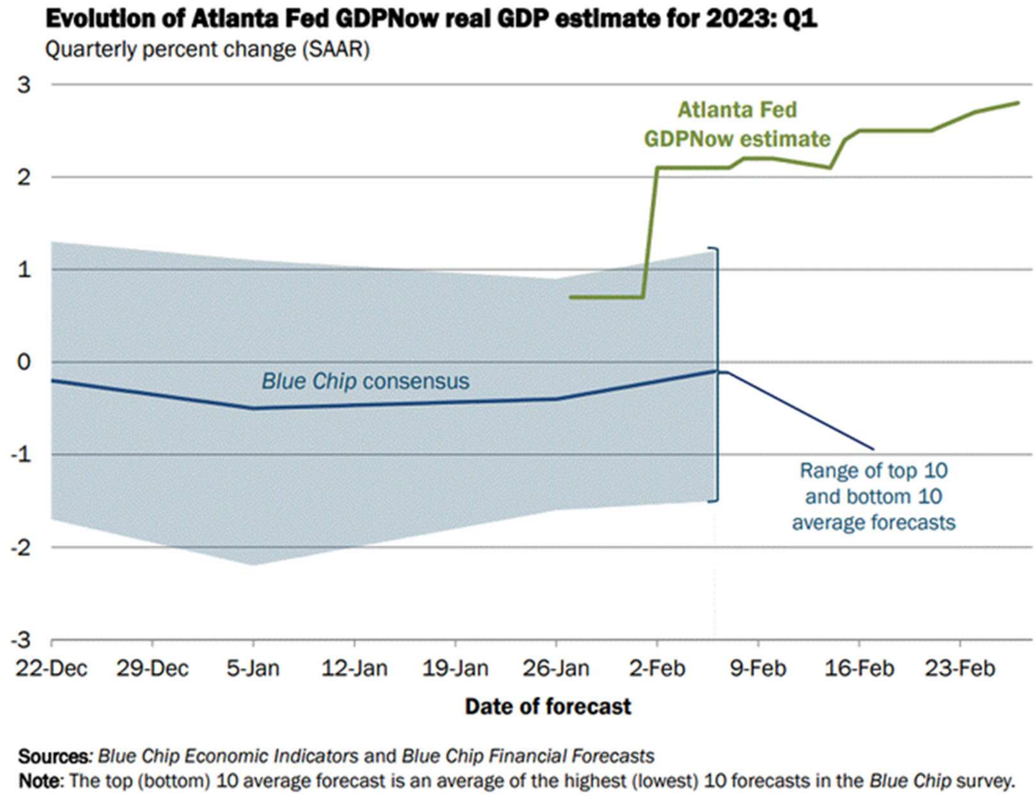
- The equity markets carried January's strength into the first 2 days of February, but as the chart below shows, the Fed "Pivot" died. The chart is illustrating, with the red line, that the peak for the Fed funds rate is now expected to be higher and that the end of year rate cuts, shown with the green line, have been priced out of the market, i.e., no "Pivot".
- The bond market also enjoyed the first 2 days of February and then followed a similar path to equities.
- The economy showed surprising strength and inflation showed signs of reaccelerating.



Source: https://www.zerohedge.com/markets/formidable-feb-data-fks-bond-bulls-fed-pivot-puke-weighs-stocks-commodities

The U.S. Economy

The second look at 4th quarter GDP came in at 2.7%, weaker than the originally reported +2.9%. The concern was that the imbedded inflation measure come in stronger than expected at 4.3% vs. the expectation of 3.9%. The current estimate for 1st quarter GDP from GDPNow is now at almost 3% while the Blue-Chip consensus is still hanging out just under 0%, as shown in the chart below. The Fed is now facing strengthening inflation and a strong economy, which all killed the "Pivot" talk as the chart referenced in the Key Takeaways shows.



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

Stocks and Bonds

Interest rates continued lower to start the month, but the Employment report, discussed below, halted the decline in interest rates and the increase in equity prices. The change from basically 3.5% became a steady march higher toward 4%, finding resistance multiple times as month end approached at the 3.98% level. The strength of the economic data and the seeming rebirth of inflationary pressures, also discussed below, lead the market to question their wisdom of the Fed "Pivot" along with the increased Fed talk about maybe shifting back to 50 basis point rate hikes along with higher for longer. The increase in yields created a headwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF fell -2.58% for the month. The U.S. 10-year Treasury bond yield ended the month at 3.92%, up significantly from January's close of 3.53%.

The Dow Jones Industrial Average declined -4.19%, the S&P 500 decreased -2.61%, and the small cap Russell 2000 eased -1.81%. The international markets traded more inline with the U.S., the U.S. Dollar finally stemmed its recent weakness. The MSCI EAFE iShares Core International Developed Markets ETF Index fell -3.00%, and the MSCI Emerging Markets iShares Core ETF Index dropped -6.60%.

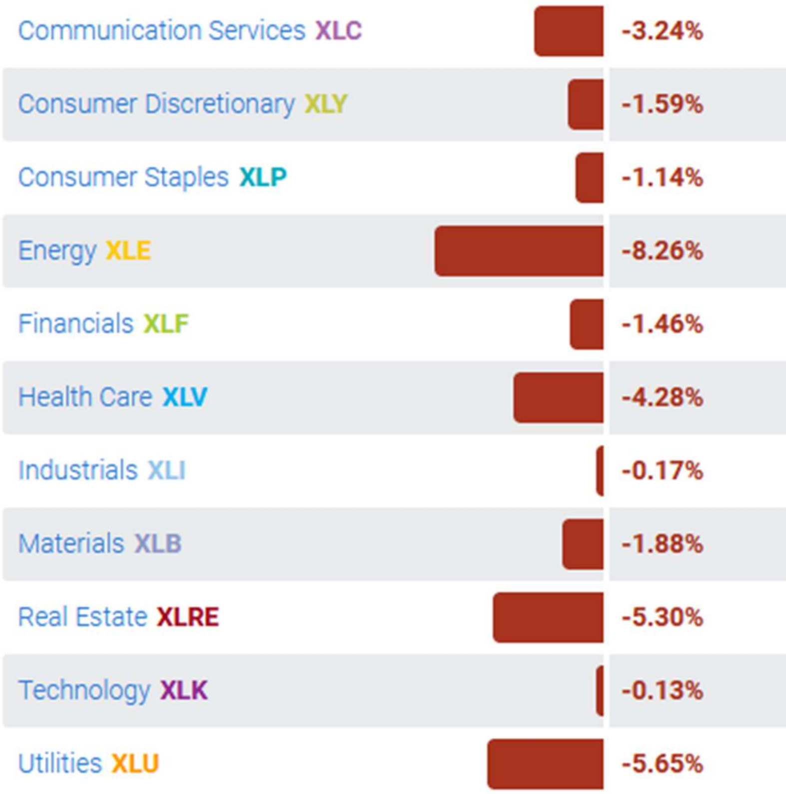
February was red across the board with a few deeply in the red.

The best "relative" performers were…

- Technology: -0.13%
- Industrials: -0.17%
- Consumer Staples: -1.14%

The worst performers were…

- Energy: -8.26%
- Utilities: -5.65%
- Real Estate: -5.30%



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

Oil Report

The oil market was again relatively stable and traded between $74 and $80 to finish almost exactly in the middle. Hopes for China's big revival were tempered with a large build in Crude oil inventories, suggesting that global growth has slowed more than China's usage increased. Additional sanctions on Russian oil did not appear to materially impact the markets. The current NYMEX WTI Crude Oil futures settled at $77.05 posting a loss of over 2% from the prior month close of $78.87 a barrel. The decline in crude oil was again countered with refining constraints and saw RBOB gasoline with a gain of almost 3% vs January's close. The current 3-months of range bound trading in Crude oil's price leaves the market in balance, awaiting a catalyst to drive prices out of the current range.

The Rest of the Data

The January ISM Manufacturing Index decreased to 47.4 from December's reading of 48.4. However, the ISM Services Index surged to 55.2 in January, largely reversing December's fall, from December's print of 49.6. The prices paid component for Services continued holding steady and remained at high and elevated levels, but for Manufacturing the number is still below 50. Any reading below 50 generally indicates deteriorating conditions and any reading above 50 generally indicates improving conditions. Consumer confidence fell to 102.9 in February, which compares to a downwardly revised figure of 106.0 in January. The unemployment rate fell to 3.4%, and the economy added an eye popping 517,000 jobs in January, which crushed expectations of only 188,000 jobs. The Consumer Price Index for All Urban

Consumers (CPI-U) jumped by 0.5% in January, on a seasonally adjusted basis, equaling the highest monthly reading in 12-months. Over the last 12 months, the All-Items Index rate eased to +6.4% on a non-seasonally adjusted basis, which was above expectations. The CPI ex Food and Energy, eased again to 5.6% over the last year. The economic data showed strong resilience in the last month, the labor market is very strong, though the Tech industry continues to announce more job cuts. The manufacturing sector continues to weaken, but services bounced back strongly, and the easing of inflationary pressures has been waning. The data currently suggests the Fed, at a minimum is correct in stating higher for longer but might even have to lean on more hikes before maintaining higher for longer. The economic reports in March will likely have a strong say in what the Fed does and how the market reacts to the reports. We will continue to monitor economic activity in concert with inflation reports and how that may impact Fed policy.

Summary

The markets started the year on signs of waning inflationary pressures and the "hope" for a Fed "Pivot", the strength of the economic and inflation data in February took the bloom off the "Pivot" thoughts. The markets now seem to be battling the thoughts of "How can the economy still be this strong with so many interest rate hikes?." Along with the thought, "Oh no, inflation is perking up again and the Fed is talking about even more rate hikes!". We will have to continue playing the waiting game to see which side takes hold. I, and many pundits, are in the camp that eventually all of these rate hikes will negatively impact the economy. However, the bigger question, especially with the Fed, if/when the economic weakness comes, does it materially impact the structural basis of the current high inflation. That then leads to the conundrum of if inflation stays firm in the face of economic weakness does the Fed get distracted by the shiny object of economic weakness and forgets to keep the fuel for future inflation in check.

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 have continued rallying and our defensive mechanisms have all shifted back to their respective equity allocations. The tactical allocations remain in Floating Rate Treasuries and will be reevaluated mid-month to see if the markets "risk-on" posture looks to have staying power.

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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