Market Commentary

As of March 31, 2023

Economy & Market Review

First Quarter 2023

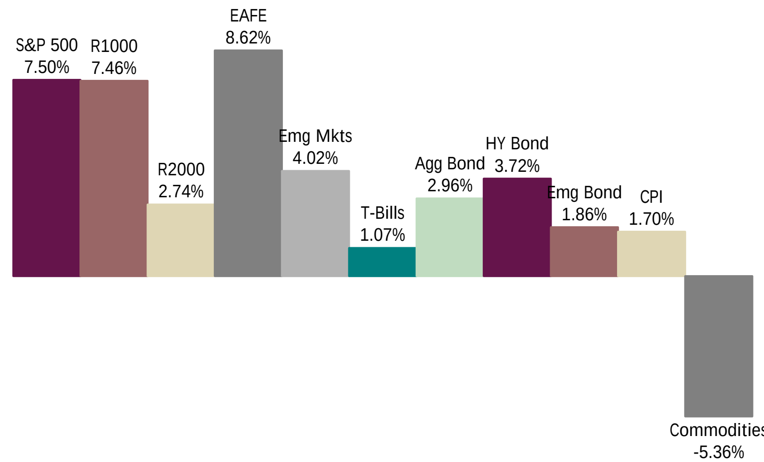
“Don't Look Up” is an environmentalist movie from 2021 where two low-level astronomers identify and try to warn humankind that a comet is going to hit earth, but no one seems to accept the premise until it's too late. Although we see no economic comet headed our way, there are some troubling signs that the markets seem to either be ignoring or at the very least heavily discounting. In the last month, the 16th and 29th largest US banks by asset size failed and a few additional regional banks have been teetering. One of the many reasons for the failures was the historically swift increase in interest rates by the Federal Reserve (Fed) to limit inflation that also sent bank assets such as long-term treasuries plummeting in value. Inflation although abating is still much higher and stickier than the Fed anticipated. Globally, the historic Swiss bank Credit Suisse collapsed as well. Then, the Swiss National Bank organized and financially supported a takeover of Credit Suisse by fellow Swiss lender UBS. Also globally, a fresh concerted effort by Brazil, Russia, India, China and South Africa has developed to wean the world off the US dollar as the reserve currency with their own currency basket possibly backed by gold. At this point, it is highly unlikely that the US dollar would lose reserve currency status, but the global effort to do so is nevertheless unsettling. Even in the face of these challenges, the first quarter provided strong returns for both stocks and bonds similar to last quarter. Equity markets produced positive quarterly results as the S&P 500 large cap stock index increased 7.5%. US small caps increased only 2.7% for the quarter as financials and increased recession possibilities weighed on results. Internationally, developed non-US stocks sustained strong relative performance up 8.6% for the quarter. Emerging market equities were up just over 4% during the quarter.

Domestic economic activity remains resilient. Although jobless claims have been above estimates, unemployment remains low at 3.5% with the technology sector representing the largest recent job losses. US housing has so far weathered the substantial mortgage rate increase without much price decline. Supporting home prices, housing inventories remain near lows and single-family housing starts have declined and settled below the 60 year average. Consumer finances are still positive relative to history, but household debt service along with auto and credit card loan delinquencies are trending upward.

Global Market Performance

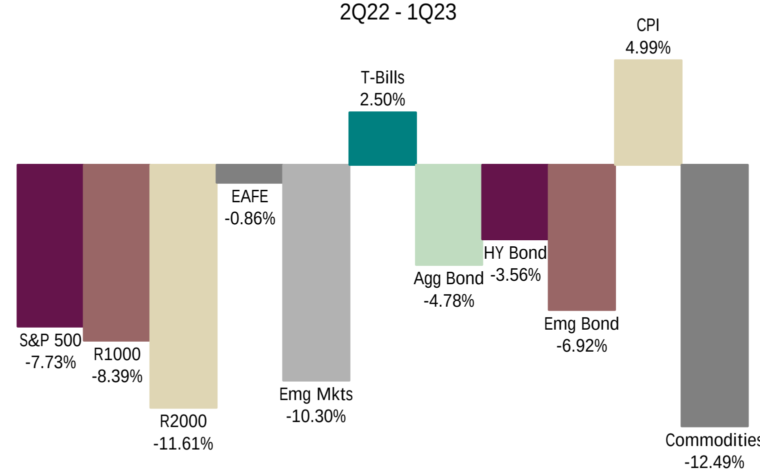
Quarter Performance

1Q23

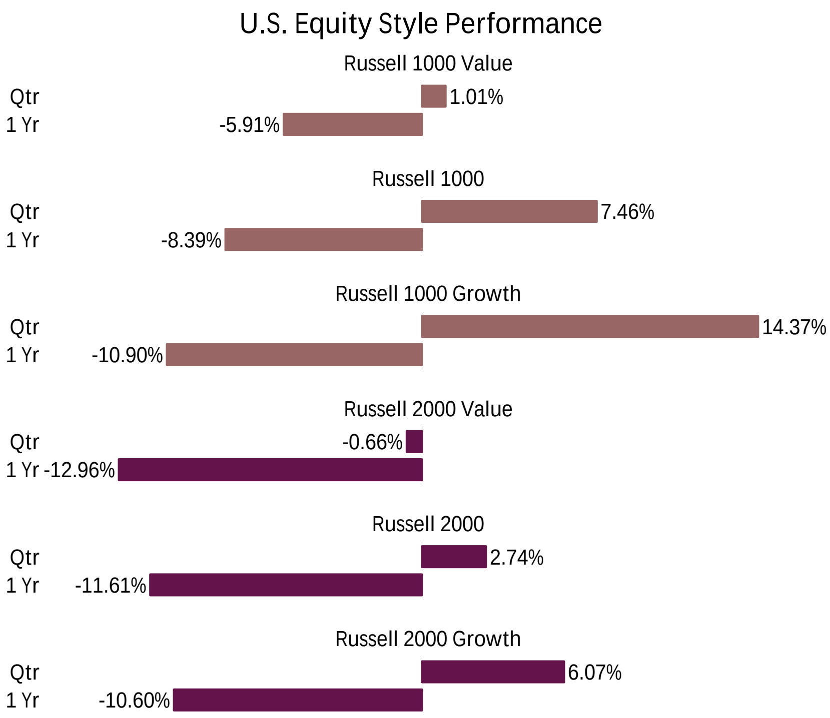


1 Year Performance

2Q22 - 1Q23

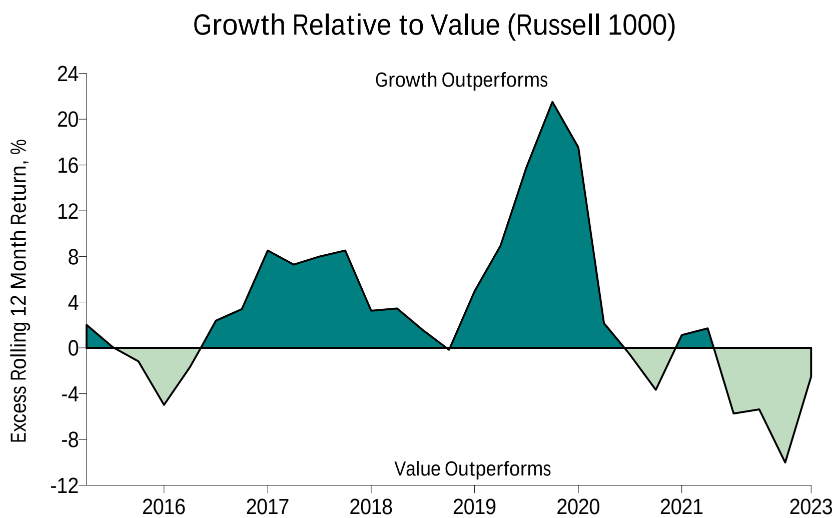


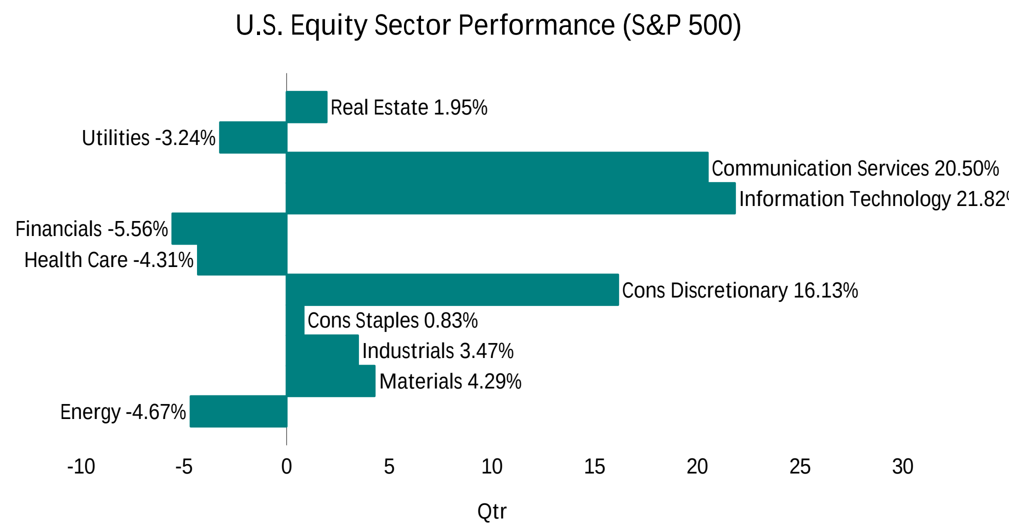
U.S. Equity Markets



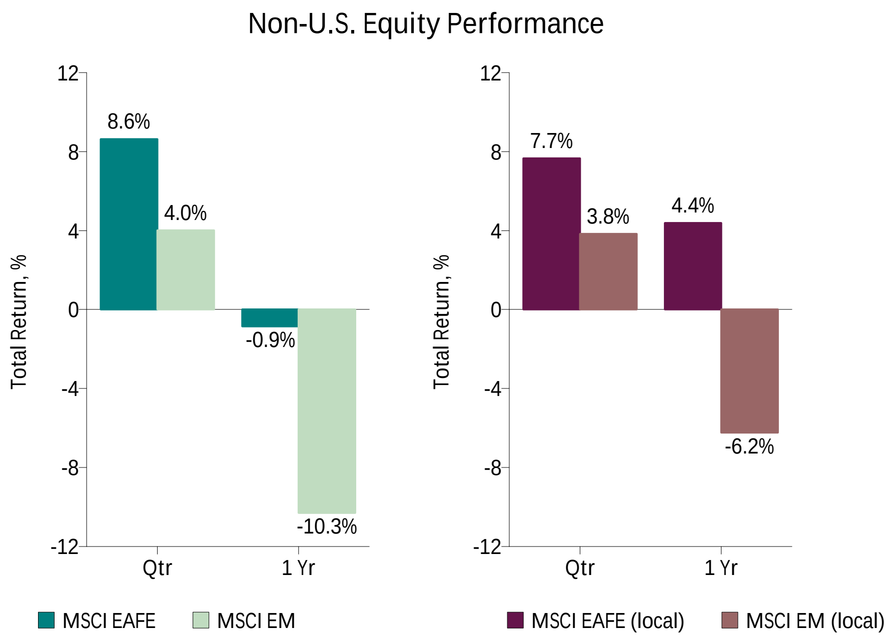
Growth stocks were back in vogue by a wide margin during the quarter as the financial sector (banks) negatively impacted value stock performance. The Russell 1000 Growth Index was up 14.4% and the Russell 1000 Value Index was only up 1% for the first quarter. Small cap value (Russell 2000 Value Index) was actually down 0.7% as a combination of higher recession chances and the negative impact of small financial companies weighed on results. Small cap growth was up 6.1% during the quarter. Most valuation measures still show the S&P 500 above its 25 year average. The S&P 500's current Price-to-Earnings ratio (P/E) of 17.8x is above the 25 year average of 16.8x. Small/mid cap value and small/mid cap blend are the styles that have a current P/E (Price-to-Earnings ratio) less than their respective 20-year average P/E ratios. On the other hand, large growth, mid growth, and small growth trade at fairly large premiums compared to respective long-term averages.

Seven of the eleven sectors had positive performance for the first quarter, with Technology, Communication Services and Consumer Discretionary representing positive outliers. Maybe not coincidently, these three sectors were the worst performing sectors during 2022. The worst performing sectors were Financials, Energy, and Health Care. Financials were negatively impacted late in the quarter by the bank failures and adjacent banking turmoil.



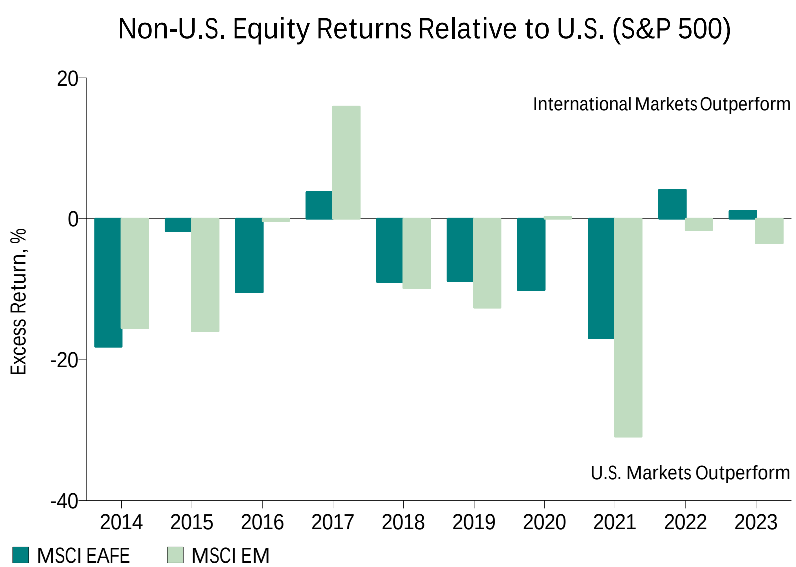


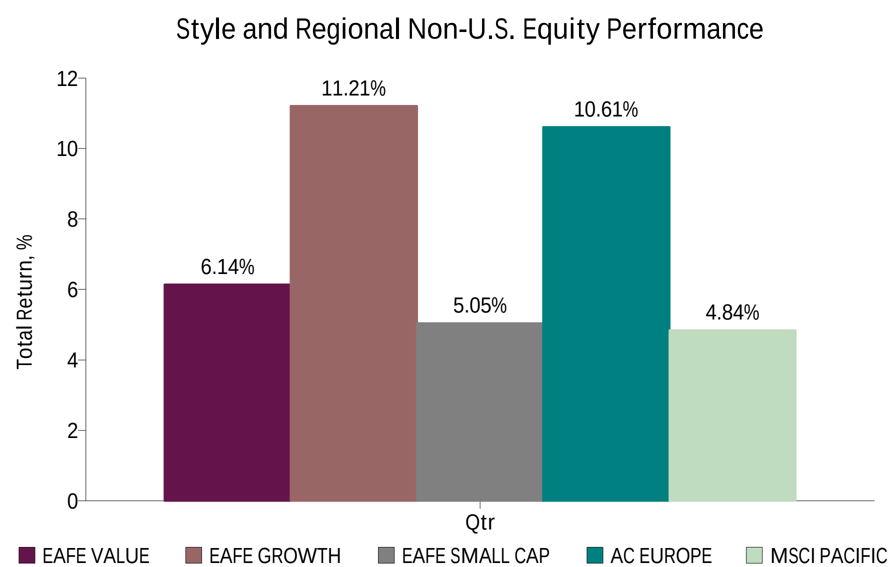
International Equity Markets



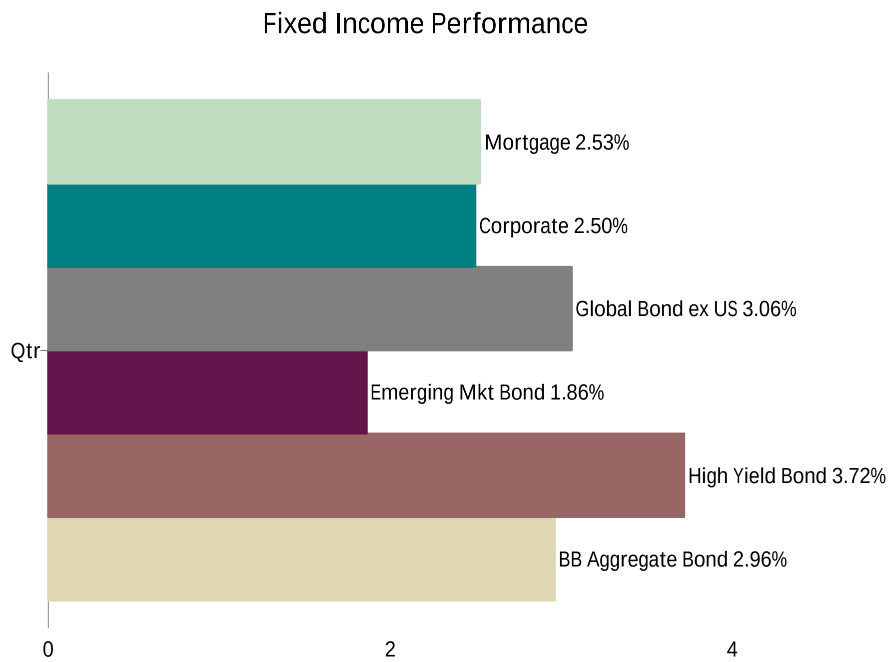
In the first quarter, emerging market (EM) relative returns were inferior compared to both international developed and the US. Even as China reopened after its Covid policy change, the improving Chinese growth prospects haven't impacted market performance yet. As the dollar was overvalued historically at year-end, international equities including EM benefited from the recent dollar weakness. The MSCI Emerging Markets Total Return Index was up only 4% to start 2023. China's restart is set to provide an EM earnings growth boost and an expectation of future positive momentum.

Although the best geographical performer year-to-date, developed international markets are experiencing some headwinds. Europe has a tight labor market which is fueling inflationary pressures. Europe's public sector has absorbed a large proportion of workers and private firms must keep raising wages to attract and retain workers. This preserves pressure on inflation. The MSCI EAFE Index, a proxy for large international developed equity markets, was up 8.6% during the quarter getting some support from a weaker dollar. Even though international valuations based on P/E (Price-to-Earnings ratio) remain very low, they have been low for decades and no upward shift in valuation is anticipated anytime soon.

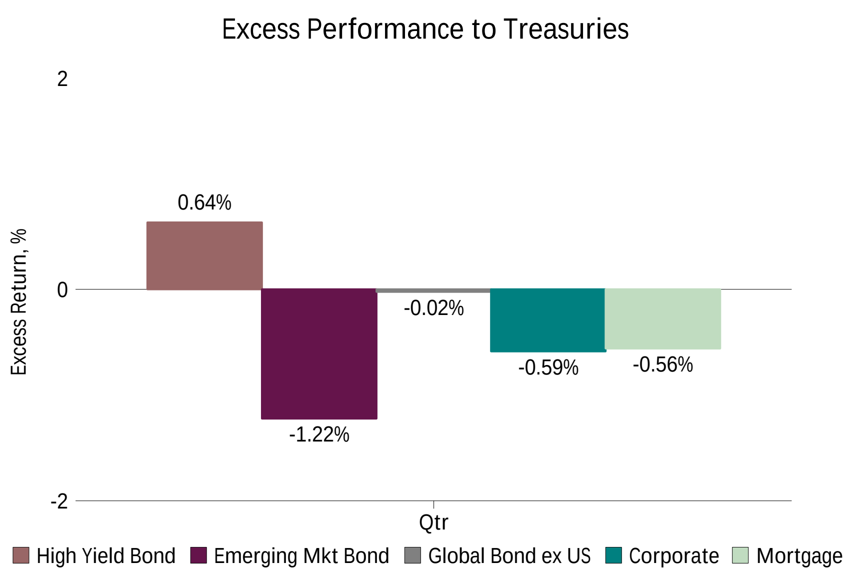




Fixed-Income Markets



During the Great Financial Crisis, bank difficulties were mostly related to poor asset quality. Today, the problem is one of liquidity. As a result of these liquidity issues, the Fed initiated two programs to stabilize deposit flight. The first initiated uninsured depositor protections. The second Fed program is the Bank Term Funding Program (BTFP). This provides banks holding certain underwater securities (US Treasuries, agency debt, mortgage-backed securities) the ability for the Fed to cover the difference between par value and the lower current value. Although BTFP may seem appealing, banks currently are opting to meet their liquidity needs through the discount window (a more familiar banking process). In mid-March, discount window borrowing set a new high even beating the prior record from 2008. Even with these issues, it was a fairly strong quarter for fixed income as higher coupon rates along with falling yields both contributed to the positive performance. Heightened concerns about further bank stress and central banks' ability to continue tightening monetary policy weighed on expectations for the path of policy rates. From a yield perspective, the US 10-Year Treasury started the year at 3.79%, hit a high of 4.08%, and recently settled at 3.40%. Although the 10-Year minus 2-Year yield curve remains inverted, it is much less inverted than March's peak inversion.



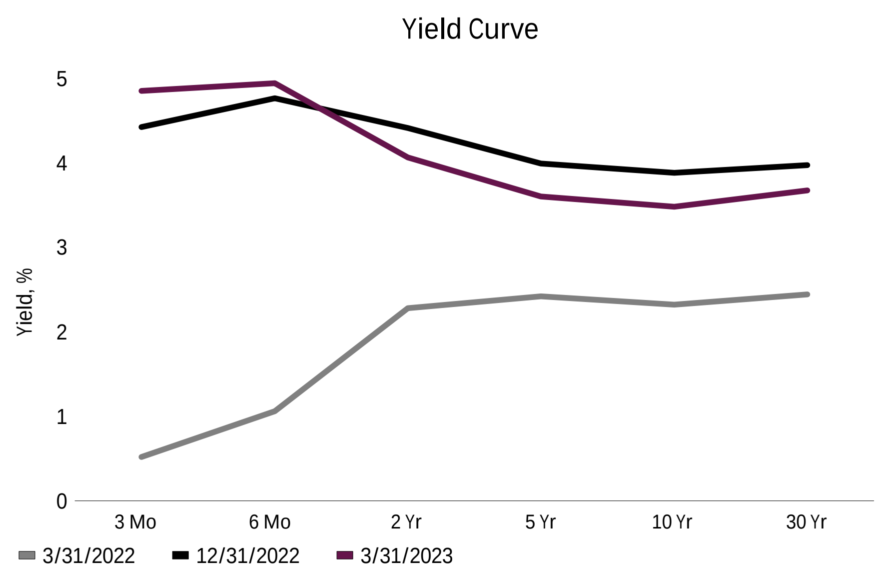
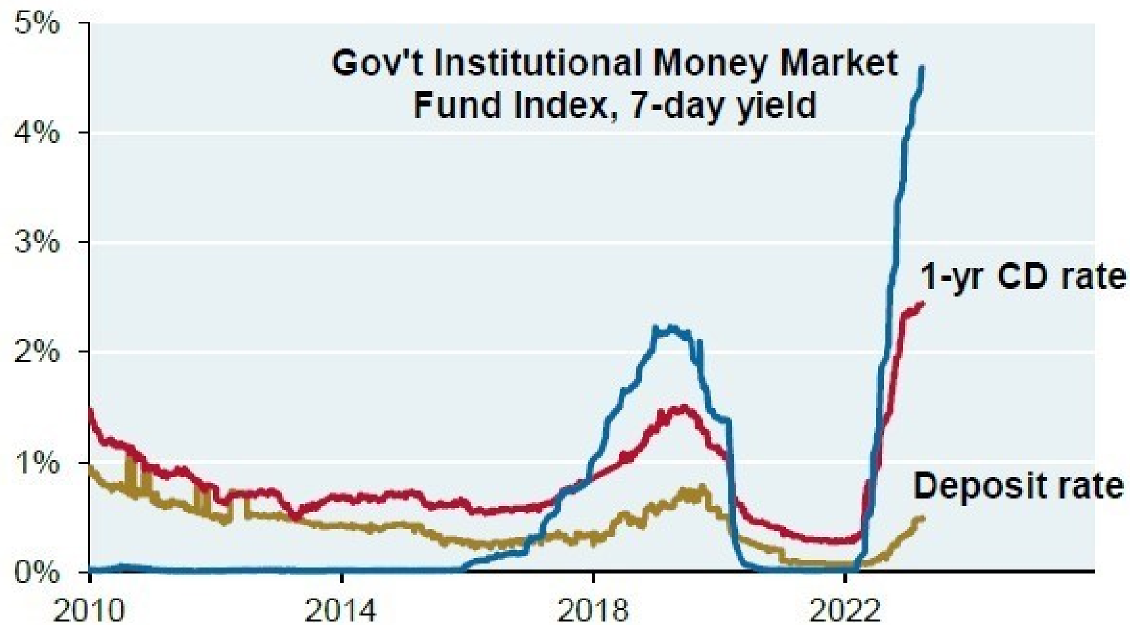


Chart of the Quarter

How you can invest your cash?



So, it probably shouldn't be a surprise there have been a few recent bank runs. Investors searching for yield are able to move money quicker than ever. The variance between a government institutional money market, a 1-yr bank CD, and the current bank deposit rate is striking and investors noticed. Over the past few years, banks have been swimming in deposits as pandemic fiscal and monetary stimulus provided tons of liquidity. Until banks need to attract deposits, the insured bank deposit rates will continue to languish. The inverted yield curve is also a disincentive for banks to increase deposit rates as their longer term investments and lending may not provide much spread.

Source: Crane Money Fund Data, Bankrate.com, JPMAM. April 7, 2023.

			Small Cap Stocks 21.31%	Emerging Mkt Stocks 37.75%		Large Cap Stocks 31.43%					
			High Yield 17.49%	International Stocks 27.77%		Small Cap Stocks 25.52%	Gold 24.61%				Annualized Return
			Large Cap Stocks 12.05%	Large Cap Stocks 21.69%		International Stocks 22.13%	Large Cap Stocks 20.96%			Gold 9.15%	1.75
	Large Cap Stocks 13.24%		Commodities 11.77%	Small Cap Stocks 14.65%		Emerging Mkt Stocks 18.90%	Small Cap Stocks 19.96%			Large Cap Stocks 7.46%	12.84
	Real Estate 12.49%		Emerging Mkt Stocks 11.60%	Gold 12.66%		Gold 18.43%	Emerging Mkt Stocks 18.69%	Commodities 27.11%		International Stocks 7.00%	4.87
Small Cap Stocks 38.82%	US Bonds 5.97%		Real Estate 8.76%	60/40 Blended Index 12.07%		60/40 Blended Index 16.50%	60/40 Blended Index 12.24%	Large Cap Stocks 26.45%		60/40 Blended Index 4.34%	6.35
Large Cap Stocks 33.11%	60/40 Blended Index 5.51%		Gold 8.10%	Intl/EM Bonds 10.41%		High Yield 14.41%	International Stocks 11.13%	Real Estate 22.18%		Emerging Mkt Stocks 4.02%	2.16
International Stocks 15.78%	Small Cap Stocks 4.89%	Real Estate 15.01%	60/40 Blended Index 7.85%	Real Estate 7.62%		Intl/EM Bonds 9.98%	Intl/EM Bonds 7.90%	Small Cap Stocks 14.82%		High Yield 3.72%	4.22
60/40 Blended Index 14.85%	High Yield 2.50%	Large Cap Stocks 0.92%	Intl/EM Bonds 5.77%	High Yield 7.48%		US Bonds 8.72%	US Bonds 7.51%	60/40 Blended Index 10.05%	Commodities 16.09%	US Bonds 2.96%	1.32
Real Estate 13.94%	Intl/EM Bonds 2.08%	US Bonds 0.55%	International Stocks 5.01%	US Bonds 3.54%	Real Estate 8.35%	Commodities 7.69%	High Yield 6.17%	International Stocks 8.29%	Real Estate 7.46%	Small Cap Stocks 2.74%	9.07
High Yield 7.42%	Gold 0.12%	60/40 Blended Index 0.11%	US Bonds 2.65%	Commodities 1.70%	3-month T-Bills 1.87%	Real Estate 5.35%	Real Estate 1.17%	High Yield 5.36%	3-month T-Bills 1.46%	Intl/EM Bonds 2.47%	0.26
3-month T-Bills 0.07%	3-month T-Bills 0.03%	3-month T-Bills 0.05%	3-month T-Bills 0.33%	3-month T-Bills 0.86%	US Bonds 0.01%	3-month T-Bills 2.28%	3-month T-Bills 0.67%	3-month T-Bills 0.05%	Gold 0.44%	3-month T-Bills 1.07%	0.85
2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	
US Bonds (2.02)%	Emerging Mkt Stocks (1.82)%	Intl/EM Bonds (2.42)%			Gold (0.93)%		Commodities (3.12)%	US Bonds (1.54)%	High Yield (11.22)%	Real Estate (3.16)%	9.49
Emerging Mkt Stocks (2.27)%	International Stocks (3.44)%	Small Cap Stocks (4.41)%			High Yield (2.26)%			Emerging Mkt Stocks (2.22)%	60/40 Blended Index (11.35)%	Commodities (5.36)%	-1.78
Intl/EM Bonds (4.13)%	Commodities (17.01)%	High Yield (4.64)%			Intl/EM Bonds (3.17)%			Gold (4.33)%	US Bonds (13.01)%		
Commodities (9.52)%		International Stocks (5.25)%			60/40 Blended Index (3.71)%			Intl/EM Bonds (4.44)%	International Stocks (15.57)%		
Gold (27.33)%		Gold (12.11)%			Large Cap Stocks (4.78)%				Intl/EM Bonds (18.17)%		
		Emerging Mkt Stocks (14.60)%			Small Cap Stocks (11.01)%				Large Cap Stocks (19.13)%		
		Commodities (24.66)%			Commodities (11.25)%				Emerging Mkt Stocks (19.74)%		
					International Stocks (13.78)%				Small Cap Stocks (20.44)%		
					Emerging Mkt Stocks (14.25)%						