PATHSTONE
THE MODERN FAMILY OFFICE™

Market Flash Report

March 2023

Key Takeaways

- Markets performed well in Q1 2023 despite economic threats. The S&P 500 and the Nasdaq finished the quarter +7.5% and +17.1% respectively. Yields dropped significantly after Silicon Valley Bank went under, which propelled fixed income markets higher.
- Growth stocks have had an impressive run so far in 2023. Technology and Telecom sectors were both up over +20.0% for the quarter, closely followed by Consumer Discretionary which ended up +16.1%. Meanwhile, Financials, Energy, Healthcare, and Utilities sectors are all down so far this year.
- Developed Non-U.S. equities had a stellar quarter, up +8.6% as the U.S. dollar continued to weaken. EM equities finished the quarter up +4.0% despite a tough month of February. Broad European equities were up over +10.5%, Japanese equities were up +6.2%, and Chinese equities were up +4.7% during Q1.
- CPI is down to 6.0% YoY from 6.5% at the end of 2022 and inflation as measured by PCE is down to 5.0% YoY from 5.3%. The Fed's projection for PCE by the end of 2023 is 3.3% which is still above their 2.0% long-term target and is higher than their 3.1% projection from last December. The Fed raised the Fed Funds rate by 0.5% during Q1 in the form of two 0.25% hikes to an upper bound of 5.0%. Their current projection for the Fed Funds rate at the end of 2023 is still 5.1%.
- The labor market remains surprisingly resilient as 236k jobs were added in March and over 1m were added in Q1. The excess number of job openings to those unemployed is shrinking as is the rate at which employees are quitting their jobs. Job openings peaked in March 2022 at 11.9m and as of February are down to 9.9m.

ARIZONA

CALIFORNIA

COLORADO

FLORIDA

GEORGIA

MASSACHUSETTS

NEW JERSEY

NEW YORK

RHODE ISLAND

TEXAS

BELLEVUE, WA

SEATTLE, WA

WASHINGTON D.C.

WYOMING

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Index Performance (as of 3/31/2023)

	Q1 2023	One-Year	Three-Year
Equity			
U.S. Large Cap	7.5%	-7.7%	18.6%
U.S. Small Cap	2.7%	-11.6%	17.5%
Developed Non-U.S.	8.6%	-0.9%	13.5%
Emerging Market	4.0%	-10.3%	8.2%
Real Assets			
Real Estate	0.3%	-20.5%	6.4%
Commodities	-5.4%	-12.5%	20.8%
Natural Resource Equities	-2.8%	0.7%	38.1%
Fixed Income			
Core Plus			
U.S. High Yield Debt	3.6%	-3.3%	5.9%
Emerging Market Debt	5.7%	-0.3%	1.7%
Core Bonds			
U.S. Aggregate Bonds	3.0%	-4.8%	-2.8%
U.S. Treasuries	3.0%	-4.5%	-4.2%
U.S. Municipal Bonds	2.0%	1.9%	0.8%
	Current	**Prior Month**	**One-Year Ago**
Month-End Values/Yield			
CBOE Volatility Index	18.7	20.7	20.6
10-Year Treasury Yield	3.5%	3.9%	2.3%

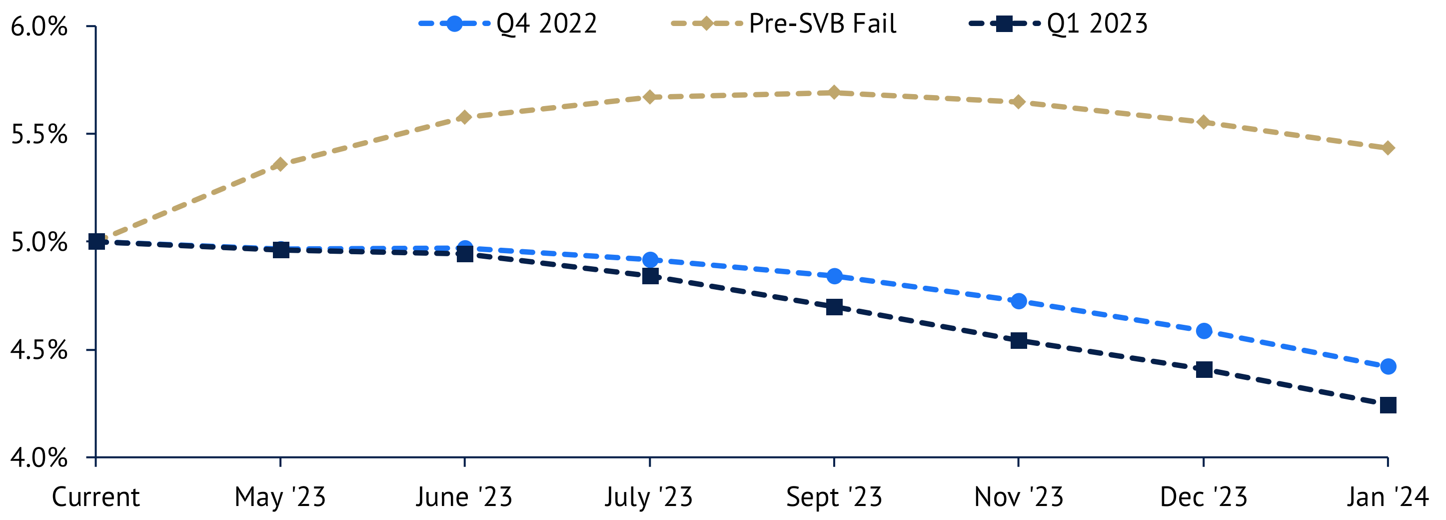
Sources: Bloomberg, Morningstar, treasury.gov. S&P Dow Jones Indices.

You cannot invest directly in an index; therefore, performance returns do not reflect any management fees. Returns of the indices include the reinvestment of all dividends and income, as reported by the commercial databases involved. Returns over one year have been annualized.

Quarterly Commentary

- Now a year into the current rate hiking cycle, we are starting to see some cracks forming. Two banks failed in Q1 2023, Silicon Valley Bank and Signature Bank, and were the first bank failures since 2020. While there were a lot of factors that led to the demise of these banks and as of now it does not appear to be a systemic issue with the banking system, this is not an issue we should take lightly and is a situation we will monitor closely. One factor we monitor every month is lending conditions. Lending standards have tightened considerably over the past year and are likely to get even more strict. This puts pressure on businesses and individuals who need access to capital and could lead to defaults and bankruptcies.
- Whether the U.S. economy enters a recession may come down to timing. As long as there is restrictive monetary and fiscal policy, the path forward is inevitable. To avoid recession, inflation needs to adequately cool and prices need to stabilize, all while keeping unemployment in check. So far so good, but the longer we stay on this path, the higher the probability of recession.
- The U.S. economy added over 1m jobs in the first quarter of 2023. The labor force participation rate for prime age workers (25-54) is back to pre-Covid levels and the unemployment rate is at multi-decade lows of 3.5%. Average hourly earnings are trending lower after a spike in early 2022. The labor market does have its own cracks. Initial jobless claims are up 25% from the low in September. Continuing claims for unemployment are up 40% over the same period. Job openings have come down and job cut announcements have increased. While the rate of change of these data points is high, current levels are still remarkably strong.
- If the unemployment rate stays low, jobs keep being added, and growth stays within reasonable levels, the Fed can keep interest rates high enough to ensure inflation does not rear its head again. Market expectations for where interest rates will go have varied widely this year. At the end of Q1, markets believed (or hoped) that rate cuts will start as soon as September. The chart below shows how quickly things can change and the delicate nature of the balance between employment, inflation, and growth.
- Earnings reported during Q1 for Q4 2022 were unimpressive for the S&P 500. Companies reported a -4.6% YoY decline in earnings and a relatively moderate +5.3% YoY growth in revenues. Analyst projections for Q1 earnings are even lower at -6.8% YoY and revenue growth estimates are +1.8% YoY according to FactSet. Materials, Healthcare, and Technology sectors are projected to have the steepest drop in earnings growth for the quarter.
- Yields and interest rate expectations came down significantly during March. Long-duration bonds and fixed income in general benefited massively and rallied as a result. Intermediate and long-term bonds are usually a good hedge during a recession as the Fed decreases rates to help stimulate the economy. We might be months away from any rate cuts, but bonds are yielding much higher than in the past and should provide better returns than we have seen for some time.

Market Implied Fed Funds Rate - Fed Funds Futures



Sources: Bloomberg, Morningstar, treasury.gov. S&P Dow Jones Indices.

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