



Market Outlook

First Quarter 2023



MARKET SNAPSHOT

The Fed is nearing an end to its rate hike campaign, and its impact on future economic growth in the U.S. is unknown.

Equity markets, in particular, have been resilient thus far this year and appear to be pricing in a “soft landing” scenario whereby the Fed is able to get inflation under control without significant economic consequences.

Many leading economic indicators and datapoints continue to worry us and point to a looming recession. Despite the approaching end to the rate hike cycle, we don’t think the U.S. economy is out of the woods quite yet.

We expect continued volatility in both stock and bond markets as investors continue to digest new data on inflation, interest rates, and growth.

We believe a defensive, high-quality positioning in both stock and bond portfolios could provide resilience in the event the economy slows, unemployment rises, and the prices of risk assets decline.

.....
The Market Outlook is mailed quarterly to our clients and friends to share our perspective. Certain material in this work is proprietary to and copyrighted by iM Global Partner Fund Management, LLC and is used by Retirement Plan Advisors with their permission. Reproduction or distribution of this material is prohibited and all rights are reserved.

Market Recap

Despite the stress in the banking system, including the failures of Silicon Valley Bank and Signature Bank, global equity markets held up remarkably well in March and posted solid returns for the quarter. The S&P 500 index was up 3.7% in March and gained 7.5% in the first quarter. Developed international stocks (MSCI EAFE Index) did a bit better, rising 8.5% for the quarter (and returned 2.5% in March). Emerging-market stocks (MSCI EM Index) gained 4% for the quarter and rose 3% in March.

Underneath the calm market surface there was wide dispersion in returns across sectors, market caps, and styles. Large-cap growth stocks (Russell 1000 Growth Index) gained 14.4% in the quarter, while large-cap value stocks returned 1% (Russell 1000 Value Index). The Nasdaq Composite Index surged 17%, while the Russell 2000 Small Cap Value Index dropped 0.7%.

Fixed-income markets had a strong quarter as longer-term bond yields fell, generating price gains. Core investment-grade bonds (Bloomberg U.S. Aggregate Bond Index) returned 3%, as the 10-year Treasury yield fell to 3.5% from 3.9% at year-end. Riskier high-yield bonds (ICE BofA U.S. High Yield Index) outperformed core bonds, gaining 3.7%. Municipal bonds gained 2.3% (Morningstar National Muni Bond Category). Flexible/nontraditional bond funds gained around 3%.

Alternative strategies and nontraditional asset classes generally underperformed traditional stock and bond indexes for the quarter. Trend-following managed futures strategies had a particularly tough period, losing anywhere from 6% to 10%, as some of the major trends from 2022 sharply reversed—particularly interest rates.

The Silicon Valley Bank Failure: What Happened and Why

By now, the story of the Silicon Valley Bank (SVB) failure is well known. But we think a quick recap is worthwhile as it provides context for our investment outlook and portfolio positioning.

In a nutshell, SVB was the victim of a classic “bank run”—too many depositors wanted their money back simultaneously and the bank didn’t have the cash on hand to meet customer withdrawals.

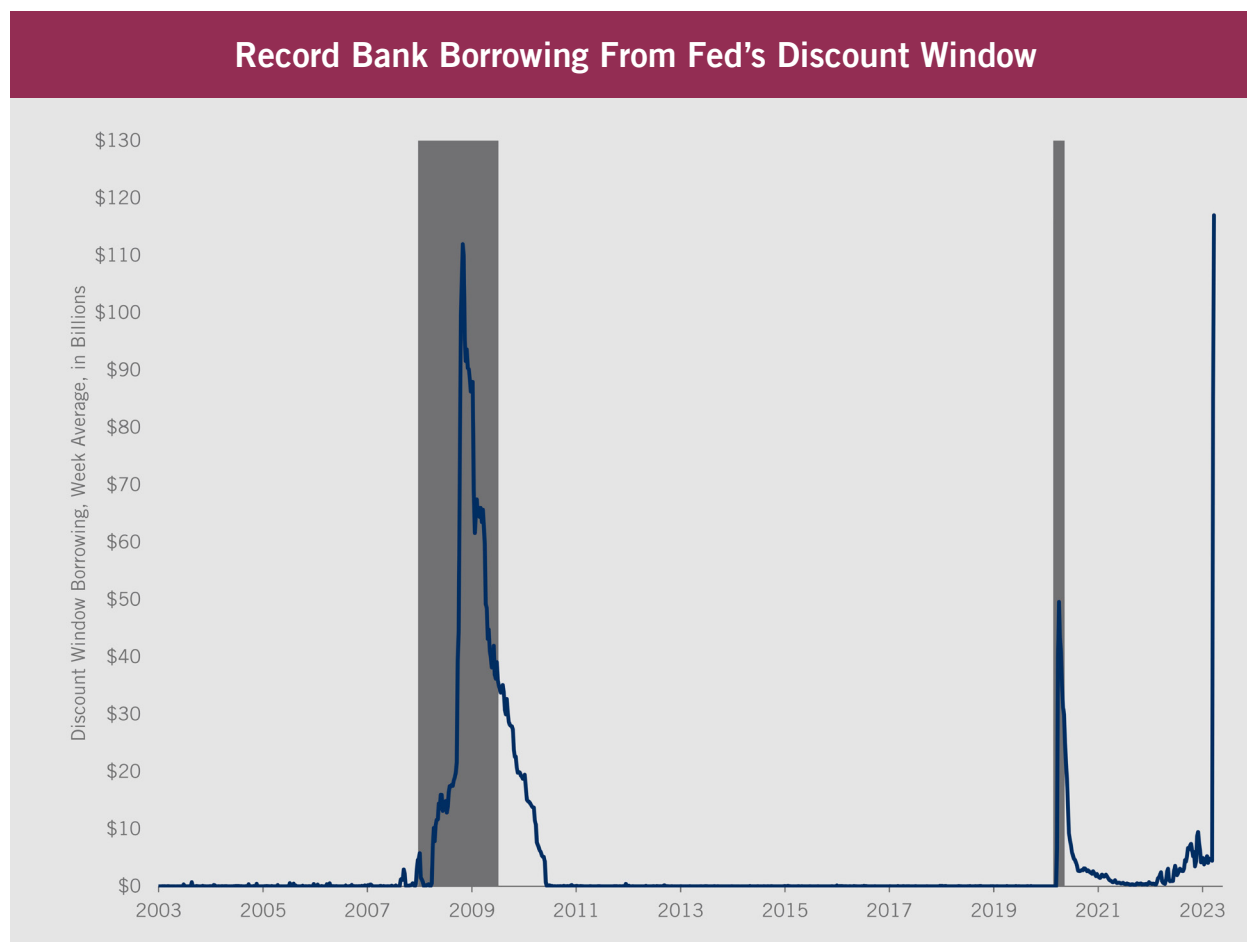
Importantly, SVB had unique characteristics that made it particularly susceptible to such a run that don’t necessarily apply

to the broader banking industry, or at least not to the same degree. This is one reason we do not see the failure of SVB as the beginning of a replay of the Great Financial Crisis of 2008. But there clearly will be broader economic and financial market impacts.

SVB was particularly exposed to interest-rate risk given it held an unusually large share of its assets in long-duration bonds. As such, SVB faced extremely large unrealized losses on their bond portfolio when rates rose sharply last year as the Fed sought to choke off inflation. Moreover, unlike most banks with a diversified deposit base that includes individuals of all sizes and types of businesses in different sectors, SVB's depositor base was made up of start-up technology firms, venture capital firms, and the like; and almost its entire depositor base was above the FDIC insurance limit of \$250,000 per account.

Combined, these characteristics of SVB caused some of their concentrated, large, uninsured depositors to start pulling their money from the bank. This forced SVB to raise capital (liquidity) to meet the withdrawals by selling bonds at losses, turning the unrealized losses on their balance sheet into realized losses, raising the question of not only liquidity risk for the bank but solvency/bankruptcy risk, leading to even more depositor flight. Ultimately, the FDIC and Fed stepped in over the weekend of March 11 to take over the bank, guarantee all SVB deposits above \$250,000, and set up a broad banking system liquidity backstop (the Bank Term Funding Program (BTFP)). The BTFP allows banks to borrow from the Fed for up to a year, based on the issued face value (par value) of their treasury and agency mortgage-backed securities bonds, rather than the current (lower) market value. This new facility enables banks to meet deposit withdrawals and other liquidity needs without having to sell currently underwater bonds at a loss. As we can see in the chart below, banks have taken the Fed up on its offer, and then some.

While the banking system is not out of the woods and there may be more smaller-bank takeovers, it seems these steps and subsequent actions from authorities have stemmed the risk of a widespread bank-run contagion.



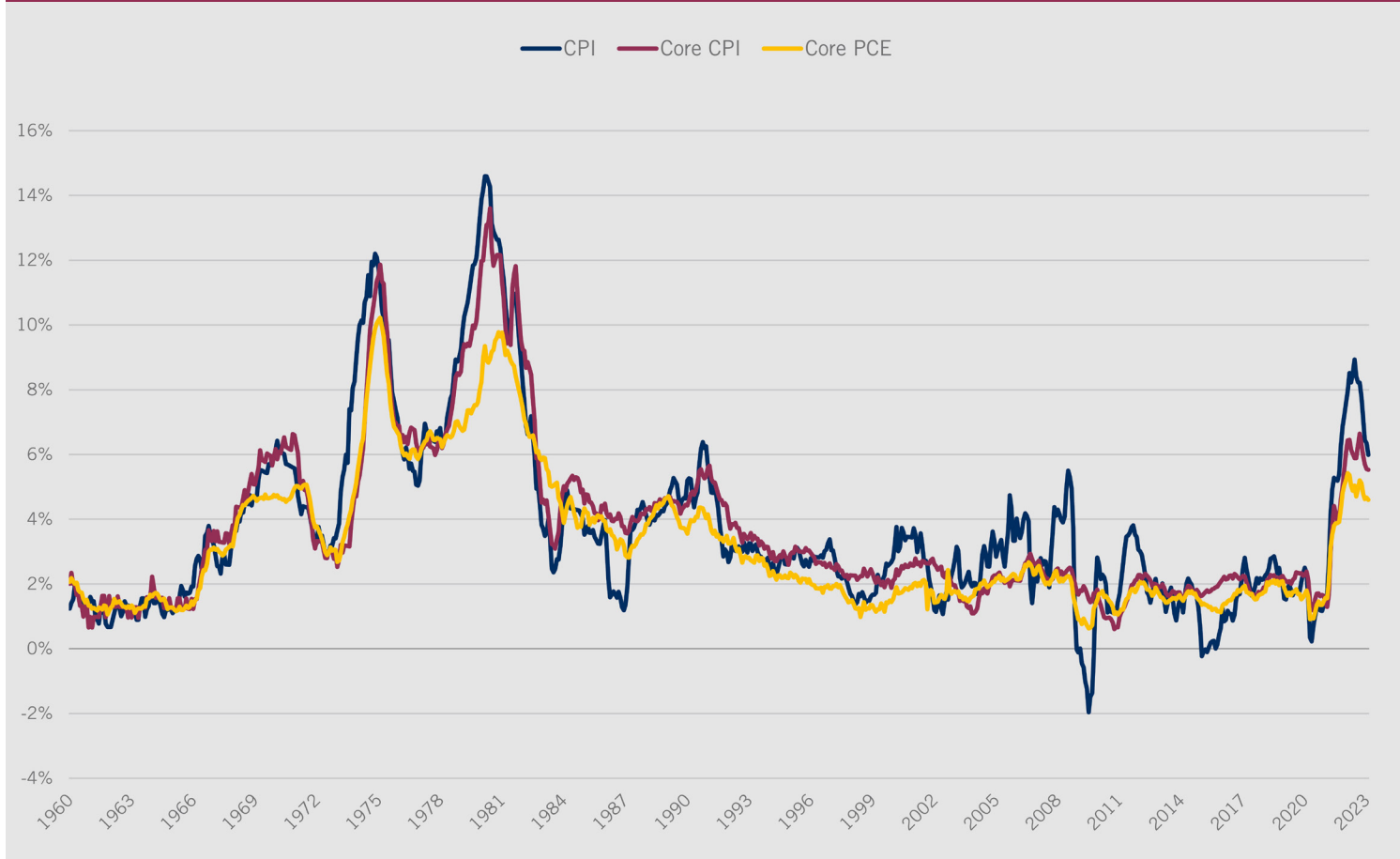
Source: Federal Reserve. Shaded areas indicate NBER-defined recessions. Data as of 3/22/2023.

Investment Outlook

We always consider a range of macroeconomic scenarios when constructing our investment views and diversified portfolios. Our approach is particularly valuable during periods of heightened uncertainty, which we would argue is the case today given the dynamics of inflation, Fed policy, and stress in the banking system.

On the inflation front, while inflation likely peaked last year and has come down, it remains too high relative to the Fed's 2% long-term target. February's year-over-year core Consumer Price Index (CPI) inflation rate was 5.5%, while core Personal Consumption Expenditure (PCE) inflation—the Fed's preferred measure—clocked in at 4.6%.

While Headline CPI Has Peaked, Core Inflation Measures Remain Far Above the Fed's 2% Target



Source: U.S. Bureau of Labor Statistics and U.S. Bureau of Economic Analysis. Data as of 2/28/2023.

Given persistently high inflation, the Fed has continued its rate hiking campaign this year, although the magnitude of rate hikes has diminished.

At its March 22 Federal Open Market Committee meeting, the Fed hiked its federal funds policy rate by 25 basis points (0.25%) to a range of 4.75% to 5.0%. This was the Fed's ninth consecutive hike since March 2022, representing a total tightening of 475 bps (4.75%). This is the most aggressive monetary policy tightening campaign since the Paul Volcker days in the early 1980s. It was inevitable something (in this case SVB and other poorly managed banks) would “break” given the magnitude and speed of the hikes.

The Fed is still hoping they can land the economy softly without causing much more damage, let alone a recession. It's not impossible, but the odds are low and history is not on their side given the complexity of the task and the multitude of economic and behavioral variables outside of their control.

With above-normal inflation and the Fed sharply tightening, the short-term outlook for economic growth was already poor coming into the year. Add to that the negative impact from tighter credit conditions due to the recent banking stress, and the growth outlook has gotten worse. How much worse isn't clear, but it definitely hasn't improved the chance of avoiding a recession this year.

However, all is not gloom and doom for the economy. Household and business balance sheets remain healthy and supportive of continued spending. U.S. households are still sitting on an estimated \$1.4 trillion in pandemic-era savings. Employment remains robust, with a stronger than expected 311,000 new jobs in February, following the shockingly strong 504,000 jump in January. Real disposable income is rising as wage growth is now stronger than CPI inflation. Moreover, the U.S. and other major global economies appear to have grown in the first quarter of the year. So even if a recession does play out, these are all reasons to believe it may be relatively mild.

In an economic recession, it is almost certain corporate earnings will decline. S&P 500 index earnings typically decline around 15% to 20% (peak-to-trough) during economic recessions as both sales growth and profit margins compress. In a mild recession, the earnings decline might be closer to 10% to 15%. The current consensus earnings expectations for 2023, however, do not reflect nearly that magnitude of decline, nor do current stock market valuations. If our base case earnings recession scenario plays out, there is a strong likelihood that the S&P 500 index will materially decline from current levels.

Closing Thoughts

We believe 2023 will present us with some excellent long-term investment opportunities. Unfortunately, in our base case we also expect we'll first have to go through a recessionary bear market with the potential for a drop in global equity prices. However, we do not rule out the possibility of the U.S. economy avoiding recession this year, or that the recession is mild and stocks do not drop as sharply as we expect.

A lot still depends on the Fed and how much further they raise rates. If the Fed pauses their hiking campaign sooner than later, equities may positively respond (at least over the short-term), as lower interest rates imply higher P/E multiples. But there are numerous other key variables for the economy and financial markets that are beyond the Fed's or any policymaker's control. The recession may be pushed out to 2024, but we doubt it's been rescinded.

As always, thank you for your continued confidence and trust.

Best regards,

Retirement Plan Advisors



Market Indicators

First Quarter 2023

S&P Sectors

	QTR	YTD	1Y	5Y
S&P Technology Select Sector TR USD	21.65	21.65	-3.78	19.72
S&P Financial Select Sector TR USD	-5.56	-5.56	-14.24	5.41
S&P Consumer Disc Select Sector TR USD	16.16	16.16	-18.28	9.34
S&P Health Care Select Sector TR USD	-4.31	-4.31	-3.70	11.82
S&P Industrial Select Sector TR USD	3.47	3.47	0.17	8.44
S&P Cons Staples Select Sector TR USD	0.72	0.72	1.30	10.32
S&P Energy Select Sector TR USD	-4.37	-4.37	13.15	9.60
S&P Utilities Select Sector TR USD	-3.24	-3.24	-6.21	9.60
S&P Real Estate Select Sector TR USD	1.95	1.95	-19.69	7.44
S&P Materials Select Sector TR USD	4.29	4.29	-6.28	9.52
S&P Telecom Select Industry TR USD	-0.31	-0.31	-11.70	4.57

Value / Growth Returns

	YTD			Previous Calendar Year		
	Large	Mid	Small	Large	Mid	Small
Value	5.17	2.51	2.53	-5.22	-6.93	-12.73
Growth	9.63	5.04	2.14	-29.41	-18.96	-21.08

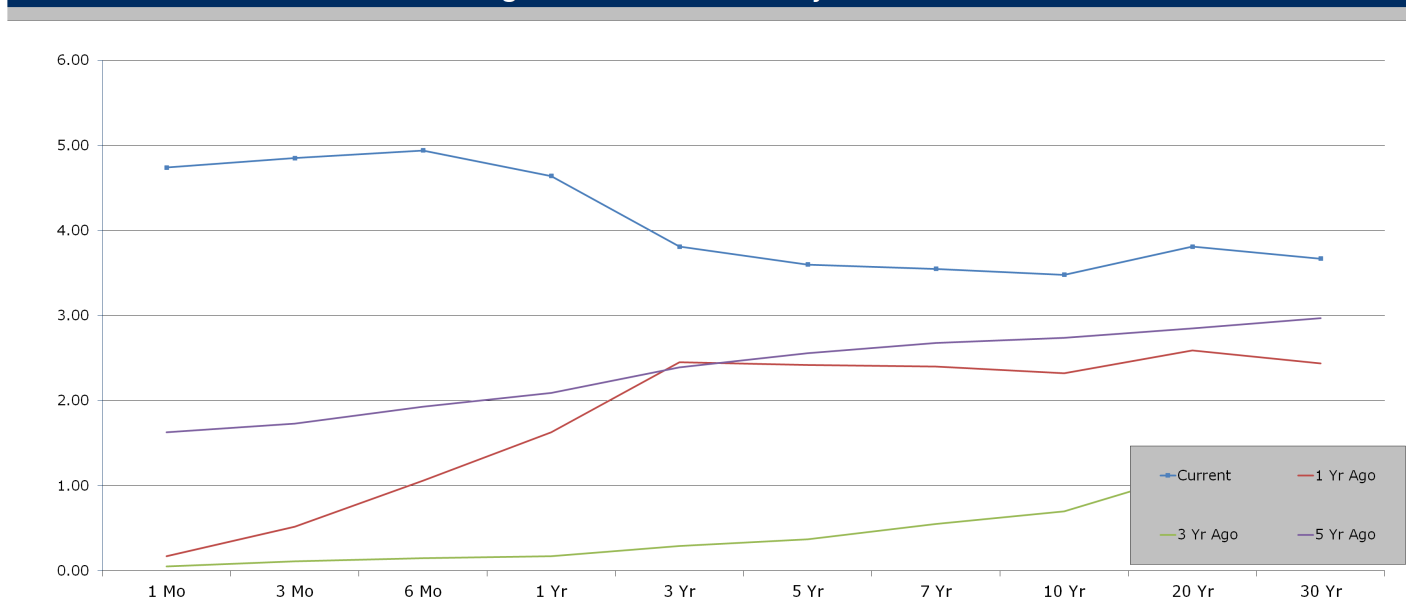
Market Returns

	QTR	YTD	1Y	5Y	10Y
S&P 500	7.50	7.50	-7.73	11.19	12.24
Russell Mid Cap	4.06	4.06	-8.78	8.06	10.05
Russell 2000	2.74	2.74	-11.61	4.71	8.04
MSCI EAFE	8.47	8.47	-1.38	3.52	5.00
MSCI Emerging Markets	3.96	3.96	-10.70	-0.91	2.00
BBgBarc U.S. Agg Bond	2.96	2.96	-4.78	0.91	1.36
High Yield	3.57	3.57	-3.34	3.21	4.10

Index Characteristics

	LTM P/E	NTM P/E	Div Yld	Earn Yld
S&P 500	20.62	18.64	1.58	5.36%
Russell Mid Cap	17.16	16.27	1.59	6.15%
Russell 2000	11.38	12.58	1.58	7.95%
MSCI EAFE	13.69	12.92	2.47	7.74%
MSCI Emerging Markets	11.11	12.20	2.39	8.20%

Long-Term Outlook on Treasury Yield Curve



Source: Morningstar

RETIREMENT PLAN ADVISORS

www.retirementplanadvisors.com

29 E. Madison St., Suite 500 | Chicago, IL 60602 | 312.701.1100

Investment Advisory Services offered through Retirement Plan Advisors, LLC, a Federally Registered Investment Adviser