QUARTERLY
Market
REPORT

1ST QUARTER - 2023

Despite a strong start, markets slid through the second quarter while the Fed stayed true to its stance on continued interest rate hikes. A "soft landing" for the economy is less likely, especially as inflation lingers at high levels and employment remains stable.

A PROMISING START AND A DISAPPOINTING END

The year started off well, opening with the best January for the S&P 500 since 2019.[1] We closed out 2022 with a fed funds rate of 4.25-4.5%,[2] and fourth-quarter gross domestic product (GDP) came in at a solid 2.7% year-over-year.[3] As a result, expectations were that the Federal Reserve might raise rates one more time before pausing hikes. Some analysts even speculated on the possibility of rate cuts before the end of the year, and that the Fed might actually pull off the promised "soft landing" for the economy.

Unfortunately, expectations didn't match reality. First, inflation didn't cooperate, as the rate of decline slowed and began leveling off. By the end of February, the consumer price index (CPI) stayed stubbornly high at 6% year-over-year, a slight 0.4% decline from the previous month.[4] What's causing the plateau? The significant drop in inflation rates last fall were likely related to a decline in gas prices, which hit record highs last July.[5] As the cost of gas dropped, the savings were passed on to consumers. But other components of inflation — including higher labor costs, supply-chain hiccups and ongoing consumer demand — all conspired to maintain elevated inflation rates.

Employment was another big factor rattling markets in the first quarter. The Fed's goal is to bring down interest rates by destroying demand, and the first step to achieving that goal is eliminating jobs. So far, they haven't been successful. The Bureau of Labor Statistics reported that we added 504,000 nonfarm payroll jobs in January and an additional 311,000 in February.[6]

For markets, the robust employment reports fell into the "good news is actually bad news" category, dashing hopes that the Fed would pause its rate hikes or even cut rates in the back half of 2023. This disappointment led to January gains giving way to February drops. Markets limped into March but ultimately finished with monthly and quarterly gains.

Equity Performance as of March 31, 2023				
Equity Index	**Q1**	**1 YR**	**3 YRS**	**5YRS**
S&P 500:	7.03%	-9.29%	16.71%	9.25%
NASDAQ:	16.77%	-14.05%	16.65%	11.59%
DJIA:	0.38%	-4.05%	14.93%	6.66%

Sources:
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BANK CLOSURES CREATE ADDITIONAL TURMOIL

As markets struggled to regain their footing in early March, they reeled from another blow. Regulators seized Silicon Valley Bank, a California-based bank predominantly serving tech companies and venture capital-backed startups.[7] Another institution, Signature Bank in New York, also failed just two days later.[8] The news initially hit markets hard, as it remained unclear whether the U.S. government would provide a bailout. In mid-March, authorities said they planned to waive the $250,000 FDIC insurance limit. All depositors at both banks would regain access to their funds and all losses would be restored.[9]

The narrative shifted following the bank closures, going from a "rates for higher and longer" discussion to whether the Fed should pause rate hikes due to the mini banking crisis. The Fed responded in late March by raising rates another 25 basis points (0.25%), taking the target Fed Funds rate to 4.75-5.0%.[10] It's the first time the target rate has reached 5% since 2006.[11]

The biggest concern is that the Fed will overdo it with the interest rate hikes. It has already broken the housing market and delivered a big blow to the banking system. Staying on its current course could result in the Fed breaking something it can't put back together quickly and force us into a recession.

THE RETURN OF THE 60/40 PORTFOLIO

There is some good news: After being declared nearly dead in 2022, traditional 60/40 portfolios are making a comeback.[12] This is mostly due to a rebound in bond yields, which have risen over the past few months:

U.S. Treasury Bond Yields as of March 31, 2023	
Name	**Yield**
2-year	3.98%
5-year	3.53%
10-year	3.45%
30-year	3.66%

Source: Bloomberg.com. https://www.bloomberg.com/markets/rates-bonds/government-bonds/us. Accessed April 1, 2023.

If interest rates are managed properly, investors can lock in significant yields. Opportunities abound, especially as fixed income reestablishes itself as a viable component of a total return strategy. However, it could be a good idea to act quickly on these opportunities, as they could diminish if the Fed begins to implement rate cuts.

LOOKING AHEAD

The events of the first quarter serve as a reminder that a recession is still possible (and probable) in the coming months. Markets will likely remain volatile as we enter the second quarter of 2023, particularly if the Fed continues on its path. If it doesn't change course quickly enough, we could be in for the "hard landing" everyone wanted to avoid.

If you haven't done so lately, we recommend scheduling an appointment with your advisor to review your financial plan and make sure your investments are aligned with your goals. Short-term events will likely continue to rattle markets over the next few months. If these events become distracting or discouraging, turn to your advisor for support. He or she can help you stick to the plan and continue working toward your long-term goals.

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