Quarterly Market Report

First Quarter 2023

Vogel Consulting

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First Quarter Highlights

Financial markets were volatile on mixed economic news and shifting rate hike views

Financial Markets

- Equities rallied early in the quarter as cooling inflation drove expectations for a near-term end to rate hikes, but stronger than expected economic data shifted those expectations and a bank crisis caused stocks to pull-back briefly before rallying again late in the quarter as worries eased.
- The bond market had unusually large swings in reaction to changing forecasts for rate hikes and the flight to safety after the bank failures. For example, the 2-year Treasury bond yield hit the highest level since 2007 but quickly fell back to levels of six months ago.
- Energy prices were sharply lower on weak demand. Industrial metals prices were mixed. Gold rose to a near record high on the flight to safety.

Overview of the Economy

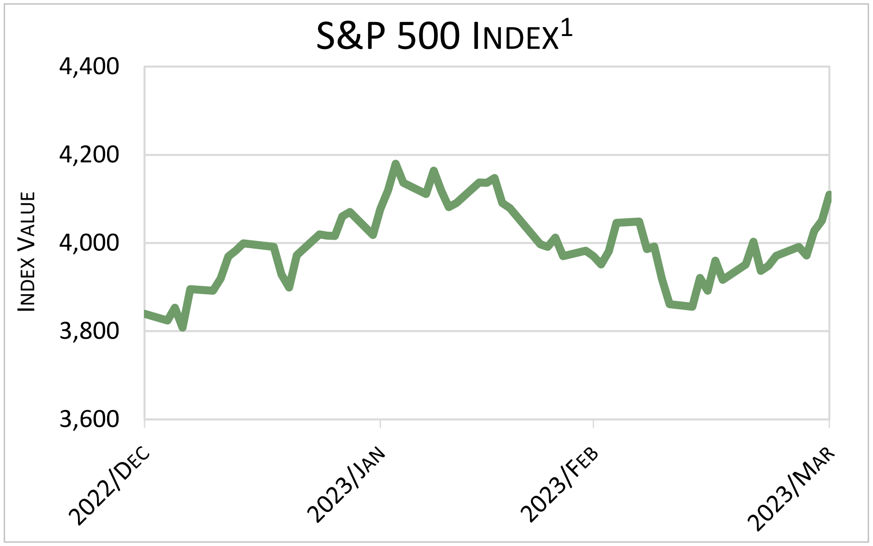
- Fourth quarter 2022 earnings reports were generally lower than expected due to rising costs and weakening demand. Many companies gave a cautious outlook for 2023 and announced various cost cutting measures.
- U.S. payroll employment surged in the first two months of 2023. The labor market remains tight despite headlines of large layoffs at major companies.
- The consumer price index (CPI) in several countries has declined but remains at multi-decade highs.
- Surveys showed slowing growth rates for manufacturing and but services activity is picking up around the world.

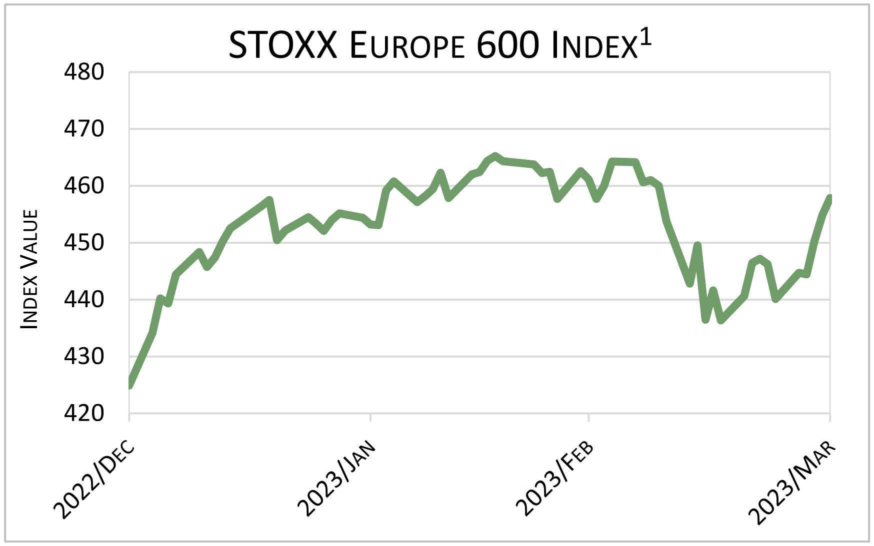
Notable Events

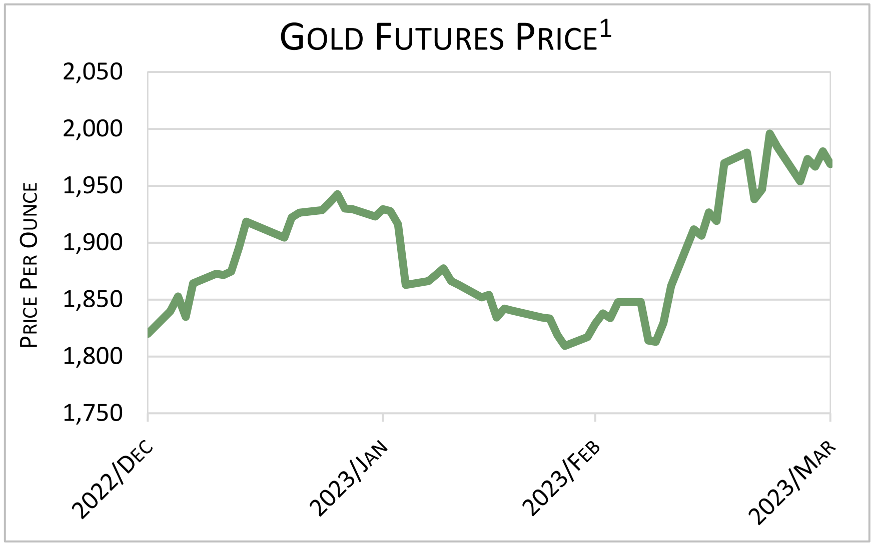
- Central banks around the world continue to battle inflation by raising interest rates. The Federal Reserve Open Market Committee (Fed) raised its policy rate twice during the quarter.
- Three banks in the U.S. failed in March and a major bank in Europe collapsed and was bought by a rival fueling fears about a credit crunch.

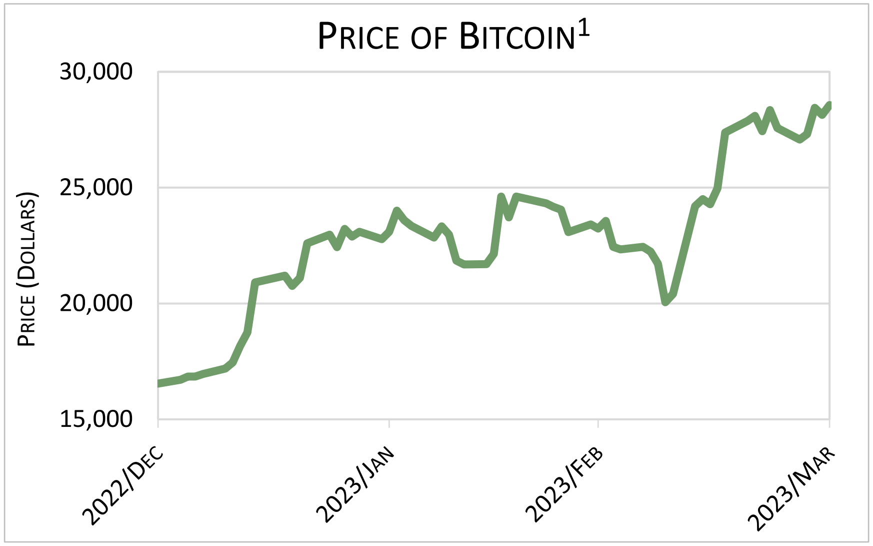
First Quarter Highlights

Early rally in stocks and crypto reversed briefly on rate and bank worries but gold spiked









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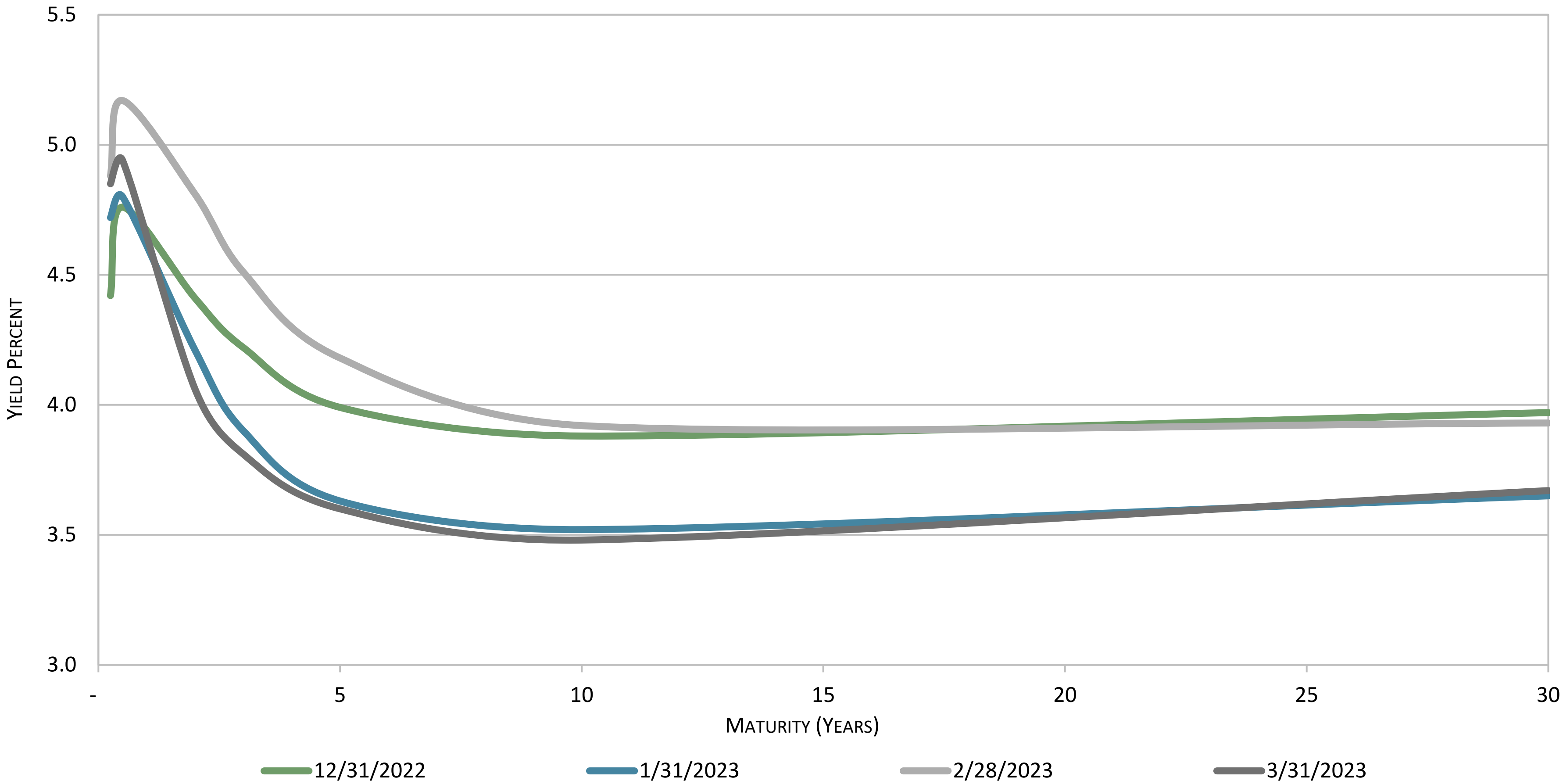
First Quarter Highlights

Bond yields were particularly volatile as rate hike expectations fluctuated

Bond prices rose and yields dropped early in the quarter when weak retail sales and subsiding inflation data fueled expectations that the Fed may soon be done raising rates. But stronger labor market data changed that view and rates spiked higher again until the bank crisis drove recession worries and renewed expectations for dovish Fed policy which pushed yields lower.

U.S. Treasury Yields[2]



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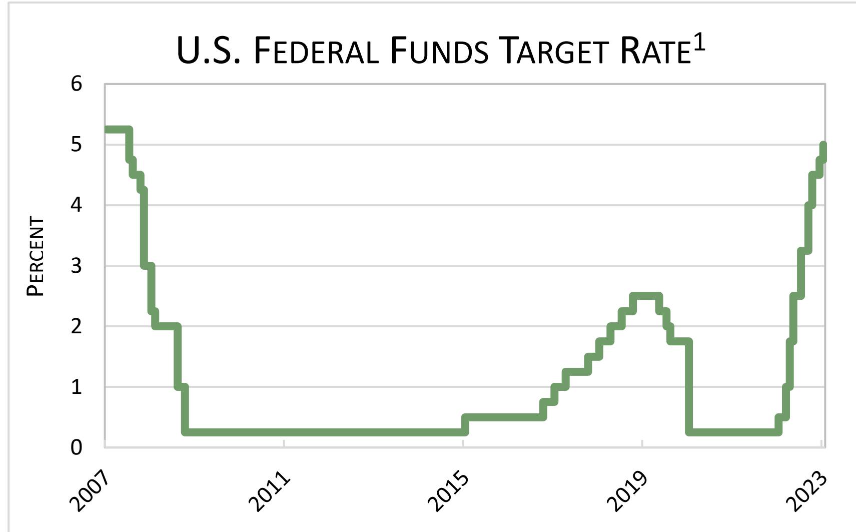
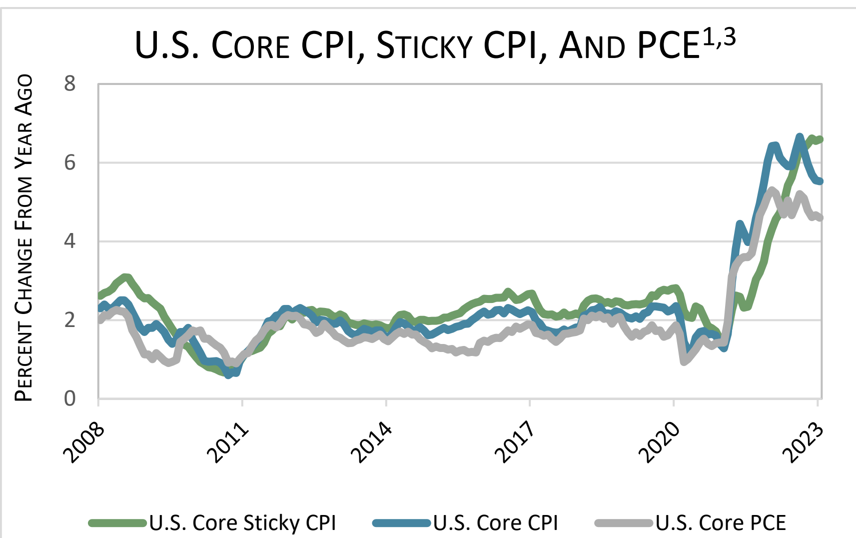
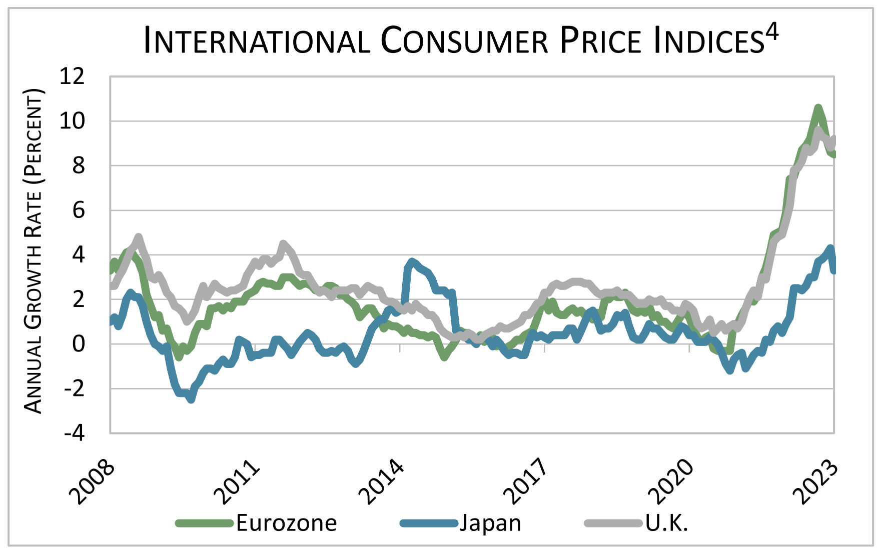
First Quarter Highlights

Central banks raised key interest rates again as inflation is still historically high

The Fed raised its fed funds rate twice in the quarter in the continuing battle against inflation. The hikes were each a quarter of a percentage point and brought the funds rate to the highest since late 2007. Inflation has come down gradually from the peak last summer but remains at an historically high level by any measure. The median of Fed member projections points to the funds rate peaking at 5.1% in 2023, or one more hike. Central banks in other countries also hiked their policy rates again such as Canada, the United Kingdom (U.K.), Norway, Switzerland, and in the Eurozone.







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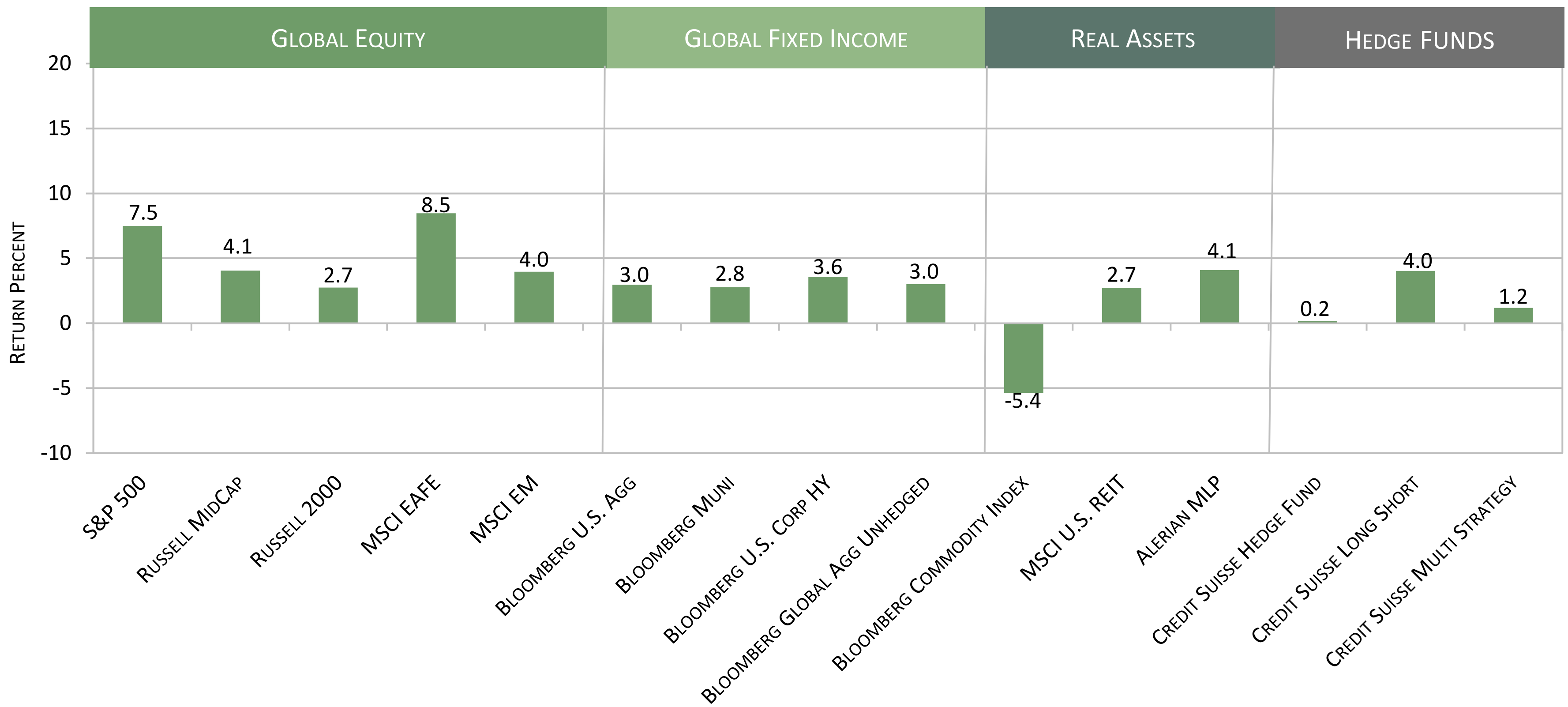
First Quarter Highlights

Most asset classes posted gains despite volatility

Equities rallied for most of the quarter on cooling inflation, a strong labor market in the U.S., improving economic data in Europe, and the impact of China's reopening. U.S. small-cap stocks were hurt the most by the banking crisis. International returns were also boosted by a weaker dollar. The bank crisis drove bond prices up. A steep drop in energy prices on recession fears drove the commodity index lower.

Market Returns: First Quarter 2023[5]



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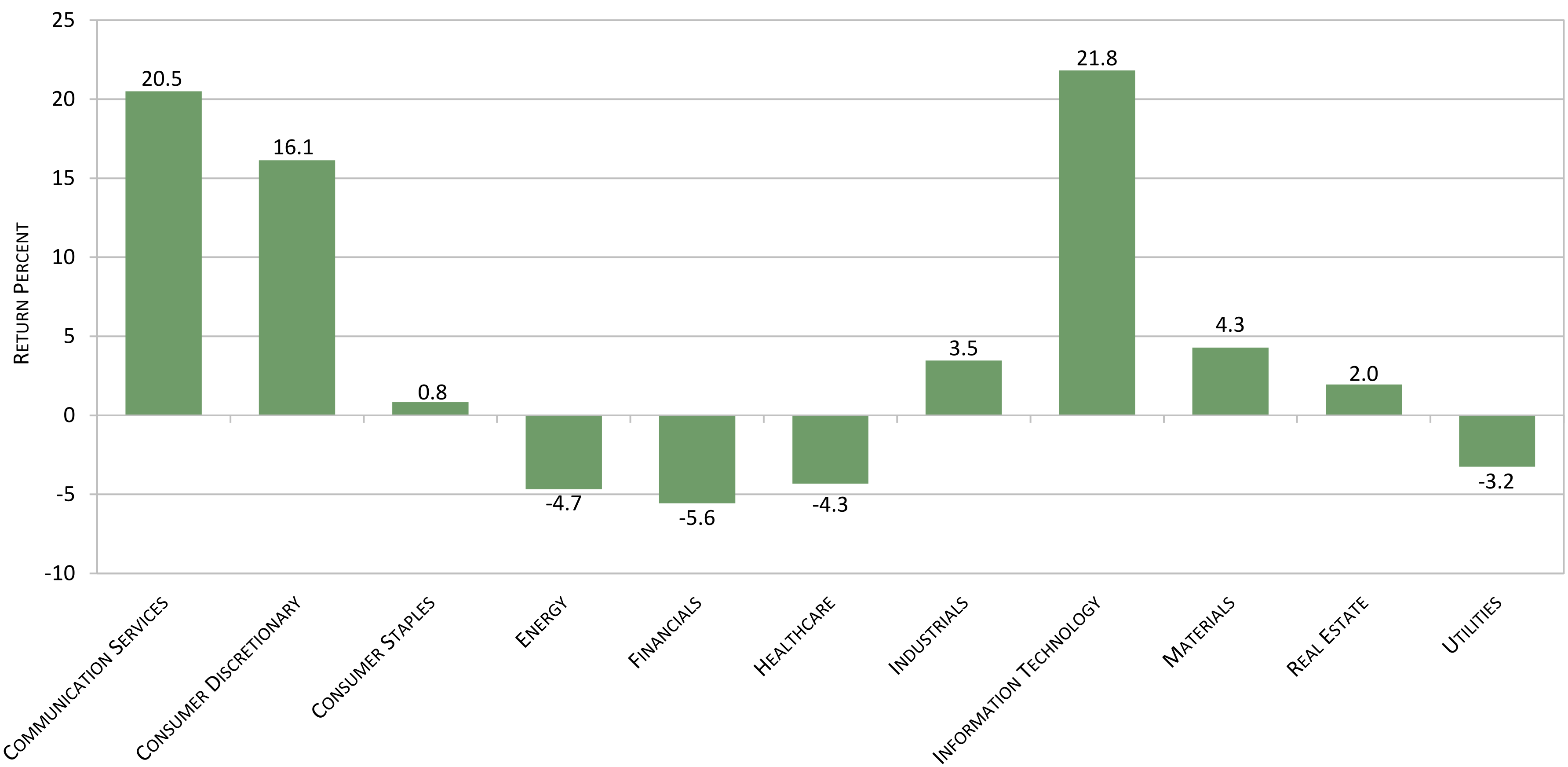
First Quarter Highlights

Growth stock outperformed value stocks

Performance leadership rotated during the quarter with last year's laggards being the top performers for the quarter and 2022's winners lagging. Cost cutting and lower interest rates boosted investor sentiment for growth stocks. Financials were hurt by contagion worries from the bank crisis. Defensive sectors were out of favor in the "risk-on" sentiment for most of the quarter.

S&P 500 Sector Returns: First Quarter 2023[5]



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Outlook

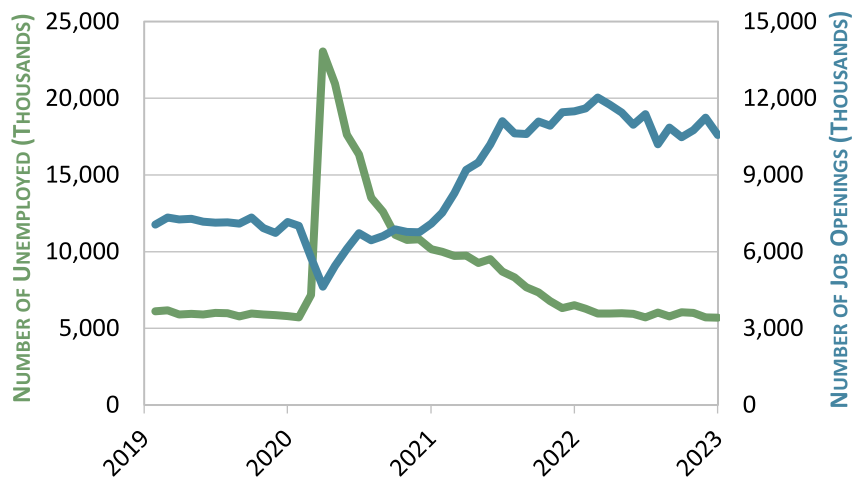
Financial market volatility likely as economic growth slows amid tight monetary policy

- Economic growth in the U.S. is forecast to slow significantly as the year progresses as the impacts of high interest rates, persistently high inflation, and now tightening lending standards weigh on consumer and business activity. If such a slowdown occurs, inflation pressures could ease and the Fed could be convinced to end its rate hikes. But the extent of a slowdown is uncertain so rates could stay at the higher levels for a longer time than some forecasters currently expect. Key economic data reports will be watched closely by market participants and could be a source of price swings if data surprises investors.
- Economic data in Europe was better than expected in the first quarter. However, inflation remains high so further rate hikes are likely which may slow growth.
- China's reopening continues to expand with service activity booming. However, the rebound in manufacturing activity has been more muted so has not caused a marked pick-up in demand for, or prices of, commodities. The government has been taking measures, such as cutting bank reserves and easing the crackdown on technology companies to boost the economy. Other countries, especially in Asia, are likely to benefit from a pick-up in the Chinese economy.
- In contrast to 2022 when most central banks around the world were raising interest rates to fight inflation, it is likely there will be more divergence in policy between countries going forward as inflation and growth trends become more differentiated. If the Fed soon pauses its series of rate hikes, the interest rate difference between the U.S. and other countries, particularly Europe, may lessen causing the dollar to decline. This could provide a boost to U.S. exporters as well as a boost to the return of international investments for U.S. investors.
- The recent decision by Saudi Arabia and other oil producers to cut output by over a million barrels per day to push prices higher may complicate central banks fight against inflation.

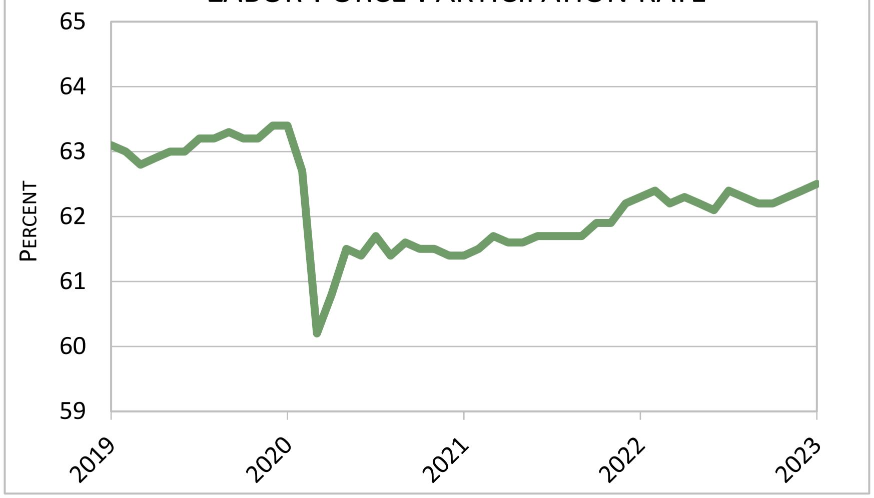
Outlook

The labor market remains tight which fuels inflation but supports economic activity

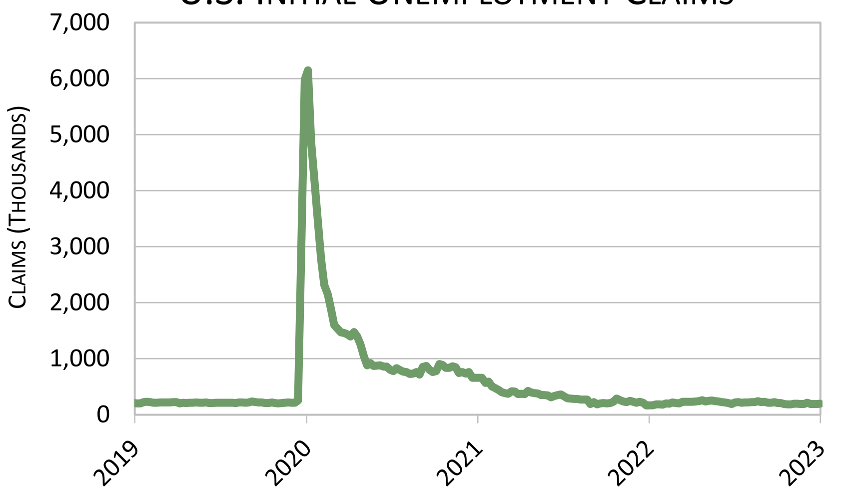
U.S. Employment[1,6]



Labor Force Participation rate[1]



U.S. Initial Unemployment Claims[1]



Wage Growth[7]

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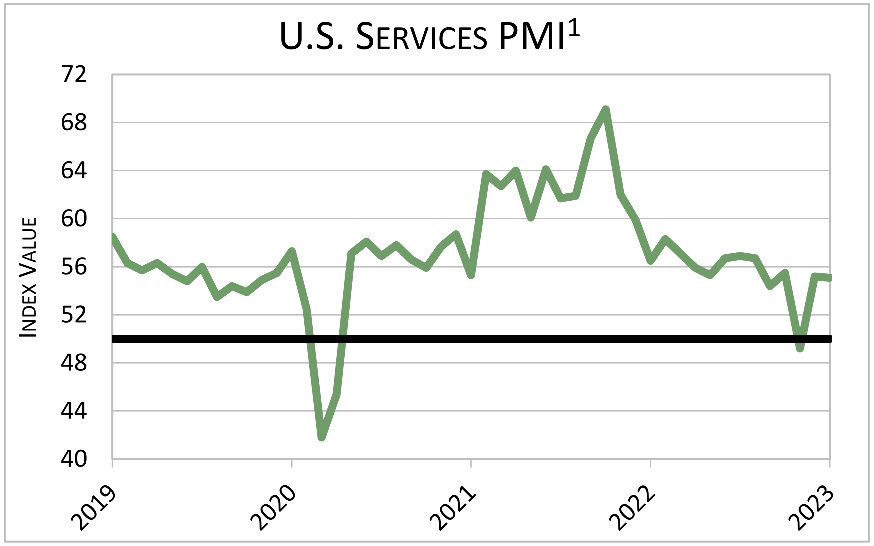
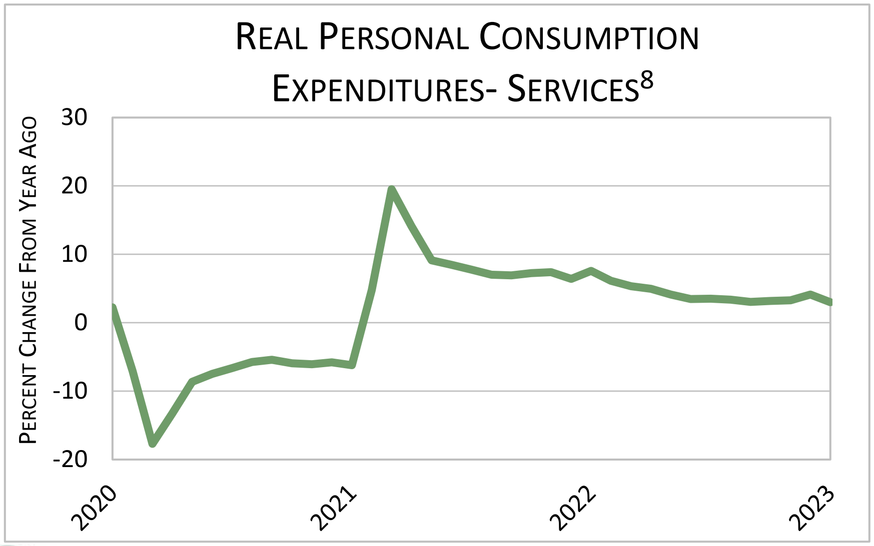
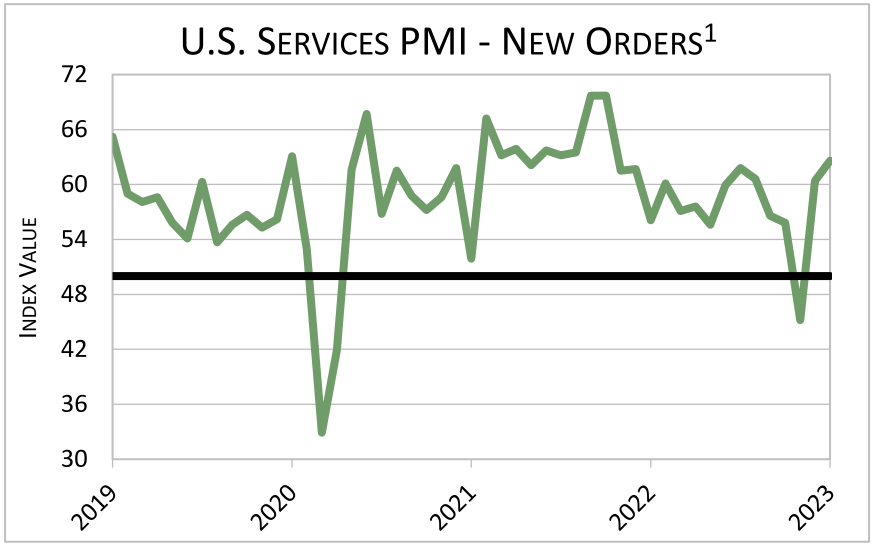
OUTLOOK

THE SERVICES SECTOR IS SHOWING MODERATE GROWTH DESPITE HIGHER INTEREST RATES

The Institute of Supply Management's purchasing managers index of service activity is well into expansion territory with a value over 50 in both January and February. Importantly, the new orders index was strong as well. Consumers continue to spend on services at a relatively steady pace. The 8.7% cost-of-living adjustment to Social Security likely provided a boost to spending. Further increases in spending may be limited due to the recent rise in credit card debt.







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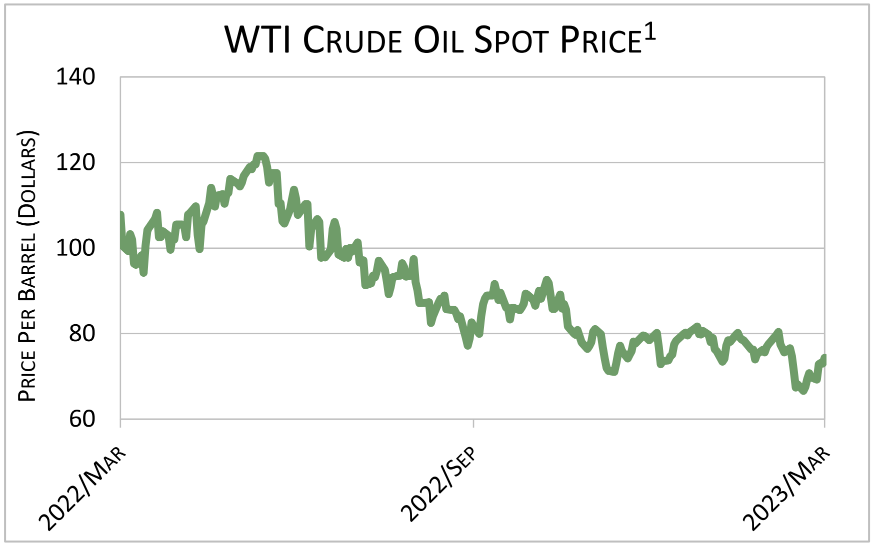
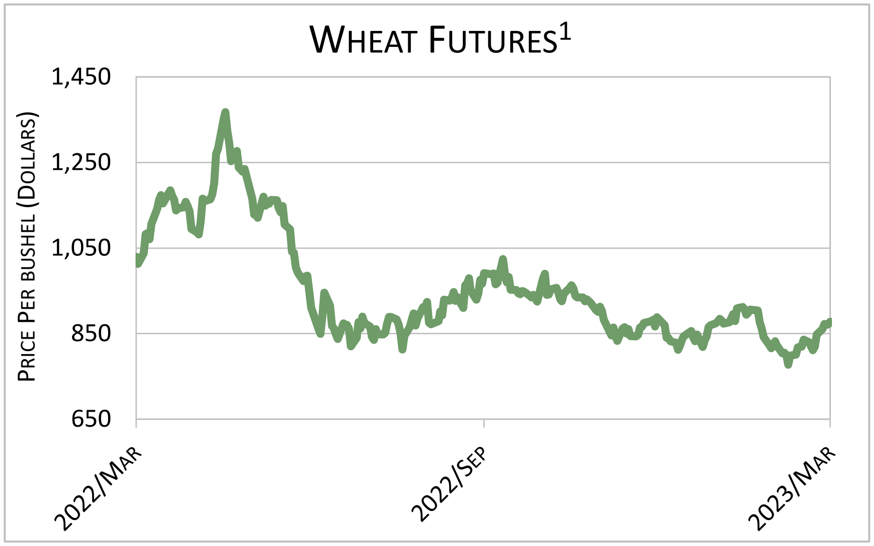
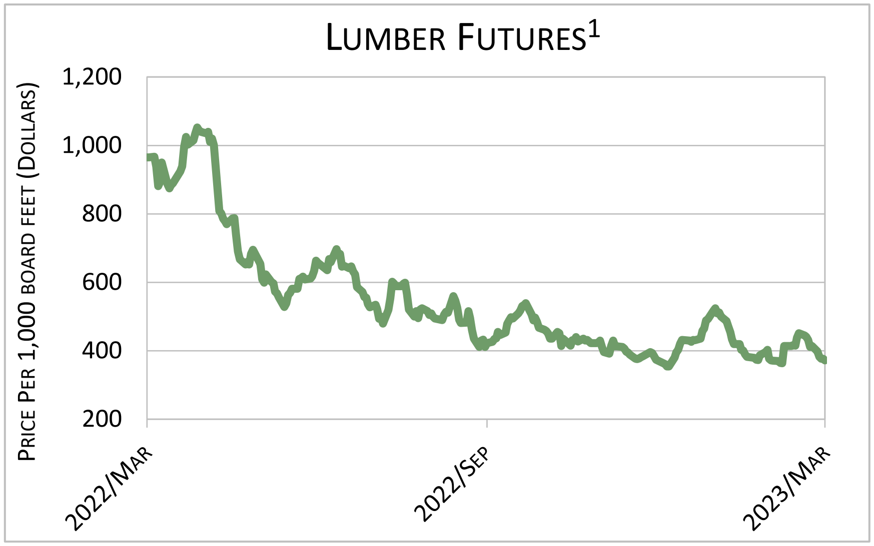
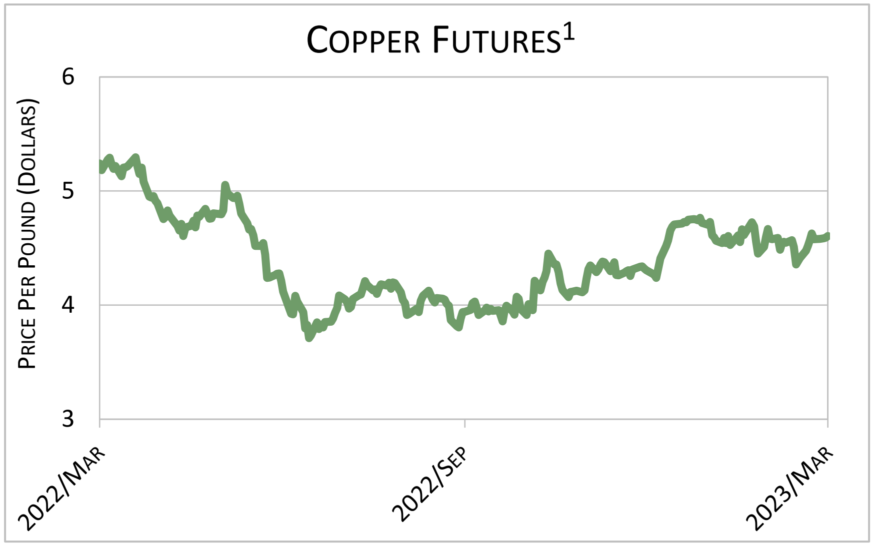
Outlook

Commodity prices have been mixed, but generally less of an inflation impact than in 2022









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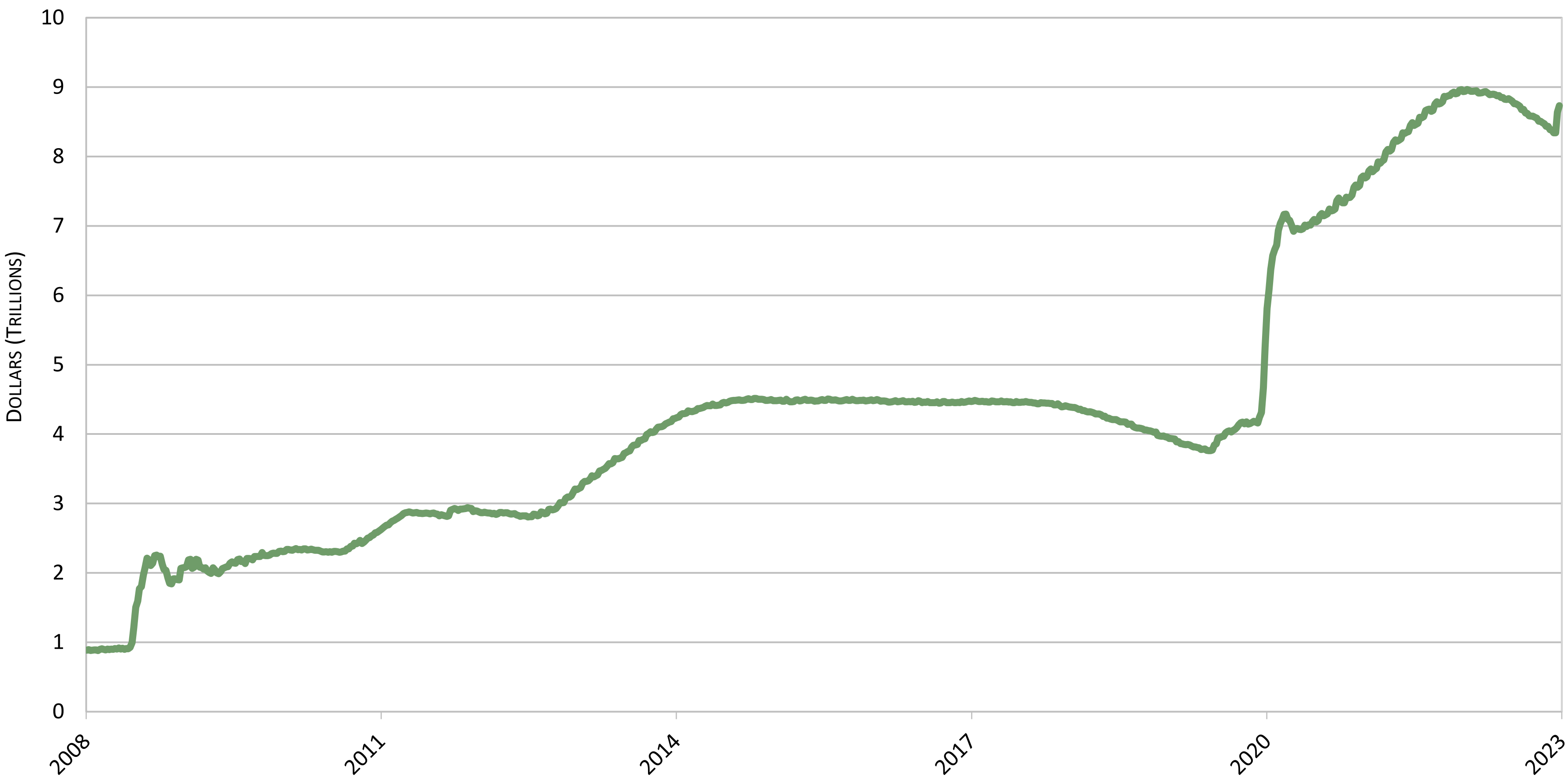
OUTLOOK

THE FED HAS NOT BEEN AGGRESSIVE IN REDUCING ITS BALANCE SHEET TO TIGHTEN MONETARY CONDITIONS

The Fed raised its policy interest rate sharply and over a short time to fight inflation but has not been as aggressive in using its other tool, which is to reduce its balance sheet. Its balance sheet remains at a historically high level. A modest reduction was seen in 2022 but the response to the recent banking crisis reversed the trend.

FEDERAL RESERVE BALANCE SHEET ASSETS[1]



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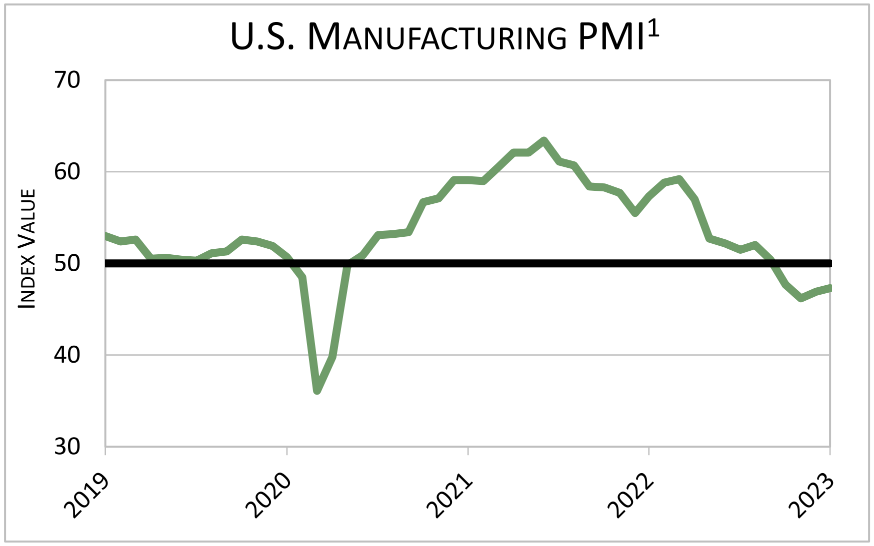
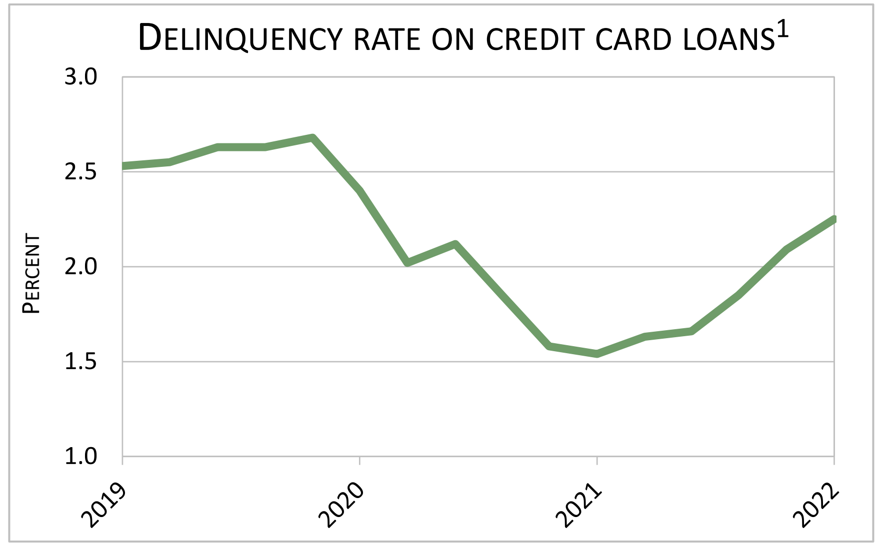
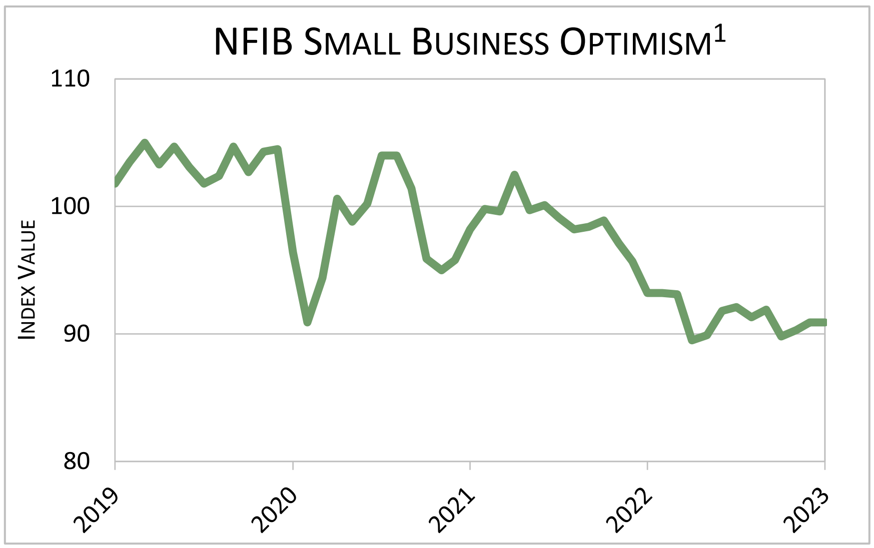
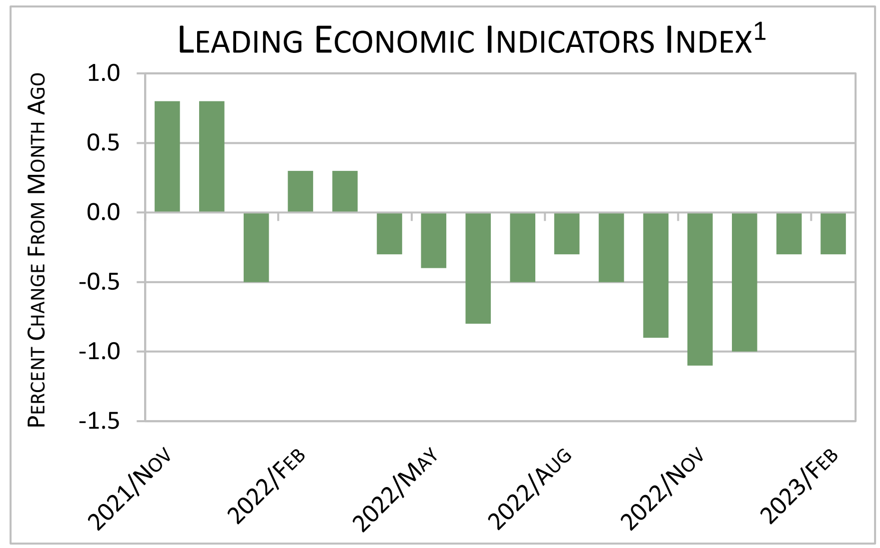
Outlook

Worries persist that the Fed will tighten too much given signs of stress in some indicators









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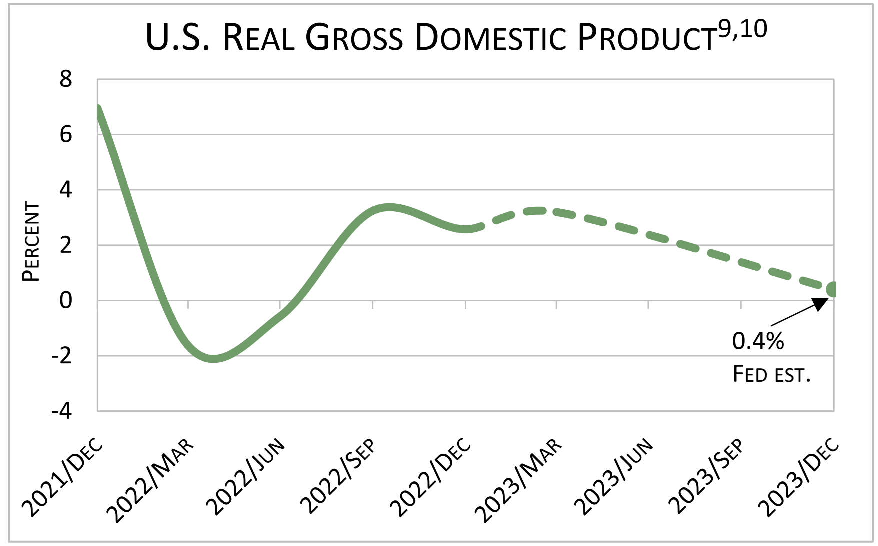
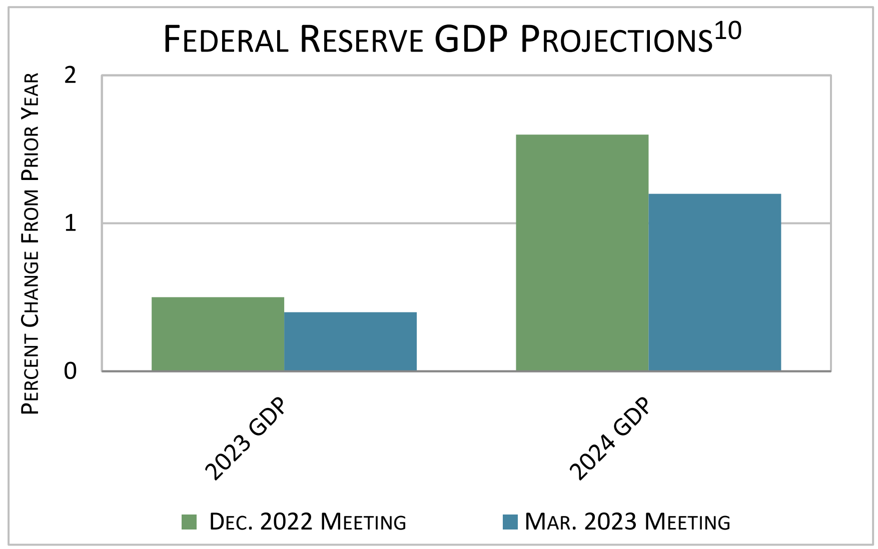
OUTLOOK

ECONOMIC GROWTH IS FORECAST TO SLOW AS IMPACTS OF RATE HIKES FLOW THROUGH

The effect of higher interest rates and tighter lending standards are likely to weaken demand resulting in businesses slowing investment and cutting costs including reducing their labor force. Rising unemployment would presumably slow spending. Forecasts point to slower and even almost no growth.

Real gross domestic product (GDP) increased at an annual rate of 2.6% in the fourth quarter of 2022. The Federal Reserve of Atlanta's GDPNow forecast for first quarter 2023 GDP growth was 2.5% at the end of March. Since then, manufacturing, construction, and international trade data have come in weaker than expected suggesting downward revisions to that forecast. At its March meeting, the Fed lowered its projection for GDP growth for 2023 to 0.4% and lowered its 2024 forecast also. Various private company forecasts also point to GDP growth of less than 1% for 2023. This means the Fed and others are expecting negative growth for at least one quarter after positive first quarter growth.



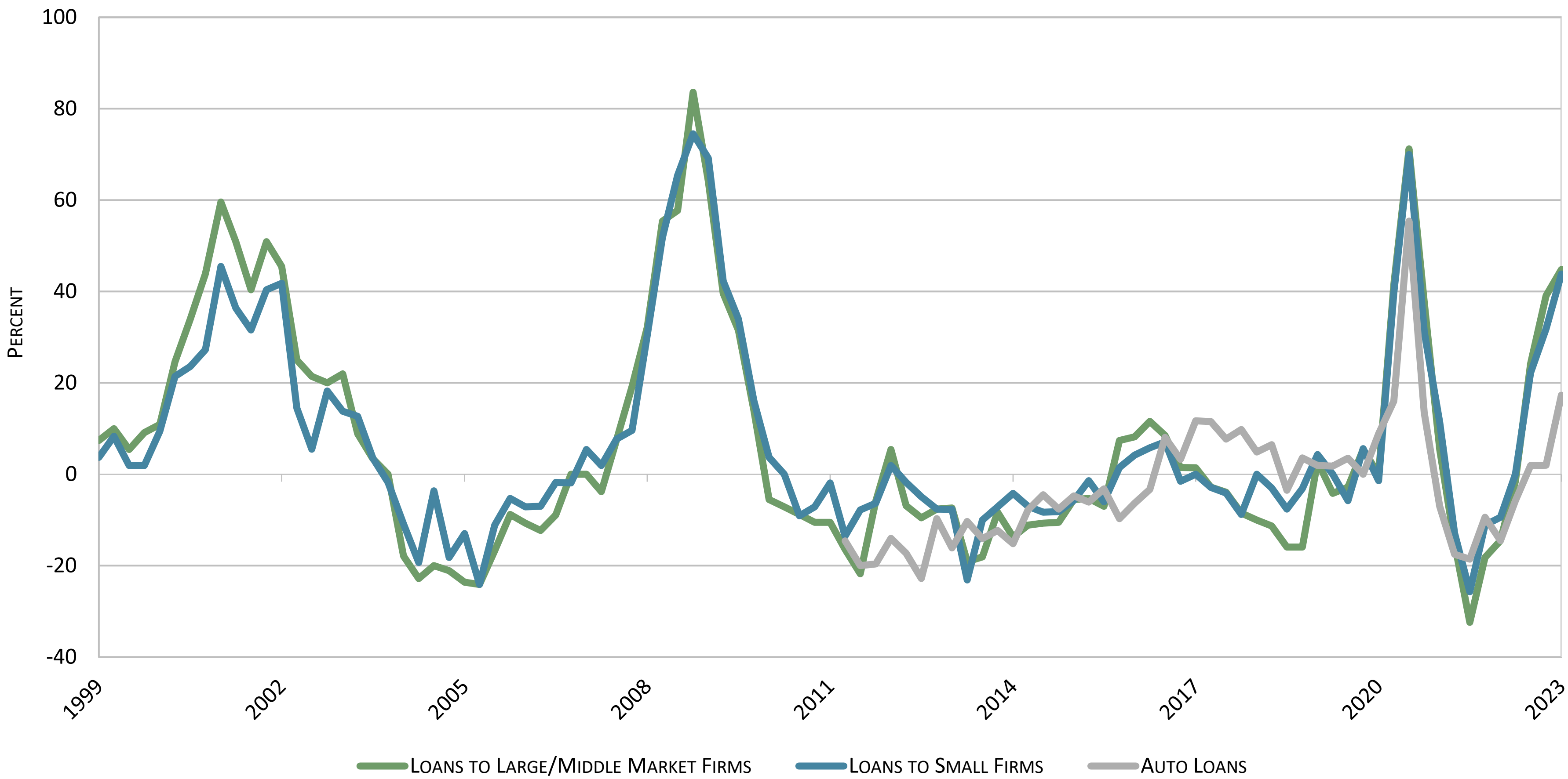


Outlook

Will the recent bank crisis lead to a deeper credit crunch and hurt the economy?

Lending standards have been tightening consistent with prior recessionary periods. The new Fed bank term funding program incentivizes banks to hold Treasury and mortgage backed bonds and cut back on other loans. Tighter standards and less lending could strain businesses and consumers and slow economic growth.

Net Percentage of Domestic Banks Tightening Loan Standards[11,12,13]



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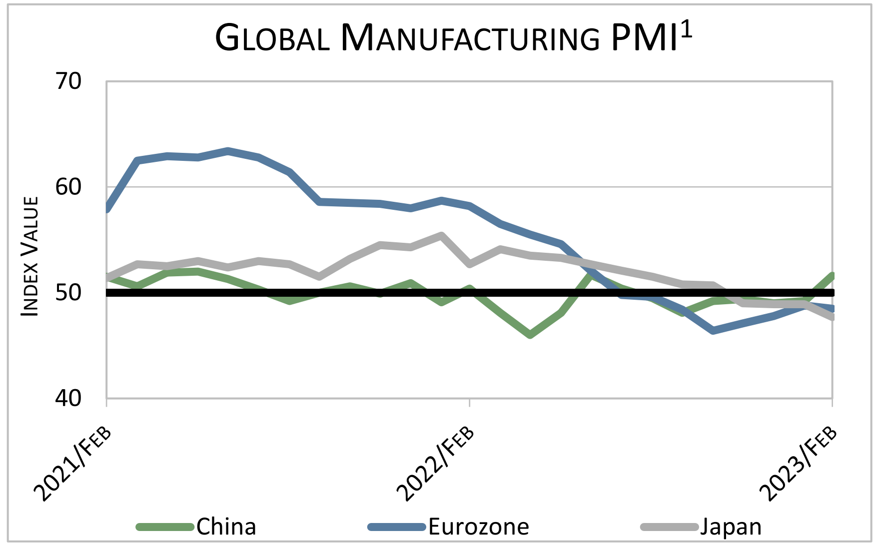
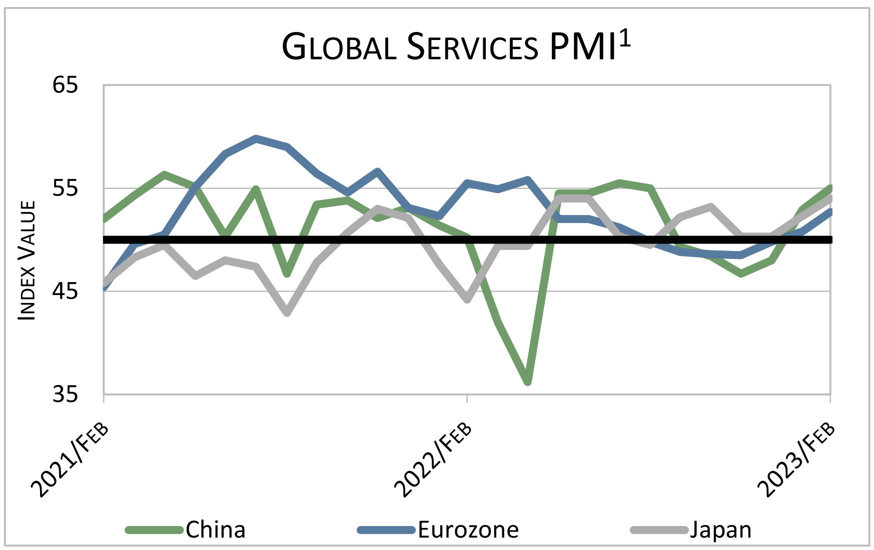
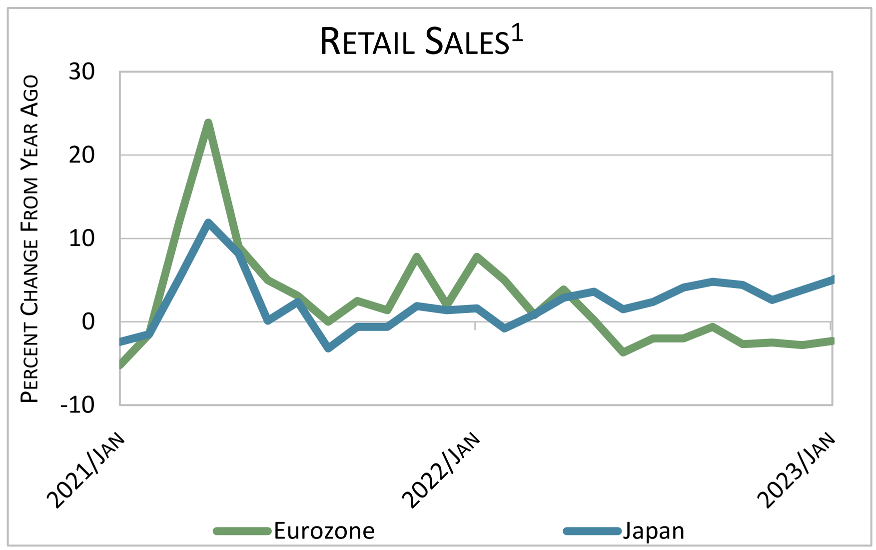
OUTLOOK

ECONOMIC DATA OUTSIDE THE U.S. IS SHOWING SOME IMPROVEMENT

Lower energy costs because of a warmer than normal winter in Europe are providing a boost to economic activity.   The reopening of China's economy is fueling an uptick in business activity particularly in the services sector, but the manufacturing uptick is slower than expected. Other Asian countries are also benefiting from a return of Chinese tourists and improving export orders. Japan's service sector is trending up but the manufacturing sector is in a downtrend due to weak demand.







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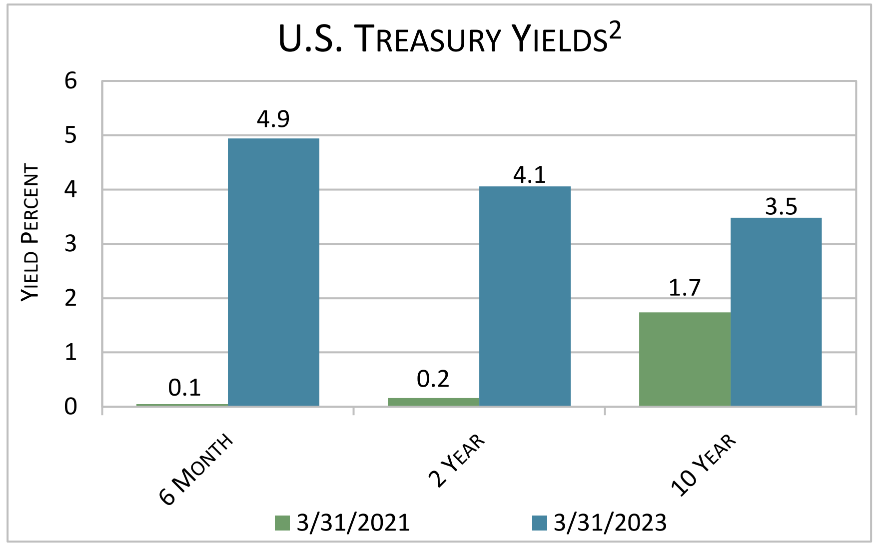
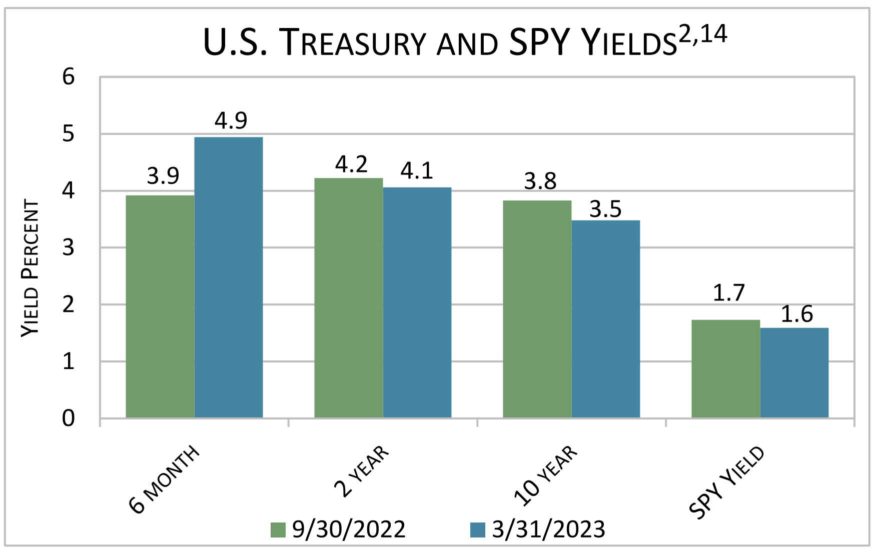
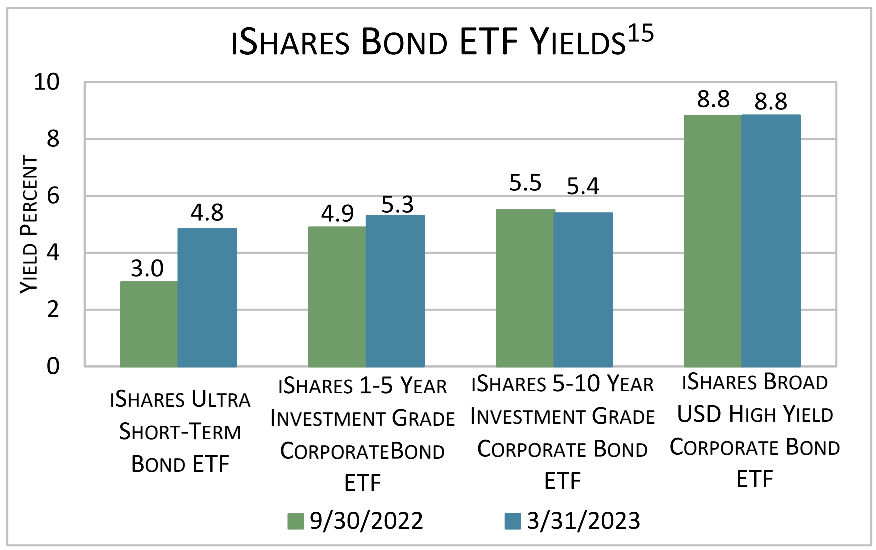
Outlook

FIXED INCOME YIELDS ARE ATTRACTIVE ESPECIALLY IF EARNINGS GROWTH SLOWS

Yields on all but the shortest maturity bonds ended the quarter modestly lower due to the flight to safety caused by the bank crisis. However, yields remain at the highest levels in years, particularly for bonds with a short time to maturity, and continue to offer more income opportunity than dividends on most stocks. For example, Treasury bond yields are significantly higher than the yield on the popular SPDR S&P 500 Trust ETF (SPY). Bonds may also provide capital appreciation potential if the economy slows enough that interest rate hikes end.







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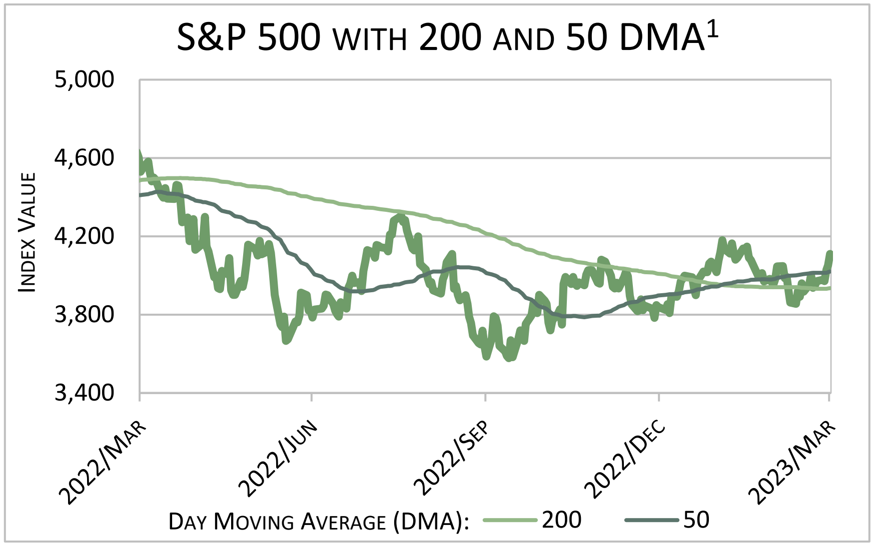
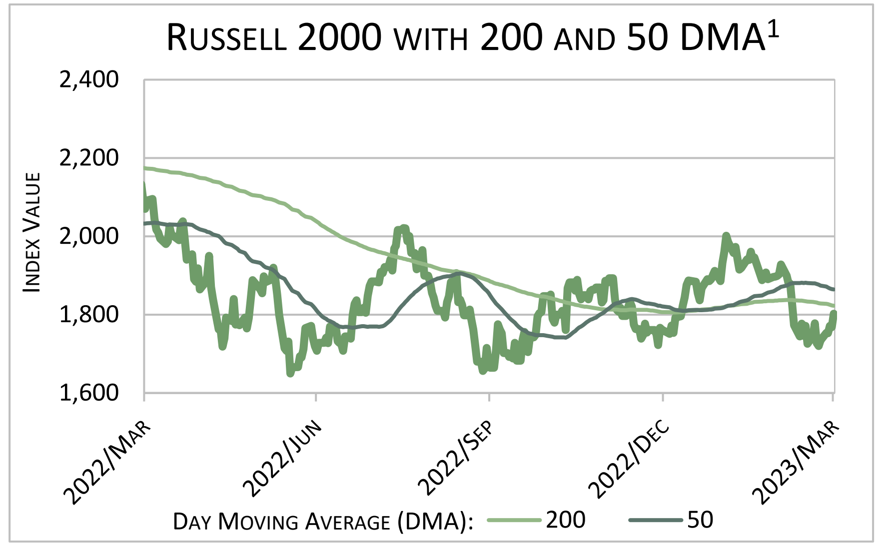
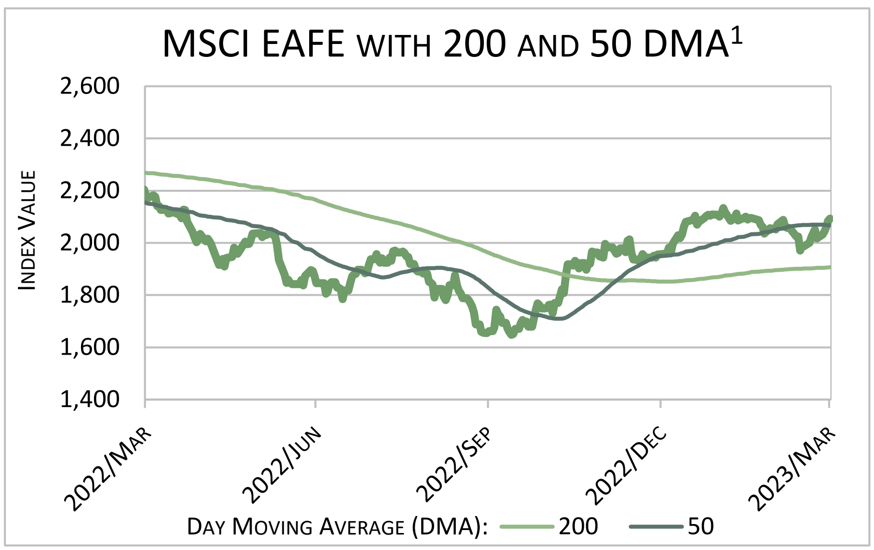
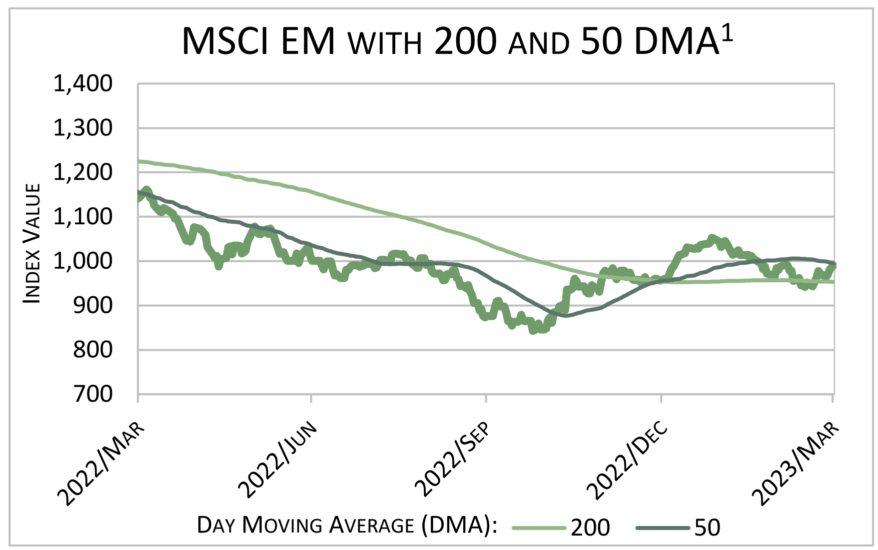
Outlook

Technical indicators improved into quarter end except for small-cap stocks









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Vogel Tactical Recommendations

Fixed income yields are attractive. Slower growth a risk to equities. Overweight cash.

Asset Class	Action	Commentary
Domestic Large-Cap Equity	Equal weight	Prices could be pressured if earnings growth slows hurt by inflation, high interest rates, and tighter lending, but maybe near the end of the rate hike cycle. Volatility is likely.
Domestic Mid-Cap Equity	Equal weight	Prices could be pressured if earnings growth slows hurt by inflation, high interest rates, and tighter lending, but maybe near the end of the rate hike cycle. Volatility is likely.
Domestic Small-Cap Equity	Equal weight	Wider than average valuation gap with large-cap stocks but also expect wider price swings in reaction to news.
International Developed Equity	Equal weight	Inflation is slowing but still high in many regions so likely more rate hikes to come, but economic activity is improving. A declining dollar could provide a boost to international market returns.
International Emerging Market Equity	Equal weight	A rebound in the Chinese economy and stocks is expected to continue which is likely to provide a boost to other Asian markets. Slowing developed country economies could pressure heavy export oriented industries and countries. A declining dollar could provide an additional boost to emerging market returns.
Fixed Income	Equal weight	Yields are the highest in several years so are a source of income and diversification. Still is a risk that prices fall as the Fed tightens policy but after market moves much has likely been priced in already. Corporate fundamentals remain solid so credit risk is low.
Hedge Strategies	Underweight	The flexibility to position for various risk scenarios can provide return opportunities, but rapid and sharp market swings can be challenging for some strategies. Opportunity set for distressed investing strategies may be improving.
Real Assets	Equal Weight	Attractive dividend yields offer inflation protection. The outlook for certain sectors is positive since demand is strong and supply remains tight, but volatility is likely.
Cash	Overweight	Keep 12 months of reserves for liquidity needs since periods of volatility are a risk if consensus expectations are not met or interest rates move higher.

DISCLOSURES

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Sources: *Number below corresponds to the superscript notation in chart titles and text blocks*

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