APRIL 2023 MARKET REVIEW

Market Recap: Portfolio values climbed higher in April as global equity and fixed income markets continued to claw back last year's losses. Equities (proxied by the MSCI World index) advanced 1.8%, while bonds (proxied by the Bloomberg US Aggregate index) advanced 0.6% in April. Defensive sectors, like consumer staples and health care, performed quite well for the month, while more economically sensitive sectors lagged. International markets led the way as companies in those defensive sectors, such as Nestlé and Novartis, tend to dominate European indices. Commodity markets largely ended the month lower, which is a welcome sign in the battle against inflation, however, inflation remains far too sticky for the leading central banks.

As of this writing, the majority of first quarter earnings results have been released. Overall, the aggregate level of earnings has come in better than feared in the US and Europe. Over the past year, analysts have reduced their 2023 earnings outlook in the US by over 12%, which mimics past recessionary environments. Perhaps the reason for a better than expected earnings season is that the bar for companies to outperform has been lowered as a result of the widely held expectation of an impending recession. The bad news is that despite coming in better than expected, aggregate earnings have actually fallen relative to the first quarter of 2022, and the expectations of future growth are nothing to write home about.

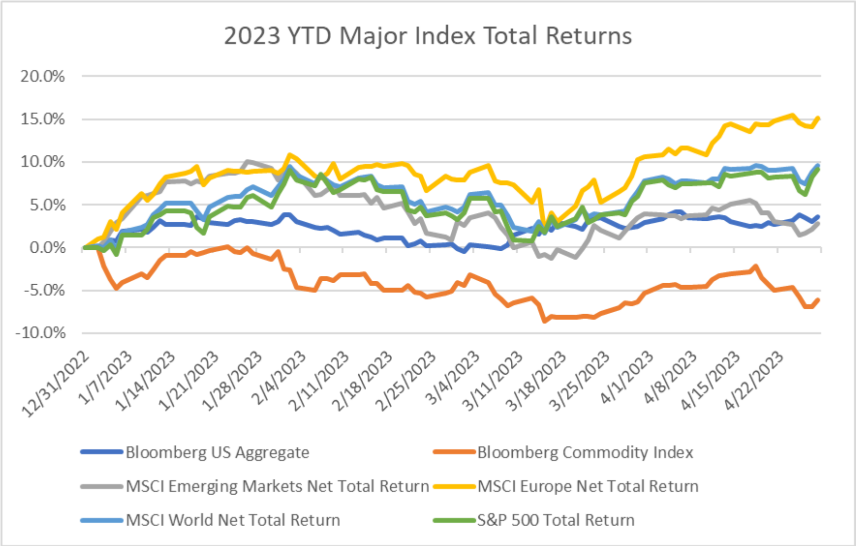
Regionally, European markets have broken out to new one-year high levels, while the S&P 500 has been range-bound for the past six months. The US market's inability to break through the top end of its range has also coincided with strong performance from a small number of large companies, leading to a narrow breadth of returns. After struggling in 2022, mega cap tech companies (FAANG) have collectively outperformed the S&P 500, thus far in 2023, by over 20%. Investors will surely be pleased with the first four months of the year, but what does the lack of breadth mean moving forward? As with most questions in finance, the answer is … "it depends". If the other ~495 members of the S&P can perform well moving forward, they can make up for any struggles at the top. However, the expensive nature of FAANG stocks constrains their upside potential and should a recession actually materialize, the popularity of these companies in portfolios leaves them, and thus the entire market, vulnerable to a downturn.

How does this impact our perspective? Based on current economic data and forward-looking expectations, it appears as though equity markets may be priced to perfection. That is, equities seem to expect the economy to continue to expand, while at the same time expecting the Federal Reserve to cut interest rates later in the year. There is a low probability that these events will happen concurrently. Because of these contradictory expectations, it is prudent to maintain higher than expected cash balances and trim any positions that have outperformed significantly in 2023. The most likely scenarios moving forward are:

1. The economy avoids a recession and therefore any expectation of interest rate cuts gets pushed to 2024. Equity values may increase higher, but upside is capped due to higher interest rates.

2. A 2023 recession occurs, inflation falls, the Fed cuts interest rates, and equities move lower as a result of the recession.

If the economy can avoid a recession, it is highly unlikely that the Fed will cut rates as inflation may remain at elevated levels.



Data Source: Y Charts