First Quarter 2023 Market Commentary

The Economy

The economic story in the first quarter of the year was the outbreak of turmoil in the banking sector, headlined by the collapse of Silicon Valley Bank, the main bank for the Valley's many start-ups. A bank run triggered by social media posts brought the financial institution to its knees in a matter of hours. And while the post-mortem has shown that the bank made very fundamental mistakes in its risk management (principally, investing its surplus deposits into long-term government bonds when interest rates were low, and not hedging the exposure), there remains a concern that the banking industry as a whole is still on slippery footing.

Although the banking turmoil - which included the collapse of a few other US banks, as well as the forced rescue of Credit Suisse by UBS in Switzerland - is not good news, it's not likely to have a material impact on global economic growth. The Federal Reserve is projecting that the US economy grew by annualized rate of 2.5% in the first quarter. Economists expect the Chinese economy - the world's second-largest - to grow by over 7% year on year in the second quarter. In addition, supply-chain bottlenecks have mostly eased and energy prices have fallen (see more below).

Inflation

The Fed's preferred gauge of inflation rose less than expected in February 2023, giving some hope that the central bank's series of interest rate hikes are succeeding in moderating price pressures.

The Personal Consumption Expenditures (or "PCE") price index increased 0.3% in February, according to data from the Commerce Department. On a rolling 12-month basis, core PCE rose 4.6%, the slowest in 15 months.

Source: [Trading Economics]

Looking forward, the markets remain confident that the Fed will succeed in its efforts to get inflation under control. The bond market is projecting that the average annual inflation rate over the next decade will be about 2.3%. This figure has remained steady over the past several months.

Source: [Federal Reserve St. Louis]

The EU is also seeing its inflation rate slow, though the rate remains significantly higher than in the US. The EU's inflation rate dipped below 10% for the first time since last summer.

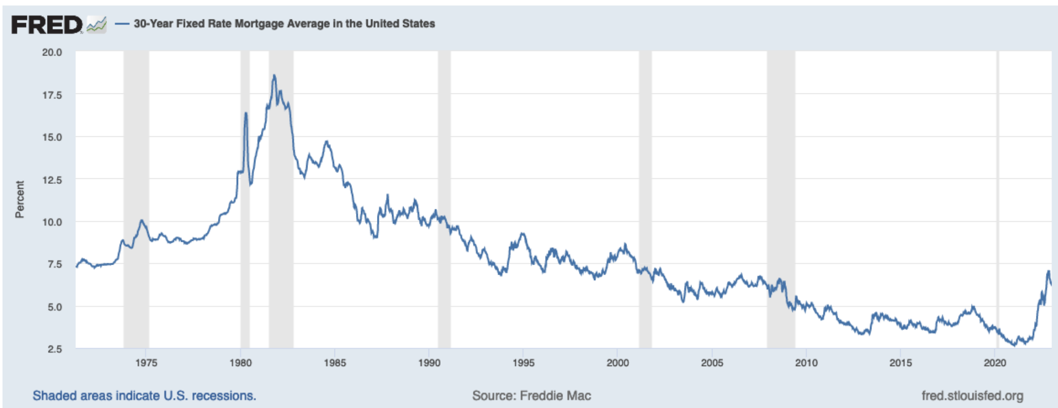
The chart below shows the annualized inflation rate in the EU area over the past 12 months.

Source: [Trading Economics]

Mortgage Rates

The average rate on a 30-year fixed rate mortgage fell for a third straight week, to just over 6.3%. The shorter 15-year fixed rate loan also dropped, to just over 5.5%. According to economists at Freddie Mac, lower rates have brought buyers back to the market, but a shortage of inventory (i.e. sellers) remains a challenge.

The chart below shows the 30-year fixed rate mortgage over the last several decades.



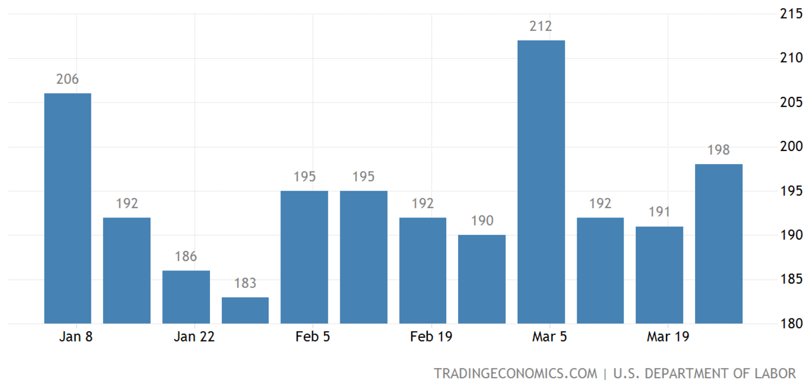
Source: [Federal Reserve St. Louis]

The Labor Market

The number of Americans filing new claims for unemployment benefits rose by 7,000 to 198,000 for the week ended March 25, generally in line with the market's expectations. The four-week moving average, which removes week-to-week- volatility, was basically unchanged at just over 198,000.

These figures reflect a continued tight labor market, which is forcing employers to raise wages to attract and retain staff.

The chart below shows weekly initial jobless claims.



Source: [Trading Economics]

The number of job openings is continuing to trend slightly downward.

Source: [Federal Reserve]

The Capital Markets

US Stocks

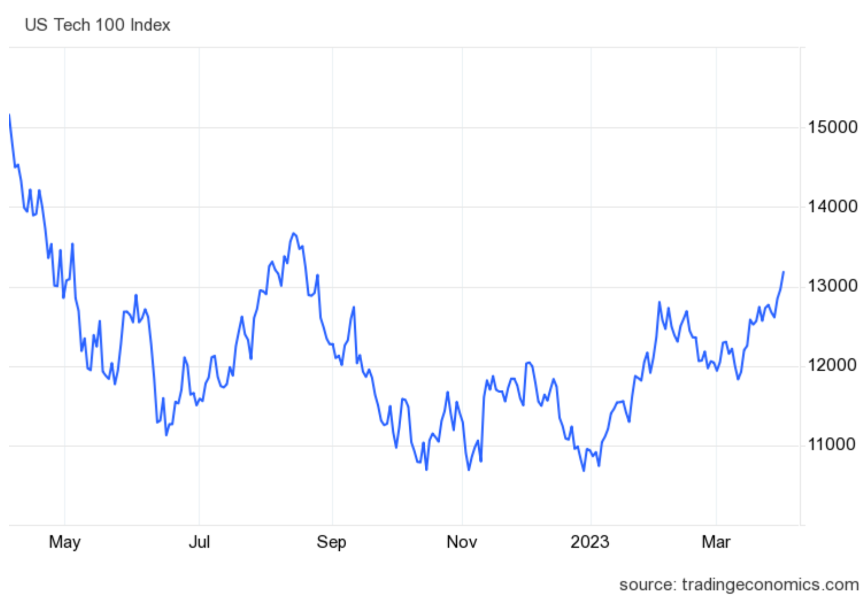
US stocks ended the first quarter on a positive note, with news about slowing inflation giving investors hope that the Fed's aggressive series interest rate increases may be behind us.

For the first quarter, the S&P 500 – a proxy for large US companies – was up over 7%, while the tech-heavy Nasdaq was up 16.8%. Over the past 12 months, the S&P 500 was down -9.3%, while the Nasdaq was down -11.3%.

The chart below shows the performance of the S&P 500 over the past 12 months.

Source: [Trading Economics]

The chart below shows the performance of the Nasdaq over the past 12 months.



Source: [Trading Economics]

International Stocks
The Stoxx 600 index – a proxy for large European companies – closed the quarter on a positive note, as well, rising 3% on the final trading day alone. Over the past month, the index is basically flat, while over the past year it is down a modest 0.1%.

The chart below shows the performance of the Stoxx 600 over the past 12 months:

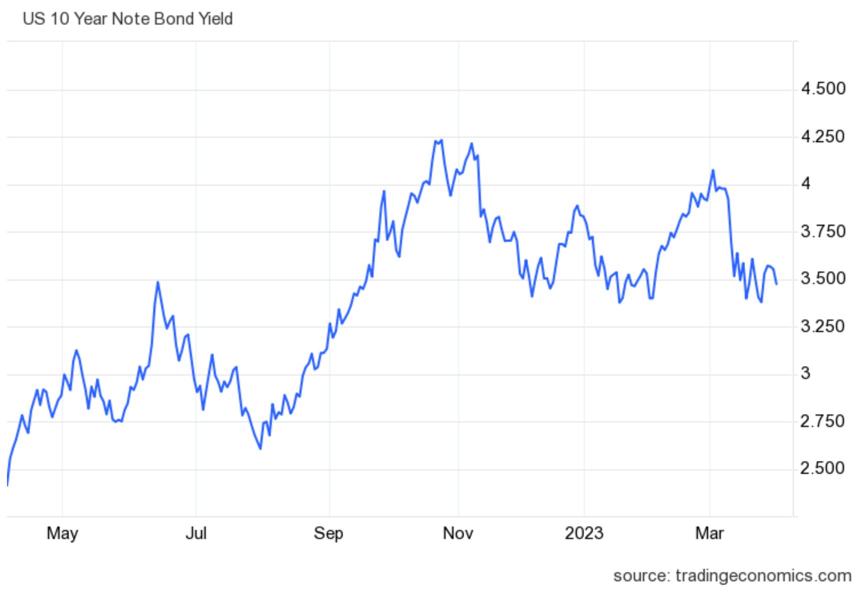
Source: [Trading Economics]

The Bond Market

The yield on the benchmark 10-year US Treasury note - seen as a proxy for borrowing costs around the globe - fell to just over 3.5% to end the quarter. Investors took note of the better-than-expected inflation numbers, which should ease pressure on the Fed to further increase interest rates.

The yield on the benchmark bond ended the quarter down about 0.3%, as concerns about the US banking sector drove some investors into a "flight to safety" in US government debt.

The chart below shows the performance of the 10-year Treasury over the past 12 months:



Source: [Trading Economics]()

<u>Oil</u>
Futures contracts for the benchmark West Texas Intermediate ("WTI") product traded at around $75 per barrel on Friday to close out the quarter.

Supply concerns and an improving demand outlook have pushed prices higher the past several weeks. Saudi Arabia has said it would like OPEC to keep supplies steady for the rest of the year, while positive news about Chinese economic growth provided investors with a dose of optimism.

The chart below shows the performance of the benchmark WTI contract over the past 12 months:

Source: [Trading Economics]

Gasoline

Gasoline futures traded below $2.70 per gallon to close the quarter, as concerns about a global recession and muted global oil prices offset growing demand. Gas demand has been surging, as drivers take advantage of longer days at the beginning of spring. Meanwhile, total domestic gasoline stocks decreased last week to the lowest since the end of last year.

Source: [Trading Economics]

Benchmark Returns

For comparative purposes, the S&P 500 index (a proxy for large US stocks) fell -9.3% for the twelve months to March 31, but rose 7.0% in the first quarter.

The Russell 2000 (a proxy for small US stocks) fell -11.6% for the twelve months to March 31, but rose 2.7% in the first quarter.

The Wilshire 5000 index (a proxy for the broad US stock market) fell -8.6% for the twelve months to March 31, but rose 7.3% in the first quarter.

The MCSI EAFE index (a proxy for large international stocks) fell -4.1% for the twelve months to March 31, but rose 7.7% in the first quarter, as measured in USD. Because the USD weakened slightly during the quarter versus the EUR, the picture was different when measured in the local currency, with the index falling -1.8% for the 12 months to March 31, but rising 5.8% for the first quarter.

Finally, the MSCI Emerging Markets index fell -13.3% for the twelve months to March 31, but rose 3.6% in the first quarter.

In the fixed income segment, the Bloomberg Barclays US Aggregate Bond Index returned -4.6% for the twelve months to March 31, as rapidly rising interest rates pushed down bond prices.

Looking Forward

As we mentioned last quarter, and as we remind ourselves (and you) from time to time, successful investing is not a sprint, but a marathon.

The equity markets tend to go up more than they go down, because investors are generally rewarded for taking risk. This reward comes in the form of higher expected returns than those that can be earned from safer investments like cash and government bonds.

But… risk also means that these higher expected returns aren't delivered day in, day out, without fail. Risk means that there will be times when the performance of the stock market is bad, even terrible, and certainly much worse than the small positive return earned on cash.

So, what is an astute, level-headed investor to do, when one of these "bad return" periods arrives? History shows us that investors are best-served with a strategy of patience, systematic rebalancing, and a long-term focus. This is not to say that one won't be uncomfortable at the time – after all, we're emotional beings, not robots. Rather, we should endeavor to ensure that our emotions don't influence our investment decision-making.

Springwater's investment philosophy is based on decades of robust, peer-reviewed academic research. One of the principles of that philosophy is that, over time, investors can expect to generate higher returns if they tilt their portfolio's equity allocation toward small stocks (the "size" factor) and value stocks (the "value" factor). The important caveat is that these tilts don't consistently deliver higher returns, day in and day out, just as stocks don't always out-perform bonds and cash.

- + -

For those of you that are not already doing so, we encourage you to follow us on Twitter (at @SpringwaterWM), Facebook (at https://facebook.com/SpringwaterWealth/), and/or Instagram (at springwaterwealth). We're conscious of the "information overload" that everyone faces these days, and by using social media we can share with you our thoughts, observations and ideas in the least intrusive manner possible.

- + -

Important Disclosure Information