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MARKET MINUTE

FEBRUARY REVIEW 2023

This month's Market Minute reflects the views of our Investment Office and was composed by
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OVERVIEW

The battle between Wall Street and the Federal Reserve reversed course in February as strong economic data supported the Fed's position to raise rates to continue to rein in inflation. The month started with the Fed lifting policy rates to a new target range of 4.50-4.75%, the highest since October '07. The Fed's statement noted the need for "ongoing increases in the target range", implying that markets may be underestimating the Fed's willingness to keep policy rates "higher for longer."[1] The Fed's position was strengthened with a blowout jobs number: Nearly 517k jobs were created in January versus expectations for 188k, and the unemployment rate dropped to 3.4%--the lowest in 53 years.[2] Although inflation continued to moderate in January, core CPI (excluding food & energy) rose 0.4%[1] – matching December's gain – except in super-core services (ex-housing/rents) where prices have shown little signs of easing, which the Fed worries may continue so long as the labor market remains tight and wage gains remain strong.

The robust start to–2023 ran into significant headwinds as equities and bonds relinquished much of their gains witnessed in January. By month's end, Wall Street appears to have abandoned its earlier belief that the Fed would begin cutting rates in the back-half of the year and largely acquiesced to the notion that interest rates will drift higher throughout most of 2023 and the downward pivot in rates will be a 2024 (or even 2025?) event.

US EQUITY MARKETS As of February 28, 2023

U.S. EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	-3.9%	-1.1%	-1.1%	-1.6%
S&P 500	-2.5%	3.7%	3.7%	-7.7%
Russell 2000	-1.7%	7.9%	7.9%	-6.0%
Russell 1000 Growth	-1.2%	7.0%	7.0%	-13.3%
Russell 1000 Value	-3.5%	1.5%	1.5%	-2.9%

After a choppy start to the month, US equities retreated in the final weeks of the month to end February down, with the S&P 500 Index losing -2.5%. Overall, growth-oriented stocks performed slightly better on a relative basis than their value-oriented peers across the cap-spectrum—the Russell 1000 Growth Index -1.2% and Russell 2000 Growth Index -1.1% versus the Russell 1000 Value Index -3.5% and the Russell 2000 Value Index -2.3%. Small caps modestly outperformed large cap stocks during the month on a relative basis (Russell 2000 Index -1.7% versus Russell 1000 Index -2.4%), and nearly every sector ended February lower except the IT sector—Russell IT Sector Index +0.5%.

INTERNATIONAL EQUITY As of February 28, 2023

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quater-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	-3.5%	4.3%	4.3%	-7.2%
MSCI EAFE	-2.1%	5.8%	5.8%	-3.1%
MSCI Emerging Markets	-6.5%	0.9%	0.9%	-15.3%
MSCI EAFE Small Cap	-2.2%	5.1%	5.1%	-9.7%

International equities also traded lower in February, with developed markets (MSCI EAFE Index -2.1%) outperforming emerging markets (MSCI EM Index -6.5%). In contrast to US equities, value-oriented stocks outperformed their growth-oriented peers—MSCI ACWI ex US Growth Index -4.3% versus MSCI ACWI ex US Value Index – 2.8%. Similar to the US, international small cap stocks outperformed their large cap peers.

Emerging market equities lagged developed market equities in large part because Chinese equities (MSCI China Index) gave nearly all their strong January gains, losing -10.4% in February. Chinese equities—particularly ADRs and Hong Kong traded equities—sold off in the face of US-Chinese tensions, which escalated early in the month with the US downing of an alleged Chinese spy-balloon. Tensions then continued to worsen with US authorities warning that Beijing was considering providing military equipment to Russia and that such a move would precipitate economic sanctions on China.

FIXED INCOME As of February 28, 2023

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	-2.6%	0.4%	0.4%	-9.7%
BarCap Global Aggregate	-3.3%	-0.2%	-0.2%	-13.6%
BarCap US High Yield	-1.3%	2.5%	2.5%	-5.5%
JPM Emerging Market Bond	-2.2%	0.8%	0.8%	-8.2%
BarCap Muni	-2.3%	0.5%	0.5%	-5.1%

The entire yield curve rose during February and interest rate levels are now higher than where they started for 2023. On the heels of stronger than anticipated economic data, the 6-month U.S. Treasury bill reached 5% — a first since 2007[1]— as markets braced for additional rate hikes. At month's end, the Bloomberg Aggregate index was down -2.6% and up just +0.4% year-to-date. High yield corporate spreads were essentially unchanged on the month, but the Bloomberg High Yield index's shorter duration (less interest rate sensitivity) resulted in a return of -1.3% and up +2.5% year-to-date. Much like 2022, interest rate levels are the main drivers of performance.

CONCLUSION & OUTLOOK

As of now, we have witnessed favorable technical support for markets though recent economic data has added to monetary policy angst, likely bringing with it continued volatility. Since September 30, 2022, the 10-year U.S. Treasury bond has traded in range between 3.37% and 4.24% and closed the month of February at 3.92%.[1] The S&P 500, since May 2022 has been in a trading range of 3,600 to 4,300 and closed on February 28th at 3,970.[1] These sideways markets, with no distinguishable trends, could easily cause investors to "zig-when-one-should-zag" and suffer losses during periods of market volatility.

As we stated last month, "... we believe Fed policy will be to continue to raise short-term interest rates over the first half of 2023 and then pause for the remainder of 2023 to ensure inflationary pressures retreat to achieve the Fed's goal of a 2% inflation level." Until the time arrives where we have conviction that the Fed has reached its terminal rate, we are inclined to maintain portfolios that drive returns from income characteristics (i.e., dividends and enhanced yield strategies) and not dependent on capital appreciation to achieve clients' financial goals.

SOURCES

1 Bloomberg, LP
2 https://www.bls.gov/news.release/empsit.nr0.htm