OBSERVATIONS:

- US markets traded higher last week, and US large caps finished positive for the month of March, despite the mid-month turmoil in the US banking sector as well as the Fed's decision to hike interest rates. The S&P 500 Index finished the week +3.5% and the month up +3.7%, while the bank-heavy Russell 2000 index (small caps) finished higher for the week +4.0% but ended March down by -4.8%.[1]
- Stress in the US banking system has eased modestly in the past week, as deposit outflows from smaller, regional banks has slowed and share prices have stabilized. In the aftermath of the failures of Silicon Valley Bank and Signature Bank, US regulators are likely to increase oversight provisions for any bank with over $100 billion in assets in terms of its capital requirements and its liquidity coverage ratio.[1]
- Europe's composite (services & manufacturing) PMI increased to 54.1 in March—any number over 50 signals expanding activity—but the composite was buoyed by the service sector (55.6) as the manufacturing PMI dipped to 49.9 during the month.[1]
- Housing price increases continued to soften as the Case-Shiller National Housing Price Index registered only a +3.8% year-over-year (YoY) increase in prices in January (the latest data available) compared to December's +5.6% YoY figure. Housing prices show YoY declines in many western US cities, but still modestly growing in most eastern US cities in February on YoY basis. [1]
- Existing home sales grew in February +0.8% over January but remain -21.1% lower than in February-2022. Sales were the weakest in the western U.S., down -2.4% in February from January, and -28.4% lower than in February-2022, but grew on a monthly basis in the Midwest, Northeast and Southern regions. [2]
- Rents are also rising more slowly; the National Rent Index showed a 2.6% YoY rent growth in March down from 3.0% YoY increase in February. About 28 of the 100 largest US cities are seeing rental price declines on YoY basis—primarily in larger cities in western states.[3]
- The PCE price index fell to 5.0% YoY last month, while core-PCE index—the Fed's preferred inflation measure, which removes food and energy prices—eased in February to 4.6% YoY from January's 4.7% YoY.[1]

EXPECTATIONS

- Hotel occupancy rates have recovered to longer-run pre-Covid levels, but hotel RevPar (revenue per available room) has surged to +8.9% on an YoY basis or +23.9% compared to 2019-levels reflecting strong Spring Break demand.[4] Overall, employment in this sector still has not fully recovered to pre-Covid levels suggesting that margins at most hotels are healthy despite having to pay higher wages to remaining staff.

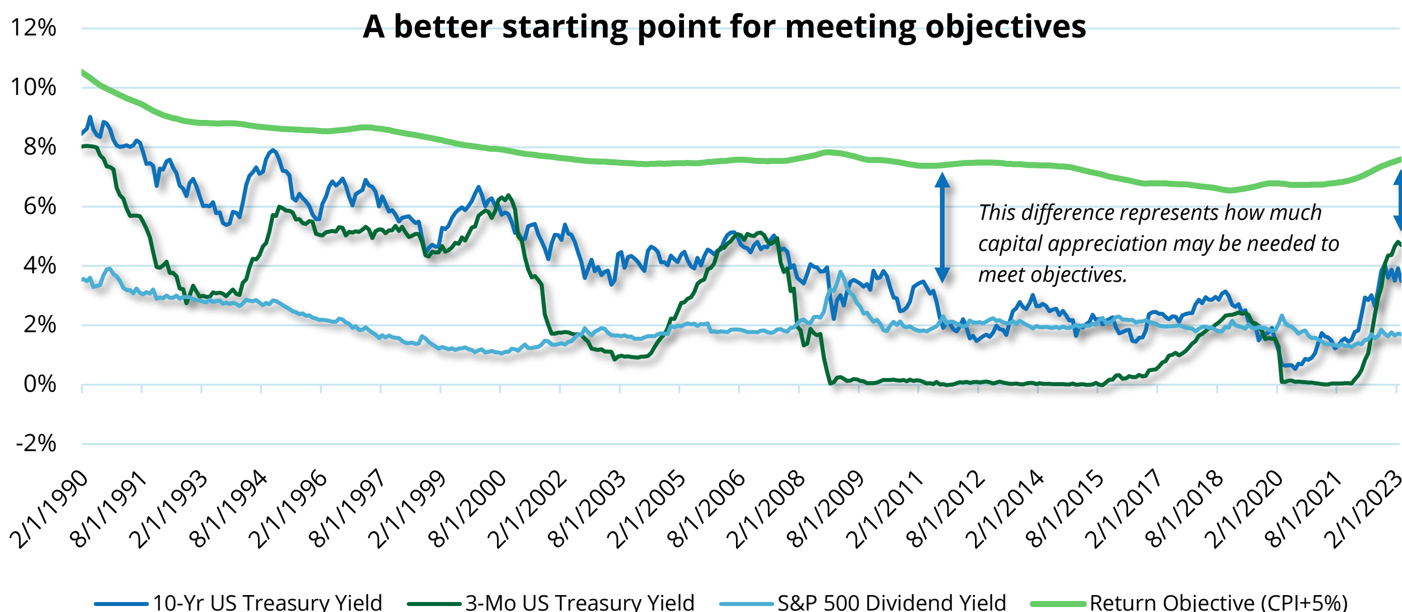
ONE MORE THOUGHT: *Less capital appreciation more income*[1]

Since 1990, the yield on the 10-Yr US Treasury has declined from nearly 8.5% to less than 1.0% during the pandemic to where it stands today at near 3.5%. Similarly, the 3-month US Treasury bill has declined from 8.0% to nearly zero during the great financial crisis and again during the pandemic, but now approaches 5.0%. Meanwhile, over that same period, the dividend yield for the S&P 500 has declined by 50% from 3.5% to 1.7%. *Setting aside that many companies began using share buybacks over this period as a tool for shareholder return, with the added benefit of managing earnings. Buybacks are not guaranteed while dividends are generally more permanent corporate decision making.* For those with return objectives of CPI+5%—which in our view captures many varying client types, individual

[1] *Bloomberg LP*
[2] *https://www.nar.realtor/newsroom/pending-home-sales-grew-for-third-straight-month-up-0-8-in-february*
[3] *https://www.apartmentlist.com/research/national-rent-data*
[4] *https://www.costar.com/article/100519141/str-weekly-us-hotel-occupancy-inches-closer-to-70-in-mid-march*

and institutional alike—the last decade plus relied heavily on capital appreciation for both stocks and bonds in order to reach those objectives. By extension, it meant investors were required to extend their risk profile into assets classes that had perceived higher expected returns vis a vis capital appreciation. As we enter this new regime characterized by higher interest rates and higher anticipated volatility, we find ourselves needing to rely less on capital appreciation—which is really code for valuation expansion for stocks and falling interest rates for bonds—and more on carry (income). In 1990, a portfolio allocated to 60% S&P 500, 35% to the 10-Yr US Treasury, and 5% to the 3-Mo Treasury bill would generate nearly 60% of an investor's return objective through income alone. At its worst, in July 2021, that same portfolio would generate income that would meet just 18% of investor objectives. Contrast that with today and that figure has doubled, where income may account for over 35% of objectives—though still less than 1990's figure thanks to lower dividend yields in stocks. We continue to think that focusing on income in a thoughtful well researched manner will play an important role in meeting objectives.

CHART OF THE WEEK



Source: Clearstead, Bloomberg LP, as of 3/31/2023, monthly data, 'Return Objective' = Trailing 120-month average year-over-year CPI + 5%, The intent of the chart is to show the percentage of dividends yields vs capital appreciation compared to a target of CPI+5% (green line). The chart does not represent total return information and the representative yields cannot be invested in directly. Past results are not an indicator of future results.

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