# MONTHLY MARKET UPDATE

April 2023

March Highlights:

- S&P 500 advanced 7.5%, but not a broad-based rally. Top ten gainers contributed 88 percent of the return of the 503 companies in the index, while 220 companies declined during the quarter.
- Intermediate and long-term bond yields continued to fall in Q1 after peaking in early November.
- First significant economic impact of last year's rapid rise in interest rates exhibited itself in the form of the two largest bank failures since 2008.

In March, two forces converged to shift the primary focus of the market. The lag effect of Federal Reserve rate hikes merged with the law of unintended consequences to create a new form of banking crisis. It began with the March 10 federal takeover of the Silicon Valley Bank, a favorite of venture capital and emerging technology companies -- the second largest bank failure in U.S. history. Soon two other sizable "regional" banks were in trouble. In short, the rate increases undermined the value of Treasuries and other bond investments of the banks. When large customers began withdrawing deposits, these banks were forced to initiate selling their bonds at a loss. Government intervention backing the troubled banks' holdings has so far contained the damage.

The ensuing flight to safety drove down Treasury yields, producing solid returns for bond investors. The yield on the 2-year Treasury hit a fifteen-year high of 5% on March 8 but immediately retreated to 4% by the end of the quarter, while the 10-year retreated to 3.5% after reaching its fifteen-year high of 4.3% in October. The decline in yields caused the U.S. Aggregate Bond Index to advance 3% for the quarter. Major stock indices showed solid quarterly returns, with the S&P 500 Index advancing 7.5% behind a strong January and a late-March rally. But the rally was not broad-based: eighty-eight percent of the return was concentrated in ten companies, predominantly mega-cap tech companies that have become a new safe-haven for investors during times of crisis due to their fortress balance sheets.

Inflation, the driving force behind Fed rate hikes, edged downward during the quarter but remained stubborn. Employment remained strong. Despite the banking issues, the Fed raised interest rates by another quarter percent in March. But many saw the banking woes as doing the Fed's work, particularly in the form of tightening credit as banks will need to pull back on lending to preserve liquidity and fund fleeing deposits.

Looking ahead, domestic and European companies are likely to face margin compression this year due to slowing sales volumes and the inability to continue passing along price increases to consumers. One economic bright spot remains China, the re-opening of its economy and the tacit acknowledgment that it needs its technology companies to grow the economy.

To put the first quarter in perspective, a year ago, the federal funds rate was still resting close to zero in the 0.25% to 0.50% range. Now we are at 4.75% to 5%, higher than current core personal consumption expenditures (PCE) inflation. Traditional economic thought is that rate increases take six to twelve months to impact the economy. March's banking woes are one lag effect so far. The remainder of the year may continue to see volatility due to other unforeseen impacts of Fed tightening.

## PORTFOLIO MANAGER Q&A - HARUKI TOYAMA

**The rapid rise in interest rates is causing ripples throughout the economy. Notably, in March, within the banking sector. What have you seen in the equity markets, at large, as it relates to the effects of rising interest rates?**

***Haruki Toyama***
***Head of Mid Cap & Large Cap Equity, Portfolio Manager***

If you remember from a year ago, the initial reaction to rates rising was pretty harsh. As things have settled down, investors are considering which companies or industries may be impacted more than others. From our standpoint, we didn't just wake up a year ago and think about the risk of rising rates or how we position our portfolio for this kind of environment. It's something that we've factored into our company and industry analysis for decades. We try to invest in "all-weather" companies that we believe will thrive in both declining and rising-rate environments.

For example, if a company has a lot of variable debt on the liabilities side of its balance sheet, will it be offset by rising income on the assets side? It's a basic example, but these are the types of questions we try to answer on a daily basis.

We've also seen a revaluation occur as it relates to high-growth companies where much of the valuation is dependent on profits 10 or 20 years down the road, as opposed to today. So when rates go up, the discounting mechanism tends to be a more significant factor for these companies.

**We've seen a string of regional banks sell off in March due to uncertainty in the banking sector. Are the larger banks at risk of a similar fate? Do you believe other financials are in jeopardy?**

The risk is somewhat heightened today with regional banks and other financial companies, but we think the risk was always there. The financial industry is diverse, and not all financials are equal. Banks are vulnerable to bank runs by definition; that's how their model operates. They lend long but borrow short. Deposits are a way of borrowing very short. Investors are finding out now that if your deposit franchise isn't strong, you can lose a lot of your deposits very quickly, and then you're much more susceptible to a bank run.

We own a couple of banks in our portfolios, and we've been very careful to own the ones we believe have phenomenal deposit franchises. From what we can gather, the two banks we own in our portfolios are net beneficiaries, achieving net deposit inflows because of their strength and the strength of their customer base.

When you look at financials more broadly, there are many kinds, with different factors that impact profits. For example, we own insurance companies in our portfolios. Insurance companies tend to benefit whenever there is a disruption in capital markets, and people become more risk aware. Rising interest rates also mean higher yield in an insurer's investment portfolio.

**How do you stay rational and level-headed with all the news headlines, market volatility, and outside noise? What can be said about opportunities in this environment?**

Our underlying philosophy is truly bottoms-up. We aim to buy what we think of as stakes in actual companies, with the intent of holding the positions for a long period of time. So, while we are cognizant of the macro environment and interest rates, we don't think in terms of "this sector is going to benefit in a certain environment at a given point in time." Instead, we invest in 25 to 30 of what we call "all-weather" companies that we think can thrive in any environment over the next five to ten years or longer.

We're finding that the current volatility is uncovering a lot of opportunities for us. Traditionally, there are two ways we find opportunities. One is that we have a library of companies we stay on top of; these are companies we're interested in buying and are just waiting for the right time, often because of valuation. The second way is when we see something happening in the market that is taking an entire sector down. If we think that something is temporary, we take advantage.

**What are the heads of companies that you speak with saying about the overall state of the economy? How are they offsetting the rising costs due to inflation?**

In the last year and a half, we've found that there was quite a bit of pricing power available to many different companies. Margins were squeezed, but most held up quite well. Consumers and business customers have been able to absorb the price increases associated with 5% to 10% inflation, which signals an overall healthy economy. Some industries and companies have passed on increases faster than others.

What we're seeing now is a slowing of the ability to pass through all of the cost inflation. And there is a lot more variability among companies when it comes to their ability to continue to pass through prices. It is often based on the strength of their franchise, how loyal their customers are, and how well they can ensure their products and services are uninterrupted in this environment. Those are the factors we look for in our investments.

## U.S. EQUITIES (%)

| | March | QTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|---|
| DJ Industrial Average | 2.1 | 0.9 | 0.9 | -2.0 | 17.3 | 9.0 | 11.1 |
| S&P 500 | 3.7 | 7.5 | 7.5 | -7.7 | 18.6 | 11.2 | 12.2 |
| Russell 1000 | 3.2 | 7.5 | 7.5 | -8.4 | 18.6 | 10.9 | 12.0 |
| Russell 1000 Value | -0.5 | 1.0 | 1.0 | -5.9 | 17.9 | 7.5 | 9.1 |
| Russell 1000 Growth | 6.8 | 14.4 | 14.4 | -10.9 | 18.6 | 13.7 | 14.6 |
| Russell Midcap | -1.5 | 4.1 | 4.1 | -8.8 | 19.2 | 8.1 | 10.1 |
| Russell 2000 | -4.8 | 2.7 | 2.7 | -11.6 | 17.5 | 4.7 | 8.0 |

## U.S. EQUITY CHARACTERISTICS - S&P 500

| | March | 2022 |
|---|---|---|
| Price/Earnings Ratio | 20.9 | 19.1 |
| Weighted Avg. Market Cap ($B) | 542.5 | 417.5 |
| Dividend Yield (%) | 1.6 | 1.7 |

## U.S. EQUITY SECTORS - S&P 500 (%)

| | March | QTD | YTD | Weight |
|---|---|---|---|---|
| Communication Services | 10.4 | 20.5 | 20.5 | 8.1 |
| Consumer Discretionary | 3.1 | 16.1 | 16.1 | 10.1 |
| Consumer Staples | 4.2 | 0.8 | 0.8 | 7.2 |
| Energy | -0.2 | -4.7 | -4.7 | 4.6 |
| Financials | -9.6 | -5.6 | -5.6 | 12.9 |
| Health Care | 2.2 | -4.3 | -4.3 | 14.2 |
| Industrials | 0.7 | 3.5 | 3.5 | 8.7 |
| Information Technology | 10.9 | 21.8 | 21.8 | 26.1 |
| Materials | -1.0 | 4.3 | 4.3 | 2.6 |
| Real Estate | -1.4 | 1.9 | 1.9 | 2.6 |
| Utilities | 4.9 | -3.2 | -3.2 | 2.9 |

## INTERNATIONAL EQUITIES (%)

| | March | QTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|---|
| ACWI | 3.1 | 7.3 | 7.3 | -7.4 | 15.4 | 6.9 | 8.1 |
| ACWI ex USA | 2.4 | 6.9 | 6.9 | -5.1 | 11.8 | 2.5 | 4.2 |
| MSCI EAFE | 2.5 | 8.5 | 8.5 | -1.4 | 13.0 | 3.5 | 5.0 |
| Emerging Markets | 3.0 | 4.0 | 4.0 | -10.7 | 7.8 | -0.9 | 2.0 |
| China | 4.5 | 4.7 | 4.7 | -4.7 | -2.6 | -4.0 | 3.4 |
| Japan | 4.0 | 6.2 | 6.2 | -5.2 | 7.4 | 1.3 | 5.0 |
| Germany | 4.0 | 14.7 | 14.7 | 2.2 | 12.8 | 0.4 | 4.1 |
| United Kingdom | -0.6 | 6.1 | 6.1 | -0.8 | 14.6 | 3.0 | 3.4 |
| India | 1.2 | -6.4 | -6.4 | -12.2 | 22.2 | 6.1 | 7.0 |

## KEY ASSET PRICES

| | March | 2022 |
|---|---|---|
| EUR/USD | 1.09 | 1.06 |
| USD/CAD | 1.35 | 1.36 |
| USD/JPY | 132.75 | 132.78 |
| GBP/USD | 1.24 | 1.21 |
| Bitcoin ($) | 28,478.5 | 16,514.0 |
| Gold ($/oz) | 1,984.0 | 1,827.0 |
| Crude Oil (WTI) ($/bbl) | 75.7 | 80.4 |

## FIXED INCOME (%)

| | March | QTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|---|
| Government Bond | 2.9 | 3.0 | 3.0 | -4.4 | -4.1 | 0.8 | 0.9 |
| Municipal | 2.2 | 2.8 | 2.8 | 0.3 | 0.3 | 2.0 | 2.4 |
| U.S. Aggregate Bond | 2.5 | 3.0 | 3.0 | -4.8 | -2.8 | 0.9 | 1.4 |
| Investment Grade Corporate | 2.7 | 3.5 | 3.5 | -5.3 | -0.7 | 1.5 | 2.2 |
| High Yield | 1.1 | 3.6 | 3.6 | -3.3 | 5.9 | 3.2 | 4.1 |

## U.S. TREASURY YIELDS (%)

| | March | 2022 |
|---|---|---|
| 3-Month | 4.9 | 4.4 |
| 6-Month | 4.9 | 4.8 |
| 2-Year | 4.1 | 4.4 |
| 5-Year | 3.6 | 4.0 |
| 10-Year | 3.5 | 3.9 |
| 30-Year | 3.7 | 4.0 |

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The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets countries (excluding the US) and 23 Emerging Markets countries. With 1,843 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.

The MSCI EAFE (Europe, Australasia & Far East) Index is a free-float adjusted market capitalization index that is designed to measure developed market equity performance, excluding the U.S. and Canada.

Emerging Markets - MSCI Emerging Market Index – captures large and mid cap representation across 24 Emerging Markets (EM) countries. With 1,138 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

China - MSCI China Index - captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs).

Japan - MSCI Japan Index - is designed to measure the performance of the large and mid cap segments of the Japanese market.

Germany - MSCI Germany Index - is designed to measure the performance of the large and mid cap segments of the German market.

United Kingdom - MSCI United Kingdom Index - is designed to measure the performance of the large and mid cap segments of the UK market.

India - MSCI India Index - is designed to measure the performance of the large and mid cap segments of the Indian market.

Fixed Income Definitions
Government Bond - Bloomberg US Government Index - measures the performance of the U.S. Treasury and U.S. Agency Indices, including Treasuries and U.S. agency debentures. It is a component of the U.S. Government/Credit Index and the U.S. Aggregate Index.

Municipal - Bloomberg U.S. Municipal Index - covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.

U.S. Aggregate Bond - Bloomberg U.S. Aggregate Bond Index - is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, mortgage backed securities, asset-backed securities and corporate securities, with maturities greater than one year.

Investment Grade Corporate - Bloomberg U.S. Credit Index - measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

High Yield - Bloomberg U.S. Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Bloomberg EM country definition, are excluded.

Definitions
Weighted Avg. Market Cap: measures the size of the companies in which the portfolio invests. Market capitalization is calculated by multiplying the number of a company's shares outstanding by its price per share.

Price-to-Earnings (P/E) Ratio: measures how expensive a stock is. It is calculated by the weighted average of a stock's current price divided by the company's earnings per share of stock in a portfolio.

Dividend Yield: the portfolio's weighted average of the underlying portfolio holdings and not the yield of the portfolio.

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