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Investment Managers

Economic Update — **March 2023**

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After a strong start in January, stocks sold off a bit in February but were still able to hold on to some of their prior gains. Large cap stocks in the S&P 500 index lost -2.44% this month but are still up 3.69% year-to-date. Small cap stocks in the Russell 2000 were down -1.69% in February but up 7.89% in 2023. International stocks in the MSCI EAFE index fell -2.09% bringing their year-to-date gain to 5.84%. Meanwhile, emerging market stocks suffered the most with a -6.48% monthly return which reduced their year-to-date return to 0.90%. Yields for the Barclays US Aggregate Bond Index jumped in February, leading to a loss of -2.59% for the month but a gain of 0.41% so far in 2023.

Economic growth in the fourth quarter was revised down slightly to an annual rate of 2.7%. Consumer spending was strong in January and jobs growth surprised to the upside causing some economists to rethink their call for a recession in 2023. First Trust economist Brian Wesbury points out that the labor market is a lagging indicator, and that traditional seasonal adjustments made November and December retail sales look worse and January look better. Wesbury along with David Kelly of JPMorgan and other analysts we follow continue to expect the economy to slow in 2023 and have not ruled out a recession.

One reason economists expect a recession is because of inflation which has proven to be resilient. Although it had been coming down, in January it climbed again at the fastest rate since 2021 signaling that the fight against inflation is not over. Wages have been growing (although at a slower rate than price levels) and are less likely to come down. The rent equivalents factor in inflation is also stickier as low inventory has kept home prices higher.

The Fed's primary tool for combatting inflation is raising interest rates. Higher interest rates slow the economy which is adding to recession concerns. The Fed acted very aggressively last year, hoping to get inflation under control. After raising rates a total of 4.5%, expectations are for three additional rate hikes before the end of 2023. Over the past several years, the money supply has been significantly expanded and the federal government has spent borrowed funds at unprecedented levels. Both actions are inflationary, so the task of getting inflation under control has been difficult.

The bond market continues to signal that it expects slower economic growth as longer-term rates are lower than short-term rates. Long-term rates did rise sharply this month with the ten-year Treasury yield climbing from 3.53% to 3.92%. The two-year Treasury yield is at 4.9%. These higher yields are resulting in money markets offering attractive rates. The Schwab Value Advantage Money Market has a current yield of 4.5%.

Earnings season is winding down for fourth quarter 2022. Earnings are down -5.8% from the same period in 2021. If not for the energy sector, earnings for the S&P 500 would have been down -9.5%. For all of 2022, earnings grew 3.5%. First quarter 2023 earnings expectations have also been coming down and are currently expected to fall -9.0%. Analyst projections for full year 2023 earnings are for slightly negative growth of -0.3%.

Congress is gearing up for what looks to be a contentious budget negotiations as the US nears the debt ceiling. Along with inflation, interest rates, and recession fears, these factors will likely result in continued volatility in the markets. We continue to encourage investors not to try and time the market by trading in and out. Instead, we advocate for investing according to risk tolerance.

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