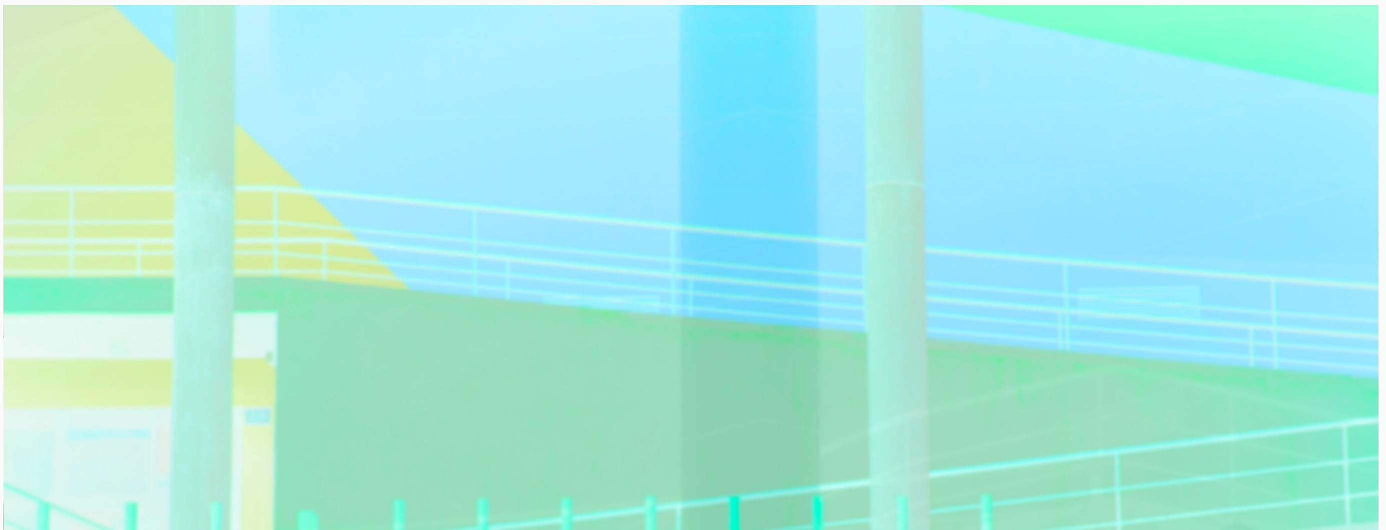
MOSAIC FI MARKET INSIGHTS

-Planning and Investing for Life



Q1 2023

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While the inflation war is not over, it appears that the Federal Reserve has made some progress on containing the post-pandemic wave. Still, at an elevated level, the consumer price index (CPI) increased 5.1% in March on a year-over-year basis. This is a significant improvement from the peak in June 2022 when it increased 9.1%.

In the first quarter the Federal Reserve continued its march to higher interest rates by increasing the federal funds rate by 25 bps. It is expected that there will be one (perhaps two) more 25 bps increases in the coming months. Then there will be a wait-and-see period to allow the economy to digest the higher cost of capital and the resulting drag on economic growth. The hope is for the Goldilocks scenario; slow the economy enough to bring inflation back down to its target of 2%, but not so much that we fall into a recession. This is the question investors are trying to answer.

The first quarter also brought a test of the strength of our banking system with the unforeseen and swift demise of Silicon Valley Bank due to a perfect storm of losses from assets on their balance sheet at a time when deposits were shrinking.

Q1 2023:

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They experienced a classic 'bank run' and loss of confidence. While the fall-out to the rest of the banking system was not insignificant, it was quickly contained. This is a testament to the strength of our banking system and an acknowledgement that the appropriate regulatory controls are in place albeit in need of some fine-tuning for small to mid-size banks.

The Equity Markets

Global equity markets, as measured by the MSCI All Country World Index, were up 7.4% in the 1st quarter as international developed equity markets again outperformed US equity markets.

Developed international was up 8.02% for the quarter and the US market, overall, was up 7.18%. Emerging markets underperformed developed markets in the quarter, up 3.96%. US REITs again underperformed the rest of the market, up 1.37% for the quarter.

Large cap growth stocks, which are sensitive to changes in interest rates, outperformed the rest of the market in the 1st quarter, up 14.37%, while large cap value stocks were up only 1.01%. Small cap stocks were up 2.74% overall, but small cap growth stocks outperformed small cap value, up 6.07% vs. -.66%.

The Fixed Income Markets

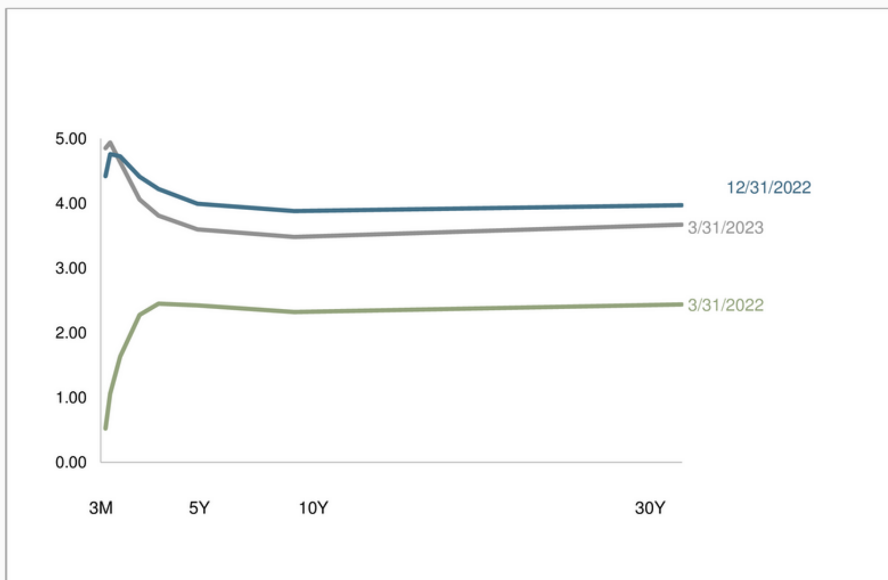
As we continue to see evidence that the Fed's fight to tame inflation is working, we saw a more positive performance in the bond markets as interest rates declined. However, we currently have what is referred to as an 'inverted yield curve'.

This means that short-term interest rates are higher than long-term interest rates. This is typically considered a key indicator of a recession ahead. This is because the market is expecting that the Fed will need to begin lowering interest rates at some point, which results in lower interest rates in 2–30-year maturities. At quarter-end the yield on a one-month T-bill was 4.74% and a 2-year UST was 4.06%; the yield on a 10-year UST was 3.48% and a 30-year yield was 3.67%.

In the 1st quarter, the Bloomberg Barclays US Aggregate Bond index was up 2.96% and the municipal bond market was up 2.78%. The high-yield market had strong performance, up 3.57% for the quarter and US TIPS (inflation protected securities) were up 3.34%

So, what did all this mean for investors? Depending on the asset allocation, a diversified portfolio returned between 3-6% for the 1st quarter.

U.S. Treasury Yield Chart



Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Yield curve data from Federal Reserve.

Looking Ahead

As we look ahead, the focus for investors in the coming quarters will remain on interest rates and whether the economy will avoid a recession in response to the interest rate hikes by the Federal Reserve, as well as the tightening of credit (lending) due to the fallout from the failure of Silicon Valley Bank and Signature Bank. Consumers and small businesses have responded to these bank failures by moving their deposits, either to increase their FDIC insurance coverage or to higher yielding cash alternatives. The result of this is that the smaller/regional banks now have less capital available to lend to borrowers.

We will continue to watch the battle in Washington over raising the debt ceiling. While this shouldn't have a significant impact on valuations it could create significant volatility in the markets as the conflict unfolds.

While looking ahead we can't help but reflect on the past three years. Wow, we have been through a lot. So much has forever changed; WFH, real estate valuations, Zoom, telehealth, to name a few. What is fascinating is that when you look at the markets' performance over that same three-year time period, it is up between 8-10%; this happens to be right in line with the long-term performance of the stock market. Some things don't change…

As always, we would love to hear from you, so feel free to contact us at any time.

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