Capital Market Review

March 31, 2023

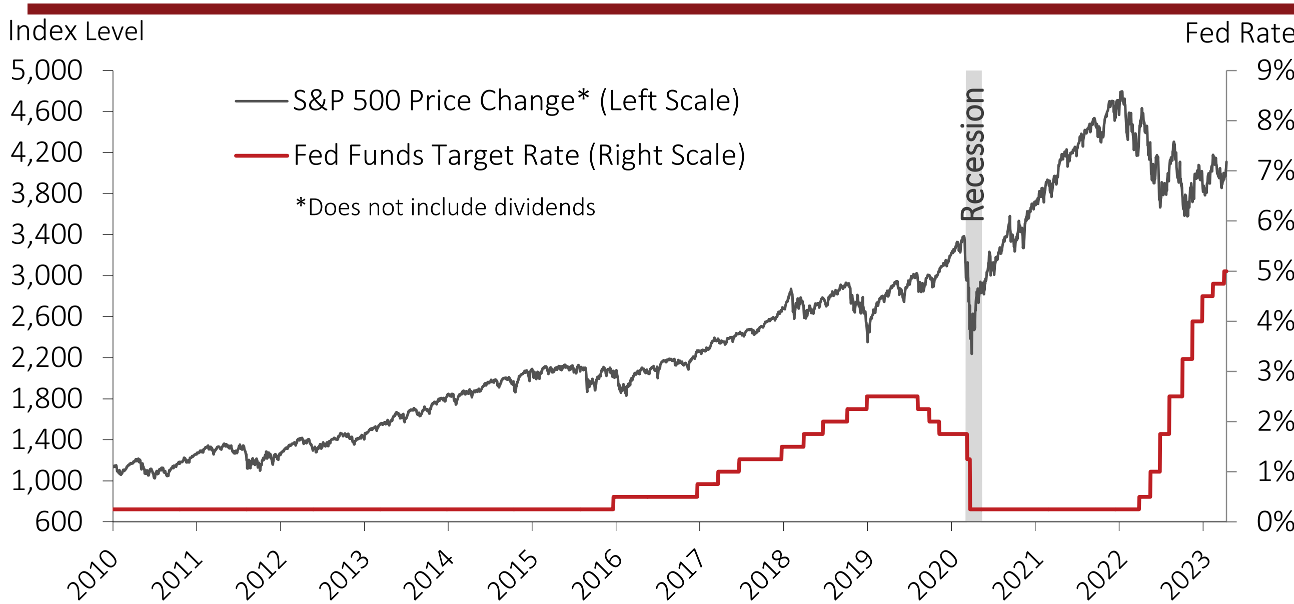



DeMarche

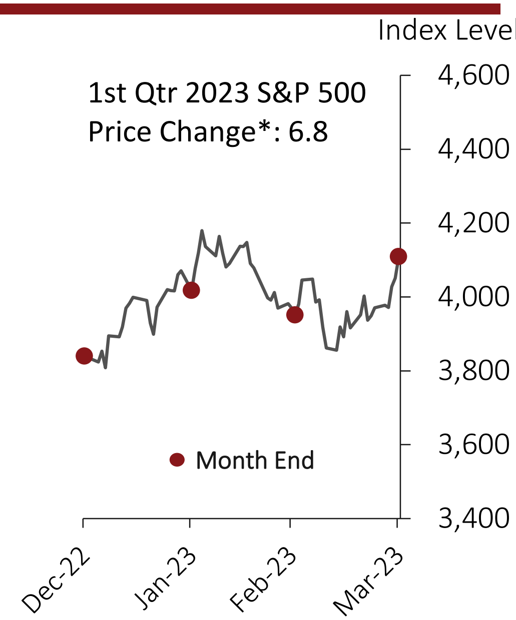
Watch the Capital Markets Review Key Takeaways Video

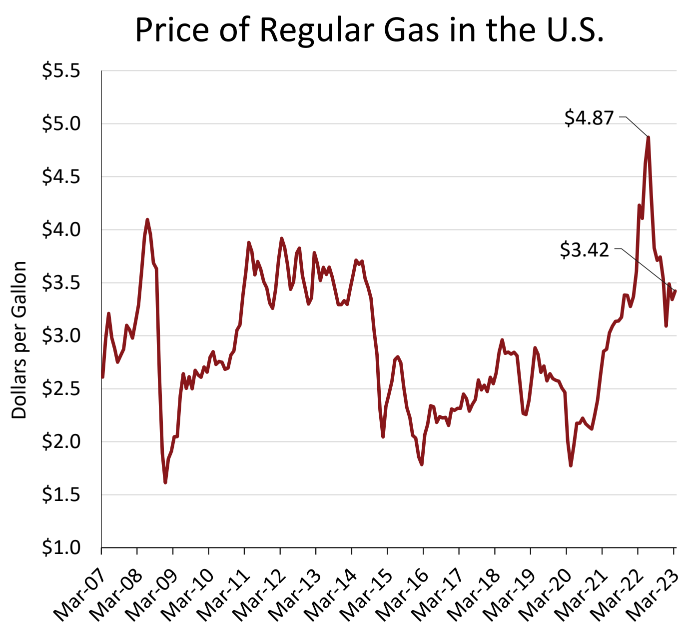
Market / Economic Overview

Is The Fed Near The End?



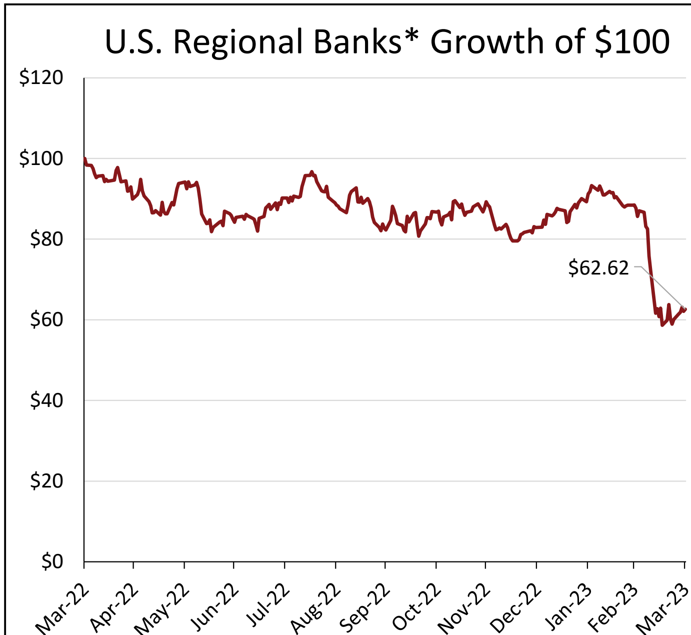
Source: Standard & Poor's, Federal Reserve





Source: St. Louis Federal Reserve

The markets rebounded in the first quarter of 2023 from the dismal performance of 2022. The Fed reduced its interest rate increases to 25 basis points each in February and March from the rapid increase of 75 and 50 basis points in the fourth quarter of 2022. Inflation data show some moderation (e.g. gas prices have eased). The rapid increase in rates were not without casualties as Silicon Valley Bank and Signature Bank failed. The fear of bank runs caused bank stock prices to fall in the quarter, negatively impacting small cap indexes. The chart to the right shows the rapid repricing of regional banks. The market is certainly nervous about what is the next shoe to drop.



Source: Yahoo Finance - *IAT iShares

Broad Market Overview

INDEX	1st Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
MSCI World	7.7	-7.0	16.4	8.0	8.9
Russell 3000	7.2	-8.6	18.5	10.5	11.7
S&P 500	7.5	-7.7	18.6	11.2	12.2
MSCI EAFE USD	8.5	-1.4	13.0	3.5	5.0
MSCI Emerging Markets USD	4.0	-10.7	7.8	-0.9	2.0
Bloomberg Aggregate	3.0	-4.8	-2.8	0.9	1.4
Bloomberg Global Aggregate	3.0	-8.1	-3.4	-1.3	0.1
FTSE Non-US Gov't Bond	3.7	-13.0	-6.2	-4.3	-1.5
NAREIT (Public RE)	1.5	-19.8	10.3	5.7	6.1
Bloomberg Commodity	-5.4	-12.5	20.8	5.4	-1.7

Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized.

U.S. Indicators Yr. Ending 3/31	2023	2022	2021	2020	50 Yr. Average
GDP Annual Growth Rate*	1.6	3.7	1.2	0.8	2.7
Unemployment	3.5	3.6	6.0	4.4	6.2
Inflation (CPI)	5.0	8.5	2.6	1.5	4.0
10-Year Interest Rates	3.5	2.3	1.7	0.7	6.0

**Note: Prior to the GDP quarterly release from BEA, we show the annual GDP Growth rate from OECD weekly tracker as the most recent year.*

Source: Standard & Poor's as of 3/31/23

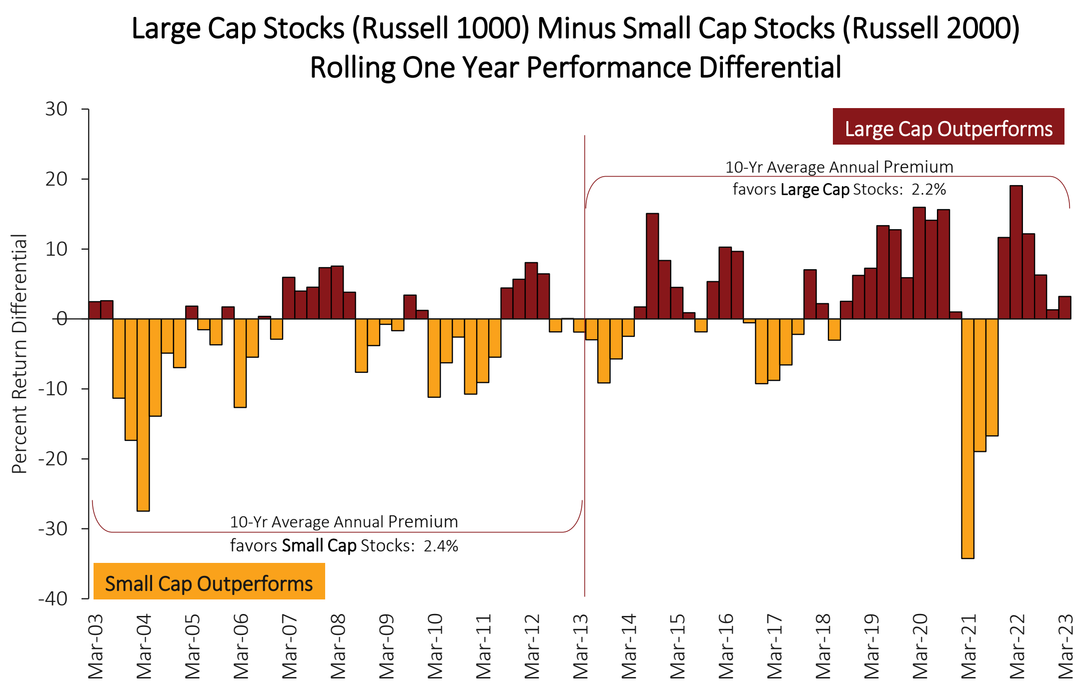
- Markets continued the rebound in 2023 that began in the fourth quarter of 2022. The rally of the past 6 months still has not reversed negative one year results. For example, the S&P 500 returned 7.5% in the quarter after a 7.6% return in the fourth quarter of 2022, but is still down 7.7% for the one year. Apple and Microsoft added 2.8 percentage points to the index return.
- Bond returns benefitted from a small drop in interest rates in the longer end of the maturity curve in addition to higher coupon rates. The Bloomberg Aggregate returned 3.0% for the quarter. Back to back positive quarters have helped the one year number significantly; however, the Aggregate is down 4.8% for the past 12 months.
- International stocks continued to perform well in the first quarter. The MSCI EAFE index has beaten domestic stocks two quarters in a row now and has posted a negative 1.4% return for the one year. The dollar has weakened against a broad trade weighted basket of currencies, which helps provide a tailwind to international returns.
- The chart to the left shows the weakening earnings growth in the first half of 2023. Stock prices reflect future earnings power, and as earnings weaken, stock market performance becomes more volatile. In addition, it seems that earnings are expected to grow late in the year. This suggests that stock market performance in future quarters could improve if earnings materialize.

DeFact

Starting point matters. Three years ago, the markets were experiencing a meltdown due to COVID lockdowns. So starting at April 1, 2020, the market rebounded and then in 2022 produced a double-digit negative return. However, over that three-year period, the S&P 500 generated an 18.6% return despite significant volatility caused by exogenous events.

INDEX	1st Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
S&P 500	7.5	-7.7	18.6	11.2	12.2
S&P Mid-Cap 400	3.8	-5.1	22.1	7.7	9.8
S&P Small-Cap 600	2.6	-8.8	21.7	6.3	9.9
Russell 1000	7.5	-8.4	18.6	10.9	12.0
Russell 1000 Growth	14.4	-10.9	18.6	13.7	14.6
Russell 1000 Value	1.0	-5.9	17.9	7.5	9.1
Russell 2000	2.7	-11.6	17.5	4.7	8.0
Russell 2000 Growth	6.1	-10.6	13.4	4.3	8.5
Russell 2000 Value	-0.7	-13.0	21.0	4.5	7.2

Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized.



Source: DeMarche

- A slowdown in the pace of interest rate increases helped boost growth stocks. Large cap growth stocks staged a strong rebound in the first quarter of over 14%. Large cap growth was pummeled in 2022 due to the pain of increasing interest rates. The 14.4% quarterly return helped the 12-month return, easing to a negative 10.9% from a negative 29.1% at the end of 2022.

- The rebound in growth stocks far outpaced the return of value stocks in the quarter. Large cap value stocks still have outperformed large cap growth over the past 12 months by 5 percentage points. The expected slowdown in the economy in 2023 has helped bring down energy prices so far in 2023, while the boost in interest rates has caused some pain in financial institutions. Both of these sectors have significant weights within the value indexes.

- Small cap stocks have underperformed large cap stocks in the quarter and the one year. Small cap value stocks suffered in the quarter primarily due to the exposure to regional banks that took it on the chin with the failure of two banks in the past few months. Financials make up a 16% weight of the small cap index and was its worst performing sector.

- It has been awhile since small cap stocks have had leadership over large cap stocks. The chart to the left shows strong small cap outperformance coming out of the COVID lockdowns. If the earnings for companies rebound in 2024 and financials regain their footing, small cap stocks could be poised to lead again.

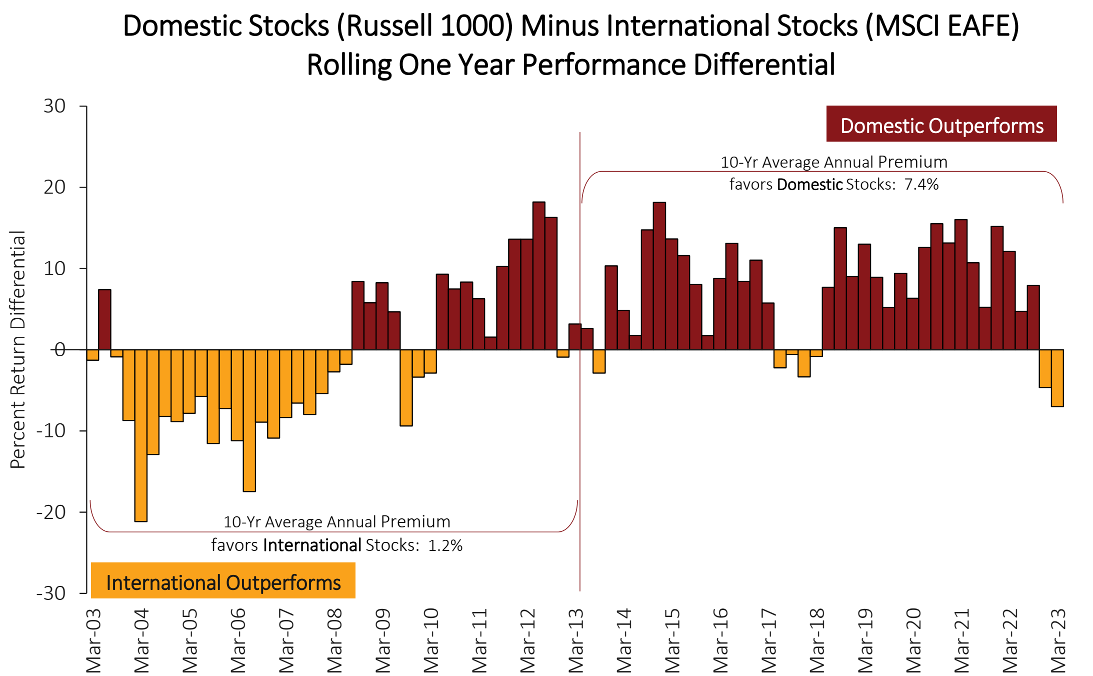
DeFact

Tech stocks are still the tail that wags the large cap dog. For the quarter, tech stocks rebounded 25% and drove the return of the Russell 1000 and the Russell 1000 Growth in particular. Tech stocks make up a 40% weight in the Russell 1000 Growth index. Over the trailing 12 months, tech stocks are still down, but now financials and consumer discretionary are the worst performing sectors.

International Equities

INDEX	1st Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
MSCI EAFE Local	7.5	3.8	14.6	6.2	7.3
MSCI EAFE USD	8.5	-1.4	13.0	3.5	5.0
Growth	11.1	-2.8	10.9	4.9	6.0
Value	5.9	-0.3	14.6	1.7	3.7
MSCI All Country-ex US	6.9	-5.1	11.8	2.5	4.2
MSCI AC Asia-ex Japan	4.3	-8.9	6.9	0.1	4.1
MSCI Emerging Markets	4.0	-10.7	7.8	-0.9	2.0
MSCI EAFE Small Cap	4.9	-9.8	12.1	0.9	5.9
MSCI Japan	6.2	-5.2	7.4	1.3	5.0
MSCI China	4.7	-4.7	-2.6	-4.0	3.4
MSCI Germany	14.7	2.2	12.8	0.4	4.1
MSCI France	14.6	8.8	19.5	6.2	7.5
MSCI UK	6.1	-0.8	14.6	3.0	3.4

Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized.



Source: DeMarche

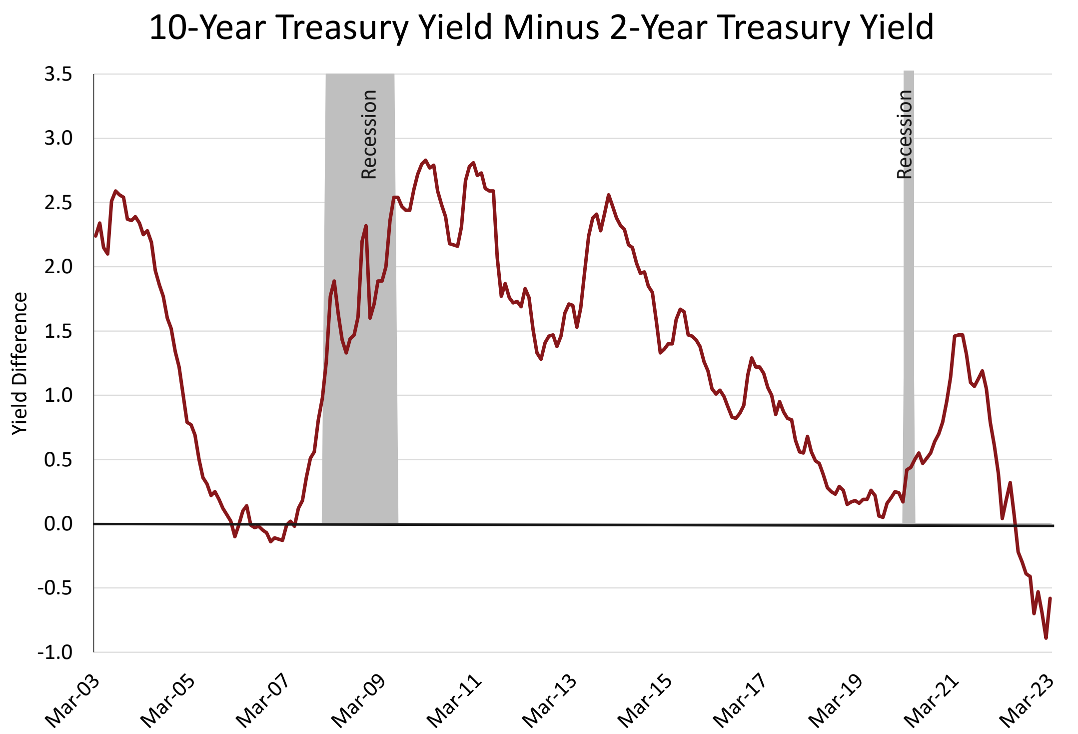
- International returns have performed well in the past 12 months on a relative basis, outperforming domestic stocks. Over the past six months, the dollar has weakened providing a tailwind. Over the longer one year horizon, the dollar still has strengthened relative to a trade-weighted basket of currencies.
- Emerging market stocks rebounded a little in the first quarter, but are down nearly 11% for the past 12 months. Chinese stocks performed better than the next highest weights in the index. Taiwan, India, and South Korea have a combined weight greater than China in the index and underperformed China in the past 12 months by 7.0 to 9.3 percentage points.
- European stocks have led the charge in the past quarter and year. The tightening cycle of interest rate hikes is further along in the U.S. than in Europe, and the dollar has been weakening. Some French stocks have performed well on hopes that a China reopening will boost luxury goods trade with companies such as LVMH.
- The chart to the left shows that international stocks have closed a bit of the gap in underperformance versus domestic large cap stocks. Over the past year, developed international stocks have outperformed by 7 percentage points. International stocks still have room to outperform.

DeFact

Banking failures were not isolated to the U.S. The largest Swiss bank, UBS, took over the second largest Swiss bank, Credit Suisse, in a $3.2 billion emergency rescue deal. Credit Suisse fell victim to its history of scandals and financial losses, most recently scandals and subsequent fines associated with money laundering and foreign exchange manipulations. The final straw was the strain of higher interest rates impairing capital. ~CNBC

INDEX	1st Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
Bloomberg Aggregate	3.0	-4.8	-2.8	0.9	1.4
Bloomberg 1-3 Gov Credit	1.5	0.3	-0.4	1.3	1.0
Bloomberg Gov Credit Long	5.8	-13.4	-6.3	0.6	2.3
Bloomberg US TIPS	3.3	-6.1	1.8	2.9	1.5
ICE BofA Merrill Lynch High Yield	3.7	-3.5	5.8	3.1	4.0
CSFB Leveraged Loan (bank loans)	3.1	2.1	8.4	3.5	3.9
Bloomberg Global Aggregate	3.0	-8.1	-3.4	-1.3	0.1
JPM EmgMkt Bd Glbl Dvrsfd (hard)	1.9	-6.9	0.0	-0.6	2.0

Notes: Data are presented as percent returns. All 3, 5-, and 10-year returns are annualized.



Source: St. Louis Federal Reserve (FRED)

- Bond returns for the first quarter reflect the higher coupons available in the marketplace in addition to slightly falling interest rates during the quarter. For illustration, the 10 Year Treasury yield fell from 3.88% at year-end 2022 to 3.49% at quarter-end 2023.
- High yield bonds posted a 3.7% return for the quarter. Over the past three years, high yield has returned a positive 5.8%. Recall that three years ago, high yield credit spreads widened significantly due to COVID lockdowns. Bank loans experienced the same phenomenon and returns reflect spread tightening over that time period. Banks loans posted one year positive returns due to the floating rate nature of the coupon.
- Inverted Treasury yield curves signal that markets believe interest rates will fall at some point in the future. The Treasury curve inverted in the middle of 2022 and continued to invert until it reached a point in early March where the ten-year Treasury was yielding over 100 basis points less than the two-year Treasury. The spread quickly narrowed as some banks failed and the fear of bank runs loomed. The two-year Treasury yield quickly fell as the market now expects the Fed to cut interest rates later in 2023.

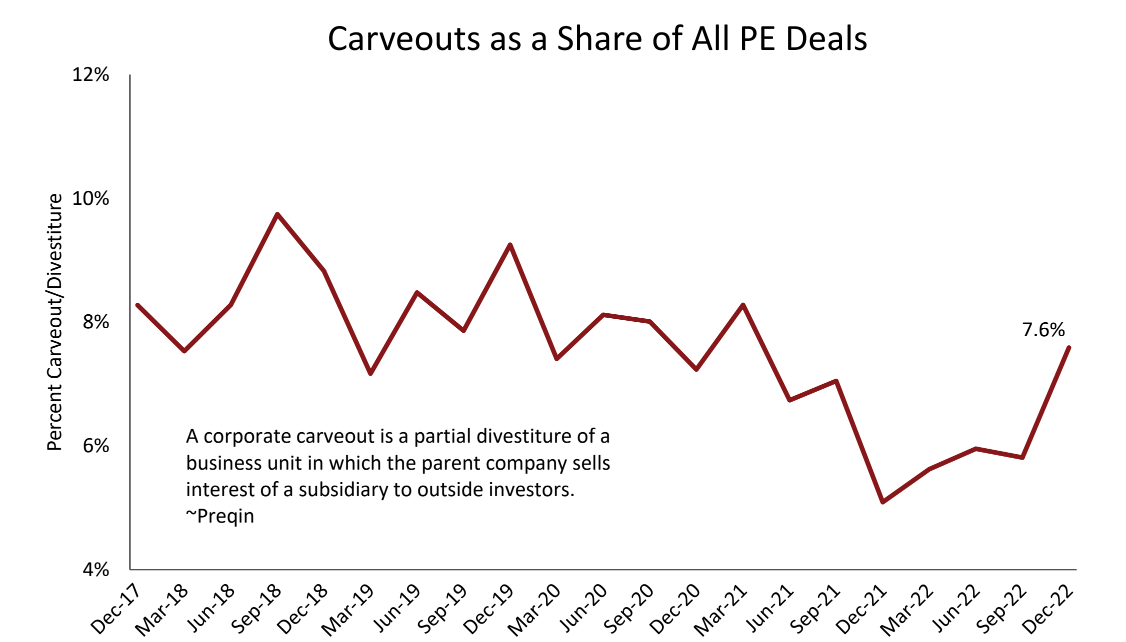
DeFact

The Bloomberg Aggregate index is weighted toward the companies and agencies that have the most debt. Therefore, the Aggregate is heavily weighted toward U.S. government exposure. In 2003, the index was approximately 22% U.S. Treasuries; in 2023 the exposure is north of 40%. Government agencies, FNMA, GNMA, and FHLMC make up an additional 24%. In the past 20 years, U.S. Treasury debt has increased from $6.5 trillion to over $31 trillion.

~St. Louis Fed, Columbia Threadneedle, Bloomberg.

INDEX	1st Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
NCREIF ODCE	-5.0	7.5	9.9	8.7	10.1
NCREIF Property (Private RE)	-3.5	5.5	8.1	7.5	8.8
Apartment	-3.2	7.1	9.3	7.9	8.6
Industrial	-3.6	14.5	22.4	18.9	16.0
Office	-4.8	-3.4	1.4	3.5	6.3
Retail	-1.6	2.7	-0.3	0.6	5.7
NCREIF Timberland	4.9	12.9	7.5	5.4	5.8
NCREIF Farmland	3.3	9.6	6.8	6.4	8.8
HFR FOF Composite	1.8	-5.3	3.7	3.0	3.5
Conservative	1.8	0.5	4.8	3.9	3.7
Diversified	1.1	-3.3	4.3	3.5	3.7
Strategic	2.8	-11.7	2.4	2.1	3.4
Preqin Private Equity	-2.5	3.5	20.6	17.4	15.7
Preqin Private Debt	-1.0	4.5	9.4	8.0	8.8
Preqin Infrastructure	4.9	20.0	13.2	12.2	11.2

Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized.
All data in the table above are as of 9/30



Source: PitchBook

- Real estate returns turned negative in the 4th quarter 2022. Over the year real estate returns were positive as capital appreciation over the years boosted returns. Income from real estate has been fairly stable quarter to quarter, generating approximately 3.3% of the 7.5% return. Rising interest rates caused appreciation to be more variable quarter to quarter, but appreciation generated about 4.2% of the 7.5% one year return.
- Private equity returns also turned negative in the quarter. Due to the lag effect of private equity valuations as compared to the instant public market valuations, private equity significantly out-performed public equity broad indexes during 2022. Expect to see private equity valuations continue to experience downward price pressure in 2023.
- Real assets, such as Farmland, Timber, and Infrastructure, showed strong performance in the quarter and one year. Inflation has boosted the valuation of those assets during 2022. If inflation battles continue throughout 2023, real asset prices could benefit.
- PE sponsors are finding increasing deal opportunities in corporate carveouts and divestitures. The chart to the left shows a recent jump in activity suggesting that PE firms are eyeing carveouts once again to add them to established PE platforms. Typically, these types of assets are attractively priced by corporate owners who want to restructure their operations.

DeFact

The number of U.S. IPOs in 2022 fell 78% (416 in 2021 to 90 in 2022), with proceeds down 94% (155.8 billion in 2021 to $8.6 billion in 2022). Health care and technology continued to comprise the bulk of the IPO activity but declined 80% and 85%, respectively, from 2021 to 2022. Market volatility and a lack of investor confidence were contributing factors in the marked slowdown from a record setting 2021. ~EY

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