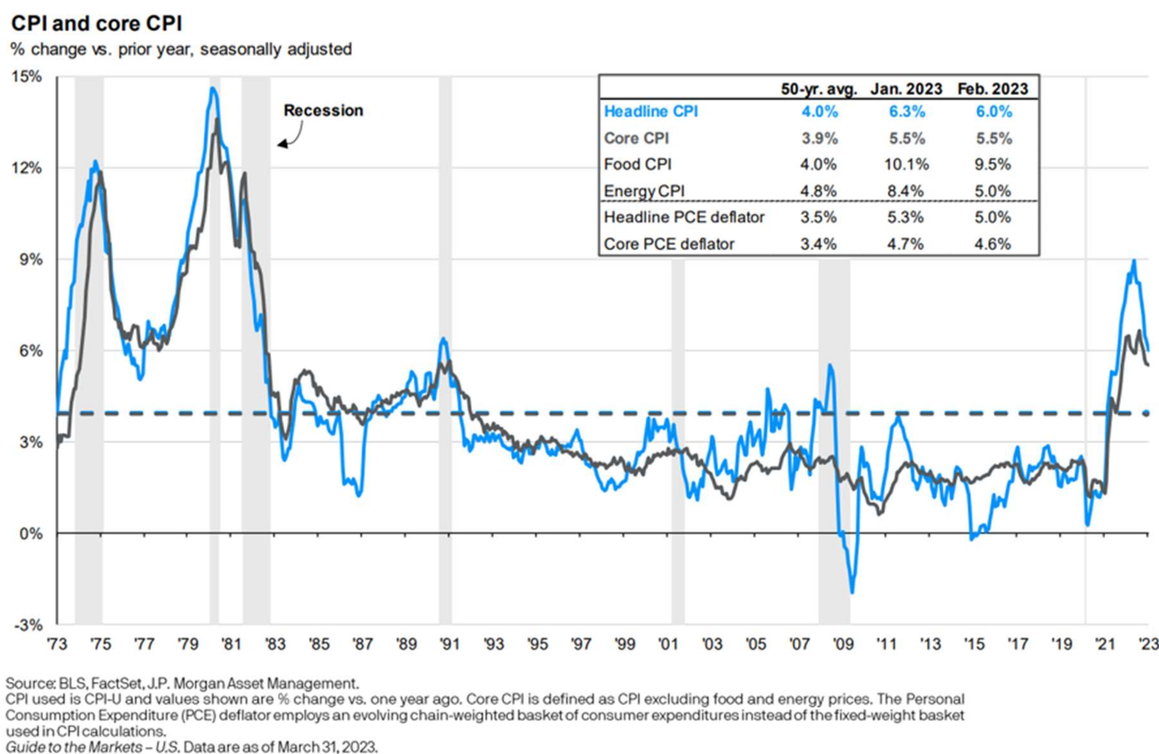
Good afternoon,

With all the rain and even snow we've been experiencing in Southern California this year, I'm reminded of the adage "in like a lion, out like a lamb." I know that applies to the start of Spring, but I think it's an apt description of the market so far this year as well.

It was a stormy quarter replete with two bank failures: Silicon Valley Bank and Signature Bank. While these banks had a unique depositor base, concerns that other banks might realize large losses on their bond portfolios if their depositors withdrew funds, triggered a widespread decline in the financial sector. By quarter's end fears of a widespread contagion eased, and the S&P 500 finished 7% higher than where it began the year.

Looking forward, many of the themes we discussed at the start of the year are still front and center.

1. **Inflation continues to drop.**



	50-yr. avg.	Jan. 2023	Feb. 2023
Headline CPI	4.0%	6.3%	6.0%
Core CPI	3.9%	5.5%	5.5%
Food CPI	4.0%	10.1%	9.5%
Energy CPI	4.8%	8.4%	5.0%
Headline PCE deflator	3.5%	5.3%	5.0%
Core PCE deflator	3.4%	4.7%	4.6%

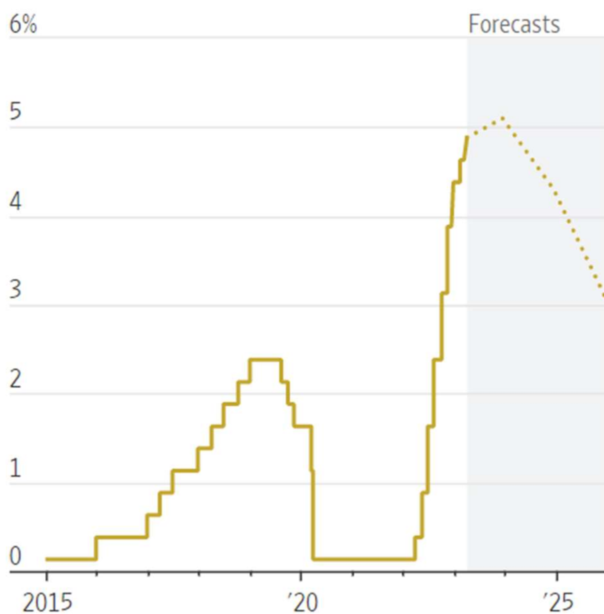
Source: BLS, FactSet, J.P. Morgan Asset Management.
CPI used is CPI-U and values shown are % change vs. one year ago. Core CPI is defined as CPI excluding food and energy prices. The Personal Consumption Expenditure (PCE) deflator employs an evolving chain-weighted basket of consumer expenditures instead of the fixed-weight basket used in CPI calculations.
Guide to the Markets – U.S. Data are as of March 31, 2023.

The most recent reading on the Consumer Price Index showed a 6% increase from a year ago, compared to a 9.1% reading last June. That being said, it is still at the highest level in over 40 years. Until it drops closer to 2-3%, there is a chance the Federal Reserve may continue to raise interest rates to slow the economy further. On a more optimistic note, looking at the historical record, 12 month returns for both

stocks and bonds have been positive following peaks in inflation, with stocks gaining 18.1% and bonds gaining 7.7%.

2. **The Federal Reserve is at or near the end of its interest rate hikes for this cycle.**

The current consensus is that they will start to lower rates perhaps as early as the second half of this year.



For the moment, short-term interest rates are near the highest they've been in over a decade. This is starting to have an impact on economic and earnings growth. There is a potential silver lining here though. Which I'll explain in greater detail at the end of the letter.

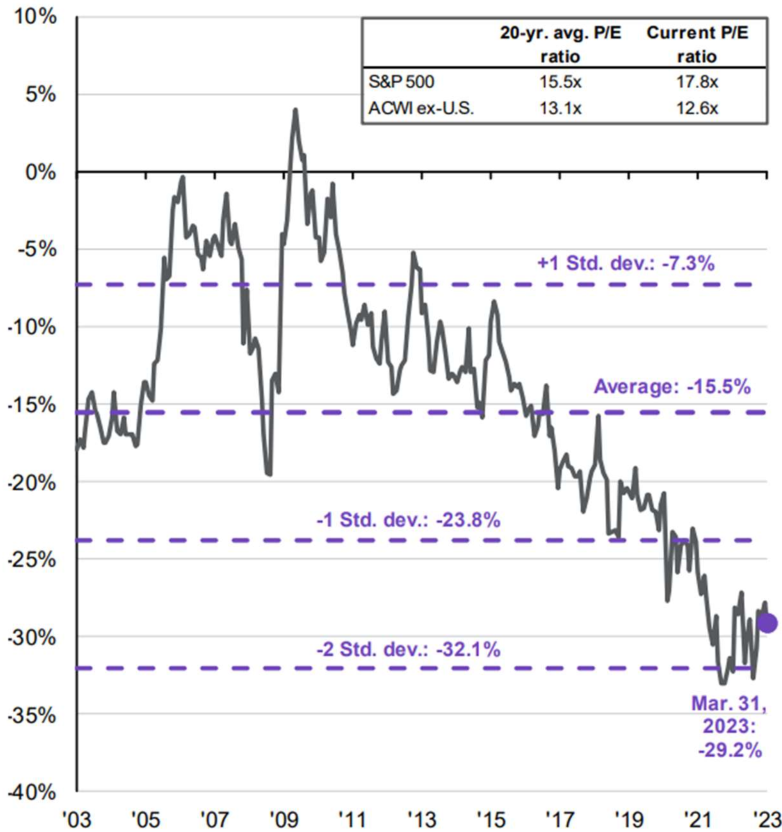
3. **The economy remains resilient.**

By many measures, the U.S. economy remains solid. The unemployment rate is at 3.6% and Gross Domestic Product (GDP) gained 2.6% in the fourth quarter. However, future growth will likely be lower than what we experienced in the last two decades, primarily due to a declining working-age population

around the globe. Tighter bank lending standards in the wake of the recent bank failures will also serve to slow economic growth.

4. International Equities are starting to look more attractive.

As the U.S. dollar had declined alongside an improving economic climate overseas, international stocks have begun to outperform those in the U.S. So far, the level of outperformance has been modest, and it remains to be seen if this is a more durable trend. Should that prove to be the case, we will consider increasing our overseas allocation. It should be noted that the argument that international stocks are attractive relative to their U.S. brethren on a valuation basis (see chart below) may be true, but this has been the case for over a decade and should not serve as the primary reason to increase one's exposure to them.



Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
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Portfolio updates:

1. Jennifer has been exploring "vintage interest rate swaps" for certain accounts that hold TIAA Guaranteed. In many cases, one can exit the old, lower rate version of the investment, place the funds in a money market fund for 120 days, and then reinvest in the Guaranteed Fund at a higher rate. Please let us know if you are interested in learning more.
2. The afore mentioned silver lining with short-term interest rates at their highest level in over a decade, it may make sense to examine your low-yielding checking account balances and consider moving some of those funds into a money market fund earning a significantly higher rate of interest.
3. Growth stocks have been outperforming Value stocks so far this year. However, I feel it is premature to increase the Growth stock allocation at this juncture, as uncertainty remains about inflation and future earnings growth.

In summary, I am encouraged by the positive returns in both the stock and bond markets so far this year. I think it is too early, given the ongoing uncertainty surrounding the banking sector, high inflation, and the potential for a continued decline in corporate earnings in the first quarter, to sound all clear. I believe a more defensive portfolio remains the better choice for now as we ride out the current economic and market turbulence.

As always, please feel free to call or email me directly if you would like to discuss the markets or your investments in greater detail.

Very truly yours,

Jim

Investment advisory services offered through NewEdge Advisors, LLC, a registered investment adviser.