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ASSET MANAGEMENT

2023 – 1st Quarter Review & Outlook

Economic and Investment Review

Mark Anderson

Chief Investment Officer

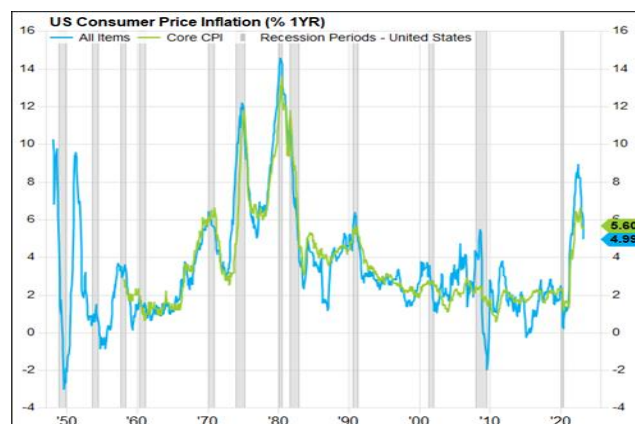
Economic Growth: Many economists, strategists and related organizations expect a recession in 2023. The Fed stated that "given their assessment of the potential economic effects of the recent banking-sector developments, the staff's projection at the time of the March meeting included a mild recession later this year, with a recovery over the subsequent two years." JPMorgan recently stated that "we continue to believe a recession is likely this year, as ongoing pressures from high rates/quantitative tightening, credit contraction (following the banking crisis), pressure on carry trades, and geopolitical headwinds permeate through the economy." Goldman Sachs (Jan Hatzius – Chief Economist) places the odds of a recession in the next 12 months at 35%. Raymond James (Eugenio Aleman, PhD – Chief Economist) expects a recession to start during the second half of the year.

The recent banking crisis, led by the failure of Silicon Valley Bank, has had a similar effect as additional Fed tightening. Many banks have seen their deposit base decline, leading to tighter lending conditions. Most of the stress has been concentrated in small and midsize banks which play a vital role in making loans to small businesses. Goldman Sachs estimates that the tighter conditions will result in a 0.4% subtraction from GDP.

If we do have a recession, it is looking more and more like it will be relatively short and shallow. The consensus GDP estimate for 2023 is 1.0%. The consensus Q/Q forecast for Q1 was 1.8% but actual growth was just 1.1%. The next three quarters are expected to be flat to down on a Q/Q basis. JPMorgan (Dr. David Kelly – Chief Global Strategist) expects the economy to grow more slowly due to problems in almost every area of demand. Consumer, business and government spending are all expected to be slower in the near term.

In an effort to thwart inflation, the Fed has raised rates at its fastest pace since the early 1980s. It appears that the Fed will raise the Fed funds rate one more time to a range of 5.00-5.25% in the May meeting. The Fed has indicated that they are likely to leave the rate at that level at least through the remainder of the year. The market seems to expect rate reductions prior to the end of the year based on an anticipated lack of economic growth. JPMorgan-Dr. Kelly expects that the Fed will have to cut interest rates in 2024 and maybe sooner.

Inflation, while still high, continued to moderate over the first quarter. CPI peaked at 8.9% last June and declined to 6.4% at the end of 2022 then continued to slowly trend down to 5.0% at the end



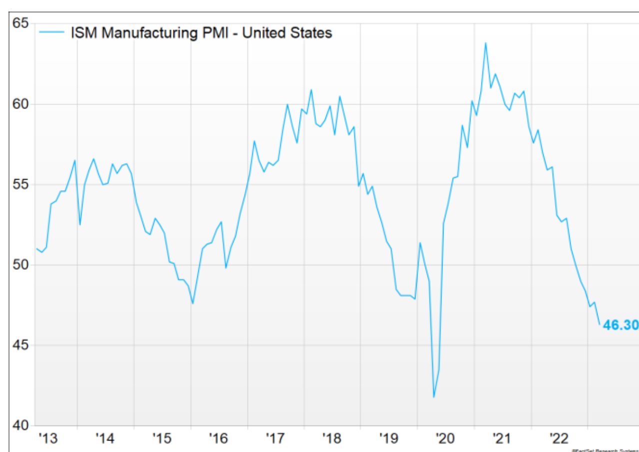
Source: FactSet

of Q1. Prices for food and shelter continue to climb at a rapid rate. However, shelter prices typically lag other cost items. The cost for fuel related energy declined in March but electricity continued to rise at over a double-digit pace on a year-over-year basis.

Unemployment remains remarkably low at 3.5%. However, the labor market appears to be cooling as hiring gains and job openings have softened and wage growth has moderated. Raymond James (Lawrence Adams – Chief Investment Officer) expects that layoffs will likely boost the unemployment rate to near 5% and inflation to ease back to 3.3% by year end.

Housing starts, building permits, new home sales and existing home sales are down significantly from the same time last year. Only multi-family starts remain positive. The median sales price looks to be finally leveling out after years of higher-than-average increases. High prices and mortgage rates near 7% continue to limit potential buyers.

According to the Institute for Supply Management (ISM), the U.S. manufacturing sector began to contract in November of last year. (Numbers less than 50 indicate contraction) The level of contraction is becoming more pronounced as the economy slows.



Source: FactSet

The U.S. services sector remains in expansionary territory but has trended down over the past few months.

Surprisingly, the Eurozone has avoided recession up to this point. Europe has largely been able to navigate around energy roadblocks sufficiently to provide the necessary inputs to its economy, although at higher price points. However, there are fewer clear signs of inflation deceleration in the Eurozone than in the U.S.

China is emerging from COVID lockdowns and consumers are spending to satisfy pent-up demand. The IMF expects China to account for one-third of global growth this year. The IMF forecasts global growth of 2.8% in 2023.

Equity Markets

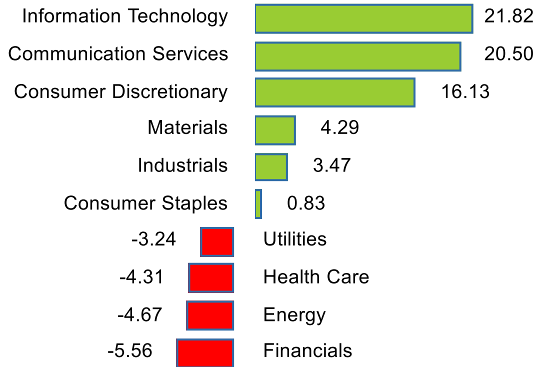
Equity markets reversed trend and rebounded in Q1. The S&P 500 moved up 7.50% in Q1 but was still down -7.73% for one year through the end of the calendar quarter. The growth benchmark outpaced the value benchmark in Q1 but continued to lag considerably for one year. The NASDAQ Composite came roaring back in the quarter, increasing 17.05% but was still down -13.28% for one year. Small cap stocks saw less of a rebound in the quarter as the potential for a recession created more hesitancy for investors to jump back in. Developed International stocks (MSCI EAFE) surprised to the upside given the impact of Russia's war against Ukraine. Europe has been more resilient than was earlier feared. Emerging Market stocks (MSCI Emerging Markets) were up 3.96% for the quarter and down -10.70% for one year.

2023 Q1 Returns				
EQUITY	Q1 2023	YTD 3.31.23	1 Year 3.31.23	3 Years Annualized
S&P 500	7.50	7.50	-7.73	18.60
S&P 500 Value	5.17	5.17	-0.16	19.12
S&P 500 Growth	9.63	9.63	-15.33	16.84
Dow Jones Ind Avg	0.93	0.93	-1.98	17.31
NASDAQ Composite	17.05	17.05	-13.28	16.65
S&P Mid Cap 400	4.06	4.06	-8.78	19.20
S&P Small Cap 600	2.57	2.57	-8.82	21.71
MSCI EAFE	8.47	8.47	-1.38	12.99
MSCI Emerging Mkts	3.96	3.96	-10.70	7.83

Source: FactSet

Some of the worst performing economic sectors in the S&P 500 in 2022 were some of the best

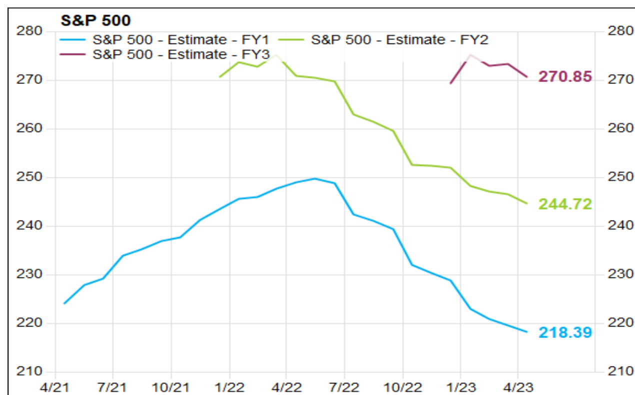
performing in Q1. Technology was down -26.0% in 2022 but moved up 21.8% in Q1. Communication Services was down -40.6% in 2022 but increased by 20.5% in Q1. Consumer Discretionary was down -37.2% in the calendar year and then rebounded by 16.1% in the first quarter.



Source: FactSet

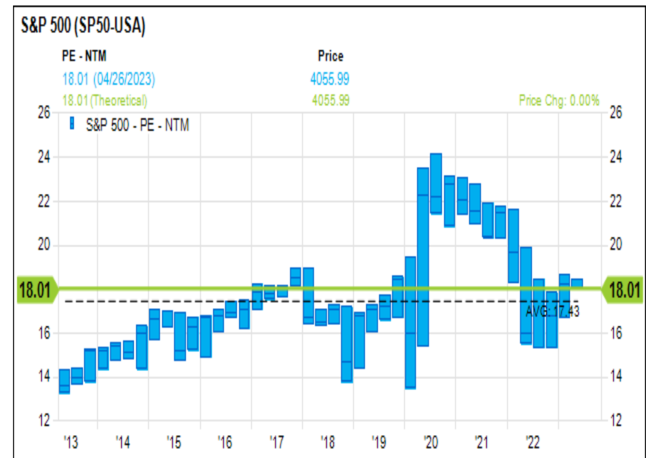
Energy was the only sector to provide significant upside in 2022 but has not been the focus of investors so far this year. Defensive stocks held up better during the downturn last year but more cyclical stocks are pushing the equity market higher so far this year.

Earnings growth for the S&P 500 was up 4.8% in 2022 but did not match the 10% growth expectations from earlier in the year. The consensus estimate for 2023 is an anemic 1.09% that may be in danger of slipping into negative territory if a recession is realized during the year. Analysts have been consistently revising estimates down over the past 12+ months.



Source: FactSet

Investors are justifying a higher than average next-twelve- months P/E multiple based on the 12.0% EPS growth estimate for 2024. Goldman Sachs forecasts



Source: FactSet

just 1.0% earnings growth for 2023 and 5.5% for 2024. JPMorgan and Raymond James expect earnings growth to be flat-to-down for the year.

The S&P 500 is currently trading at 18.6x the 2023 earnings estimate of 218.39 and 18.0x for the next 12 months. Goldman Sachs maintains a forecast of 4,000 for 3, 6 and 12 months. Raymond James expects the S&P 500 Index to rise to ~ 4,400 by year-end 2023 based on the belief that the Fed will be successful in its battle against inflation, that interest rates will decline, and that P/E multiples will expand to ~20x.

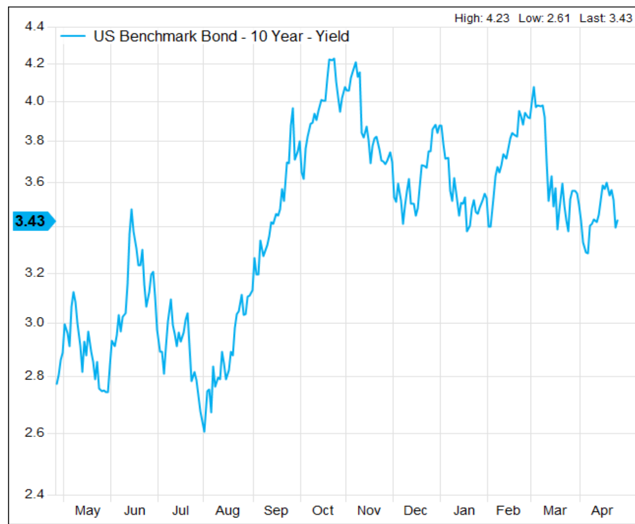
We forecast the S&P 500 to end the year near 4,250. The forecast is based on 1.2% earnings growth in 2023, compared with the consensus estimate of 1.1% and a rebound of 10%+ earnings growth in 2024 and 2025. At the same time the P/E multiple is expected to regress slowly towards the long-term mean. If the S&P 500 reaches 4,250, the market would be up 10+% for the year.

Q1 S&P 500 earnings season is starting out better than the last two quarters. So far 76% of companies have reported actual EPS above estimates compared with the 5-year average of 77%. The magnitude of the earnings surprises is below their 5-year averages. Despite the relatively positive earnings news, the

index is still reporting the largest year-over-year decline in earnings since Q2 2020.

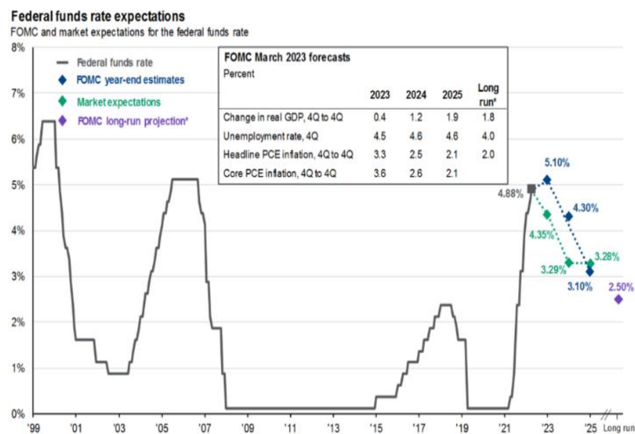
Fixed Income Markets

The 10-year U.S. Treasury yield is near the low end of the trading range since November of last year. Bond investors appear to be anticipating reduced inflationary pressures, an end to the Fed tightening cycle and a renewed Fed easing cycle later this year or next year.



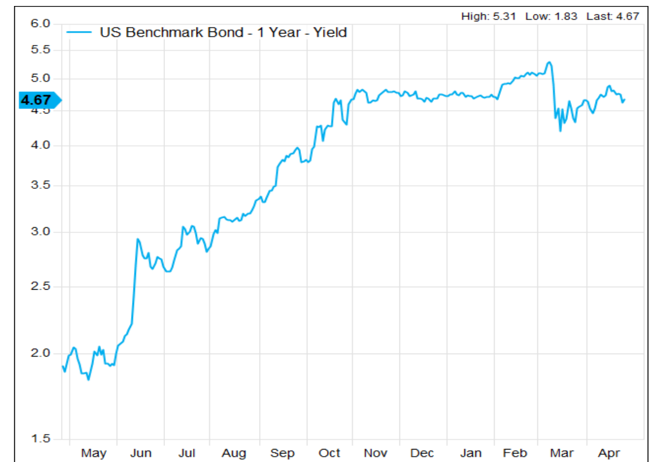
Source: FactSet

However, the Fed is still expected to raise the Fed Funds target rate from a range of 4.75-5.00% to 5.00-5.25% in the May meeting.



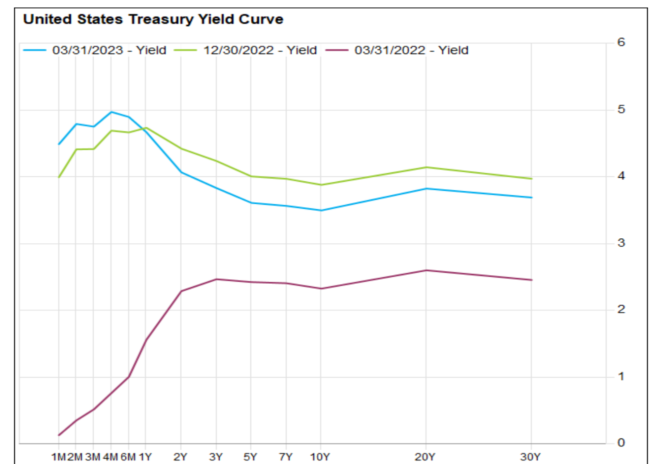
Source: JPMorgan Asset Management

The 1-year U.S. Treasury yield has remained elevated due to Fed tightening and will not likely move appreciably lower until the next easing cycle.



Source: FactSet

Yields on U.S. Treasury bonds with maturities longer than one year have declined since the end of last



Source: FactSet

year. Investment grade bonds, as represented by the Bloomberg Aggregate Bond Index, were up 2.96% in Q1. However, due to Fed rate increases

2023 Q1 Returns				
FIXED INCOME	Q1 2023	YTD 3.31.23	1 Year 3.31.23	3 Years Annualized
Bloomberg US Agg Bond	2.96	2.96	-4.78	-2.77
ICE AMT-Free Nat'l Muni	2.64	2.64	0.42	0.45
Markit iBoxx USD Liquid High Yield Index	3.65	3.65	-3.25	4.76

Source: FactSet

and inflation, yields remain considerably higher than one year ago. As a result, the return for one year through March 31, 2023 was negative at -4.78%. The good news for bonds is that when the Fed completes a cycle of increasing rates, yields tend to be lower for at least 18 months.

Municipal bond yields have also moved down since the end of last year as supply has declined and demand has remained strong. Even though yields have declined slightly, they remain near the highest levels in at least four years depending on the maturity. Municipal bonds were up 2.64% in the quarter and were able to post a slight positive return for one year.

For investors in a higher tax bracket, municipal bonds are a great high-quality investment that will provide tax exempt cash flow. This becomes even more important for investors in high tax states.

High yield bond funds experienced $16 billion in outflows in Q1. Fears of a banking crisis and a potential recession led investors to withdraw funds. The banking crisis appears to be under control but a recession is still a possibility. Historically, a U.S. recession has given rise to a significant number of defaults in the high-yield bond market. The average default rate is about 4% over a five-year period. It is generally expected that if a recession takes place, it will be relatively mild and the default rate will only increase slightly. Experts point to a previous spike in defaults during COVID, a record level of issuance following COVID and strong corporate fundamentals as reasons why the default rate may not increase significantly.

The opportunity should be taken to bring fixed income allocations to target since rates generally decline in a recession and prices should respond positively to lower inflation.

We continue to recommend focusing on high credit quality but look to extend duration from the shorter posture that was maintained in 2022.

Real Assets

Real Estate, as represented by the Dow Jones U.S. Real Estate Index, increased by 1.58% in Q1. Real Estate declined -18.72% for one year due to higher interest rates as well as higher office property vacancies and lower valuations. Industrial and multi-family properties continue to hold and increase their values.

2023 Q1 Returns

Real Assets	Q1 2023	YTD 3.31.23	1 Year 3.31.23	3 Years Annualized
Dow Jones U.S. R/E	1.57	1.57	-18.72	9.85
S&P GSCI	-4.94	-4.94	-10.04	30.53

Source: FactSet

Commodities were down -4.94% in Q1 and -10.04% for one year through the end of the quarter primarily due to the decline in energy prices.

Asset Allocation

After a disastrous year in 2022 and much discussion about whether the 60% equities/40% fixed "balanced" allocation was broken, the allocation returned to positive territory in Q1. The allocation was up 5.68% for the quarter. A 60%/40% allocation will likely still function as an appropriate starting point for a balanced investment portfolio.

Within fixed income, we returned duration to a more intermediate-term average position by selling off ultrashort funds and reinvesting in more intermediate funds during the quarter.

Disclosures

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