ambwealth

Wealth Advisory Market Update

April 10, 2023

ambwealth

Market Update

Equities

The equity markets finished the month of March strong, with all three major indexes positive for the year. The S&P 500 was up 3.67% for the month and 7.50% for the year. It is important to note that the S&P 500 is being driven by seven tech stocks (Apple, Meta, Alphabet, Nvidia, Amazon, Tesla & Microsoft). Without the massive outperformance from these growth names the index would be down for the year. In addition, the top 15 stocks in the index have increased their market cap by $1.8 trillion while the remainder of the index has lost $21 billion. The short squeeze in growth stocks, especially tech stocks, has continued longer than we expected. This has been driven partly by the collapse of Silicon Valley Bank, as many investors have shifted from cyclical names into tech companies viewing their balance sheets to be strong because of their relatively lower debt levels. This is driving multiples higher in tech, back to levels we last saw in 2021. The technology sector is not usually viewed as a defensive sector, as it is cyclical in nature and if the economy turns, their earnings will be hit. We believe a revision to the mean is on the horizon as the rest of the market outperforms or there is a downside move in these growth names.

While the three major indexes are all positive for the year, there is plenty of uncertainty heading into the second quarter. The collapse of Silicon Valley Bank triggered a bank run which caused several banks to fail, mostly due to mismanagement of their balance sheets and investments. In all, there have been five banks that have collapsed or had to be rescued in the last month. Most notably, 167-year-old Swiss giant Credit Suisse had to be rescued by UBS and the Swiss National Bank. This has led to banks tightening lending standards which will lead to tightening of liquidity in the economy. This will put even more stress on an economy that is already slowing. The current banking situation, coupled with a struggling economy and a restrictive Federal Reserve, will cause more volatility which is why we seek quality stocks that have inelastic demand for their goods.

Uncertainty abounds heading into the second quarter. The Federal Reserve remains a major question mark on how they will handle inflation going forward due to the recent bank stress. Geopolitical tensions continue to strain global relations as China has formed alliances abroad that puts US Dollar hegemony at risk. The war in Ukraine does not have a clear end in sight. The US economy is slowing, yet inflation remains sticky. Significant banking stress will pull even more liquidity out of the economy making conditions even more restrictive. The S&P 500 remains elevated, as forward price-to-earnings are at 18.5x, and the major driver of performance, the tech sector, is trading at 27x forward earnings which is where we were before the collapse in 2022. Market technicals continue to influence more than fundamentals. We do expect this to change as earnings season is here. Our focus will remain on guidance, as we believe margins are going to show contraction and show an earnings recession is near. This is why we believe it is important to take positions in companies with strong balance sheets that have pricing power, while waiting for the right time put more cash to work.

Monetary Policy and Economic Indicators

The Federal Open Market Committee (FOMC) met in March and the result was a bottom-line rate hike of 25 basis points. The data the Fed examined was stale but the meeting did come after the recent bank failures. Fed Chairman Jerome Powell centered his remarks around the banking system during his March press conference, as expected. He assured market participants that the banking system as a whole was “well-capitalized, strong and resilient.” He also used similar commentary as Janet Yellen, United States Secretary of the Treasury, that the Fed has all the tools necessary to protect depositors and that depositors should feel safe. With regards to the fight on inflation, Powell mentioned that the current banking situation can have the same effect as increasing the Fed Funds rate. The Chairman, as well as other Fed speakers, have reiterated the importance of getting inflation down to their 2% target. The Fed remains concerned that services inflation remains hot. But Powell did mention that goods inflation has come down for six months in a row. With many looking for hope that rate cuts would be on the horizon, Powell squashed those hopes by saying that the other FOMC participants do not see rate cuts occurring this year.

Recent data since the Fed meeting has shown signs of tighter financial conditions which will hopefully lead to cooler inflation. The Fed has continued mentioning the labor market being tight, needing to bring wage growth down and the unemployment rate up. Recent data has shown this may be starting to happen as private payrolls increased by 145,000 which is below the consensus expectation of 210,000. This is also down from the February number which saw private payrolls increase by 261,000. The Labor Department also reported on their Job Openings and Labor Turnover Survey (JOLTS) that available positions have dropped by 632,000 to 9.93 million in February. This is the first-time that job vacancies have dropped below 10 million since May of 2021.

The biggest political risk for the markets, the debt ceiling, remains unresolved, as debt ceiling conversations have stalled. There have not been any meetings between House Speaker McCarthy and President Biden since their talk two months ago. The President is looking to raise the debt ceiling without any spending cuts, while McCarthy and the Republicans strongly oppose a deal with no spending cuts. We still believe a deal will get done.

Strategy

As we stated in the previous update in February, “The squeeze in growth stocks has continued into February and will likely last longer.” The same still holds true today, and we still believe there will eventually be a reversion to the mean. We continue to be overweight quality and value as we are in the midst of the fastest rate hiking cycle in history, slowing domestic growth, heightened geopolitical risks, and stretched valuations, just to name a few current issues. When times are uncertain, being patient is usually the best strategy.

Fixed income has performed well to start the year, as longer duration rates have moved lower. Adding duration to our portfolios at the end of last year and throughout the first quarter has been beneficial. We will continue to stick with high credit quality and take advantage of spreads widening in names we feel are strong. Adding paper that offers proper compensation for the underlying risks remains our strategy.

As always, we continue to navigate this difficult environment to the very best of our ability. We at AMB thank you for your support and for allowing us to partner with you in reaching your financial goals.

Matthew J. Roach, CFA®
Chief Investment Strategist

Mike Servetas
Assistant Portfolio Manager