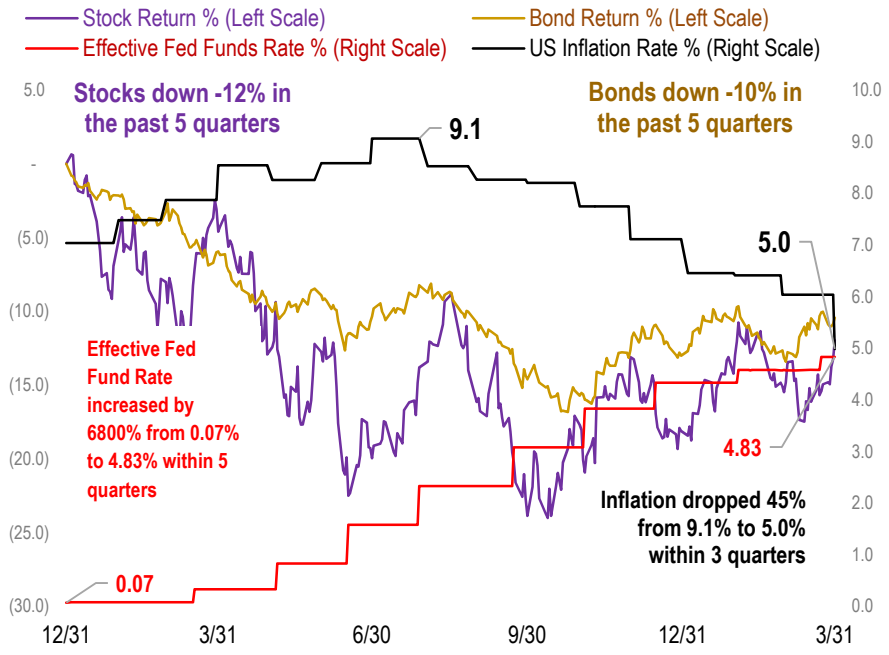
Market Movement Highlights

Following a gut wrenching 2022, stocks and bonds rallied sharply in January posting +6.3% and +3.2%, respectively, amid optimism that the Fed would soon pivot away from continuing rate hikes. However, stronger than anticipated economic data in February quickly dashed those hopes as both markets pulled back on average some (2.6%). In these inflationary times, it now seems that any good economic news is construed as bad news by the Fed! Then following the first few games of March Madness, two large US banks failed (Silicon Valley and Signature Bank) resurrecting fears of 2008 and sending shivers across the banking public as depositors pulled billions in deposits online and by phone with "lightning" speed. By month's end, cash infusion rescues delivered by a consortium of our "too big to fail" banks, like JP Morgan, Wells Fargo and Citibank, did much to ease investor fear that another banking contagion was in the making. Once again, the markets seemed to embrace a renewed optimism that the FED would have no choice but to curtail more rate increases. The immediate result was a market rebound with stocks and bonds garnering +3.7% and +2.7% respectively.

As the first quarter came to a close, the S&P 500 TR index had gained +7.5%, while the NASDAQ posted a whopping 17.0%. Leading the parade were the mega-cap growth stocks, including Nvidia up +87%, Facebook +73% and Tesla +59%, while financial stocks such as First Republic and Charles Schwab fell (89%) and (37%) to drag down overall value-driven performance. US small cap stocks rose +2.7%, while developed international stocks returned +8.6%. Meanwhile, the US Aggregate Bond index returned +3.0%, while Treasury yields fell across maturities greater than one year. Municipal bond markets were a bit slower to recover but still posted +2.8% on the quarter.

Looking back on the last five quarters of the current bear market from December's 2022 peak (see Chart**),** stocks and bonds rebounded from their October lows of (25%) and (17%), respectively. Over this period the FED had actually begun dialing down its outsized .75% rate hikes, as inflation was seen moderating from its mid-2022 peak of 9.1% to its current 5% level. And so, for those of us who remained largely invested, portfolio returns declined by (10-12%).

Stocks, Bonds, Fed Fund Rates and Inflation in Current Bear Market (2022 and YTD)*



Notwithstanding the disappointment of the "paper losses", those returns are still much more emotionally manageable than for those who capitulated during October's price trough. And while today's cash and equivalent yields, including Treasuries, CDs and the like, are now so much more attractive than at any time over the last ten to fifteen years. Those who did exit the markets for the safety of cash have set themselves up for another equally difficult decision… When to begin re-investing in stocks and bonds? As the now ancient axiom goes, timing the market is most often simply a fool's errand.

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Looking Forward

As we emphasized in our last commentary, an obvious trend has emerged wherein the market's perception (mistakenly or not) of the disposition of future interest rates and how it diverges from FED policy will continue to impact daily, monthly and quarterly price returns over the next 6 to 12 months. All things considered and keeping in mind what we just witnessed in Q1, we offer the following observations.

Geopolitical risk aside, short and intermediate term market prices will be wholly dictated by the FED's rate pace. As it appears now, the markets have likely priced in what many have appropriately labeled the most *"anticipated recession"* in recent memory. Most believe that we are already in recession, many believe it is just around the corner and others optimistically think we may escape it altogether. Whatever your view, signs of further disinflation should invite at least a moderate pivot away from additional tightening and thereby lend to upside results. On the flipside, if inflation continues to remain "too sticky" (as the FED most recently characterized it), the notion of another rate hike, irrespective of its size, will likely trigger some market give back and slow the economy down further. For the moment, however, we suspect a nominal rate hike in May, likely another .25%, is in the cards and probably already priced into the market. What happens from there, one can only guess but however it unfolds we know it will surely impact the economy and dictate whether market risk is to the up or downside. Again, our mantra during times like these is to know and ensure you have enough cash on hand to meet your near term consumption and liquidity needs, but otherwise stay your portfolio's course and don't underestimate the value of your fixed income and its contributions to portfolio income and the overall long-term stability of your portfolio.

Peering Beyond

Meanwhile shifting away from our granular views on today's markets to a more pedantic, macro-economic and longer term perspective, we wish to offer some thoughts on the recent introduction of "generative artificial intelligence" i.e. ChatGPT, etc. Apparently this technology espoused by the usual suspects, Microsoft, Google and Nvidia, is being positioned to become the next engine of economic growth.

While such technology-driven advancements are inevitable, if generative AI survives current societal scrutiny, including an absolute assurance that it can be harnessed, the idea of relying on expansive robotic thinking somehow still presents enough concern to fill a Pandora's Box!

We think the lessons learned, in our historically short but collective experience with social platforms, is that while social media has by all measures become a global utility and so beneficial in many respects, the technology did not come without a price. Some of its consequences, which we have all become painfully aware of, include its power to fuel social and political toxicity and unrest, offer spontaneous communication often leading to discord and thoughtlessness, an ability to incite and organize all manner of protest, and for more users than we can imagine, an ability to inflict tragedy and personal loss. For all of these shortcomings, the technology should be held accountable and be managed. But, much like trying to solve a Rubik's cube, solving the puzzle of who and how it should managed unfortunately presents some of the most profound questions of our time.

As to the perceived benefits of next gen AI technology, which is said to have the potential to dramatically improve productivity and level the playing field across a myriad of industries, it is imperative that the lessons learned from social platforms not be lost on the downside risks of expanding AI. Among them are its impact on ethics, politics, national security, education, and even employment just to name a few. Suffice it to say skepticism and vigilance must rule in any serious discussion concerning next generation AI if for no other reason than to avoid the risks we were blind to and the remedies which remain so elusive in the world of social media.

For now thankfully, we'd much prefer to focus on current macroeconomics and our financial markets as they play out over the next 6 to 12 months. We suspect the challenges of both come nowhere near the discussion and imminent deployment of next gen AI.

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