MONTHLY MARKET UPDATE

February 2023

OPAL WEALTH ADVISORS

Markets in February reflected concerns of persistent inflation and a higher for longer monetary policy, resulting in a give back of some of January's stock market rally and most of January's bond market rally. A variety of economic data points during the month including a blowout January jobs report, strong retail sales, robust consumer spending, and an elevated inflation reading contributed to the notion that the job for central bankers is not yet done. Strong labor markets, decelerating inflation data, and resilient consumption remained the key trends throughout the month.

U.S. inflation of 6.4% is running at a higher pace than E.U.'s 8.5%, posing heightened risk of a persistently hawkish policy coming from the ECB as well. Emerging markets shouldered the China 'reopening' trade fizzling out as it became clear, as we've seen around the world, normalization of consumption patterns and consumer behaviors will take time and ultimately end up looking different than the pre-pandemic era.

Rising bond yields and upward revisions to interest rate policy expectations in February translated to pressure on equity multiples and concerns surrounding a move deeper into restrictive territory and the associated impacts on corporate earnings and economic growth. Accordingly, the S&P 500 fell 2.4% with growth outperforming value and small caps outperforming large caps. Energy, REITs and utilities lagged thanks to growth concerns and rising interest rates while technology and industrials outperformed. The USD appreciated 2.8% in a trend reversal from 2022, acting as a headwind to broad non-U.S. equity markets which lost 2.33% in USD terms but fell only 0.29% in local currency terms. Developed international markets fell 2.09% with the U.K. (+0.25%) and Eurozone (-0.66%) leading the way over Japan (-3.84%), Hong Kong (-7.09%), Australia (-6.57%), and Canada (-4.37%). Emerging international markets fell 6.48% as China (-10.37%), India (-4.57%), and Brazil (-9.21%) struggled.

Government bonds sold off sharply (-3.6%) in February with the 10yr UST yields rising 43bps to close at 3.94%, just shy of the 4% level last seen on November 9th. This washed out the 3.1% gain we had in January to begin the year. Bond yields surged overseas as well, with the German 10yr bund yield hitting a 12-year high of 2.64%. Interestingly, credit spreads did not reflect the same risk-off sentiment in the equity markets during the month with high yield spreads actually tightening from 430 to 422 and investment grade increasing slightly from 125 to 130.

Market Anecdotes

- Fourth quarter earnings season wrapped with S&P 500 companies reporting with an underwhelming blended earnings decline of 4.6% but a more constructive revenue growth number of 5.3%. The decline in earnings alongside increase in price has taken the P/E multiple from 16.7x to 17.5x this year.
- The direction of core PCE and resulting monetary policy is widely accepted as the most important factor when attempting to forecast financial markets for the remainder of 2023 through inflation data trends, economic models, and survey-based data.
- Inflation may be the bigger risk to 2023 than recession with forecasts for economic growth, a well-capitalized and well-paid consumer, and expanding and readily available consumer credit.
- Federal Reserve data on U.S. household debt service shows mortgage debt service, while increasing, remains near 20-year lows while consumer debt is at its highest levels since 2008 with delinquencies steadily on the rise since early 2022.
- An Alpine Macro research paper on the labor crisis highlighted multiple contributing factors including aging demographics, declining immigration, and a labor market mismatch—all in motion well before the pandemic with immigration seemingly the only valid solution.
- The decline in money supply means much less since the FSRR Act passed in 2006 authorizing the Fed to pay interest on bank reserves, first used in October 2008, effectively severing the link between money supply and the price of credit.

- With a healthy 5% yield on treasury bills, investors must remember that 5% yield after inflation may not turn out to be such a great value after all. Real yields matter.
- A Bloomberg article highlighted the rapidly fading SPAC fad noting the frequency of SPAC IPOs folding in bankruptcy or quietly wound down for cents on the dollar.
- Preqin noted the difficult market for public technology stocks translated to a ripple effect in venture capital fundraising with Q4 '22 registering a nine year low in fundraising.

Economic Release Highlights

- The PIO (Personal Income and Outlays) reported accelerating and above consensus YoY PCE headline and core inflation of 5.4% and 4.7% alongside MoM readings of 0.6% and 0.6%. Both Personal Consumption Expenditures of 1.8% and Personal Income growth of 0.6% came in strong as well.
- The YoY headline and core CPI registered 6.4% and 5.6% with MoM readings of 0.5% and 0.4%. YoY readings were slightly above but MoM were right in line with consensus. Headline and core PPI registered 0.66% and 0.49% respectively.
- U.S. PMIs (C,M,S) of 50.2, 47.8, 50.5 improved over the prior month and came in slightly (manufacturing) and well (services) above the consensus forecast.
- Global PMIs (C, M, S) of 50.2, 47.8, 50.5 were higher than forecasted across the board and improved notably over prior readings with Europe registering particularly strong.
- The ISM Manufacturing Index registered 47.7, in line with the 48.0 spot forecast and within the consensus range of 47.0-49.0. The ISM Services Index registered 55.1, in excess of the 54.5 spot forecast and within the consensus range of 53.0-55.5.
- Durable Goods Orders reported New Orders of (-4.5% vs -4.0%), Ex-Transportation of (0.7% vs 0.0%), and Core Capital Goods of (0.8% vs -0.1%).
- Pending Home Sales were up 8.1%, well in excess of the 1% forecast and consensus range of -1.3%-1.3%. Existing Home Sales declined -0.7% to 4mm, coming in below consensus forecast but well within the low and high end of the range.
- The Case Shiller Home Price Index declined -0.5% MoM, right in line with consensus, and posted a YoY increase of 4.6%, slightly below the 5.3% spot forecast.
- UofM Consumer Sentiment index for February registered 66.4, slightly ahead of consensus estimate of 65.0.
- The NFIB Small Business Optimism Index came in right at consensus with a reading of 90.3.

Outlook

We have a strong consumer balance sheet, robust consumption, and a white hot labor market countered by a higher for longer restrictive policy from central banks, underwhelming Chinese stimulus, and persistent geopolitical risks which probably left markets more properly priced given the uncertain outlooks in monetary policy, economic growth, and earnings. We expect persistently hawkish central bank policy draped over clearly decelerating inflation trends to pose some challenges over the intermediate term with the duration and scale of restrictive FOMC policy acting as the key determining factor.

We continue to see recession risks more prevalent toward the end of 2023 well into 2024, with recession still not a foregone conclusion. We expect the start-stop conditions experienced in the first two months to continue favoring periodic tactical (0-6 months) asset allocation shifts rather than a decided pro-growth or defensive investment posture.

We continue to recommend a tight neutral position toward equities relative to respective benchmarks with routine rebalancing into pockets of strength, still favoring value over growth stylistically and small caps over large caps. From a geography perspective, we are neutral U.S. to non-U.S. (which was recently upgraded) and will closely monitor China for market relevant policy shifts. Recommended fixed income positioning remains short duration over our forecast horizon with a recent underweight recommendation on bank loans.

Equity	Level	1 Mo	3 Mo	YTD	1 Yr	3 Yr
Dow Jones	32657	(3.94)	(5.18)	(1.13)	(1.59)	10.96
NASDAQ	11456	(1.01)	0.11	9.61	(15.96)	11.04
S&P 500	3970	(2.44)	(2.28)	3.69	(7.69)	12.15
Russell 1000 Growth		(1.19)	(1.15)	7.05	(13.34)	12.06
Russell 1000 Value		(3.53)	(2.62)	1.47	(2.81)	10.96
Russell 2000		(1.69)	0.89	7.89	(6.02)	10.08
Russell 3000		(2.34)	(1.72)	4.39	(8.07)	11.79
MSCI EAFE		(2.08)	5.98	5.87	(2.64)	7.34
MSCI Emg Mkts		(6.48)	(0.45)	0.92	(14.91)	1.34
Fixed Income	**Δ Yield**	**1 Mo**	**3 Mo**	**YTD**	**1 Yr**	**3 Yr**
US Aggregate	2.30	0.15	0.29	(0.09)	0.67	(0.06)
High Yield	5.63	0.22	0.52	(0.43)	1.59	0.57
Municipal	1.76	0.09	0.12	(0.11)	0.18	(0.13)

Commodities	2/28/23	12/31/22	9/30/22	6/30/22
Oil (WTI)	80.39	80.16	79.91	107.76
Gold	1824.60	1813.80	1671.80	1817.00

Currencies	2/28/23	12/31/22	9/30/22	6/30/22
USD/Euro ($/€)	1.06	1.07	0.97	1.04
USD/GBP ($/£)	1.21	1.21	1.11	1.22
Yen/USD (¥/$)	136.09	131.81	144.71	135.69

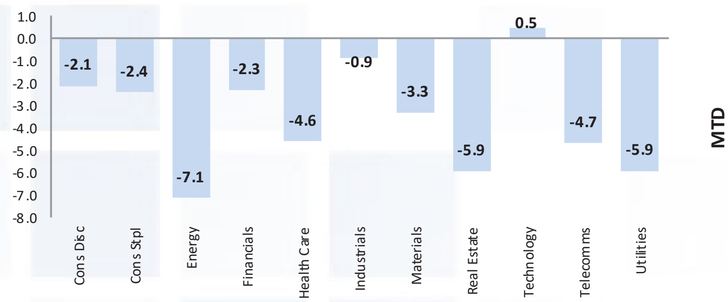
Treasury Rates	2/28/23	12/31/22	9/30/22	6/30/22
3 Month	4.88	4.42	3.33	1.72
2 Year	4.81	4.41	4.22	2.92
5 Year	4.18	3.99	4.06	3.01
10 Year	3.92	3.88	3.83	2.98
30 Year	3.93	3.97	3.79	3.14

Style Returns

MTD

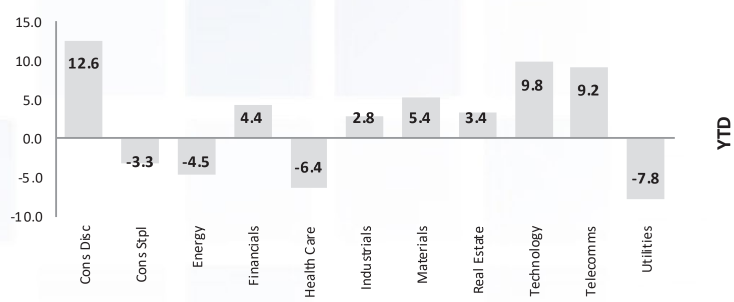
	V	B	G
L	-3.53	-2.38	-1.19
M	-3.20	-2.43	-0.99
S	-2.31	-1.69	-1.08

S&P 500 Sector Returns



YTD

	V	B	G
L	1.47	4.17	7.05
M	4.62	5.68	7.65
S	7.02	7.89	8.76



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