

First Quarter Summary

Stocks began the year strongly, with the S&P 500 increasing 7.5% over the first quarter of 2023. However, that rosy number masks significant turmoil beneath the surface, since the median S&P 500 stock is down year to date and the iconic Dow Jones Industrial Average is roughly flat. Perhaps the most notable event contributing to market volatility in Q1 was the regional banking crises that emanated from the failure of Silicon Valley Bank (SVB) and Signature Bank. The Federal Reserve and U.S. Treasury acted swiftly in an attempt to contain the damage by guaranteeing the deposits of the failed banks and providing other banks with increased lines of liquidity. However, investor fear and more cautious banking lending standards may further weaken a somewhat shaky economy. The stock market gains have been largely driven by a small group of large cap Technology oriented stocks, such as Microsoft, Alphabet, Amazon, Apple, Meta, NVIDIA, and Tesla.

Bonds returned to their traditional role in providing income and acting as ballast during times of equity market distress, after a tumultuous 2022. The widely followed Bloomberg Barclays Aggregate Index (“The Agg”) increased 3.2% over the first quarter as longer-term interest rates fell. The decline in long-term interest rates is in sharp contrast to the Fed’s continued rate hikes that directly affect the short-term portion of the yield curve. U.S. Treasury Bill rates now stand at a generational high of 5%, while the benchmark 10 U.S. Year Treasury Note currently yields 3.3%, resulting in an inverted yield curve which often signals an economic slowdown ahead.

Circling back to stock market outperformers thus far this year, the new buzzword is “AI”, which of course stands for artificial intelligence. The software program Chat GPT has taken the world by storm setting a record by obtaining more than 100 million active users within two months of its official launch. Chat GPT has a multitude of uses including content creation, computer code writing, and the ability to act as an effective virtual assistant. Many firms across a variety of industries have substantial AI initiatives underway and it is not much of an exaggeration to say that our world will be changed forever despite some ethical concerns that underlie the technology and its uses.

Market Outlook

The Federal Reserve appears to be nearly done raising short-term interest rates with the odds of a further 0.25% increase amounting to a coin flip. The outcome for its May 3rd meeting will largely be based on emerging economic data that may show a negative impact from the regional banking crisis. Community banks account for roughly half of the lending in the U.S. and are particularly important for the financing needs of small businesses. 2023Q1 GDP is expected to show a modest gain of roughly 1.5% and increased lending standards in concert with higher interest rates from a year ago are expected to slow the economy further, placing it on the precipice of a recession.


For the full calendar year we expect broad stock market averages to remain in positive territory. However, we also expect stock prices to remain highly volatile until there is greater clarity on the impact of a possible recession on company earnings, as well as the extent of a possible credit crunch generated by a mix of heightened lending standards and the Fed’s quantitative tightening (QT) monetary policy. Federal Reserve policy is often implemented with a lag, so in spite of the fact that it may be done raising interest rates, the true effect of higher rates takes time to ripple through the economy. In our view, inflation is unlikely to plummet from its current rate of 6% to the Fed’s target of 2% overnight, so we are preparing for a stagflation type economic environment, favoring high quality firms and managing risk via intelligently diversified portfolios.

Moving on to geopolitical risks, the war between Russia and Ukraine continues with no clear end in sight. Finland has formally entered NATO and its Scandinavian neighbor, Sweden, is likely to follow suit. Political tensions between China and the U.S. were exacerbated in February when the U.S. military downed a Chinese spy balloon flying over the central region of our country. Tensions may worsen further between the two countries if China decides to supply

military equipment to Russia, which is grappling with depleted supplies and disengaged troops. China has moved beyond its zero tolerance COVID policy, but its economy is still not at full strength as it battles not only a post-COVID world, but also the aftermath of a real estate bubble and negative secular demographic trends. Lastly, OPEC+ inserted itself back in the financial news in late March, sharply cutting projected oil output, which resulted in oil promptly rising from \$65 to more than \$80 per barrel. All of us at Beacon wish you a wonderful spring season.

John M. Longo, PhD, CFA

Chief Investment Officer, Portfolio Manager

 **Beacon Trust** 163 Madison Avenue, Suite 600 | Morristown, NJ 07960 | 973.377.8090 | BeaconTrust.com
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