MARCH 2023

MARKET UPDATE

Markets pulled back after a strong start to the year with the S&P 500 losing 2.45% in February, putting its year-to-date total return at 3.68%. Over the month, the S&P 500 slightly underperformed the MSCI EAFE, with the MSCI EAFE losing 2.09%, outperforming the S&P 500 by 0.36 percentage points. Across the US, large cap underperformed both mid and small cap, with the Russell Midcap and Russell 2000 losing 2.43% and 1.69%, respectively.

Bonds fared even worse than equities with the Bloomberg US Aggregate losing 2.59% in February, though it is still slightly positive over the year so far. The yield curve jolted upwards in February, reversing January's downward shift and then some. This upward shift in yields pushed bond prices lower as they reset to match the latest bout of shifting Fed expectations. Elsewhere in the bond market, investment grade corporate bonds significantly underperformed, losing 3.18%.

The overall economic picture remains mixed, though the latest trends have been shifting. The job market reversed its cooling trend with the US economy adding 517 thousand new jobs in January, while initial jobless claims continue to remain historically low. Also, retail sales surged 3.0% in January, reversing December's 1.1% decline. Together, these trends have seemingly had an impact on improving consumer sentiment, with the University of Michigan's preliminary February survey showing the third consecutive month of improving attitudes. On the flip side, improving trends in inflation have nearly halted with yearly prices increasing 6.4% in January compared to 6.5% in December.

ADVISORS' PERSPECTIVE

Fourth quarter 2022 earnings season is mostly over with 489 of the S&P 500 companies having reported results. In aggregate, earnings have beat analyst estimates by 1.26%, though earnings have fallen versus the prior quarter by 3.25%. Of the companies who have reported, 69% of them have beat analyst earnings estimates, but that is still below the 5-year average of 77%. Communications companies were a notable laggard where only 46% of companies beat estimates and aggregate earnings were 7.49% below estimates.

While the fourth quarter's earnings season was soft, top-line growth across the S&P 500 constituents and a resilient jobs market may slow any short-term reversal of recent market trends. The Fed remains a key driver of equity market volatility, and the "higher for longer" thesis around Fed interest rate policy has been gaining ground as a result of the most recent Fed governor comments, combined with the latest economic and inflation data.

Markets are now starting to anticipate a Fed that will maintain rates higher for a longer period of time to combat inflation. January's lack of improvement in annual inflation figures and recent Fed governor comments shifted prior expectations, causing the yield curve to reverse January's decline. At the short end of the curve, yields rose higher than they were to start the year. Even though they still outperformed across February, this will put additional pressure on short-term bonds.

Focus remains on the Fed, the pace of rate hikes, and for how long the Fed will need to keep rates elevated as they attempt to tame inflation and navigate economic risks. The next FOMC

meeting ends on March 22nd, where the market is expecting a 25-basis point hike, though still a chance of a 50-basis point hike. The latest data has led the market to believe there are at least a couple more rate hikes over the next few Fed meetings, with diminishing probabilities of rate cuts later in the year.

We remain cautiously optimistic. Considering that we are in or approaching a recessionary period, it would not be a surprise if we recovered quicker than previous ones. In times like these, investors tend to trade based on emotions. We disagree, it is more important now than ever to follow the data. Hilltops partnership with Helios relies on facts and data, which we use during our recalculations on a bi-weekly basis. Our models adjust appropriately to market conditions.

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