DirectWealth ADVISORS

creativeOne WEALTH

Market Commentary

April 2023

- In April, major equity indices ended the month modestly up. Strong earnings from big tech helped the Nasdaq Composite Index hold onto its significant outperformance for the year.
- The Federal Reserve raised interest rates by 25 basis points during its meeting on May 3, 2023, and signaled toward a potential pause in further rate hikes.
- A recession in 2023 or 2024 seems likely, but the resilience of the economy and mixed earnings picture does not yet give any reason to believe that we are in the midst of a downturn.

MARKET RETURNS AS OF APRIL 30, 2023[1]

	April %	YTD %	1 Year %	3 Year %	5 Year %	10 Year %
S&P 500 TR	1.56	9.17	-1.05	15.18	11.27	12.31
DJ Industrial Average TR	2.57	3.53	2.72	14.59	9.36	11.31
NASDAQ Composite TR	0.07	17.12	-4.15	13.30	12.43	15.26
Russell 2000 TR	-1.80	0.89	-6.35	12.27	3.96	8.02
MSCI EM GR	-1.11	2.86	-4.09	5.57	-0.53	2.36
MSCI EAFE GR	2.93	11.80	10.17	12.63	4.16	5.41
Bloomberg US Agg Bond TR	0.61	3.59	-0.93	-3.14	1.20	1.32

MARKETS

The S&P 500 and the Dow Jones Industrial Average saw modest gains, in addition to the developed markets index MSCI EAFE USD. Strong earnings from big tech companies such as Meta Inc. and Amazon helped the Nasdaq Composite index solidify a 17.12% gain for the year. Meta reported an unexpected increase in revenue for the first quarter after three straight periods of decline.

Small cap stocks, as measured by the Russell 2000 Index, struggled during the month as investors reduced risk in their portfolios and as a downstream effect of regional bank failures.

First, some foundational facts on this dynamic. Small cap stocks tend to have higher debt-to-equity ratios, which can pose a challenge for their balance sheets. Many of the debt loans have floating interest

rates, meaning that small cap companies must take on higher borrowing costs to conduct their businesses. This cuts into their bottom line and so, such companies will need to reduce spending in other ways, possibly through layoffs or restructuring their businesses. Additionally, small cap companies often seek loans from small or regional banks which are currently at the center of the bank crisis. This complicates their ability to secure capital at what had historically been reasonable levels.

Speaking of the regional bank crisis, First Republic Bank (FRC) is back in the news following disappointing earnings, snowballing into a severe stock price decline. Deposits were of particular importance in their most recent earnings report, which noted that customers pulled about $100 billion from the bank last month. This was an indication that some Americans are losing faith in regional lenders, limiting the capital available for distribution to small and medium sized companies. Ultimately, the loss of deposits was too severe for FRC to continue operating, and the federal government seized the bank and sold it to JPMorgan Chase on May 1, 2023. This event will add pressure to the already high borrowing costs that consumers and businesses are facing.

THE FED AND RATES

Despite some strategists predicting a recession in the back half of 2023, the Fed just hiked interest rates by 25 basis points and will likely continue to reduce its balance sheet as bonds come due. The Fed's balance sheet has shrunk slightly since the Fed began tightening, with assets down to $8.6 trillion from a peak of $9.0 trillion, as some bond holdings matured without the proceeds being reinvested. However, the substantial size of the asset values could force the Fed to take rates even higher, prolonging pain in the markets.

Along with inflation remaining sticky, the Fed appears concerned about the resilience of the labor market. While a slowdown in wage growth in the most recent Department of Labor's unemployment report was encouraging, falling from 4.6% YoY in February to 4.2% YoY in March, the unemployment rate remained strong, even falling to 3.5%. The Fed is likely looking for a rate much higher than that, potentially as high as 5.0%, to confirm that the economy is slowing enough for The Fed to take its foot off the gas pedal with interest rates. In this market, it is evident that "good news" is in fact "bad news," as positive data invalidates any argument that the economy is struggling to withstand the more than 500 bps of interest rate increases by the Fed to date.

WHAT'S NEXT?

- **Review your 401(k) contributions for the year.** As a reminder, the Internal Revenue Service (IRS) increased the limit for 401(k) contributions from $20,500 in 2022 to $22,500 in 2023. If you aren't on track to hit the maximum contribution this year, consider a plan that will help you reach that goal. Contributing to a 401(k) plan is a great systematic way to dollar cost average into the markets.
- **Focus on diversification across asset classes and markets.** Diversification reduces risk by investing in various instruments that have different correlations to one another.
- **Find out your optimal asset allocation.** Being able to identify your risk profile (e.g., aggressive, moderate, conservative) is critical in determining your optimal asset allocation. The risk profile provides important guidance as to how much of your portfolio you should be allocated to equities and bonds. For example, an aggressive investor may look to allocate 75% of their

portfolio to equities and 25% to bonds, while a conservative investor may look to allocate 25% of their portfolio to equities and 75%to bonds. Aligning your investments with your risk profile is a step in the right direction toward your goals.

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FOOTNOTES:

Past performance is no guarantee of future returns.

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The information here is not intended to constitute an investment recommendation or advice.

Sources:

1. Data from Morningstar. Returns over one year are annualized.
2. JPMorgan Wealth Management. Source: Bloomberg Finance L.P., J.P. Morgan Wealth Management. Data as of March 28, 2023. Note: Tech proxied by the S&P 500 Technology Sector, Regional Banks by the KBW Regional Bank Index, and All Banks by the KBW Index.

Returns are based on the S&P 500 Total Return Index, an unmanaged, capitalization-weighted index that measures the performance of 500 large capitalization domestic stocks representing all major industries. Indices do not include fees or operating expenses and are not available for actual investment. The hypothetical performance calculations are shown for illustrative purposes only and are not meant to be representative of actual results while investing over the time periods shown. The hypothetical performance calculations for the respective strategies are shown gross of fees. If fees were included returns would be lower. Hypothetical performance returns reflect the reinvestment of all dividends. The hypothetical performance results have certain inherent limitations. Unlike an actual performance record, they do not reflect actual trading, liquidity constraints, fees and other costs. Also, since the trades have not actually been executed, the results may have under- or overcompensated for the impact of certain market factors such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. Returns will fluctuate and an investment upon redemption may be worth more or less than its original value. Past performance is not indicative of future returns. An individual cannot invest directly in an index.

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