“Live the Life You’ve Imagined”

Accredited Wealth Management

Investment Commentary

March 2023

January’s market optimism faded in February as investors’ expectations for inflation and interest rates shifted towards a higher for longer mindset. After rallying to start the year, both stocks and bonds declined in February.

- Following a 25-bps rate hike in February, the Federal Reserve indicated additional tightening may be necessary to fight persistently high inflation.
- The rates of annual US *headline* and *core* CPI slowed slightly in January versus December, from 6.5% to 6.4% and 5.7% to 5.6%, respectively.
- After rallying in January, the S&P 500 declined (2.4%) in February, while small-cap stocks were down (1.7%). Foreign developed market stocks were down (2.1%) for the month while emerging stocks were off sharply at (6.5%).

Return (%)	1 MO	3 MO	YTD	1 YR
S&P 500	-2.44	-2.28	3.69	-7.69
Russell 2000	-1.69	0.89	7.89	-6.02
MSCI EAFE	-2.08	5.98	5.87	-2.64
MSCI Emerging Markets	-6.48	-0.45	0.92	-14.91
Bloomberg U.S. Aggregate Bond	-2.59	-0.04	0.41	-9.72

Data as of 2/28/2023, Performance in USD. Source. Morningstar.

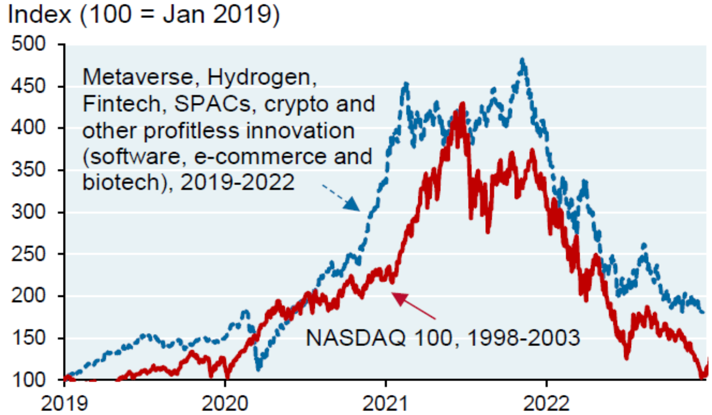
- Most sectors in the S&P 500 declined in February. The technology sector was the only positive performer, up 0.5%, while energy stocks were the weakest, down (7%).
- In the US, growth stocks outperformed value by a couple of percentage points. In the foreign markets, large-cap stocks slightly outperformed, and value stocks generally did a little better than growth stocks.
- Based on ongoing inflation and interest rate worries, bond yields rose for the month. In general, higher yields led to losses across the board in February for the bond market.

What Happens When a Bubble Bursts?

At year-end, we highlighted how several speculative parts of the market had reached bubble status that ultimately burst in 2022. The chart to the right illustrates the bursting of those speculative positions and nicely compares their performance to the tech stock bubble that collapsed in the early 2000s.

Dumb and Dumber

Index (100 = Jan 2019)



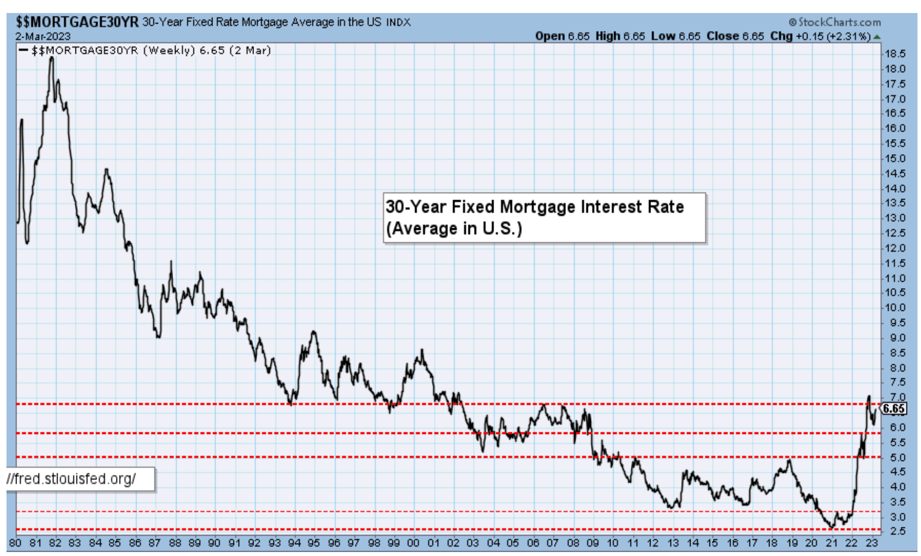
Source: Bloomberg, JPMAM. December 27, 2022.

In early 2023, a lot of the speculative positions that burst in 2022 have rallied sharply, with some up 20% or more. Raising the question, is the bull market in speculative assets back on?

In our opinion, the answer is not likely. The reality is, it's not uncommon to see big rallies during extended bear markets, in fact, some of the biggest rallies on record have occurred during bear markets. To illustrate this point the chart to the right shows how there were multiple large rallies in the NASDAQ 100 during the extended bear market of 2000 to 2002. In fact, there were eight rallies of over 20%, three of which were 45% or greater, in the midst of a bear market that lost a total of 77% over a multi-year period. In our opinion, these rallies are bear traps that try to suck capital back into the markets and are likely to lead to further losses. We would resist the temptation to chase these speculative assets, when bubbles burst it is hard to reinflate them!

Housing Outlook

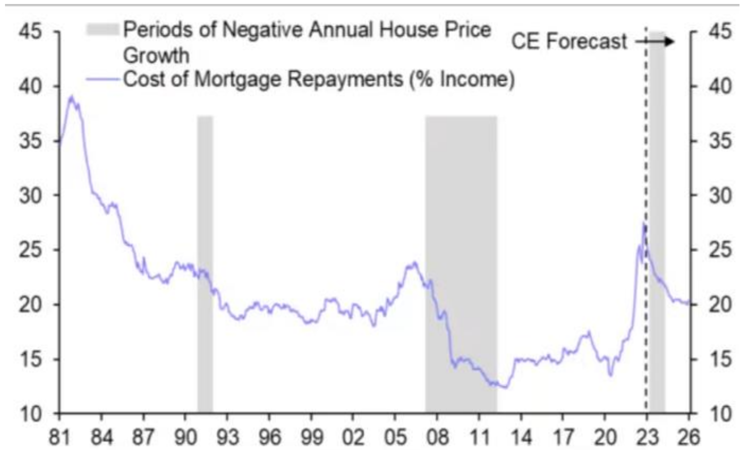
We often get questions about the outlook for the housing market, and although we claim no particular expertise on the local market we do think it is valuable to monitor the national housing trends. Mainly because housing is a big portion of people's net worth and can provide insights into how they are feeling about their financial well-being and willingness to take risks. We also like to track housing due to its rate-sensitive nature, which can provide information on how monetary policy is impacting the real economy. The chart to the right shows how quickly mortgage rates have increased over the year, increasing from the 3% range to the current 7% level. A massive adjustment in a short period of time. Looking longer term you can see mortgage rates are back at levels last seen in 2007-08, but well below levels reached in the 1980s and '90s.



The real impact of higher interest rates, is simply that it makes buying a house less affordable. The first chart on the next page compares the affordability of buying a home relative to renting. With the mortgage payment-to-income ratio approaching 40%, buying a home has become less feasible for a lot of people and making renting a more attractive option.

Exhibit 15 : Housing vs. Rental Affordability Indices
Rental affordability has held up better than mortgage affordability

Source: Goldman Sachs Global Investment Research



The second chart above from Capital Economics illustrates the previous times the cost of mortgage repayments (slightly different calculation) reached these levels, and how the housing market went on to experience negative annual price growth afterwards. We think this is likely again, and investors temper their expectations for home price growth over the next few years.

Closing Thoughts

Economic growth in January exceeded expectations and spooked the market that inflation and interest rates are likely to be higher than previously anticipated. Fed Chairman Powell added to the uncertainty by stating "If the totality of the data were to indicate that faster tightening is warranted, we would be prepared to increase the pace of rate hikes." Clearly, the Fed has become data dependent, and the market's uncertainty about their next move is climbing and weighing on financial markets. Investors with a shorter time horizon may want to side-step some of the market volatility by adding to short-term Treasury bonds which have reached 5%. For investors with a longer time horizon, this is an excellent time to identify positions that will emerge as future leaders. If you have questions about the economy, the impact of interest rates on different asset classes, or your portfolio strategy in general, don't hesitate to give us a call.

Best regards,
Steve Giacobbe, CFA, CFP®