Making Sense of Finance

Karagosian Financial Services | 4/18/2023 | Volume 26, Issue 2

First Quarter 2023 Review

STOCK MARKET

The first quarter of 2023 saw a repeat performance of the S&P 500 index with a gain of over 7%, similar to the last quarter of 2022. However, this time it was the Dow Jones Industrial average that was the laggard, posting an increase of less than 1%, while the Nasdaq Composite index increased 17% in the first quarter. Technology stocks that dragged down the Nasdaq last year are the stocks that have led the indexes higher so far in 2023. This rise in equities came despite the fact that two of the largest bank failures in history occurred last quarter. The Federal Reserve stepped in quickly to help prevent the same situation from spreading to other banks by offering a Bank Term Funding Program. This program allows loans of up to one year to lenders who pledge as collateral US Treasuries, agency debt and mortgage-backed securities which are valued at par (not market value as these may have declined due to an increase in interest rates). This was done to help ensure banks have the ability to meet the needs of all their depositors. Also in these instances, depositors, no matter the dollar amount of assets in the affected banks, were made whole. The fast response caused investors to feel more comfortable that the contagion among other financial institutions may be halted. The stock market was not deterred either by the Federal Reserve raising the Fed Fund target rate twice in the first quarter, each time by 25 basis points. The Fed Fund target rate range now stands at 4.75-5.00%, the highest level since 2007. (the Fed Fund rate of 5.0% also coincides with the latest reporting of 5.0% annual inflation). Many seem to believe that the Fed may be at or near the end of its tightening cycle, which provides optimism to equity investors.

As happens many times with stocks, there is a reversion to the mean. Last quarter's best performing stocks are part of this quarter's worst performers. Energy stocks, which were the stars of 2022, were among the worst stock sectors in the first quarter. Other sectors which posted losses last quarter were, not surprisingly, financials, as well as healthcare and utilities, the latter two sectors also among the better performers of last year. The best performing stock sectors were communication services, technology and consumer discretionary, the three worst performing groups of 2022. A handful of stocks contributed to much of this outperformance.

After lagging for a few years, foreign stock markets had back-to-back quarters of outperformance

Making Sense of Finance

Everyone and their neighbor has an opinion. At Karagosian Financial Services, we have a combined 40 plus years of investment experience. We have seen the markets at their highest highs and lowest lows. Through this newsletter we attempt to convey our opinions on current events in the investment world and their likely outcomes. Forecasting is inherently difficult and our advice is geared toward making sensible and prudent choices based on logic and experience, and not based on emotion.

Contributors:

Seaver T. Wang

Christine Terry

1 Baltic Place suite 201D

Croton on Hudson, NY 10520

Representatives are registered through, and securities are sold through Nationwide Planning, Inc., Member FINRA/SIPC, located at 115 West Century Road, Suite 360, Paramus, NJ 07652. Investment advisory services are offered through Karagosian Financial Services. Nationwide Planning, Inc. and Karagosian Financial Services are non-affiliated entities.

versus domestic stocks. The MSCI EAFE index, an index of developed countries' stock markets, increased 8% when measured in US dollar terms. European stocks were the primary reason for the strong performance. The US dollar index continued to weaken, which boosted returns of foreign equities when measured in US dollar terms. Valuations are still lower than comparable US stocks, which has drawn the attention of many investors. Although typically this has been the case, it is even more pronounced now with price/earnings multiples below 25-year averages in Europe and Japan. Although emerging market stocks rose in the first quarter, they lagged their developed country peers.

BOND MARKET

Bonds had positive total returns across all sectors in the first quarter. The Bloomberg Barclays US Aggregate Bond Index, a measurement of investment grade US bonds, had a total return of 3%. Investment grade and lower grade junk corporate bonds performed in line with similar maturity Treasuries as credit spreads stabilized. Intermediate and longer-term yields declined (prices rose) except at the very short end of Treasuries as the Fed Fund rate still climbed. The worries about regional banks that developed in March may have stalled future rate increases for quite a while or possibly lead to a cut in rates by the Federal Reserve sooner rather than later. The bond market is pricing in an economic slowdown at the very least, as the longer-term rates stay persistently lower than shorter term rates (inverted yield curve).

Municipal bonds had positive returns last quarter as demand was strong, but the supply of new issues decreased 27% from the same quarter last year. Even though yields have come down in recent months, they are still at higher levels than they have been in the last few years.

OUTLOOK

Even though calendar 2022 was difficult (down 18%) for most investors in the stock market, we maintain that the enormous rise in 2021 (up 28%) was unjustified and was mostly based on post-pandemic optimism. Recall that 2019 and 2020 were both up 31% and 18%, respectively, well above the long-term average return of the stock market of about 10%. In the grand scheme of things, with the doubling of mortgage interest rates and runaway inflation in 2022, the economy held up relatively well, in our view.

Both Silicon Valley Bank (SVB) and Signature Bank (SB) had niche exposures to the technology sector. When disasters strike, there are usually multiple factors that cause the meltdown. SVB was a bank that catered to technology companies and during the past year deposits had tripled, a seemingly good thing; but with not enough mortgages to lend out, they instead invested in longer-term treasury bills. Again, a seemingly safe investment. However, two things happened that sank them. First, interest rates increased rapidly, making the Treasuries decline (on paper) in value and this happened in conjunction with the crash of crypto currency and a slew of announced tech sector layoffs. What proceeded was essentially a traditional "run on the bank"; or people taking out more money than the bank has on hand. Anecdotally, we have heard that due to banking apps and online accounts that the withdrawal of funds was especially quick, which did not allow the banks to adjust fast enough. Signature bank had positioned itself as a cryptocurrency-friendly bank. During the past year, Bitcoin for example, declined over 70% in value. As a result, SB ended up having an insufficient balance sheet and required FDIC assistance. It's important to note that all customers were made whole and that no taxpayer dollars were used to bail out the banks. Since those bank failures, large banks have reported strong earnings due to a flight to "quality" i.e., larger banks. Ironically, the failure of these banks caused people to invest more in cryptocurrencies with the thinking that traditional banks were unsafe; but ignore the fact that the unstable values of "crypto" was one of the root causes for the failures.

We do view the SVB and SB failures as isolated incidents, but we are still not out of the woods, in our opinion. Commercial real estate remains a concern of ours and could be another obstacle for banks as customers can only refinance at higher rates now. Also, the economy could slow down the economy further if consumers tighten their belts. This change in consumer sentiment can seemingly flip-flop overnight. Political tensions between China and Russia could also throw a stick in our spokes. Some positive scenarios, though, include the Fed likely curtailing interest rate hikes and subsiding inflation. Sadly, we do not have a crystal ball and don't currently see any obvious catalyst that could re-ignite growth in the economy or negatively impact it.

Representatives are registered through, and securities are sold through Nationwide Planning, Inc., Member FINRA/SIPC, located at 115 West Century Road, Suite 360, Paramus, NJ 07652. Investment advisory services are offered through Karagosian Financial Services. Nationwide Planning, Inc. and Karagosian Financial Services are non-affiliated entities.