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Investment Update

By Mike Skoric

After a turbulent 2022, equity markets started off strong only to be tripped up by renewed inflation concerns and more recently by the "mini" banking crisis. The forced closure of several banks by Federal regulators fueled panic that pummeled bank and many other financial sector stocks, but also the broader markets. However, as we wrote about several weeks ago, the prompt and decisive action by the Federal Reserve and the US Treasury seemed to have averted a broader crisis. Things have stabilized in the banking sector, and we also continue to see more positive data on the inflation front. Last week's PCE Price Index is another promising sign that inflation continues to slow, with a monthly increase of only 0.3% at the "core" level (excluding more volatile food and energy prices). We will all be looking very closely at March's CPI inflation report.

Based on current estimates, we could see the headline inflation (including energy and food) fall closer to 5% after the 6% year-over-year increase recorded for February 2023. This would take more pressure off the Federal Reserve and allow it to slow if not completely suspend any further interest rate hikes. That would help the economy by keeping borrowing costs from rising further, thus helping consumers and corporate borrowers, and aiding current or potential homeowners. In addition to simply keeping borrowing costs lower, knowing that there will possibly be no more hikes in this cycle also provides borrowers and investors with greater clarity. In turn, this helps individuals and businesses make purchase/investment decisions for things like new autos, machinery, plants, personal goods, etc., all of which ultimately benefit corporate profits and the broader economy.

In short, this banking crisis may have actually helped the chance of a "soft landing" by forcing the Fed to stop raising rates earlier rather than later, and at a lower terminal level than what was planned just a few weeks ago. And all of this is with unemployment still being at historically low levels, most recently 3.6% for February 2023. We also still see stocks at fairly reasonable valuation levels with domestic large-cap equities at a forward Price/Earnings ratio of around 18x. Meanwhile, bond prices are at more attractive levels than we have seen in years with corporate bonds yielding around 5%. This means that, unlike last year where both major asset classes had double-digit negative returns, we can realistically hope for the opposite to happen this year. The first quarter results are a sign of that, with equities having returned over 7% (as measured by the S&P 500) and investment grade bonds returning over 3%. A good start to the year by any measure!

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