March 9, 2023 Update

Good morning. To say the start to 2023 for the markets has been an emotional roller-coaster would be an understatement. At the beginning of the year, it seemed like The Federal Reserve was going to engineer a “Soft Landing”, rates would soon peak and then drop by the end of the year and inflation had been beat. Then came the data. As February progressed, the economic data began to reverse the belief that inflation would be so easily beat. This was not too surprising since inflation tends to stick around a lot longer than we want it to. Of course, this leads to the fear that the Fed will raise rates too much, choke off the economy and get us back to a “hard landing”.

Let’s take a step back and put things in perspective (something rarely done from cable financial news or online articles). As I mentioned, the economic data that has been released over the past 6 weeks or so has largely confirmed what everyone now sees, that inflation is still an issue. The bond market has responded with short term rates, as measured by the 2 year Treasury yield, increasing from around 4.10% at the beginning of February to over 5% by the beginning of March according to CNBC. That is a huge move for such a short period. The silver lining here is that the data we are all paying attention to just now has largely been priced in by the bond market! So now the market is forecasting, as shown by the increase in short-term interest rates, a Terminal Rate of between 5.5%-6%. Since economic growth has held up so well, and everyone that wants a job seems to have a job, the economy should be able to handle the higher rates although the higher rates will inevitably slow things down.

Since 2022 is still fresh in our minds, many investors fear a repeat of what we saw last year. While the Federal Reserve is still on a mission to hike rates, slow the economy (i.e. get people to stop spending money) and squash inflation, the biggest difference today is that the rate from which we are moving forward from is MUCH HIGHER! Allow me to clarify. At the beginning of 2022 the One Month Treasury rate was just above ZERO. Today it’s at 4.66% per CNBC. That is over a 450% increase in less than 15 months. So if the rate increases another 1%, that would be about another 20% from here. There is a big difference between a 450%+ move and a 20% move. While rates may move higher, clearly we are much closer to the end of this cycle and that just simply can’t be ignored.

In closing, we often get the question from clients: Do you have a plan if X, Y or Z happens. The answer: Yes. Mike Carilli and I (we jointly run our asset allocation and discretionary investment management) talk daily about the markets, the economy, technical trading levels and how we are positioned. Often, that discussion also entails forecasting outcomes in the short term and predetermining what we should be doing in the event that X, Y or Z takes place. A great example of that lately has been our call to increase our fixed income allocation (bonds are finally paying a competitive yield) and maintain our defensive equity allocation by overweighting value and maintaining a position in Managed Futures (Mutual Fund) to help hedge against volatility in the stock market. We are keeping a close eye on trading levels to determine if getting even more defensive makes sense. So yes, we have a plan, a discipline and a methodology as every investment professional should.

If you have any comments or questions, please let me know as I am happy to address them. Thank you as always for your time and attention to this update. FYI – There will be no update next week as I will be traveling. In my absence, please reach out to Michaelyn Bortolotti or Mike Carilli.

Regards,

Tim

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https://davis.stewardpartners.com/.6.htm

Timothy Davis, CFP®
Executive Managing Director – Wealth Manager
Partner
Davis Executive Wealth Management Group

Steward Partners Global Advisory
One International Place, Suite 3210
Boston, MA 02110
(Direct) 617-377-4418
(Office) 617-377-4422
(Toll Free) 888-371-0086
(Fax) 857-233-2966

t.davis@stewardpartners.com
http://www.davis.stewardpartners.com/
https://www.linkedin.com/company/timothy-davis-executive-wealth-management

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Tim Davis is a Wealth Manager with Steward Partners participating in the Steward Partners Discretionary Management program. The Discretionary Management program is an investment advisory program in which the client's Wealth Manager invests the client's assets on a discretionary basis in a range of securities. The Discretionary Management program is described in the applicable Steward Partners ADV Part 2, available at https://adviserinfo.sec.gov/Firm/283004 or from your Wealth Manager.

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