



Market Update – April 2023

“How did you go bankrupt?” Bill asked. “Two ways,” Mike Said. “Gradually and then suddenly.”

- Ernest Hemingway, The Sun Also Rises

With the first quarter of 2023 officially in the books, investors begin Q2 wondering whether the recent regional banking crisis marks the beginning of the end, or the end of the beginning. Nowhere in our survey of 2023 forecasts did we see “collapse of Silicon Valley Bank” as a top risk for the year, and yet, there it was. On February 2nd the stock traded for \$333 per share. Today it trades at \$.98.

Somewhat ironically (in our estimation anyways), the big winner from Q1’s banking tumult was cryptocurrency. While many strong regional bank stocks were tumbling 20+% during the quarter, the Bloomberg Galaxy Bitcoin Index surged 71%! The price of Bitcoin soared from \$16,539 at the start of 2023, to over \$28,000 as we go to press. Crypto adherents pointed to the collapse of both SIVB and Signature Bank as proof positive that digital currency represents a more sound alternative to fiat currencies and the traditional banking regime. Color us skeptical.

Behind all the turbulence experienced during the quarter was a pretty sound set of returns for the major indices. Led by the big-cap tech companies, the S&P 500 finished Q1 with a +7.5% return, followed by US mid-caps up +3.8% and small-caps gaining +2.5%. Both mid and small caps roared out of the gate in 2023, with double-digit returns through early February, before giving back much of those gains during the regional bank meltdown.

Internationally, developed markets returned +8.6% for the first quarter, despite the Swiss-government orchestrated fire sale of Credit Suisse to UBS in mid-March. Emerging markets rebounded from a lousy 2022 with a +4.0% return in Q1, as China looked to reopen after a seemingly eternal series of Covid lockdowns.

Lastly, bonds, which suffered one of their worst years on record in 2022, saw prices edge higher in Q1 despite an additional 50bps in interest rate hikes from the Federal Reserve. The Bloomberg US Aggregate Index returned nearly 3% during the first quarter. The trigger for the rally in prices, of course, was the regional bank turmoil of early March. The 2yr Treasury note yield collapsed from 5.07% on March 8th to 3.77% on March 24th, as investors fled to the safety of U.S. government debt. Even longer-term Treasuries were impacted, despite continued high inflation, with the 10yr Treasury note yield falling from 4.06% in early March to 3.36% today.

Perhaps the most notable development in Q1 was the Federal Reserve holding firm in its battle against inflation, hiking short-term rates by 25 basis points at their March 22 meeting, despite surging stock and bond market volatility. This move prompted many “no-landing” adherents, Nottingham included, to pivot towards the “soft-landing” camp. At the start of 2023, we felt the strong US labor market would shield the US from economic recession during the year. Given further interest rate hikes, not to mention the credit contraction associated with the banking crisis, we now believe the odds for a mild recession have increased.

Like the famed economist Keynes, as the facts have changed, so have our views. We are less bullish on the short run today than we were at the outset of 2023. However, as we mentioned in

January's *A View From the Top*, paraphrasing Howard Marks, the short-run is the least important thing. Though we feel caution is warranted today, we remain steadfast in our belief that a diversified basket of equities will offer investors the best chance to earn real returns over time (returns in excess of inflation).

We'll soon get a peek at the current health of corporate America, as first quarter earnings are released in coming weeks. Nottingham monitors these reports closely as a means of assessing current equity market valuations, as well as the prospects for future earnings growth. Reports in line with forecasts will be reassuring, while an increasing number of companies guiding lower will likely cause us to reconsider the soft landing thesis. Talent management will also be something we're monitoring as an increase in layoffs or hiring freezes could hasten or exacerbate an economic slowdown.

Not to get overly technical, but investors may feel like they're slogging through mud over the next few months. The "sell in May and go away" adherents often leave voids in liquidity during summer months, increasing volatility. The debt ceiling debate will heat up soon, leading to more D.C. drama and sensational headlines touting impending U.S. defaults. Ignore these if you can. The Fed may hike again at its May 3rd meeting, pushing the terminal Fed Funds rate higher than markets currently anticipate. Inflation readings have abated since peaking last summer; although the headline CPI figure still has a 6-handle. It is not yet "under control", or close to the Fed's desired rate of around 2%.

For long-term investors, it's almost always best to stay the course, whatever the crisis du jour. China is back open for business, and very well could help stave off a global recession as pent-up demand there gets released into the world economy. In the U.S., fiscal policy still favors spending over restraint. While the Fed pushes on the brakes, Congress is hammering the accelerator. Reshoring various industries back to the U.S. is a trend that likely isn't going away any time soon. The demand for labor far outstrips supply currently.

With bond yields measurably higher than a year ago, and stocks cheaper, investors should be clamoring for future 60/40 type returns. Although likely subdued relative to the era of free money, they should be enough to help one achieve realistic financial goals. At Nottingham, we're cursed with a fierce sense of optimism. That occasionally sets us up for disappointment when the winds change abruptly. Nevertheless, the journey is a long one, and optimism, or being long stocks and bonds, usually wins out over time. In addition, with cash equivalent yields now above 4%, it is far easier to actively manage risk in our various portfolio strategies.

2023 is off to a rocky start, yet diversification is once again proving its mettle. The broad indices that form the core of Nottingham's investment strategies continually self-correct as volatility spikes and wanes. At some point, maybe soon, the regional bank crisis will end, and pockets of opportunity will arise. As referenced earlier, cash & equivalent yields are north of 4%, which means investors can be paid handsomely while awaiting opportunity. The coming weeks and months should prove informative as we get Q1 earnings, an updated labor picture, and more clarity on the debt ceiling. We'll do our best to keep our clients informed and ensure our investment strategies remain centered around the long run.

Happy Easter,

Larry Whistler, CFA

President

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