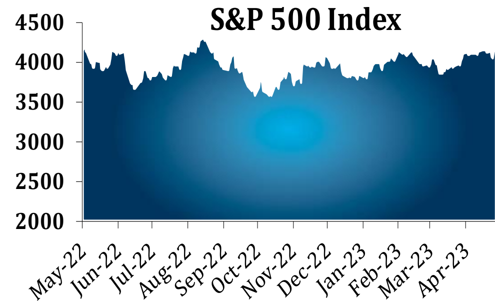
This Month in the Markets

April 2023

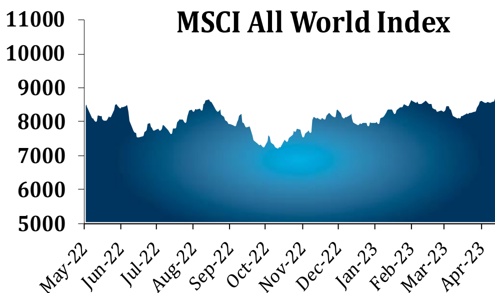
Equity Commentary

Has The Shift Begun?

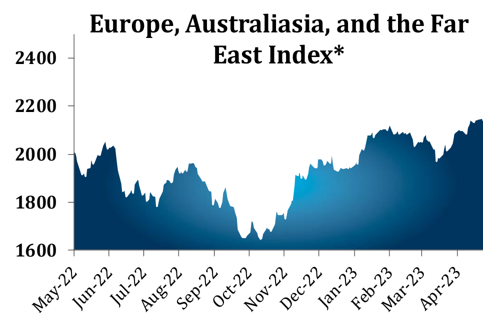
The equity market rallied in April as the MSCI ACWI Net Total Return Index was up 1.4%, extending the 2023 gain to 8.9% despite the current economic challenges. The MSCI World Value Net Total Return Index rose 1.9% compared to the rise of 1.6% in the MSCI World Growth Net Total Return Index. International developed markets outperformed the U.S. as the S&P 500 gained 1.6% and the MSCI EAFE Net Total Return Index climbed 2.8%. Developing markets lagged with the MSCI Emerging Markets Net Index lower by 1.1%. The MSCI ACWI Energy Sector index was the top performer, posting a gain of 4.1%, driven by a rebound in some more prominent energy names. The MSCI ACWI Consumer Discretionary Sector was the under-performer, with a loss of 0.8%.



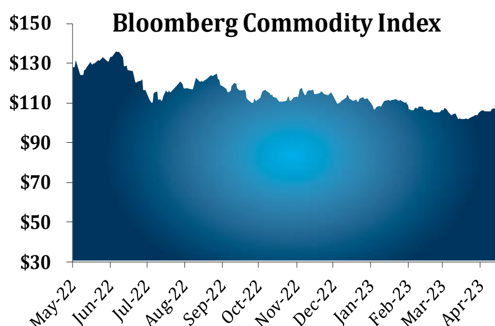
Even with higher interest rates, economic growth exhibited a relatively solid sense of resilience and strength. We expect that growth through the back half of the year will likely slow further as interest rates increase and the financial tightening of the past runs headlong into the reflationary force of continued fiscal expansion. We suspect that the recent banking turmoil will offer additional resistance in the form of reduced liquidity around higher funding costs and tighter lending restrictions that will now begin to provide new headwinds. Much of the negative macro, however, is not reflected in earnings. As of this writing, S&P 500 earnings for 2023 are pegged at about $220, or only about a 1% drop from 2022. In the milder recession of 1990 and 1991, earnings fell a cumulative of 10%, according to data from S&P Global[1]. We still expect more negative revisions as we move through the year.



The gains seen year to date in the S&P 500 have been narrow in scope as a mere handful of larger cap companies account for the bulk of the performance. In fact, almost 90% of the S&P 500 gains have come from only 20 stocks in the first quarter[2]. We suspect that lower growth and tighter liquidity will make stock selection more decerning from here. We believe that there is a reasonably high probability that a contrarian and value-focused style will be more successful than one surrounding momentum and liquidity-driven buying from now on. We will not be surprised if the Anchor equity portfolio looks even less like market cap indices in the future as benchmark names become fully, and in many cases, overvalued. The market, on the margin, likely begins a rotation away from "must own story stock" companies to more value-oriented discounted names. Our overarching macro focus revolves around the world going "3D": deglobalized, dangerous, and disrupted.



Palo Alto Networks Inc. ("PANW") was the largest underperformer in the portfolio for the month, falling 8.7%, as some competitor cyber security peers reported weaker billings and revenue growth. Comcast Corp. ("CMCSA") was the top performer in the month, up 10%, which rose after reporting better-than-expected earnings as its streaming service, Peacock, continued to gain subscribers.



*MSCI EAFE Index

[1] ChatGPT
[2] https://www.ft.com/content/b01c0a46-1162-4893-8b92-d42fbf4424a0

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Fixed Income Commentary

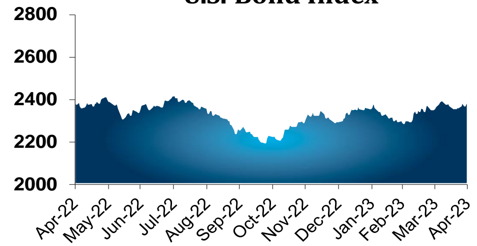
After the bank induced volatility in March, it was a relief that April was a month of relative calm. Credit spreads were largely unchanged, while treasury rates were also little changed, for the most part, from the end of March. Rates on the very short end of the curve did move, however, driven by debt ceiling dynamics. The 1-month treasury rate declined 0.046% while the 3-month rate rose 0.337%. The 1-month T-bill has been in high demand because it matures before the earliest estimates of when the government could run out of money, while the tenors thereafter do not. Ultimately, we do not believe the US will default on its debt. There will be political brinkmanship for sure, which we are already seeing, but at the end of the day it benefits neither side of the aisle to let the US default.

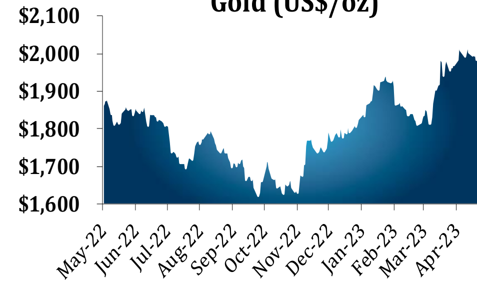
Another point to note is that while rates were largely unchanged from month to month, intra-month treasury rates moved in a wide range in April. For example, the 2-year treasury yield reached a high of 4.24% and a low of 3.78% before ending the month at 4.01%. These large moves in treasury rates have been the norm since the Fed began lifting rates in March 2022. The fed funds rate is currently 5.0% (upper limit), compared to just 0.25% at the beginning of 2022. There is a clear divergence between the Fed and the bond market. As per the Fed's "DOT plot", the median projection is for the fed funds rate to end 2023 at 5.125% and end 2024 at 4.25%. Meanwhile, fed fund futures, a proxy for market expectations, are pricing 4.50% fed funds rate at the end of 2023, and 2.875% at year-end 2024. Ironically, fed fund futures and the DOT plot show very similar expectations (~3%) for year-end 2025, however the projected paths to get there are very different…

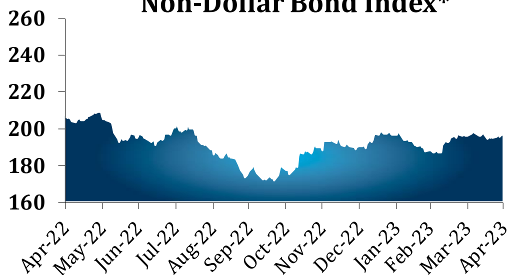
Chairman Powell has been vocal about his desire to quash inflation. Inflation is clearly falling on a year-over-year (YoY) basis – YoY Consumer Price Index (CPI) has declined every month since September 2022 (5% latest reading). Core CPI (excluding energy and food) has remained around 5.50% YoY for the last 5 months, though it has been heavily influenced by the shelter component (8.2% YoY in March). Shelter is a notorious laggard in official inflation data and has been a key driver of the elevated YoY inflation prints over the last six months. It is very possible the shelter component has now peaked and will begin to decline. As the shelter component eases, YoY inflation data should continue to trend lower. Chair Powell has cited core services ex-shelter inflation, dubbed "super core inflation", as a component he is watching closely. This measure continues to fall on YoY basis, however looking at it on a 3-month annualized rate of change basis to gauge the momentum without any YoY base effects, super core inflation has been relatively steady at 4% for the last four months.

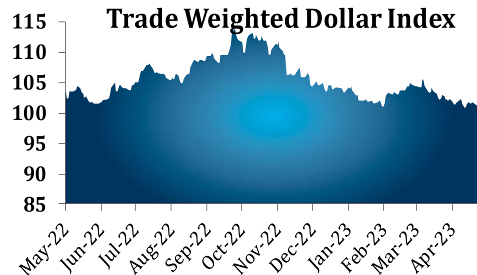
The market expects headline CPI inflation to fall from 5% to just above 3% over the next 3 months, using inflation swaps as a proxy for market expectations. There have been a number of high profile lay-off announcements and jobless claims have been rising which are signs that a tight labor market is beginning to weaken. In addition, the recent banking sector stress is going to perpetuate a reduction in lending activity which was already taking place before March. As such, the market believes the Fed will cut rates to support growth to counteract the negative impact of these forces as they filter through to (lagging) economic hard data. Put another way, the market expects the economy to slow and inflation with it, which will necessitate a dovish reaction from the Fed. On the other side of the coin, the Fed is saying it wants to hold rates in restrictive (tight) conditions to ensure inflation is wrung out of the economy. The Fed's own Summary of Economic Projections (updated on March 22nd) shows an increase in the unemployment rate to 4.6% versus 3.5% currently – all while keeping rates unchanged. The next few months should be telling as to how this plays out…

Anchor continues to position our fixed income portfolio cautiously, as we enter a more challenging period for the economy. At the same time, we used the recent market dislocation as an opportunity to buy M&T Bank 10-year bonds with an attractive 5.9% yield-to-worst. We believe the FDIC and the Federal Reserve have taken significant action to stabilize the regional banking sector in the U.S. and M&T Bank does not face the same deposit outflow and balance sheet issues of the three troubled banks where the FDIC took action to protect the depositors.









*Merrill Lynch Global Broad Market, Ex US Dollar Index

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