



Quarterly Market Summary – Q1 2023

Market Results as of the First Quarter of 2023

Selected Index Results for Q1 – 2023

<u>Index⁽¹⁾</u>	<u>%Growth For FY 2022</u>	<u>%Growth For YTD 2023</u>	<u>%Growth For Q1 2023</u>
DJIA	-8.78%	0.38%	0.38%
Core U.S. Aggregate Bond Index (U.S. multi-sector bond)	-14.98%	2.73%	2.73%
S&P 500 (large cap)	-19.44%	7.03%	7.03%
S&P 400 (mid cap)	-14.48%	3.36%	3.36%
Russell 2000 (small cap)	-21.56%	2.34%	2.34%
MSCI EAFE Index (developed international)	-28.81%	8.96%	8.96%
iShares MSCI Emerging Market Index	-28.60%	4.12%	4.12%
iShares Dow Jones US Home Construction	-37.24%	15.98%	15.98%
MSCI US REIT Index	-30.15%	1.65%	1.65%
Amex Oil Index	27.65%	-3.10%	-3.10%
Barclays Global Agg ex-US Corp Bond Index	-27.46%	2.96%	2.96%

(1) These results do not include reinvestment of dividends.

Q1 Quick Summary

- The U.S. economy started the quarter in better shape than expected; however, the growth picture has clouded again with stubborn inflation, continued interest rate hikes and recent concerns about the banking system.
- The global economic outlook has improved as China's economy reopens more broadly, Europe experiences a mild winter and supply chains continue to rationalize. Questions remain, however, as the war drags on in Ukraine and European inflation remains higher than in the U.S.
- Silicon Valley Bank, one of the largest regional banks in the U.S., failed on March 10th, followed shortly thereafter by the failure of Signature Bank in New York. These events increased scrutiny on bank balance sheets and prompted the U.S. Federal Reserve (Fed) to reevaluate their current monetary policy.
- While headline inflation decreased in the U.S. in Q1, core inflation is proving much tougher to bring down, with labor costs and rents being the key drivers. Prior to concerns over bank stability, many believed this would intensify, and perhaps extend, the current Fed tightening cycle.
- The Fed raised its benchmark interest rate by 0.5% in Q1, with quarter-point increases in February and March. The current target rate is 4.75% - 5.0%. Fed monetary policy decisions are likely to be a key driver of economic growth and market volatility in the near term.



U.S. Economic Outlook Still Unclear

The outlook for the U.S. economy has become murky—again, as the Fed continues to react to economic data and market events. First, Federal Reserve Chair Jerome Powell spooked investors on March 7th by suggesting the central bank might need to raise short-term interest rates higher than previously expected to fight inflation. But within days, two bank failures in the U.S. jolted financial markets and led to speculation that the Fed might instead pause or slow its rate hikes in an effort to ensure financial stability.

This push-and-pull has weighed on the markets for months. The U.S. economy continues to add jobs at a robust pace, and the strong pace of hiring suggests larger and/or more rate hikes will follow this year. On the other hand, gains in the labor force participation rate (to 62.5% from 62.4%) and a modest increase in the unemployment rate (to 3.6% from 3.4%) indicate that more people are coming off the sidelines, looking for work, and not finding it—factors which argue for a gentler Fed approach.

The latest Consumer Price Index (CPI) data was mixed. In March, inflation for the prior twelve months was at 5.0% and prices rose by 0.1% over the prior month. “Core” inflation, however, was at 5.6% year-over-year and 0.4% for the month. Shelter costs were the largest driver of inflation in both the headline result and the core inflation measure. The nature of housing costs, combined with persistently high labor costs, could make it much harder for the Fed to hit its 2% long-run inflation target without more tightening, which will act as a damper to economic growth.

Global Economic Outlook Improving

Globally, there’s greater confidence that the collection of last year’s risks have passed a peak uncertainty period, but there is ample reason for caution to leave a mark on the outlook. Peace seems far away in Russia’s war in Ukraine, and the pandemic continues to cast a long shadow on the economic data. Despite a normalization in global supply chains, inventory swings remain outsized and shifting seasonal patterns are contributing to data volatility. Calling a turning point in the data will be difficult and raises the risk that central banks misread the tea leaves.

A key issue over the coming months will be the extent to which recent events cause banks to reduce lending. This in turn would weigh on consumer demand and business investment and therefore accelerate the deterioration in the global economy. One of the complex aspects of the current economic slowdown has been the rolling aspect of it. There have been many negative Gross Domestic Product (GDP) quarters lately among the Group of Seven (G7) economies. Yet Canada's oil-driven economy has avoided declines as it benefits from rebounding demand and tight supplies, few of the negative quarters have been back-to-back, and the timing has not been synchronized across all the economies.

Inflation also is not likely to recede in a linear fashion, if history is any guide. Like subsequent waves of COVID, waves of inflation could be milder in their impact on the economy and markets, yet still cause investor nervousness by raising uncertainty about the direction of economic growth, inflation, and central banks' policy responses. It's possible that any upticks in inflation coinciding with the recent wave of growth could delay central banks from declaring an end to rate hikes.

One could still make the case for declaring a global economic downturn, amplified by the recent banking issues—calling it a recession, a rolling recession, or some sort of "landing." But this unusual rolling characteristic could persist in the months and quarters to come and may mean further market volatility.



U.S. Banking Crisis A New Wrinkle

The first quarter saw several high-profile bank failures in the U.S. and globally, the most notable being Silicon Valley Bank (SVB) based in San Francisco, followed in quick succession by Signature Bank (SB) in New York. While each of these banks had characteristics that made them susceptible to a run on deposits, their failures triggered a severe market reaction and intense scrutiny of bank balance sheets and loan portfolios.

A run on SVB began when many of their depositors needed immediate cash, with "fire" shouted in the crowded building, so to speak, by a couple of key stakeholders via social media. With the effects of rapid news flows, especially via social media, and banking that can be done quickly and via mobile devices, the bank's collapse happened with lightning speed. It was the second-largest bank failure in history, second only to Washington Mutual's during the Global Financial Crisis (GFC). In terms of the speed factor, we are in a brand new era.

The Fed, in conjunction with the Federal Deposit Insurance Corporation (FDIC), has taken a double-barreled approach: a guarantee to cover all the deposits of SVB and SB; and a new short-term lending facility, the Bank Term Funding Program (BTFP). That program allows banks to borrow, at par value, U.S. government bonds for up to a year, regardless of their present mark-to-market price. Those terms were also applied to the traditional discount window. This helped stabilize confidence in the immediate wake of the failure of SVB and SB (even if it wasn't a permanent confidence fix).

The economy can certainly support higher interest rates – as evidenced by the solid job market and stubborn inflation – but the Fed's unprecedented rapid rate hike cycle has exposed a vulnerability within smaller regional banks and their deposit holdings, as investors seek out higher yielding investments. Until market confidence is fully restored and investors assured on a longer-term basis that there are no more SVB's lurking, the Fed is likely to prioritize financial stability over the near-term economic data.

Inflation Is Down, But Not Out

Core inflationary pressures will not go gently into that good night. January introduced a double hit to market optimism on inflation. The data for the month of January halted a nascent downtrend that had emerged in the three-month annualized measure for core services – a Fed favorite measure of late – and that trend only worsened in February. This was made worse by revisions to the past data that revealed far more persistence. As a result, inflation forecasts were marked up. The Fed's terminal rate would likewise have been lifted closer to the 6% mark if not for caution injected due to the recent failure of two regional banks.

Regardless of recent financial events, the road to lower inflation still runs through the labor market. So long as job vacancies remain elevated, wage gains will continue to run above a level consistent with 2% inflation. There have been some early signs that job openings are coming down in key cyclical sectors like construction, but the data lacks breadth across industries. Hiring has a long way to slow before the Federal Reserve would have comfort that the labor market is moving back into balance. This may indicate that a slower, more prolonged period of weak economic growth is a more likely outcome than a short recession followed by a return to near-trend growth in the following year. However, no matter the economic trajectory, a rise in the unemployment rate is a consistent theme across forecasters. Economists estimate the unemployment rate needs to rise by at least 1.2% to normalize job vacancies and restore balance in the labor market.



The Fed's Job Is Getting Tougher

There's an old saying about Federal Reserve tightening cycles: The Fed "tightens until something breaks." Cracks emerged during the first quarter, as rising rates, tighter lending conditions, and shrinking liquidity weighed on economic growth. The banking system turmoil that emerged near the end of the quarter was an unsettling addition to investor concerns.

On March 22, the Fed raised the federal funds rate by 25 basis points, a move that was widely expected. The question is what the central bank will do next. The Fed is trying to thread a needle in balancing the threats associated with the banking crisis and the need to combat still-high inflation. Fed Chair Jerome Powell made it a point to say there were costs to bringing inflation down to the Fed's 2% target, but the costs associated with allowing inflation to remain high would be more severe.

The reality, however, for those trying to guess what the Fed is likely to do, is that recent issues in the banking system will likely continue to be important factors in the Fed's thinking. It's not a stretch to say these are unlikely to be contained and isolated problems, for the simple reason that we are only starting to wring out the excesses of easy money and ample liquidity.

Either way, there's likely to be more volatility in the coming months, making this a good time to remember the benefits of portfolio diversification, rebalancing, and staying focused on stocks of companies with higher-quality factors—such as stable earnings and reasonable valuations—and higher-credit-quality fixed income investments.

Conclusions

We believe economic uncertainty and market volatility will remain high for the remainder of this year. As It's important during this transition period to maintain a well-balanced, diversified portfolio, with a risk profile consistent with your goals. Your portfolio should contain an appropriate mix of investments, including cash, bonds, and various types of stocks (large cap, mid cap, small cap, domestic and international) in appropriate allocations based on your goals, investment time horizon and tolerance for market risk.

Projecting stock market direction is always rife with problems, doing so in such an environment can quickly make even the most thoughtful projections irrelevant. In a rapidly growing economy with rising inflation, assets with exposure to high nominal growth rates, including value stocks and commodities, may hold up well, whereas bonds could struggle. Should tightening Fed policy, higher inflation or a change in consumer sentiment start to weigh heavily on the economy, however, bonds will be seen as a safe-haven alternative to equities. This highlights the benefits of a well-diversified portfolio and a consistent investment strategy to navigate through the volatility.

Fundamentally, stock valuations are based on long-term expectations for dividend payments and price appreciation. Assuming continued success in combatting the virus and returning the economy to more "normal" levels of activity, the long-term impact on economic growth and equity values should not be significant. However, as we have stated previously, the ongoing and unprecedented level of government stimulus, both fiscal and monetary, continues to raise concerns about deficit spending and the corresponding growth in national debt. While such stimulus may be critical in times of stress, the long-term implications for economic growth are likely to be negative. In the near term, uncertainties around these policies (among other developments) will likely result in continued high levels of market volatility.



In periods of higher market volatility, maintaining investment discipline will be more difficult emotionally. However, we need to remember that market timing as an investment strategy has never worked consistently (and results in lower longer-term yields). Trying to time markets has a high probability of creating permanent losses in your portfolio.

As always, stay with a consistent and disciplined investment strategy; it is the only course of action with any track record of success (in any investment environment). There is no reason to believe, even with the changing economic dynamics, that the disciplined approach to investments will be less effective than in the past at delivering the best possible relative returns.

At the most fundamental level, match your investment time horizon to your spending timeline – if you have short term cash needs then those funds should be in short term investments. These are simple asset/liability matching principles practiced by the most sophisticated investment managers every day (but far too complex to explain in sound bites and not conducive to selling products). Additionally, don't try to solve short-term financial problems with long-term equity exposure. If you try to chase returns, you may get lucky sometimes but, if pursued long enough, it always ends in extreme frustration and often with serious financial losses. The reality is that no one has ever consistently predicted investment markets and they never will - and there is always a consequence to continued unsound financial behavior.

As always, if your personal or family situation has changed (or is likely to), a discussion with us as to how this may impact your financial plan and your overall asset allocation is warranted. Or, if you simply feel a need to discuss any aspect of your portfolio and/or financial plan, or you haven't had a planning update within the last 12 months, please contact us to review your financial plan and investments.

Risks

Investors should be aware of the risks associated with all portfolio strategies and variable market conditions. Monetary policy changes, military activity abroad, the level and change in market interest rates, corporate earnings, domestic and foreign governmental policies, global economic data, vaccine missteps, other geopolitical events can have a substantial effect on portfolio performance and the effectiveness of strategic and tactical portfolio approaches.

Your financial plan is the most important financial document that you possess! Keep it updated and use it.

Please note that you are entitled to receive Fullen Financials' Form ADV whenever you would like to. This document outlines many details of who Fullen Financial is, their investment methodologies and their advisor's education and experience. You may do so by contacting Paula Miller (paula@fullenfinancial.com) and requesting such. Alternatively, you can go to the Fullen Financial website at www.fullenfinancial.com and click on "Resources" in the top menu bar, and then on "Client Forms."

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Appendix: Economic Indicators and Outlook

Economic Indicators: G7 & Europe

	2021	2022	2023F	2024F
Real GDP (annual per cent change)				
G7 (30.1%)*	5.3	2.3	0.8	0.9
U.S.	5.9	2.1	1.3	1.0
Japan	2.2	1.0	1.1	1.2
Euro Area	5.3	3.5	0.6	0.5
Germany	2.6	1.9	-0.1	0.7
France	6.8	2.6	0.4	0.6
Italy	7.0	3.8	0.4	0.4
United Kingdom	7.6	4.0	-0.5	0.8
Canada	5.0	3.4	0.8	0.4
Consumer Price Index (annual per cent change)				
G7	3.3	7.3	4.7	2.1
U.S.	4.7	8.0	4.7	2.5
Japan	-0.2	2.5	2.1	1.2
Euro Area	2.6	8.4	5.6	2.3
Germany	3.2	8.7	6.1	2.4
France	2.1	5.9	5.2	2.3
Italy	1.9	8.7	6.7	2.2
United Kingdom	2.6	9.1	6.1	2.2
Canada	3.4	6.8	3.7	2.3
Unemployment Rate (per cent annual averages)				
U.S.	5.4	3.6	3.6	4.5
Japan	2.8	2.6	2.4	2.4
Euro Area	7.7	6.7	7.1	7.7
Germany	5.7	5.3	5.7	5.9
France	7.8	7.3	7.5	7.9
Italy	9.5	8.1	8.5	9.0
United Kingdom	4.5	3.7	4.4	4.7
Canada	7.5	5.3	5.5	6.4

*Share of 2019 world gross domestic product (GDP) at PPP
 Forecast as at March 2023.
 Source: National statistics agencies, TD Economics.

Global Economic Outlook

[Annual Per Cent Change Unless Otherwise Indicated]

	2019 Share*	Forecast		
Real GDP	(%)	2022	2023	2024
World	100.0	3.3	2.8	2.7
North America	19.2	2.3	1.3	1.0
United States	15.8	2.1	1.3	1.0
Canada	1.4	3.4	0.8	0.4
Mexico	1.9	3.1	1.3	1.6
European Union (EU-28)	15.4	3.6	0.7	0.8
Euro Area (EU-19)	12.5	3.5	0.6	0.5
Germany	3.5	1.9	-0.1	0.7
France	2.4	2.6	0.4	0.6
Italy	2.0	3.8	0.4	0.4
United Kingdom	2.4	4.0	-0.5	0.8
EU accession members	2.9	4.3	0.3	2.0
Asia	43.2	3.5	4.4	4.3
Japan	4.1	1.0	1.1	1.2
Asian NIC's	3.5	2.0	2.2	2.9
Hong Kong	0.3	-3.5	2.8	2.9
Korea	1.7	2.6	1.9	3.0
Singapore	0.4	3.6	2.1	2.7
Taiwan	0.9	2.5	2.6	2.9
Russia	3.1	-2.2	-0.6	1.8
Australia & New Zealand	1.2	3.5	2.0	2.0
Emerging Asia	31.4	4.6	5.7	5.2
ASEAN-5	5.7	5.9	5.0	5.1
China	17.3	3.0	5.7	4.6
India**	7.1	7.3	6.1	6.8
Central/South America	5.6	4.2	1.1	2.2
Brazil	2.4	3.0	1.0	2.0
Other Emerging Markets	13.0	3.2	3.4	3.1
Other Advanced	1.1	3.6	1.9	2.1

Annual Per Cent Change Unless Otherwise Indicated
 *Share of world GDP on a purchasing-power-parity (PPP) basis.
 Forecast as at March 2023. **Forecast for India refers to fiscal year.
 Source: IMF, TD Economics

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Investors should consult with their investment advisor to determine the appropriate investment strategy and investment vehicle. Investment decisions should be made based on the investor's specific financial needs and objectives, goals, time horizon and risk tolerance.



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