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February 2023 Recap

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For months, we have been watching a tug-of-war between the Federal Reserve and the public. Fed officials maintained a hawkish position with a "higher for longer" trajectory for interest rates, but the markets were not convinced. As we began 2023, the fed funds futures market was forecasting rate cuts starting in the second half of the year. Equity markets soared and U.S. Treasury yields fell as inflation seemed to ease naturally and the narrative of "no recession" weaved through market sentiment. During February, however, the motto "don't fight the Fed" prevailed and the markets reversed course. The latest print of inflation reversed the falling trend,[1] supporting the Fed's hawkish position as a blow to the markets. In general, they say that markets are smarter than people, and for the last few months, many people wondered if the markets were smarter than the Fed. But in February, we learned that markets may not be able to read minds of the Fed officials, and indeed, they can always reprice themselves.

GLOBAL EQUITY

Risk assets sold off during February, and the Dow Jones Industrial Average recorded a year-to-date decline as of month end. From a sector standpoint, losses were led by interest rate sensitivity and growth scares. Real Estate and Utilities sold off as bond proxies

TABLE 1: **Global Equity**

	FEB	QTD	YTD	1 YR
Dow Jones Industrial Average	-3.94	-1.13	-1.13	-1.59
S&P 500 Index	-2.44	3.69	3.69	-7.69
Russell 2000	-1.69	7.89	7.89	-6.04
Russell 1000 Growth	-1.19	7.05	7.05	-13.34
Russell 1000 Value	-3.53	1.47	1.47	-2.81
MSCI ACWI USD	-2.87	4.10	4.10	-8.26
MSCI EAFE USD	-2.09	5.84	5.84	-3.14
MSCI EM USD	-6.49	0.90	0.90	-15.28
MSCI ACWI ex US USD	-3.51	4.31	4.31	-7.19

Source: Bloomberg, as of 2/28/2023. Past performance does not guarantee future returns.

1 Personal Consumption Expenditure Deflator, Bureau of Economic Analysis, 2/24/2023
2 FactSet Earnings Insight as of 2/24/2023

with rising Treasury yields, while energy and materials fell with concerns around global economic malaise. On the profit front, the Q4 year-over-year earnings growth rate for companies in the S&P 500 Index is still in the negative territory (-4.8%[2]) and the guidance is mixed at best. Consumer-facing companies like Walmart and Home Depot have issued outlooks that warrant caution on the economy for the rest of the year. With consumption being 70% of U.S.'s GDP growth, frugal consumers may spell a bumpy road ahead.

Overseas, equity returns were mixed. The European markets continued to benefit from the upside surprise of a warm winter and better-than-expected economic activity. Across the globe, the Bank of Japan is preparing for a new Chairman, Kazuo Ueda who is expected to keep the status quo on easy monetary policy for the time being. The Japanese yen plummeted against the U.S. dollar, yielding negative returns on equities for U.S. investors. Emerging market equities saw losses stemming from the Chinese market, as MSCI China returned -10.4% for the month of February. The promise of the great reopening of its economy from zero-COVID policy fell flat as consumer spending remained isolated to leisure and travel. Of course, the famous balloon incident, as well as China's continued support of Russia in the European war are among the factors applying strain on an already frayed geopolitical dynamics.

FIXED INCOME

February was a month reminiscent of the year 2022, as both equity and fixed income markets fell together. Repricing of the Fed's rate trajectory meant rising U.S. Treasury yields, which in turn translated to falling bond prices. Longer duration instruments were hit, with

TABLE 2: **Fixed Income**

	FEB	QTD	YTD	1 YR
Bloomberg US Aggregate	-2.59	0.41	0.41	-9.72
Bloomberg 1-3 Yr Gov/Credit	-0.74	0.05	0.05	-2.51
Bloomberg Treasury 5-7 Yr	-2.57	-0.23	-0.23	-9.46
Bloomberg Investment Grade Corp	-3.18	0.70	0.70	-10.43
Bloomberg High Yield Corp	-1.29	2.47	2.47	-5.46
JPMorgan EMBI Global Diversified	-2.21	0.89	0.89	-8.64

Source: Bloomberg, as of 2/28/2023. Past performance does not guarantee future returns.

the Bloomberg Investment Grade Corporate Bond Index and the Bloomberg U.S. Aggregate Bond Index recording the largest losses on our fixed income table. Indeed, the upward shift in the U.S. Treasury yield curve was significant, with the 2-year yield rising 61 basis points (bps) and the 10-year yield rising 41 bps. Equally significant is the deepening inversion of the Treasury yield curve, extending beyond a 90-basis-point spread between 2-year and 10-year yields during the month. The prevailing idea that the economic conditions have improved to the point of avoiding a recession is difficult to support in the context of a yield curve that continues to invert to levels not seen in nearly forty years.

It is human nature to pay attention to the most recent thing and the most pronounced events. For example, recency bias would have us conclude that the latest personal spending figure for January[3] means upbeat consumers. An easily observable rise in the stock market can lead us to be more positive on the outlook for the U.S. economy. But it is important to remember the things that move slowly and behind the scenes. The higher borrowing cost from the rate hikes will make its way through Main Street slowly, so we have not yet seen their full impact. Also, loan delinquencies are creeping upward, but not fast enough to make a splash on the front-page news. These small observations can affect the lending appetite of banks, which could tighten its credit spigot even if the borrower is willing to take a higher interest rate. The choices by lenders and borrowers have an impact on the aggregate financial liquidity in the economy. All these things happen slowly and in various corners of the economy, and that makes it difficult to forecast the trajectory of the economy. So, recession or no recession? Deep or shallow? These questions are impossible to answer. The only certain thing seems to be the stubborn inflation profile of the U.S. economy, and that is why we expect the Fed to deal with this known problem by staying hawkish in 2023.

POSTLUDE

In a reversal of January's optimism, February saw a selloff of most major stock and bond indices. Experienced investors know that markets oversell and overbuy in the short term. That is the volatility investors endure while keeping their eyes on their investing goals. As we look out to the coming months, uncertainties circle around a recession, geopolitical tensions, and monetary policies around the world. And as winter thaws into spring, the debt ceiling debate will no doubt escalate if it is not resolved during the second quarter. These uncertainties may be the source of yet more volatility in the first half of 2023. For investors, riding out the volatility means drowning out the short-term noise and focusing on a long-term investment strategy that is right for you and your institution. And at the heart of implementing a good strategy is discipline, discipline, discipline. We hope that a solid investment discipline will help to guide you through any uncertainties that may lie ahead.

3 Bureau of Economic Analysis, 2/24/2023

Anna Rathbun serves as the Chief Investment Officer for CBIZ Investment Advisory Services. Her tenure with the firm has spanned economic and market research, portfolio construction, and creating insights in investment themes to share with the investment community. Anna began her career in investments at Wellington Management, and subsequently, Harvard. She has served as a Managing Director for a registered investment advisory firm where she specialized in alternative investments. She is a graduate of Harvard University with a B.A. in Economics. Her early passion for the arts led her to classical music, for which she obtained a Master of Music and Doctor of Musical Arts from the Cleveland Institute of Music. Anna's career in music spanned a wide spectrum of performances to a faculty position at her alma mater. With a unique background that embraces both finance and the arts, Anna is dedicated to the issue of financial sustainability for organizations serving a mission.

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