SlateStone WEALTH

Balancing Your Life Goals with Financial Results

Investment Review & Outlook

April 2023

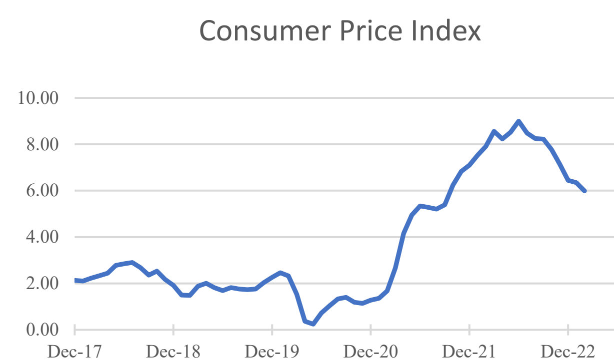
Review

Both share prices and bonds rallied in the first quarter. But we do not expect the rally to carry over into the second quarter. A meaningful growth slowdown is underway in the US and Europe.

Real GDP						
	FY 2023	FY 2024	1Q:23	2Q:23	3Q:23	4Q:23
United States	1.9	0.4	3.3	1.0	0.5	-0.5
Canada	1.1	1.3	2.0	0.3	0.3	0.3
Japan	0.8	0.6	1.4	1.4	0.2	0.2
China	5.8	5.5	9.0	6.3	5.5	5.5
Euro Area	1.1	0.9	1.0	1.5	1.5	0.5
United Kingdom	0.5	0.6	0.5	0.6	1.3	0.8

Source: JP Morgan, Global Data Watch, April 7, 2023

We expect the Federal Reserve to continue to push over-night interest rates higher over the coming months. We believe a 0.25% increase in early May will bring the terminal rate to 5.25%.



Source: Bloomberg, Feb 28, 2023

There is a significant lag between monetary policy change and effect. The Fed is likely to pause and reassess its restrictive policy by the end of the second quarter. Some improvement in the inflation rate is already apparent, but we are a long way from the Fed's 2% goal. At this point, there is no sign of a Fed pivot away from its' tightening stance.

Global Markets

The US equity market's strength has surprised us. Communication Services and Information Technology have offered the best sector returns on a year-to-date basis. Financials and Health Care have been the weakest sectors.

Short-term Treasury interest rates have continued to move higher, particularly on the shortest side of the yield curve. We have extended maturities to take advantage of the increase. Meanwhile, longer-term Treasury yields have fallen.

The US Dollar, measured against a basket of major currencies, has drifted to modestly lower levels in recent weeks.

Equity Market Performance
To 31-Mar-2023, in US Dollars

	1st Quarter 2023	12 Months 3/31/2023
MSCI World Index	7.7%	-7.0%
EMU	14.2%	5.6%
France	14.6%	8.8%
Germany	14.7%	2.2%
Switzerland	6.7%	-6.8%
United Kingdom	6.1%	-0.8%
Japan	6.2%	-5.2%
Australia	2.8%	-9.2%
EAFE	8.5%	-1.4%
USA	7.8%	-8.9%
Emerging Markets	4.0%	-10.7%

Source: Morgan Stanley Capital International,
Total return, dividends less withholding tax reinvested

Data sources: Standardandpoors.com, Bloomberg, MSCI.com *Continued on page*

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Outlook

We do not know if the US economy will slip into recession in 2023. It does seem highly likely that the US economy will experience slower growth and more modest inflation over the next few years. Europe is probably already in recession.

Source: Bloomberg, April 7, 2023

As the US economy begins to slow, five-year forward inflation expectations have already drifted down closer to the Fed's long-term goal. The challenge for the Fed is more related to wages than prices. By some measures, the US is facing the tightest labor market ln decades. Wage growth is beginning to roll over. Headline generating layoffs have been concentrated in technology and home building. The March nonfarm-payroll increase was much stronger than the 100,000 increase that Chairman Powell has cited as consistent with population growth. The labor market is gradually softening. But the slow pace of deceleration increases the risk that the unemployment rate will undershoot the Fed's year-end forecast of 4.5%. In that case the Fed will probably be forced to continue to push interest rates higher after May.

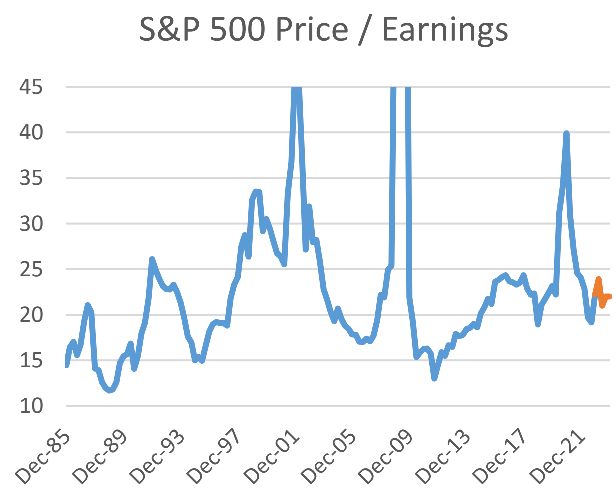
Once S&P earnings for 2022 are finalized, we expect to see a decline of 12.7% year-over-year. Current consensus calls for a robust earnings rebound in the fourth quarter 2023, taking the yearly gain to 16.1%.

Standard & Poor's 500				
	Annual Earnings	%Change Y-o-Y	Price/ Earnings	Year-end Price
Dec-13	100.20	15.8%	18.5	1848.36
Dec-14	102.31	2.1%	20.1	2058.90
Dec-15	86.53	-15.4%	23.6	2043.94
Dec-16	94.55	9.3%	23.7	2238.83
Dec-17	109.88	16.2%	24.3	2673.61
Dec-18	132.39	20.5%	18.9	2506.85
Dec-19	139.47	5.3%	23.2	3230.78
Dec-20	94.13	-32.5%	39.9	3756.07
Dec-21	197.87	110.2%	24.1	4766.18
Dec-22e	172.75	-12.7%	22.2	3839.50
Dec-23e	200.65	16.2%	21.9	4400

Source: Standardandpoors.com, March 31, 2023, Slatestone Wealth

In Europe consumer spending is being crowded out as energy costs replace other forms of consumer spending. While European governments attempt to shield consumers from high energy bills there is a negative impact on employment, housing, and production. Core inflation in Europe is still running at 5%, forcing the European Central Bank to tighten into economic weakness.

The impact of rising interest rates should be seen in the falling Price / Earnings ratio for the S&P 500. However, that theory has not held up so far in 2023. Since both interest rates and the market P/E are mechanisms that discount future cash flows, they are loosely correlated at best. Our best guess is that a market P/E of in the vicinity of 22X earnings can be sustained over the visible horizon assuming the 10-year Treasury normalizes around 3.5%.



Source: Standardandpoors.com March 31,2023, Slatestone Wealth

If we do move into recession sometime in late 2023, the risks from an over leveraged banking sector look much better than in 2008. US bank tier 1 capital ratios are substantially higher than in 2008, plus a lot of risky lending has migrated from banks to capital markets and private credit lenders.

On the fixed-income side, our conservative approach to bond investments in the context of credit quality remains in place. The short end of the yield curve has moved up over the course of recent months. As short-term Treasuries move up above 4.5%, we have been extending our average maturity by reducing our exposure to cash equivalents. That assumes the 5-year average inflation rate tops out near the current estimate of 2.5%.

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April 2023
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