LOOK AHEAD

Q2 2023

DISCLAIMER

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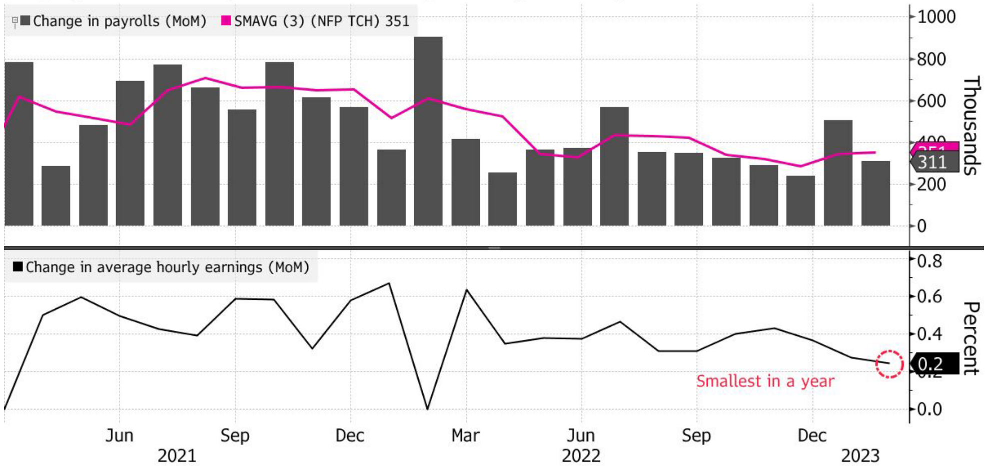
Consumers Are Still Strong, But…

The most recent jobs report came in stronger than expected and was certainly a green light for the Fed to raise rates by 50 bp, but not so fast…wage growth was the smallest in a year.

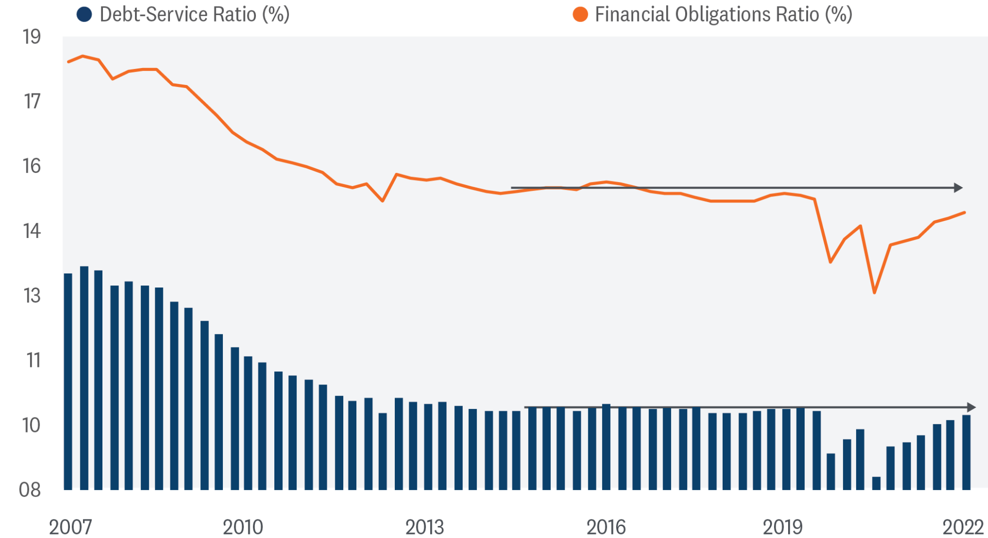
US Payrolls Growth Exceeds Forecasts for an 11th Month

Employers add 311,000 while average hourly earnings moderate

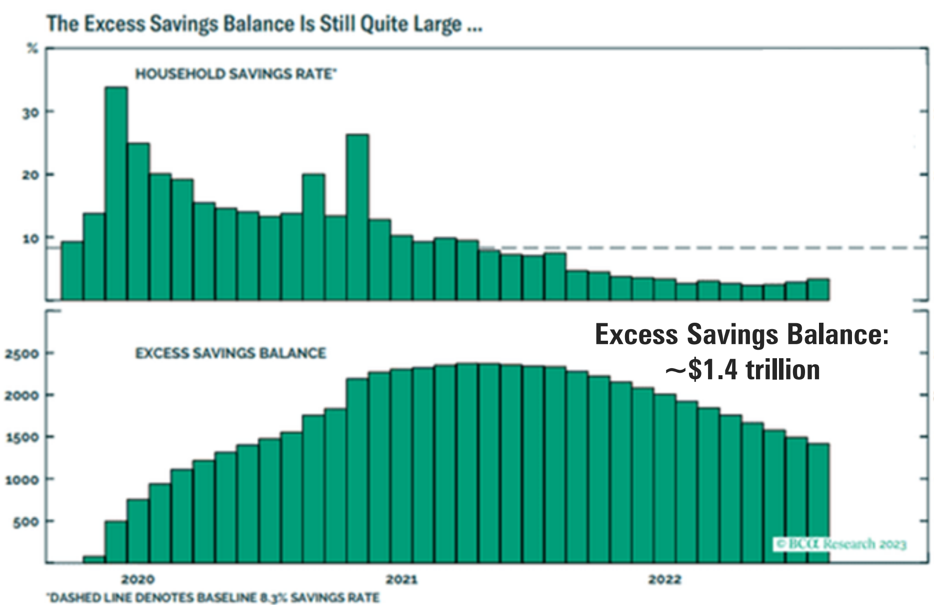


To further pad spending, consumers will likely tap into consumer credit.

Consumers' debt load remains manageable and while the debt service burden on the American household recently moved back up to pre-pandemic levels, it is still relatively low.



Consumers are finding ongoing support from excess savings carried over from pandemic stimulus. $1.4 trillion in supplemental savings is equivalent to 5% of GDP.



However, consumer confidence is weakening. The University of Michigan's sentiment index declined to 63.4 in early March, the biggest drop since June, primarily due to persistently high prices.

University of Michigan Consumer Sentiment Index

Data Sources: Bureau of Labor Statistics, BCA Research, Federal Reserve Board, University of Michigan

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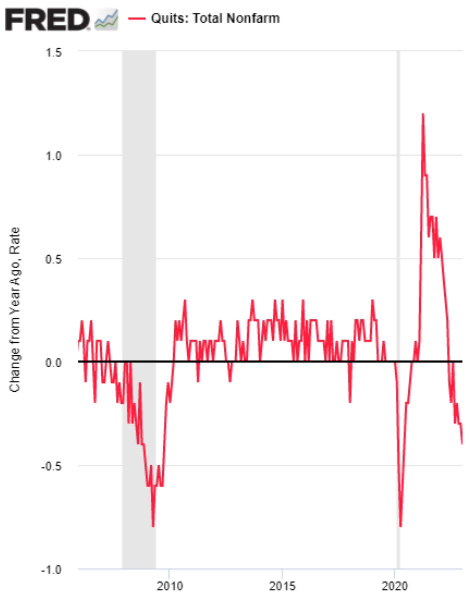
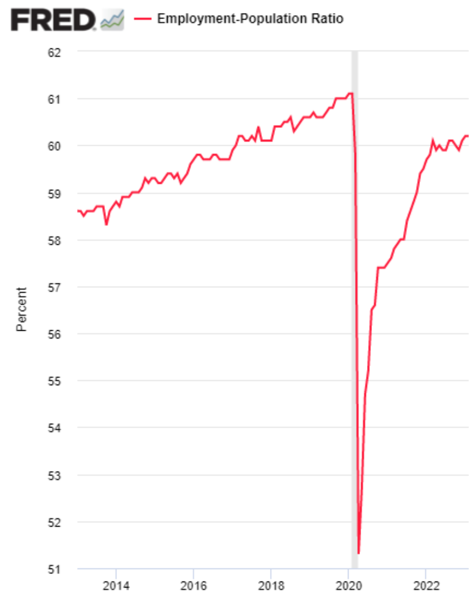
Jobs vs. Inflation

The job quit rate reflects fewer job switchers in the U.S. economy. Combine that with more people entering the workforce (Employment to Population ratio) and we should see some moderation in wage growth.



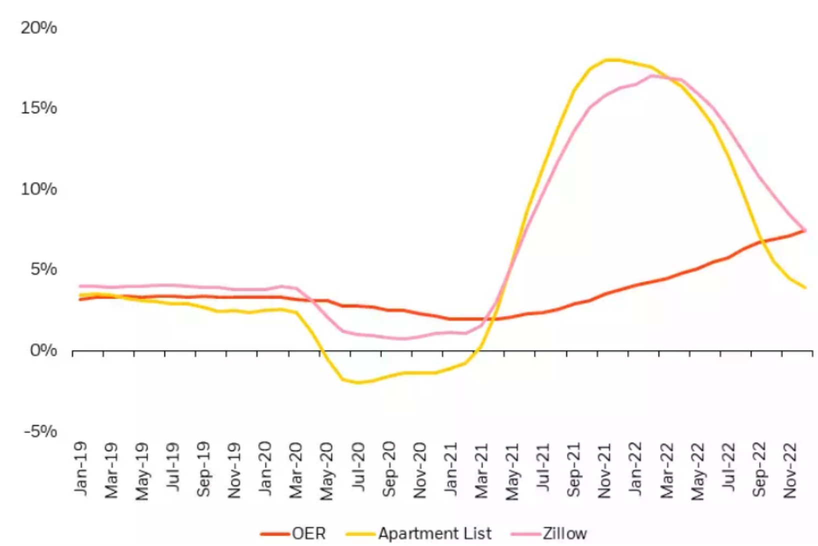


Inflationary trends continue to cool. The closely-watched services inflation, less housing, has been moderating since September and is a trend that should continue.

Core services inflation less housing continues to moderate

When it comes to housing, we are now seeing rent inflation moderating. All of this should continue to give the Federal Reserve more interest rate policy room to manage the bank crisis along with inflation simultaneously.

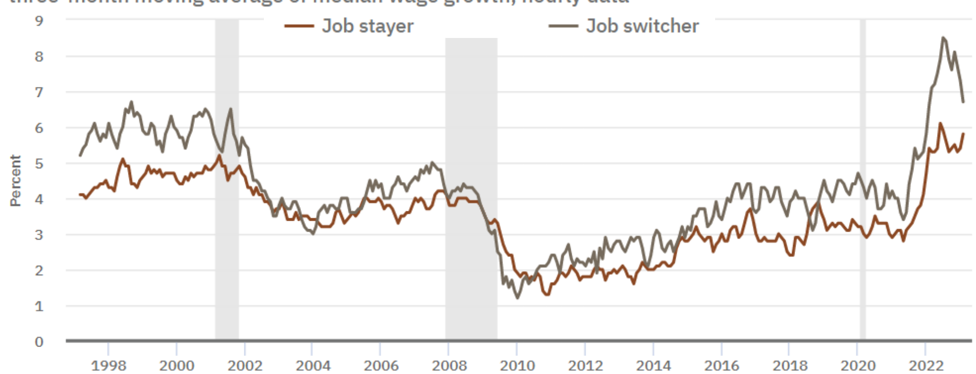
Online new rental leases vs. Owners' Equivalent Rent ("OER")



That trend is indeed resulting in moderating wage growth among job switchers. This should support a moderation in service sector inflation, especially in the food/beverage and hospitality sectors.

Wage Growth Tracker

three-month moving average of median wage growth, hourly data



Data Sources: Bureau of Labor Statistics, Federal Reserve Bank of Atlanta, Apartment List, Zillow

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Banking & Credit

Bank investment accounts are broken, with many holding securities portfolios heavily tilted to mid-to-long maturities. That was far from conservative in a rising rate environment.

Small-Mid Size Regional Bank Capital & Risk Comparison

3/20/2023

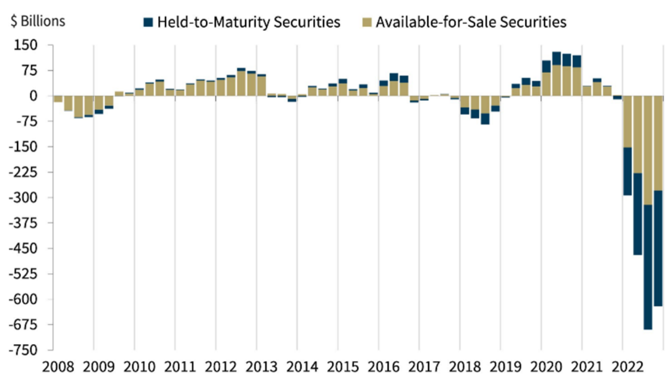
**Dollar amounts in thousands*

Maturity Data as of December 31, 2022

	Bank #1	Bank#2	Bank #3	Bank #4	Bank #5
3 months or less	2.42%	1.59%	6.72%	0.59%	3.34%
3 months to 12 months	2.84%	7.00%	33.22%	2.37%	1.03%
1 year to 3 years	3.77%	48.71%	16.14%	20.54%	1.03%
3 years to 5 years	2.39%	17.38%	22.85%	1.38%	0.35%
5 years to 15 years	13.55%	21.21%	8.39%	14.46%	3.43%
Over 15 years	25.74%	0.38%	2.66%	4.90%	69.58%

The paper losses on banks holding bonds to maturity and available for sale at any time are now over $600 billion and could be as high as $1.8 trillion.

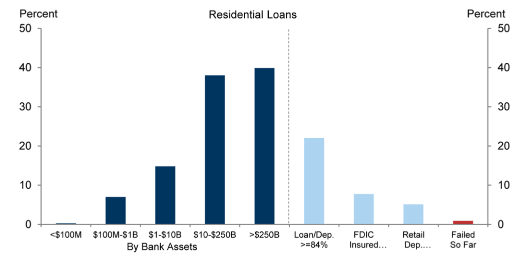
Unrealized Gains (Losses) on Investment Securities



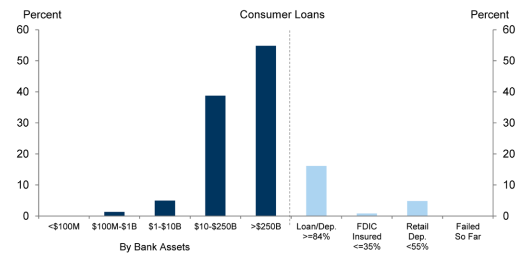
There is likely going to be an ongoing run on their investment stupidity. It's not rocket science that a depositor can own a treasury bond with 3.5%-4% yield, versus a savings account that has a 0.5% yield.

Small and mid size banks provide large amounts of credit, with 60% of residential and 45% of consumer lending driven by small and medium size banks.

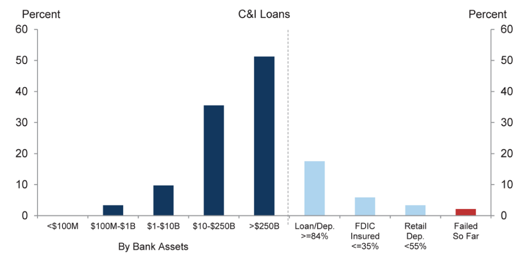
Small and Medium-Sized Banks Account for 60% of Total Residential Lending



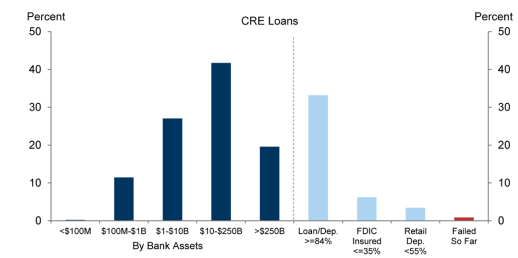
Small and Medium-Sized Banks Account for About 45% of Total Consumer Loans



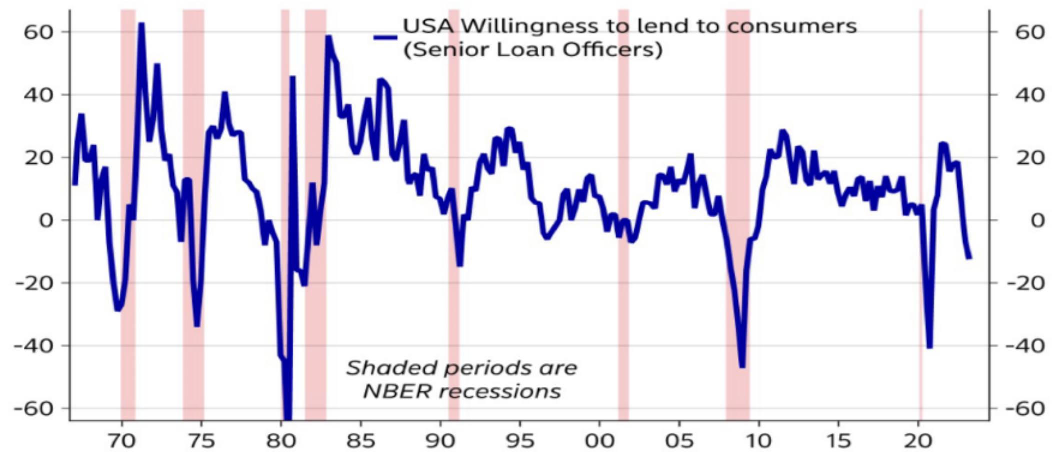
Banks With Less Than $250 Billion in Assets Account for About Half of All Commercial and Industrial Lending



Small and Medium-Sized Banks Account for About 80% of Total Commercial Real Estate Lending

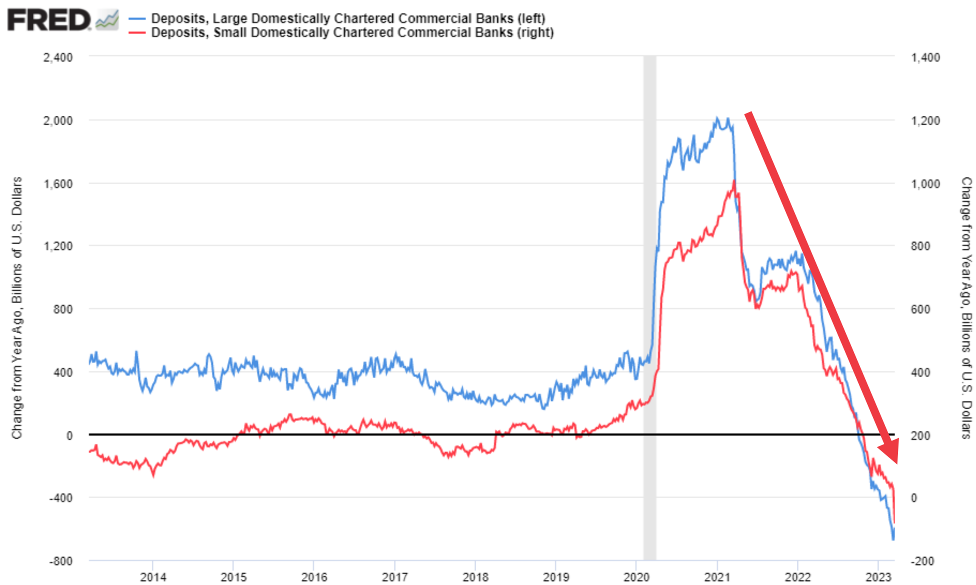


We expect a credit crunch to impact credit availability and a modest drag to the U.S. economy in the quarters to come. A recent survey by Senior Loan officers reflects this cautious attitude even before the recent banking crisis.



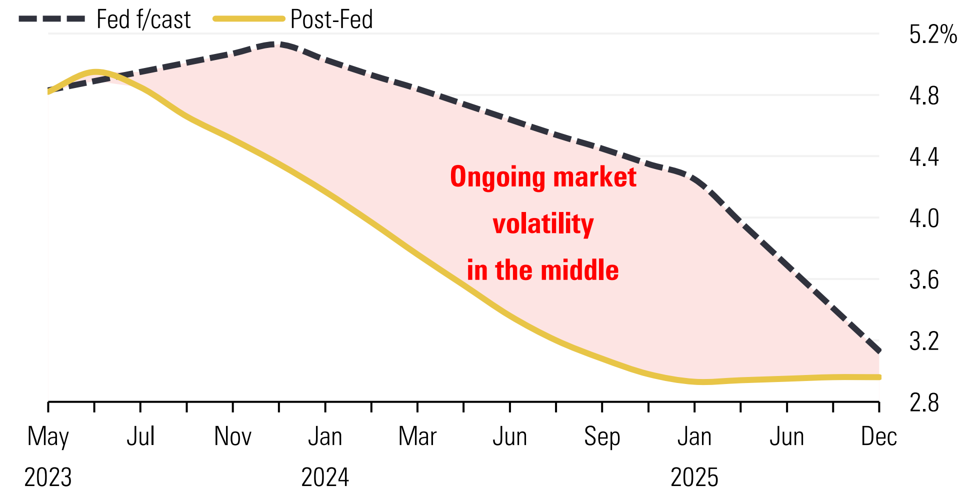
What's the Fed To Do? Lower for Longer?

With ongoing flows out of large and small banks alike, the Fed is in a tug of war between supporting long duration bank portfolios with lower rates and battling inflation with higher rates.

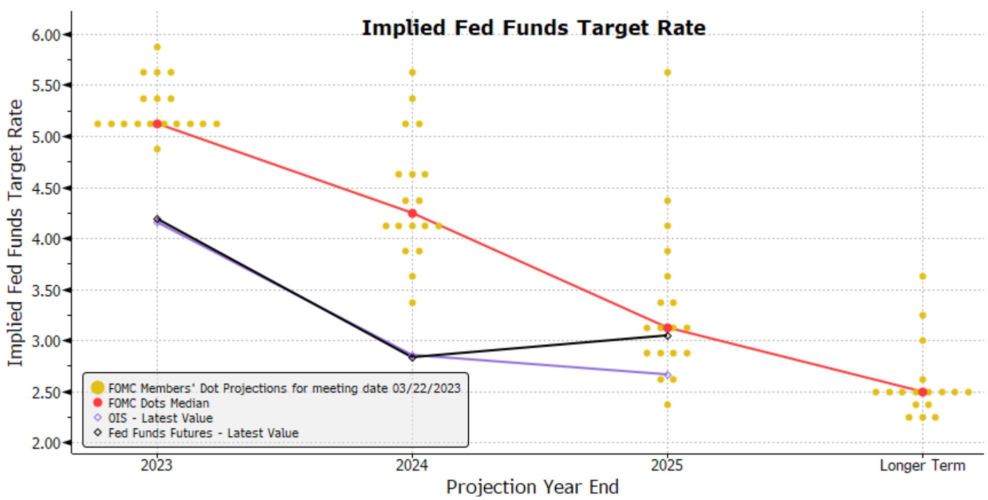


Market volatility will be pronounced as investors grapple with the difference between credit capacity in the real economy versus the Fed's inflation mandate.

Fed-swaps price in a more dovish policy path vs. Fed's March forecast

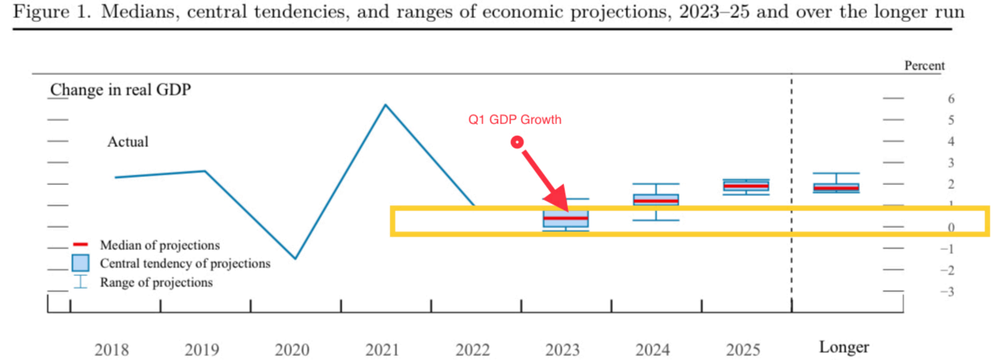


The FOMC raised the federal funds rate by 25 bps at its March meeting, with the median dot showing a rate of 5.125% at the end of 2023. Notably, Chairman Powell suggested he still thought a soft landing was possible – though acknowledged that the recent bank turmoil has not helped.



The Fed is expecting full year 2023 GDP growth to come in at an anemic 0.4%. When you match that with Q1 2023 GDP likely coming in at 3%+, members of the Fed are admitting to negative GDP growth in the coming quarters.

Figure 1. Medians, central tendencies, and ranges of economic projections, 2023–25 and over the longer run

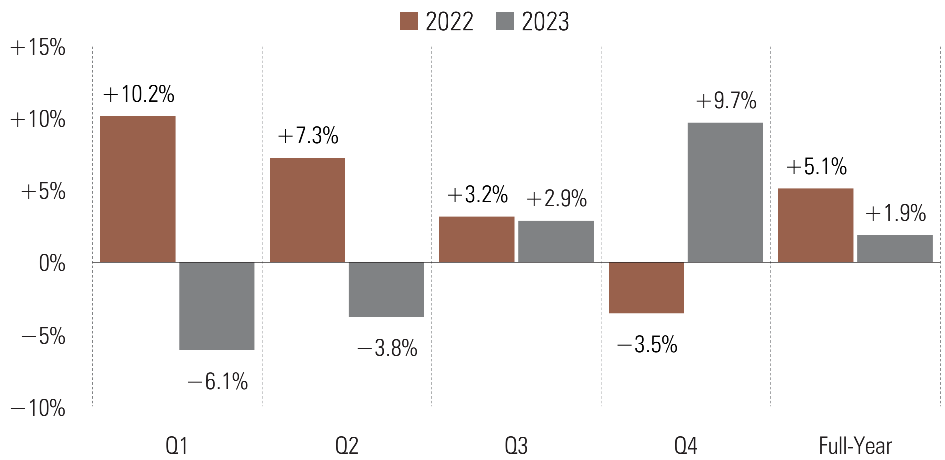


U.S. Earnings

Due to the ongoing banking strain, there will be a downgrade of the Financials sector and that will be a drag on S&P 500 earnings in Q2.

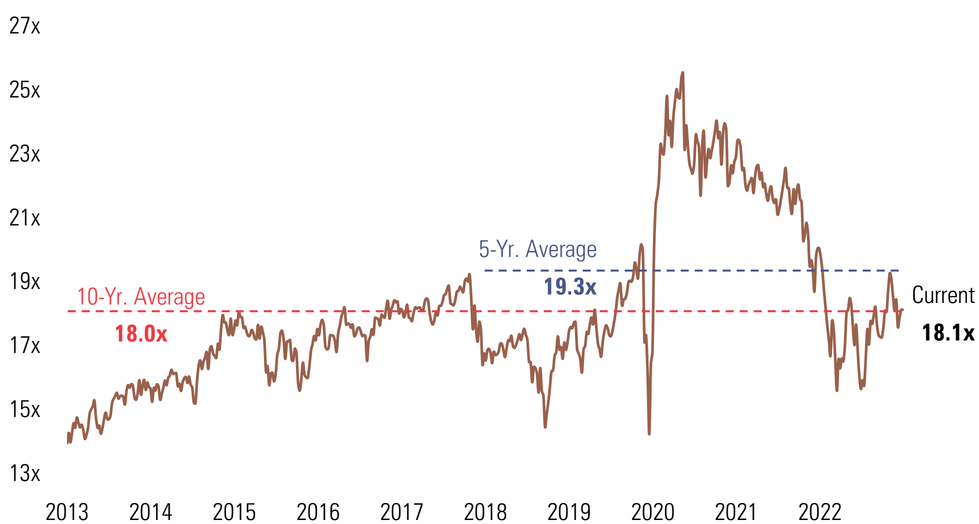
Growth headwinds pose a potential downside risk to earnings (especially given Financials account for 14% of earnings).

S&P 500 Earnings Growth 2022 – 2023

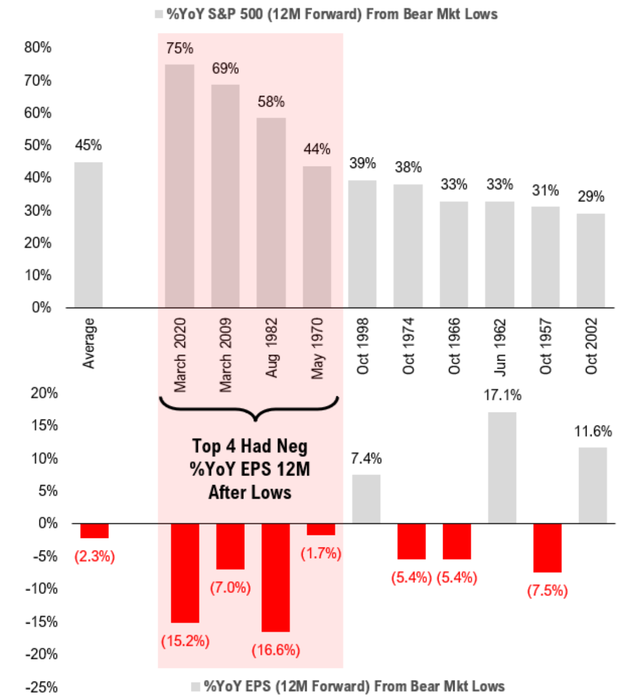


The forward P/E multiple for the S&P 500 index is currently at 18.2x, roughly in line with the 10-yr. average. That suggests valuations are fair and that a soft landing, or a short-lived, mild recession, is probably priced in.

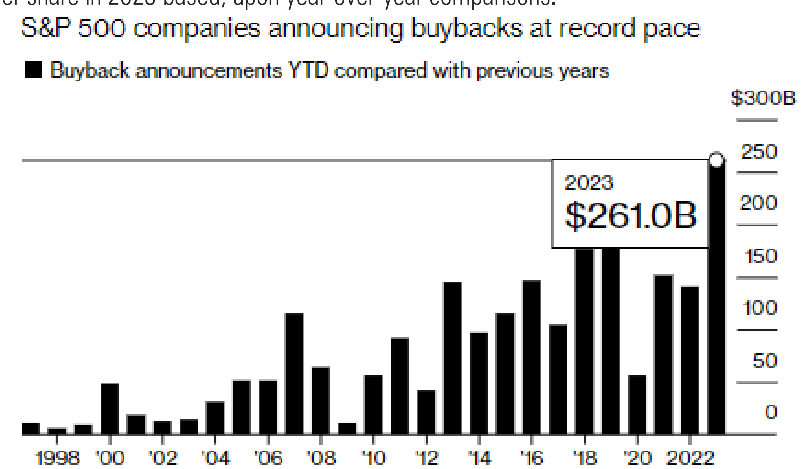
S&P 500 Forward Price-to-Earnings



While negative earnings should reflect poorly on equity prices, it's counterintuitive. Some of the biggest moves in equities occur off of negative earnings. It would appear negative earnings mark bear market lows.



U.S. buyback announcements are running at a record pace this year and should benefit corporate earnings per share in 2023 based, upon year-over-year comparisons.



Data Sources: FactSet, Bloomberg

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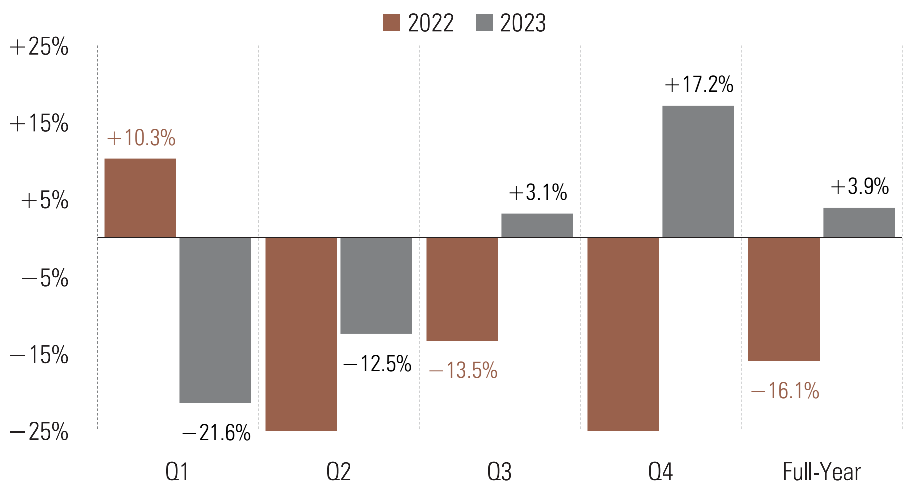
Emerging Markets

After poor absolute performance in 2022, Emerging Markets earnings expectations have been cut significantly and valuations have cheapened.

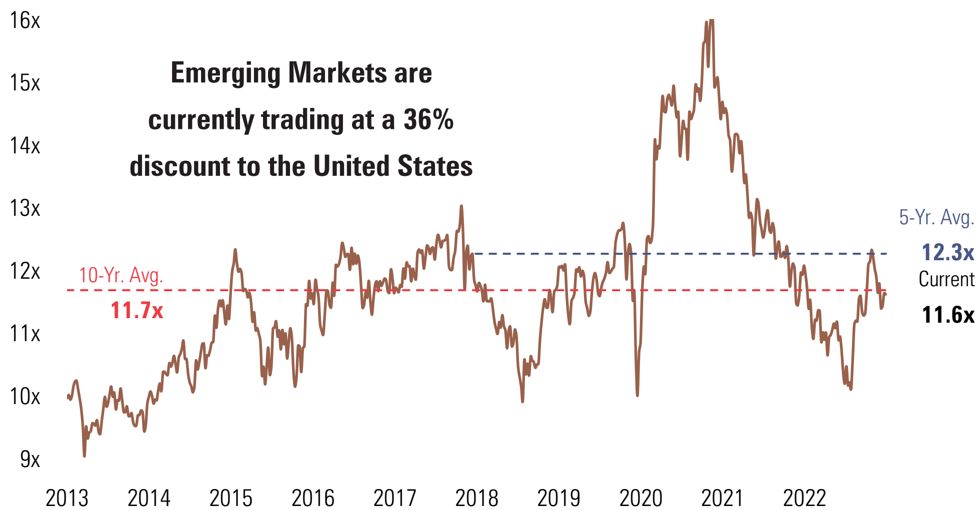
Current estimates are calling for subdued growth in the first half of 2023, followed by a recovery in the second-half.

MSCI Emerging Markets Earnings Growth: 2022 vs. 2023



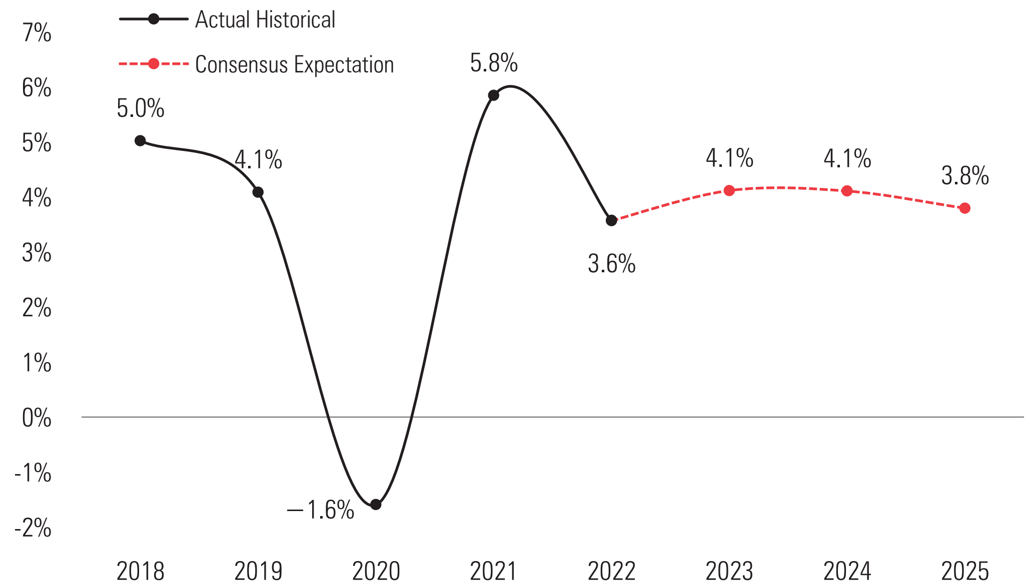
Conversely valuations are at lows, providing an opportunity for an upside surprise. Especially when you consider China opening up.

MSCI Emerging Markets Forward Price-to-Earnings

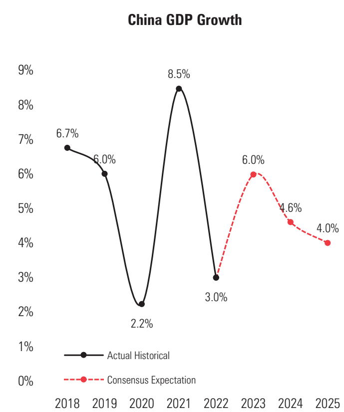


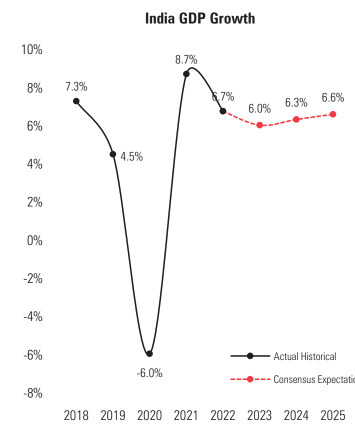
While GDP growth in emerging markets could moderate around the 4.1% level, China and India should present stronger growth in 2023.

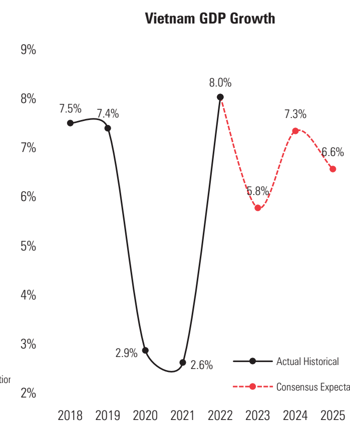
Emerging Markets GDP Growth



China's planned economic GDP expectation is at 5% for 2023. Wall Street estimates are closer to 4%, providing for a nice upside surprise.







Data Sources: Bloomberg

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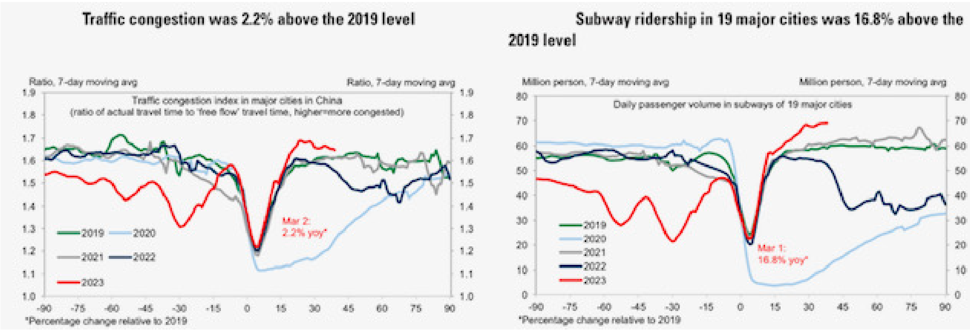
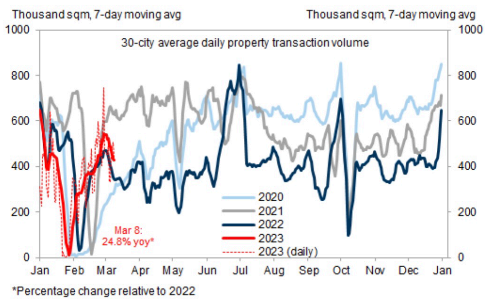
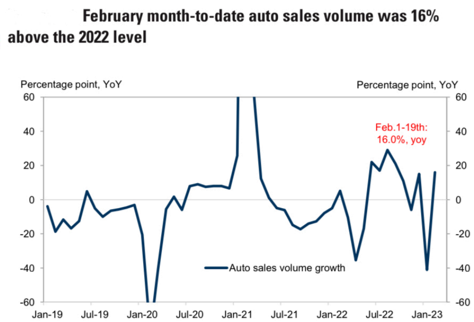
Investing In China – "The Trick is Not Minding the Pain".

So far it looks like the Chinese population is getting back to normal post Covid lockdowns. High frequency data like traffic congestion and subway ridership are tracking above 2019 levels.

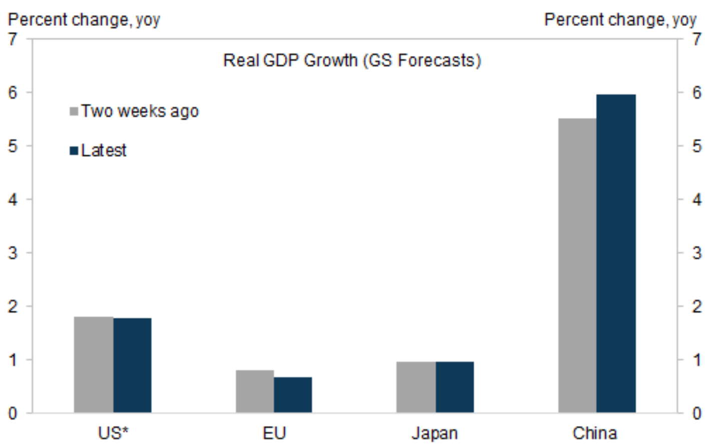


In addition, other return-to-normal indicators like daily property transactions and auto sales are recovering above 2022 levels.

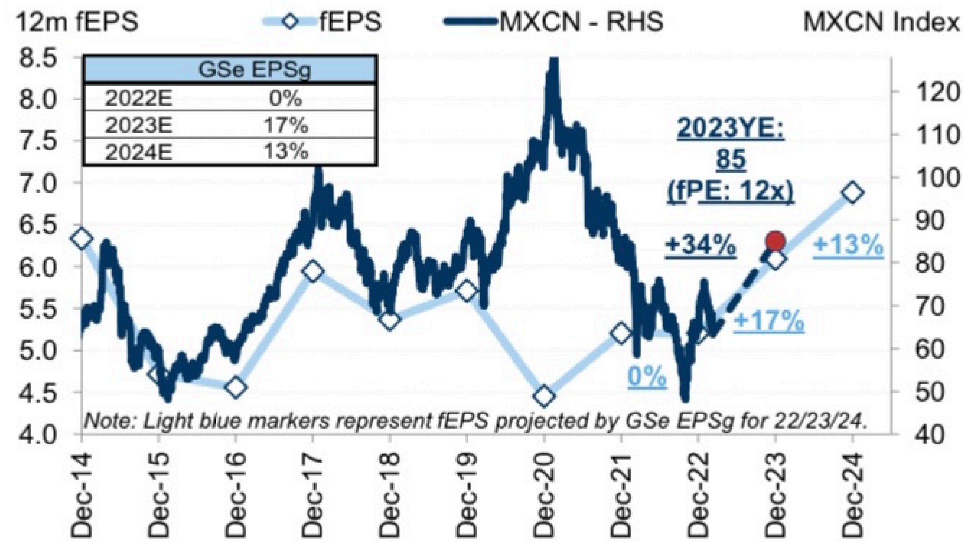




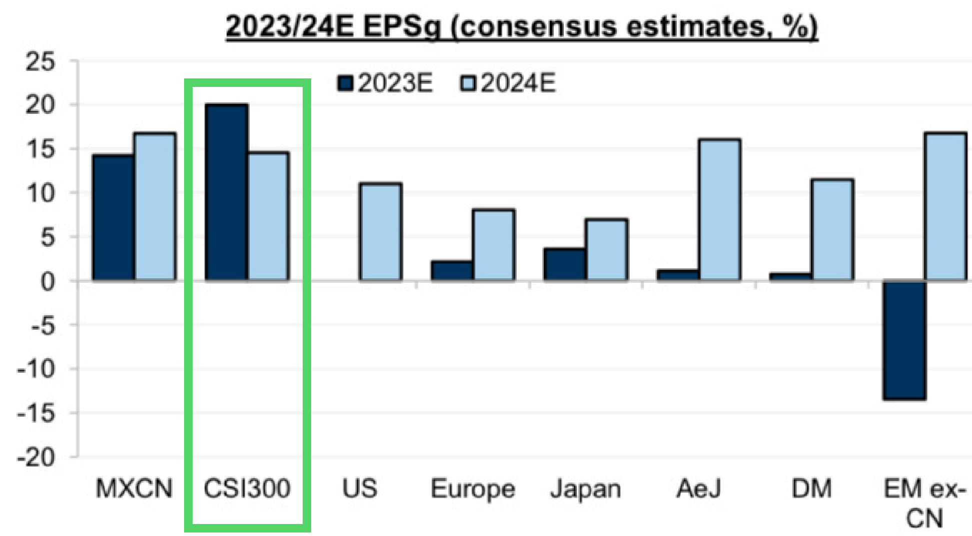
With domestic demand surging and macro data improving, GDP growth forecasts are being revised upward. Goldman Sachs now expects the Chinese economy to grow 6% in 2023, well above other global peers.



With the Chinese population gaining momentum, flows into the domestic equity markets should follow suit. When you consider other emerging market valuations relative to China, the 12x forward PE is a real value.



China also stands out among global equity peers in EPS growth terms for this and next year.



Data Sources: Bloomberg, Goldman Sachs

Review our [video] with Best Selling Author of *Psychology of Money*, Morgan Housel on "Not Minding the Pain"

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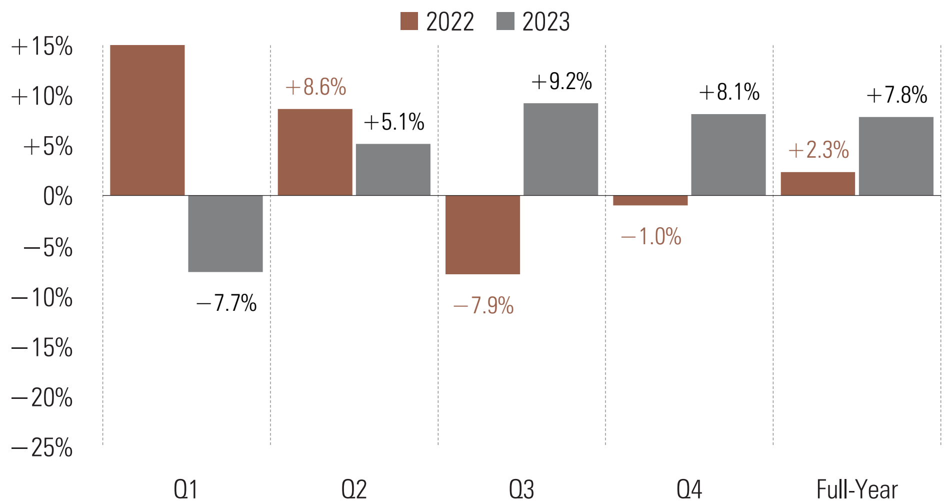
Developed Markets

Developed markets EPS estimates have been rising recently. However, higher rates and stress in the Banking sector are downside risks in Q2.

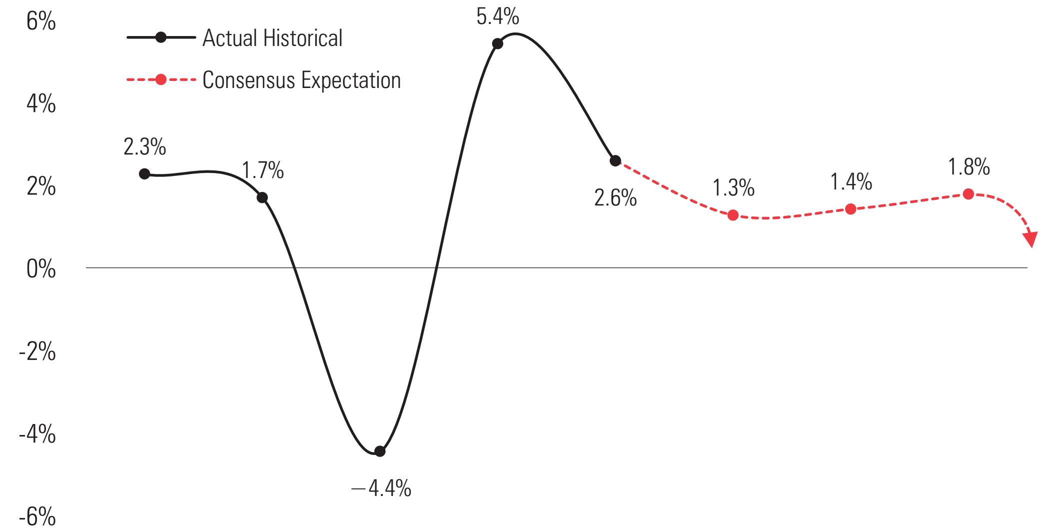
Developed Markets stocks trade on a forward P/E of 13.1x, a significant discount to long-term averages and a 28% discount to the United States.

Financial stability, liquidity concerns, and credit risk are at the forefront given risks related to the Banking sector. Developed markets GDP growth remains muted given elevated inflation and higher rates that are still working their way through in terms of their economic impact

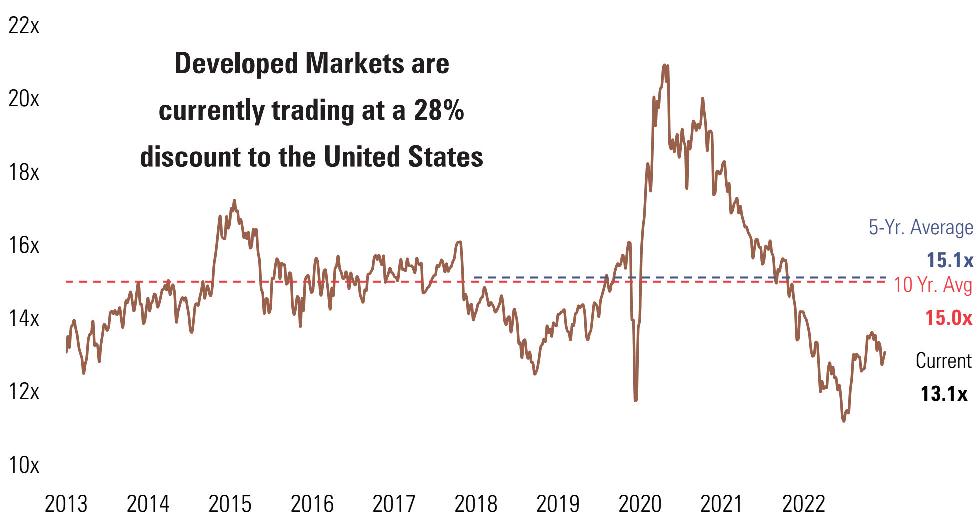
MSCI EAFE Earnings Growth: 2022 vs. 2023



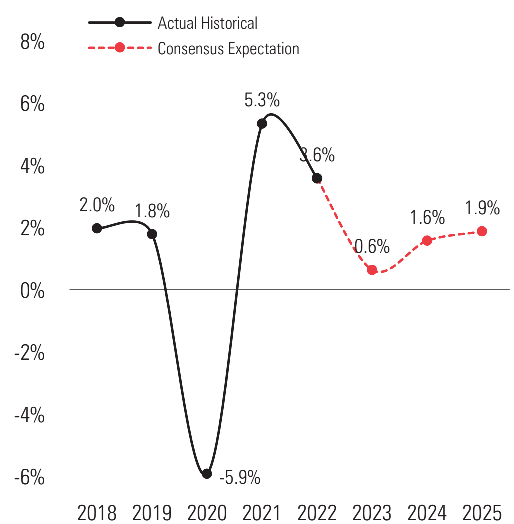
Developed Markets GDP Growth



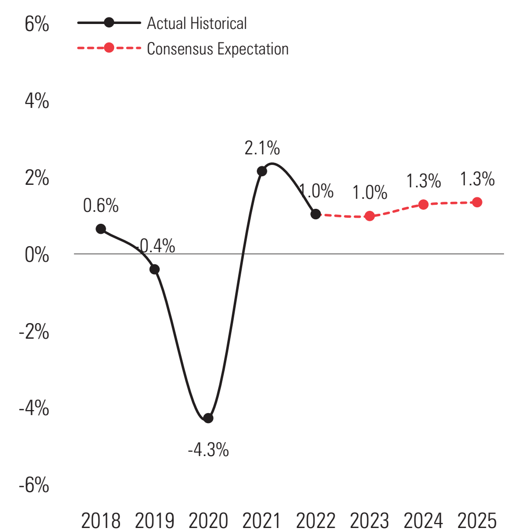
MSCI EAFE Forward Price-to-Earnings



Euro Area GDP Growth



Japan GDP Growth



Data Sources: Bloomberg

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Fixed Income

While most sectors have positive year-to-date total returns, higher quality areas like Treasuries, Investment Grade Corporates, and Agency MBS have outperformed since the collapse of Silicon Valley Bank on March 10th.

Best Performing Areas of Fixed Income

TICKER	NAME	RETURN SINCE COLLAPSE OF SVB ON MARCH 10	RETURN 2023 YTD	YIELD % CURRENT	DURATION (YEARS)
LEMB	Emerging Markets Bonds	1.82%	3.17%	0.84%	4.57
LQD	Investment Grade Corporate Bonds	1.55%	3.57%	4.11%	8.56
TIP	TIPS Bonds	1.39%	2.96%	6.15%	6.91
IEI	3-7 Year Treasury Bonds	1.32%	2.23%	1.97%	4.40
MBB	MBS	1.29%	2.32%	3.18%	5.84

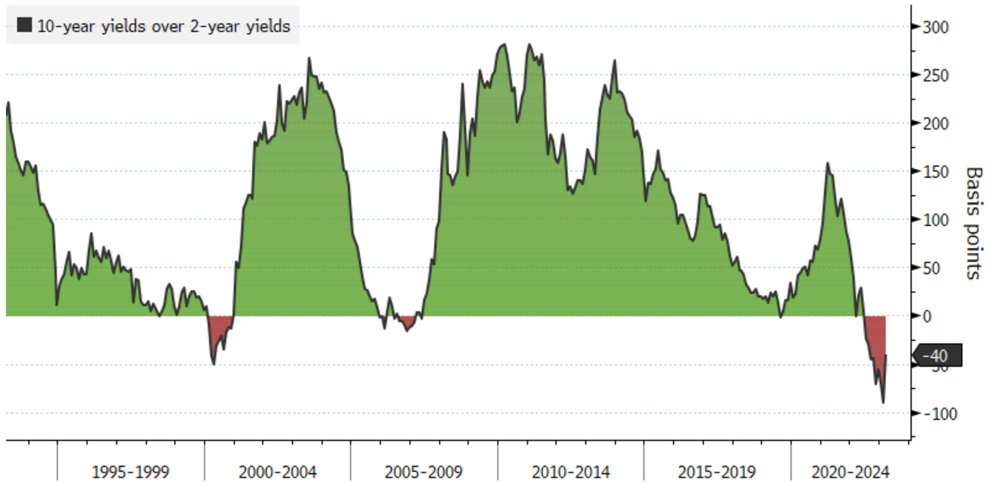
In contrast, concerns around financial stability have generated market volatility and weighed on fixed income risk/spread sectors like Preferreds, Senior Loans, and Floating Rate Bonds.

Worst Performing Areas of Fixed Income

TICKER	NAME	RETURN SINCE COLLAPSE OF SVB ON MARCH 10	RETURN 2023 YTD	YIELD % CURRENT	DURATION (YEARS)
EDV	Extended Duration Treasury Bonds	−2.36%	6.41%	3.14%	24.54
PFF	Preferred & Income Securities	−1.52%	1.71%	7.43%	7.17
TLT	20+ Year Treasury Bonds	−1.20%	5.31%	2.87%	17.54
SNLN	Senior Loans	−0.99%	2.57%	8.39%	–
FLOT	Floating Rate Bonds	−0.61%	0.93%	4.85%	1.63

The most favorable yields continue to be found at the short-end, as the Treasury yield curve remains deeply inverted.

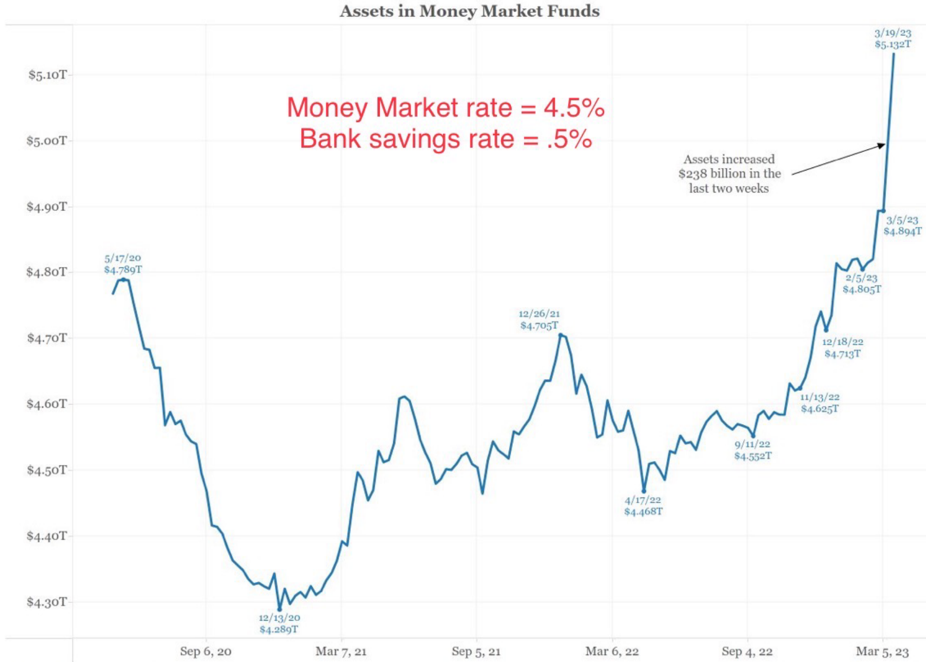
Treasury Curve Remains Deeply Inverted



The last two weeks have seen massive inflows into money markets.

Assets have increased $238 billion as bank depositors are still yield seeking and leaving for ~4.5% money market rates.

Assets in Money Market Funds



Data Sources: Bloomberg, Bianco Research

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Our Views & Recommendations

Our View

- After the latest Fed Funds increase to 5%, we expect the Fed to pause rate increases below the 5.25% level. A credit crunch combined with moderating inflation and eroding consumer sentiment will allow more policy room for the Fed. Expect Q2 to have extraordinary policy responses to flows from traditional savings to higher yielding instruments, putting pressure on bank capital.
- The U.S. consumer is still resilient, as strong jobs and wages provide a positive backdrop. However, expect an erosion in sentiment and a contraction in consumption.
- Europe will continue to experience inflationary pressures and higher rates. This will put pressure on bank stability and equity prices. We remain underweight in developed markets and Europe.
- With a transition from Zero Covid to living with COVID, we should expect strong revenge consumption out of the Chinese consumer. All of this will support better than expected corporate earnings.

Recommendations

- Reaffirm your investment strategy and maintain strategic liquidity to cover spending needs and provide opportunities for cost averaging.
- Reevaluate weightings in Developed Markets as the ground war in Europe poses a real risk to consumption habits and earnings growth.
- Maintain an overweight to Emerging Markets and China as they continue to represent reasonable earnings growth to valuation prospects.
- Selectively bullet fixed income if the 2-year Treasury creeps above 4.4% and likely moves closer to benchmark duration as the quarter unfolds.
- We made a dramatic move out of defensive-focused sectors and pivoted to Core Large Cap to capture some growth in anticipation of lower rates in the second half of the year.

What's On Our Mind?

ARE WE IN THE MIDST OF A SECULAR REGIME CHANGE FROM:	POSSIBLE ALLOCATION RESPONSES
Moderating Inflation → Possible Disinflation Higher Interest Rates → Lower Rates for Longer	Cash alternatives and lower duration fixed income
Globalization & Importing Deflation → Deglobalization & Higher Costs Carbon Driven Energy → Carbonless Economies	Commodity exposure – minerals, energy, & oil
Correlated Stock & Bond Movements → Uncorrelated Stock & Bond Movements	Dividend, Large Cap Core, & Quality Growth Non-correlated equity alternatives – illiquid, event-driven, hedge, China

Mean Reversion Dashboard

Style Forward P/E as a % of 20-Year Average

Size	Value	Blend	Growth
Large	99.3%	109.4%	122.8%
Mid	88.0%	92.7%	106.1%
Small	105.4%	100.0%	81.5%

Regions & Countries Forward P/E as a % of 20-Year Average

Regions

World	Developed Markets	Emerging Markets	Frontier Markets
105.6%	94.0%	100.3%	86.1%

Countries

United States	Germany	United Kingdom	China	Brazil	India
113.1%	90.6%	82.5%	89.0%	61.8%	114.1%

Sector Forward P/E as a % of 20-Year Average

Sectors

Energy	Materials	Industrials	Consumer Discretionary	Consumer Staples	Health Care	Financials	Technology	Telecom	Utilities	Real Estate
34.6%	104.6%	107.8%	112.5%	111.7%	110.6%	98.2%	135.6%	103.6%	108.9%	78.2%

Data Source: Bloomberg

THANK YOU

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