The *Philadelphia* Story

A Quarterly Commentary on the Economy & the Financial Markets April 2023

From: *Philadelphia* Investment Management Group

OVERVIEW

- ***While Inflation and Inflation Signs Continue to Show More Positive Numbers, Markets are Reacting Now to Indications of Recession Realities.*** *As with the last financial disruption arising from the Lehman situation, the concern is again that banks and other financial institutions may pull back in lending, which could inhibit growth and weaken the economy going forward.*
- ***Wages Have Been the One Sticky Point With the Federal Reserve's Position on Interest Rate Hikes.*** *Most recent numbers, however, do suggest that employment is becoming of less concern in their rate decision-making.*
- ***The Prospect of a Long Global Slowdown has Prompted Governments Around the World to Announce Tax Breaks, Subsidies, and New Laws to Accelerate Investment.*** *In addition, the U.S. ratcheting up investment in semiconductors and funding for clean energy should set the stage for renewed economic growth rates in the later part of 2023 and into 2024.*

THE ECONOMY

The U.S. economy is meandering along and sending mixed signals about its future path. Over the past several weeks, manufacturing data, economic indicators, consumer spending and the housing market have all weakened, while inflation has decelerated. The strength of the economy continues to lie with the labor market. On a positive note, recent indicators suggest the imbalances in the employment market arising from the pandemic are slowly correcting themselves. We forecast real annualized U.S. Gross Domestic Product (GDP) of 2.6% in this first quarter, accelerating in the fourth quarter. We do not believe a recession is in the works. However, if there is a mild recession, it should be short-lived with economic momentum building over the course of 2024 and 2025.

FINANCIAL MARKETS

EQUITIES

Equity markets gained in the first quarter, as reflected in the table below, pointing to confidence that regulators had acted with sufficient speed and force to avert a full-blown banking crisis. Global stocks delivered a gain of 7.3% in the quarter, while the S&P 500 gained 7.5%. The big story about the equity markets in the quarter was the bounce in Technology and Communication Services stocks. Technology overall was up 21.82% in the first quarter. Though these groups are higher from where they were a year ago, they are still well off their highs. The important message from all of this is the notion in the marketplace that the economy and, thus the security markets, are finding a bottom and should move forward in the quarters ahead. Technology and Communication Services, with their revenue growth numbers, are expected to continue their upward paths.

	Equity Returns*			
Index	**Jan**	**Feb**	**Mar**	**1st Qtr**
S&P 500	6.28%	-2.44%	3.67%	7.50%
Dow	2.93%	-3.94%	2.08%	0.93%
NASDAQ	10.68%	-1.11%	6.69%	16.77%
Russell 2000	9.75%	-1.69%	-4.78%	2.74%

*Total: price change + reinvested dividends

Value stocks, in the period, lagged growth companies, as to be expected with such enthusiasm for the reduction in inflation numbers. Further contributing to the decline in the so-called value and defensive companies was the Energy sector, dropping 4.67% through March 31st. In summary, with regard to equities and despite the rebound in the first quarter, the S&P 500 is still in bear market territory and now sits about -12.6% below the all-time high reached on January 3, 2022.

	S&P 500	
		Returns*
Sector	**Weight***	**1st Qtr**
• Energy	4.6%	-4.67%
• Materials	2.6%	4.29%
• Industrials	8.7%	3.47%
• Cons. Discretionary	10.1%	16.13%
• Consumer Staples	7.2%	0.83%
• Health Care	14.2%	-4.31%
• Financials	12.9%	-5.56%
• Info Technology	26.1%	21.82%
• Communication Svcs	8.1%	20.50%
• Utilities	2.9%	-3.24%
• Real Estate	2.6%	1.95%

03/31/23
*Price + income
Source: S&P Dow Jones

Inflation is still key to the markets, as it will likely determine the Fed's next move and the future state of the economy. While recent releases of financial information have been encouraging, we are not out of the woods with clear sailing yet. Of recent concern, which has attracted the attention of investors, is the worry that banking credit conditions could slow business recovery. Of course, the Fed, if they conclude that there will be some slowdown in the economy as a result of banks' hesitations to lend money, could decide they would not have to raise rates as much. The majority opinion, however, is that the economy will not be derailed by banking system stress.

FIXED INCOME

The first quarter of this year saw the investment grade bond market increase by 3%+ as the 10-year Treasury yield declined from 3.88% on December 31st to 3.47% at quarter end. The fixed income market is still trying to find its footing after coming off the worse calendar year since 1976, with a negative return of 13.75% in 2022. Although Treasury yields declined throughout the quarter, the yield curve is still inverted, with both the three-month and two-year yields higher than the 10-year yield. This phenomenon has always been a sign of a pessimistic economic outlook and typically signals that investors expect the Fed to cut rates soon. If this were to happen, then the inverted curve would disappear and the curve would be upward sloping.

Fixed Income Returns

Index	1st Qtr
Corp/Govt	3.17%
Int. Corp/Govt	2.30%
Long Corp/Govt	5.69%
U.S. Government	3.08%
- Intermediate	2.24%
- Long	6.01%
Corporate	3.45%
- Intermediate	2.50%
- Long	5.47%
- **Quality**	
- AAA	4.54%
- AA	3.59%
- A	3.26%
- BBB	3.56%
Municipal	2.82%
- Intermediate	1.80%
- Long	3.58%

Source: ICE BofA

Municipal bond yields declined as well in the first quarter. The concerns over bank balance sheets caused the Fed to provide liquidity support in March. The short end of the tax-exempt curve continued to experience significant volatility, and the spike in the shortest tax-exempt rates left the curve inverted by 169 basis points.

The bond market overall is really the area to look for clues about where the economy might be heading. As we mentioned earlier in these remarks about bank credit conditions, one has to understand that the recent developments in the banking sector have upset a trend of improvement in the bond market, where lower quality bonds are suffering as investors worry that a credit crunch could make it difficult for low-quality borrowers to borrow. We mention this point as a proxy for the overall health of the fixed income market going forward.

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In conclusion, it appears that there is progress being reported on the inflation front. With jobs and other employment data recently the "sticky wicket," those numbers seem to be better, supporting improved business conditions.

Our continued posture of maintaining a well diversified equity portfolio with short-to-intermediate bonds in balanced and fixed income portfolios remains in force until there are further signs of improved conditions on the inflation front and the inverted bond yield curves.

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