MARKET UPDATE

APRIL 12, 2023

"In the short run, the market is a voting machine but in the long run, it is a weighing machine."
Benjamin Graham, Economist and Author of *The Intelligent Investor*

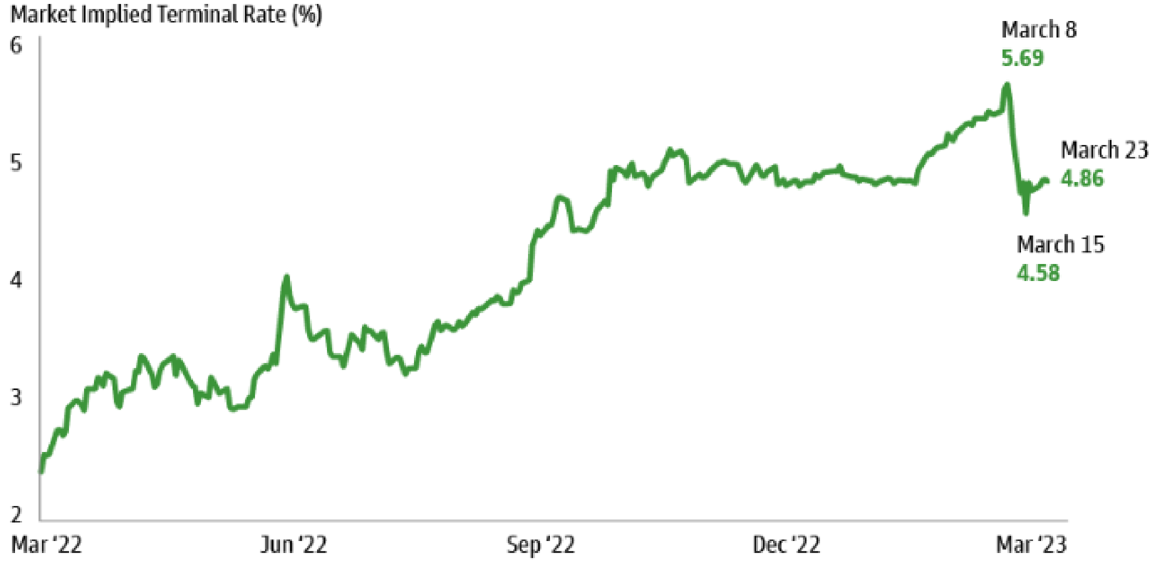
Any discussion of market activity in March would be remiss not to mention multiple bank failures including the 2nd and 3rd largest banks to fail in U.S. history. The failure of these banks along with the takeover of Credit Suisse by UBS left investors naturally unnerved; however, these failures were unique and not reflective of the banking system more broadly. Moreover, inflation continued to accelerate in the face of the Fed's rate hiking campaign.

Following the pandemic, both monetary and fiscal policy pursued extreme, stimulative efforts to prevent a recession amidst a locked-down economy. These efforts led to a massive increase in money supply, swelling deposits in bank balance sheets across the U.S. By regulation, banks must hold quality, liquid assets to meet deposit withdrawal requests. To do this, the failed banks took excessive risk by investing large amounts of capital in long duration assets. While these investments met the regulatory criteria for credit and liquidity risk, interest rate risk remained as the banks sought higher yields from longer dated securities.

When inflation came into the picture, the Federal Reserve responded with a series of rate hikes at a velocity not seen in decades. For banks with concentrated deposit bases in startups and tech companies, rising yields can result in withdrawals as raising capital becomes more difficult. Additionally, rising yields led bond prices to fall. Longer duration bonds are more sensitive to rising yields and prices fell at a greater magnitude. This double-edged sword of shrinking deposits paired with a drawdown of assets culminated on Friday, March 9th when Signature Bank of New York and Silicon Valley Bank were taken over by the FDIC after several billion dollars of deposits were withdrawn.

The response was swift. By the end of the weekend, the FDIC, Federal Reserve and Treasury Department issued a joint statement on the matter. The three agencies introduced responses that would support the depositors of the impacted banks and banking liquidity more broadly. By the end of the week, investors were cautious but remained confident in the banking system as a whole with the S&P 500 up 1% and the Nasdaq up 4.41% in the following week.

As the Fed's first casualties emerged, expectations for the upcoming FOMC meeting shifted dramatically. Previously, Fed Chair Jerome Powell had testified before Congress, responding to questioning with a hawkish tone and noting the Fed's continued commitment to reducing inflation. Markets reacted by pricing in a 50bp hike, in contrast with February's more muted 25bp move. On March 8th, the day prior to banking crisis, fed funds futures placed a probability of a 50bp rate hike at nearly 80%. On Monday, that probability fell to zero. The Fed subsequently raised rates 25bp on March 22nd, leading terminal rate projections to settle at 4.86%.



Source: Bloomberg and Goldman Sachs Asset Management. As of March 23, 2023.

Despite the turmoil, major indices were the lucky recipients of lower rate expectations. Investors once again pondered whether *this* was the pivot. In March, the Dow Jones Industrial Average was up 2.1%, the S&P 500 was up 3.7%, and the Nasdaq was up 9.5% as the forecast of lower rates increased growth multiples and propelled stocks higher as investors positioned themselves for easier monetary policy.

Recent returns are not necessarily a sign of the *all-clear* being sounded. When investors drive up equity prices, they risk having done so myopically by focusing on the impact of interest rate changes to multiples in the absence of the implications of those changes for the greater economy. The recent cut in terminal rate projections may suggest fixed income investors believe the danger of recession looms. Have equity investors overlooked the risk?

In light of the challenging market environment, Seacoast Wealth Management stands confident in its investment process. We invest in companies with strong balance sheets and evaluate many aspects of each before investing, including: financial ratios, earnings, valuation, and profitability. We believe that markets are emotional in the short-run and rational in the long-run. While we welcome March's price action, we invest with caution in the wake of a crisis. Prices rise and fall but returns are driven by intrinsic value.

As always, we are grateful for the opportunity to work with you. Please do not hesitate to reach out to your Seacoast Wealth team with any questions.

Sources: JP Morgan Asset Management; NASDAQ; FactSet; Bloomberg; Broadridge: *Data sources: Economic: Based on data from U.S. Bureau of Labor Statistics (unemployment, inflation); U.S. Department of Commerce (GDP, corporate profits, retail sales, housing); S&P/Case-Shiller 20-City Composite Index (home prices); Institute for Supply Management (manufacturing/services). Performance: Based on data reported in WSJ Market Data Center (indexes); U.S. Treasury (Treasury yields); U.S. Energy Information Administration/Bloomberg.com Market Data (oil spot price, WTI, Cushing, OK); www.goldprice.org (spot gold/silver); Oanda/FX Street (currency exchange rates). News items are based on reports from multiple commonly available international news sources (i.e., wire services) and are independently verified when necessary with secondary sources such as government agencies, corporate press releases, or trade organizations. All information is based on sources deemed reliable, but no warranty or guarantee is made as to its accuracy or completeness. Neither the information nor any opinion expressed herein constitutes a solicitation for the purchase or sale of any securities, and should not be relied on as financial advice. Forecasts are based on current conditions, subject to change, and may not come to pass. U.S. Treasury securities are guaranteed by the federal government as to the timely payment of principal and interest. The principal value of Treasury securities and other bonds fluctuates with market conditions. Bonds are subject to inflation, interest-rate, and credit risks. As interest rates rise, bond prices typically fall. A bond sold or redeemed prior to maturity may be subject to loss. Past performance is no guarantee of future results. All investing involves risk, including the potential loss of principal, and there can be no guarantee that any investing strategy will be successful. The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The S&P 500 is a market-cap weighted index composed of the common stocks of 500 largest, publicly traded companies in leading industries of the U.S. economy. The NASDAQ Composite Index is a market-value weighted index of all common stocks listed on the NASDAQ stock exchange. The Russell 2000 is a market-cap weighted index composed of 2,000 U.S. small-cap common stocks. The Global Dow is an equally weighted index of 150 widely traded blue-chip common stocks.*