Marketline February 2023

Stocks:

February drew a halt to the rally that began late last year, with declines in stocks across the board. The S&P 500 dropped 2.6%; the Dow was off 4.2% and the Nasdaq drifted down 1.1%. Technology – after a shellacking last year – held up better than most sectors. Despite the decline, we didn't find that stocks became materially more attractive than in January. We would need to see steeper declines for things to get really interesting.

Overseas, returns were similar, with Canada's TSE dropping 2.6% and Mexico off 3.3%. Europe has continued to be a bright spot, posting a small gain of 1.3%. Despite droughts, energy costs and other headwinds, Europe has been recovering from the pandemic, with tourism, consumer sentiment and manufacturing picking up.

Much of the blame for softening prices can be hung on developments around the interest rate environment and inflation last month. Inflation was higher than expected and interest rates reacted by rising to near the top of their recent range out in the ten to thirty year area. Of course, rates rose in the short end as well. It's not hard to get 5% on short term Treasuries now, or close to it. Meanwhile, earnings results presented a sanguine picture, with a few shortfalls of note especially in retail stocks but many coming in on target. Still, while the year has yet to show us what is in store economically, plenty of CEOs have warned about the upcoming second half of the year. We've mentioned before that two factors - interest rates and earnings – are the primary drivers of stock returns, with sentiment, expressed as valuation, a distant third. At the moment, we have a struggle between interest rates on the negative side, and earnings on the positive side, resulting in a whole lot of going nowhere.

Bonds:

Bond yields rose last month, as noted, to near the top of a recent trading range. The ten year bond – important to the economy in many ways – closed at 3.92% and has since breached 4%. The long bond closed identically, at 3.92%. That rate, too, briefly touched 4% before backing off. One-year Treasury bills are trading at 5% now, though as we've noted in the past, when long term rates are below short term rates, it's often a better time to buy long bonds than short bonds.

As it has been since last summer, the yield curve remains inverted with short maturity bonds yielding more than long bonds. We remarked last month that the longest lasting inversion took over 2 ½ years to correct itself, while run of the mill inversions seem to last a year and a half. If we are going to live with this for several more months, we know to look for moments when rates come up, like they have lately, to invest cash. Last month we were mourning that municipal bonds at 4% had disappeared but they are back for the time being. So, this month we give the "good value" edge to munis, though we do still have a number of "favorite" corporates.

Note: Last year we discovered that some clients were still not aware that if they have no need for required minimum distributions from IRA accounts, those can be given to charity through a mechanism known as a Qualified Charitable Distribution (QCD), which eases the tax liability associated with RMDs. We've written about this technique in the past but it is time for a reminder. If you are giving money to charity and also saddled with RMDs, consider using the QCD. You can cut your tax bill. Also, if you are well aware of QCDs, it's not too early to think about what you want to do for 2023. We can't accept QCD directions after about December 15th, because the timing becomes too tight to guarantee that they will execute. Any questions, be sure to ask us or your accountant!

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