Marketline March 2023

Stocks:

March offered a confusing array of returns. On the one hand, US indices were all positive, but the spread among the three indices was notable. The Dow rose only 1.9% and the S&P was up 3.5%, but the NASDAQ surged 6.7%, thanks to technology stocks. Overseas, returns were mixed, with Canadian stocks off slightly; European stocks posting the worst number on the board by far, down 3.1%; and Mexico managing a 2.2% price rise.

As we explained today to a client, investors are pricing for a recession one day, and inflation the next. When sentiment leans to recession, stock prices falter and bonds rally; when inflation is at top of mind, the roles switch – stocks can perform a bit better but bonds suffer. Sometimes, though, both stocks and bonds can make a bit of progress, and as we'll see from the bond discussion below, that was the case in March.

We touched on inflation above. Is it possible that we could see a recession but still experience inflation? Possibly. Many large trends underway are inflationary and also not within control of the Fed. Examples include:

- Fiscal spending to improve infrastructure. This requires workers – scarce now – as well as cement, wood, steel, fuel, and a host of other commodities, pushing up prices of those items as each new project competes for resources.
- Initiatives to build more housing. See above, rinse and repeat.
- The transition to renewable energy. Requires nearly everything that is on plates one and two, in addition to copper, battery chemicals, factories, grid expansion – pressuring prices still more. The cost of new facilities must be borne by ratepayers, so while the energy may be "renewable", generating it is not cheap. You can see that in your electric bill.
- The United States' new industrial policies encouraging on-shore production of steel, charging equipment, minerals, computer chips. We will be building factories to produce a fraction of what China is able to – and already – produces. Where one factory made an item, now two will. Consumers will bear that cost.
- Household formation in two large population cohorts – Millennials and Gen Z. Like their parents, many will want to move out of apartments to new homes in suburban locations. Cars will come onto the wish list, and kids will be born. In the 1970s, the Baby Boom generation was constantly "surprising" the marketplace with its strong consumerism - spurring inflation as well.
- Trade barriers, such as the European Union requirement that imported items show a roster of materials and ingredient sources acceptable to authorities. When only a select few can import, it's easy to predict that import prices will rise.

The confluence of these trends is not a recipe for tame prices. A recession could knock prices back, but if policies continue to encourage commodities consumption, avoiding inflation will be difficult. At the same time, investments in commodities producers may prove fruitful. When politics dictates winners and losers, it's best to be on the side of the winners.

Bonds:

Bonds rallied last month, rising in price as interest rates fell. All rates fell, in all maturities. Gone is that fat, comfortable 5% yield. The ten year dropped all the way from 4% to 3.5% - no it doesn't sound like much but it's a lot in the world of bonds. The long bond sank from 4% to 3.65%. Today, as we write this, rates are even lower. It's the ascendency of recession worries: bank failures, weakening labor reports, and sluggish manufacturing numbers are all sounding alarm bells.

Meanwhile, the yield curve has changed markedly. From inversion at every maturity from short to long, we are now seeing a positive slope from five years on out. The shorter end of the curve remains inverted, but less so. This change in the shape of the curve is telling is that slower growth is here, and the Fed may pause or even cut rates in coming months. That forecast is echoed by strong performance in tech stocks, noted above, which tend to do well when rates fall.

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