Market Review Commentary

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Investment Management

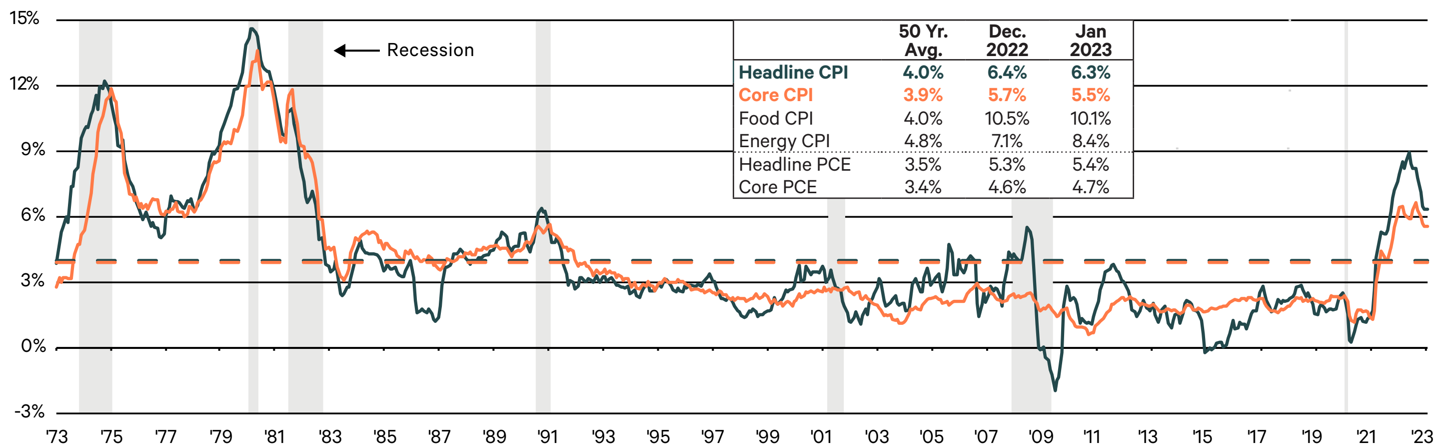
MARKET OPTIMISM FADES IN FEBRUARY

While the month of January delivered strong returns across the major indexes, February's market performance ended in negative territory. The S&P 500 Index fell 2.44% for the month, while the Russell 2000 Index of small capitalization stocks declined 1.69%, outperforming larger stocks. Growth stocks continued their early performance trend from January and, while negative, outperformed value stocks, returning -1.19%, as represented by the Russell 1000 Growth Index versus -3.53% for value stocks, as represented by the Russell 1000 Value Index. Bond yields were on the rise, especially toward the end of the month.

What a difference a month makes. The strong market returns in January reflected investor optimism that the Federal Reserve's interest rate hikes may have peaked. February inflation data and commentary from the Fed unraveled the new year's brief rally.

FIGURE 1: CPI AND CORE CPI

% Change vs. Prior Year, Seasonally Adjusted



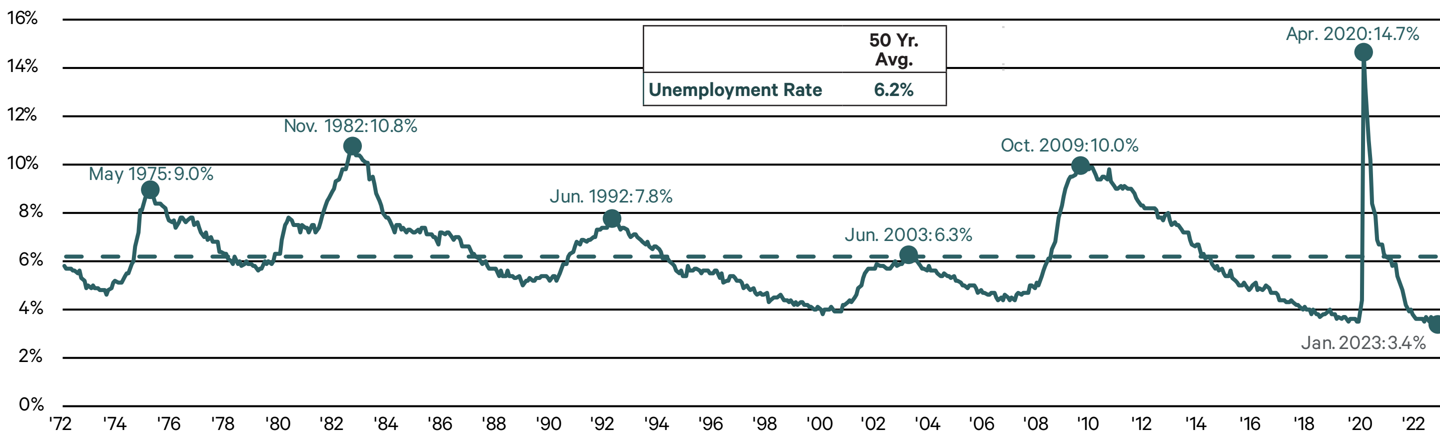
	50 Yr. Avg.	Dec. 2022	Jan 2023
Headline CPI	**4.0%**	**6.4%**	**6.3%**
Core CPI	**3.9%**	**5.7%**	**5.5%**
Food CPI	4.0%	10.5%	10.1%
Energy CPI	4.8%	7.1%	8.4%
Headline PCE	3.5%	5.3%	5.4%
Core PCE	3.4%	4.6%	4.7%

Data presented is as of March 2, 2023 and is obtained from BLS, FactSet and J.P. Morgan Asset Management and is assumed to be reliable. CPI used is CPI-U and values shown are % change vs. one year ago. Core CPI is defined as CPI excluding food and energy prices. The Personal Consumption Expenditure (PCE) deflator employs an evolving chain-weighted basket of consumer expenditures instead of the fixed-weight basket used in CPI calculations. ***Past performance is no guarantee of future results.***

Now the conversation has swung to perhaps a return to 50 basis point hikes versus the previously expected 25 basis point increases (a basis point is 1/100 of a percentage point). Another pivot this month was the target for terminal interest rates (the rate range at which the Fed will stop raising rates). That range was previously thought to be around 5% with the anticipation that the Fed may need to then begin reducing rates toward the end of 2023. Now current speculation has the Fed increasing rates to around 6% and holding rates there to bring inflation under control.

So, what changed? We mentioned in last month's commentary that the Fed will need solid economic evidence that inflation pressure is abating. Unfortunately, the economic evidence in February showed a red-hot labor market and stronger-than-expected economic data, such as consumer spending, making inflation sticky and problematic for the Fed.

FIGURE 2: CIVILIAN UNEMPLOYMENT RATE
Private Production and Non-Supervisory Workers, Seasonally Adjusted, Percent



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So, while some areas of the economy are tracking in the right direction with prices receding, the pace of change has not been sufficient to convince the Fed that its inflation-fighting job is complete. Unlike last year's market preoccupation that hoped the Fed would embrace a policy of slowing and reducing rate increases, which market participants got completely wrong, the market this year seems to have embraced the notion that the Fed will steadfastly hold to its tightening policy. The Fed reality of "whatever it takes" has caused investors to reassess riskier assets and reverse course from January's rally when most speculative assets increased.

We are also seeing many companies reducing earnings forecasts and lowering guidance under a higher-for-longer rate environment. The belief is that a Fed determined to fight inflation longer than the market anticipates will likely be successful at slowing growth. As growth slows, this may lead the economy into one of the most forecasted recessions in the history of market projections. Whether or not a recession happens is open to debate given there are no signs of the labor market cooling.

We continue to believe that stock selection in companies that experience growth in a slower environment will be important this year. We anticipate active management versus indexing will be beneficial to building a defensive portfolio in what will likely continue to be a choppy investing environment. While inflation is showing some signs of cooling, it is still elevated and will keep the Fed on track to raise rates at their meeting in March, with further increases likely to follow.

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Douglas S. Foreman, CFA is Chief Investment Officer, Portfolio Manager, and a member of the Executive Management Committee. He has approximately 37 years of investment experience.

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