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MARKET COMMENTARY

The volatility that defined financial markets in 2022 continued into the first quarter of 2023. US Equity and bond prices lunged higher in January on the back of easing financial conditions as investors positioned for an economic "soft landing". In February, equity and bond prices fell hard as interest rates surged due to hotter than expected inflation, resilient consumer spending and tight labor market dynamics. The spike in interest rates that we saw in February was unwound by the end of March as two large financial institutions, Signature Bank and Silicon Valley Bank (SVB), failed and had their deposits and loan portfolios purchased by competing banks. These failures and the ensuing activities led to mixed results from a total return perspective across asset classes for the month of March.

Given this volatile backdrop, it would be reasonable to assume that the first quarter of 2023 was a tough environment for financial assets and that returns were probably poor. But in actuality, financial asset returns in the first quarter of 2023 were strong.

If an investor had been watching any of the financial news outlets over the past month, they would have been certain the economy was in dire straits. Yet if that same investor had only looked at the end of quarter equity returns, they would have thought that the economy was humming along. What is the reason for this dichotomy?

This divergence can be explained by the fact that stock and bond markets are forward looking with pricing that is reflective of investors' expectations about the future. In other words, to a certain extent markets have already priced in many of the economic events (i.e. job layoffs, bank failures, impact of high interest rates on the economy) we are currently experiencing. The implications of this dynamic are considerable. To add value, it requires investors to: A) extrapolate what scenario the market is currently pricing in for a financial asset and B) have a viewpoint that differs from market consensus and, be right in that viewpoint. The forward looking nature of the stock and bond markets impacts all investment decisions. This dynamic is a critical pillar of Sigma's investment management process.

Being forward looking also plays a large role in risk management. Sigma Investment Counselors routinely stress tests its investments under a wide variety of scenarios to understand how these investments

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may behave in the future under varying assumptions.

For bond investments, this includes analyzing a bond portfolio to understand its sensitivity to moves in interest rates. While the failure at Silicon Valley Bank was multi-faceted, the impact of rising interest rates on the bank's bond portfolio and its impact on the bank's asset base was a driving force for the failure. By simply looking at the maturity schedule of their bond portfolio, managers at SVB could have had a better understanding of the impact rising rates would have had on their bond portfolio and been able to manage this specific risk better. Understanding and monitoring interest rate risk is an ongoing exercise at Sigma Investment Counselors and helps define the management of bond portfolios.

Rising rates also pose a threat to equity investments as investors demand a higher return from all asset classes as interest rates rise. In addition, in contrast to the last several years when interest rates were very low, the rise in interest rates now makes bond investments a more compelling alternative to stocks. Sigma's research team regularly stress tests the equity investments in the portfolio to understand what impact further rate increases (or decreases) may have on these positions.

As of this writing, green shoots are starting to appear as winter fades and spring comes into full bloom. The recent divergence between economic events and financial asset returns may be green shoots for financial markets as well. With an understanding that financial markets are forward looking, investment success is predicated on being forward looking as well. At Sigma we continue to look ahead to manage risk. Risk management is one of the key components in allowing our clients to achieve both their short and long term investment objectives.

Thank you for your continued support and confidence.

Paul Warholak Jr
Research Analyst

Did you know in addition to our monthly Sigma Summaries, we have an excellent blog written by members of our own Investment Committee? The blog topics include investments, economic outlook, financial planning, and includes our new weekly report "Sigma Signals". Click here to start receiving the blog or visit https://sigmainvestments.com/blog/ to see prior posts.

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Please remember to contact Sigma Investment Counselors if there are any changes in your financial situation or investment objectives