TRANSCRIPT: Q1 2023 Market Update

This is a transcript of a video created on April 20, 2023. Visit our YouTube Channel to view this video at https://youtu.be/dFmCn5CByJk or our website at www.levelFA.com

Hi, everyone. This is Steve Elwell, chief investment officer of Level Financial Advisors. And this is your first quarter 2023 market commentary. The stock market had a pretty good quarter here in the first quarter, the US stock market being up 7.18%. International stocks did a little bit better, up 8.02%. Emerging markets were up about 4% and the global real estate investments were up about 1.37, so a pretty good quarter across the board. And the bond market also had a really good quarter. A partial rebound from last year's downturn as the US bond market was up 2.96% for the quarter. The quarter started off pretty good with January and February both being good for stocks and bonds. And then March hit, which as most people will remember was the banking crisis that temporarily took hold as Silicon Valley Bank and Signature Bank were both taken over in the second week of March by the FDIC Corp. And the Treasury and the Federal Reserve came together and determined that they needed to step in to prevent a banking crisis and panic of confidence over that weekend.

And they did some pretty extraordinary things by guaranteeing all the deposits, even the ones over the FDIC limits at those banks. But then maybe even more importantly, created a loan facility to be able to allow banks to borrow against their government backed bonds at full value, even if the bonds were slightly below their full value. Now, keep in mind many of these banks do have bonds that are a little bit below their full value as a result of interest rates going up so much in the last year. When interest rates go up, bond values go down. But as those bonds slowly approach their maturity, their values usually start to creep back up towards par, when par is just defined as the dollar amount that you originally purchased them for that will be paid when they mature.

So to be able to borrow against those bonds at full value, even if their actual value is three, four, 5% below their full value was actually a calming act within the markets and helped stem some of the panic that was happening during that brief moment that couple of weeks there where things looked pretty shaky. And it appears, as the month ended on a positive note, it appears that, so far anyways, the FDIC Corp and Treasury and the Federal Reserve Board accomplished their goal in calming the markets, preventing a larger scale banking crisis, and helping to stabilize things while these banks slowly wait for their bonds to mature back at full value here.

And so that was an encouraging sign to see the market calm after all that happened through March. But the end result was a pretty good quarter despite the headlines looking kind of negative when you look at all the different bank things that ended up happening in the panic during that moment. But let's not forget the reports that came in throughout that quarter too, which are relatively easy to forget or overlook or not even see to begin with. So January, jobs report, 517,000 jobs created. February, 311,000 jobs created. March, 236,000 jobs created. The first quarter GDP, it's not out yet, but that's the gross domestic product, which is the economic report everybody looks at to see if the economy is growing or contracting.

GDP estimated first quarter, like I said, the report's not out yet. It'll come out at the end of April. But estimated to grow at 2.5% for the first quarter, which would be right in line with average type growth to slightly above average type growth. So that's not even to mention the inflation reports, which if we all remember right at the peak, inflation was 9.1% last summer and has come down now to 5% as of the March report with indications that it is moving more towards the Federal Reserve's ultimate goal of about 2%, which is what we've had before all this for the last 10, 15 years. So on the economic front, despite everybody calling for a recession, despite it nonstop being in the news that we're expected to go into a recession because the Federal Reserve has raised rates so fast, and they did raise rates another quarter percent in March. And it looks like they're poised to do another quarter percent here in May potentially.

And then after that is really anybody's guess. We're going to kind of see what the data says. I think they're going to see what the data says. But the general consensus, and any economist you ask on the street or financial professional you ask on the street or market pundit that you ask on TV has been calling for a recession. And we talked about this last quarter in the commentary. This will be the most predicted recession of all time. Everybody is expecting it to happen, and we just keep waiting and waiting and waiting. And that's not to say that it maybe doesn't come, but it might be so mild that ultimately we find out after the fact, like we almost always do from the National Bureau of Economic Research, we find out after the fact and the market and the economy has already recovered before we even realized that we were in a recession.

And that aspect might be part of what's happening here in the stock market over the last six months. I mean, like I said, fourth quarter was great, first quarter was great for stocks and for bonds. So what does the wisdom of the crowds of the investment markets telling us? It's telling us most likely that markets were too negative in the first and second and third quarter of 2022. And as some of the economic data has come in, even after interest rates went up, it was not as bad as expected. And so the market has started to recover some of what was lost during the first nine months of 2022. Now, are portfolios back to their all time highs from early January 2022? No, but they have gained a significant amount of ground. So here's a nice chart that we pulled from our friends at YCharts showing the last six months.

So September 30th, 2022 through March 31st, 2023, the purple line here is the Vanguard total stock market, which would represent the global stock market, so the US and everything outside the US. And the total bond market, which is obviously just a general measure of the US bond market. And over the last six months, the total world stock has gained 18% and the bond market has gained 4.88%. And depending on your risk level, many of you have gained eight, 10, 12% or more over the last six months if you go from September 30th through March 31st. And it just doesn't feel like it. It's true, but it doesn't feel like it.

And anytime we end up going over that type of data with clients, that's just kind of a little bit of a head scratching moment to say, "Really?" But that's true. That's what's happened. Stock market and bond market has had a really good six-month run here. And it's kind of feeling unloved and unappreciated within the national media and the market pundits, just whether that's because so many things have gone on in between including this banking crisis. And the old stock market Wall Street saying that stocks climb a wall of worry could not be more evident in this six-month period.

I mean, there's just so much inflation information, banking crisis, continued war in Ukraine. I mean, there's just so many things. Debt ceiling crisis, add that one to the list. Just so many things, quote unquote, to worry about. But despite that, ultimately, the stock market has moved upward as a result of all this economic data and corporate profit data and earnings report data showing that, yes, things are down, but they are not as down or as bad as what was originally predicted through the early part and first nine months of 2022. And so this goes back to one of my favorite things to talk about when people say, "Well, how is it possible that markets can go up on an economic report or a corporate earnings report that is unequivocally negative?" And to which I would respond, it's not a question of is the report a positive or negative report? It's a question of, is it better or worse than what they were expecting?

So for instance, if we're expecting GDP to go down 1% for the second quarter, which would be a bad quarter, the economy would contract. If we're expecting it to go down 1% and it only goes down a half a percent, don't get me wrong, a half a percent contraction, still bad. That's not good, but it is better than expectations. And that's what moves markets. That's what can move markets in the tune of... in that type of scenario, often markets would go up. Even though the report itself technically was negative, it wasn't as negative as everybody thought it was going to be. And that's like when you think about the information and the digestion and reflection in stock market, bond market prices that millions of investors do every day, when every single piece of information comes out like that, I mean, the mechanism to convert all that information immediately into prices is unbelievable.

I mean, it's just unbelievably impressive to watch happen, which is why we end up reminding people how it's nearly impossible to try and outsmart in the short-term or out bet the market in the short-term, given that market moving information is already priced in. It's the unknown that will move markets. And so in effect, if you were to say, "Hey, I want to make a big bet on the markets one way or another about the next three months," you are simply just trying to predict the future because the information that we already know is already priced in.

So a lot of times people say, "Well, what's your prediction for the next six months?" I don't know. I don't know what's going to happen. Nobody else does in the next six months either. I mean, don't get me wrong. There's going to be a lot of people who are going to talk very confidently about what they think is going to happen. But unfortunately, the reality is they have the same information that the other hundred million investors do and have already reflected into the prices of stocks and bonds. And so to pretend that they're going to somehow be able to use that information to predict the next six months, as you think about it that way, is a pretty foolish strategy. Because what's going to move markets over the next six months is information that has not yet come out, events that have not yet happened.

And so from that perspective, that's why trying to make predictions and short-term movements in the markets that take advantage of what you think might happen is more of a flip of a coin than anything else, which is not really a suitable long-term investment strategy. So like I said, all in all, not a bad first quarter at all. And hopefully the year continues at this pace, which would result obviously in a pretty good year if we get another couple of quarters that look like this first quarter. And so big picture what we want to reiterate, and we can tell this a little bit with this J.P. Morgan chart, is this chart does a really good job of showing stocks here in green, bonds in blue, and then just a simple 50/50 portfolio that would have half in stocks and half in bonds. And just show over the last 72 years the range of outcomes for each of these three things. Over a one-year timeframe, a rolling five-year timeframe, a rolling 10-year timeframe, and a rolling 20-year timeframe.

And rolling just simply means they look at every five-year period, every 10-year period, and every 20-year period. And so clearly, as you look at the chart, in any 12-month period, there's a pretty wide range of outcomes. I mean, they're stocks most evidently, right? There's scenarios where stocks lost 47, or sorry, lost 39% in a one-year period, and periods where they've gained 47% in one year. Bonds have had somewhat of a not quite equal but pretty dramatic one year timeframe. And in fact, interestingly enough, that negative 13% over the one-year timeframe is pretty darn close to what bonds lost last year. I wouldn't be surprised if that one-year timeframe is actually the 2022 timeframe. It was one of the worst years on record for bonds. But as you look at the five-year timeframe, 10-year timeframe, and 20-year timeframe, the range of outcomes gets narrower and narrower.

And ultimately, as you get past, I mean, even for a five-year 50/50 portfolio, over the last 72 years with rolling five years, there has been no rolling five-year period where a 50/50 portfolio lost money. There's been rolling five-year periods where bonds have lost money and stocks have lost money. But if you owned half of each, there was no five-year period where you ended up losing money. And then you get into a 10-year period, same story. Stocks and bonds, or excuse me, bonds in a 50/50 portfolio positive. And stocks even have a 10-year period where there was one period where they lost negative 1% over that rolling 10-year period. You get out to 20 and now your returns are very, very, very likely to be positive. They're not guaranteed, but they're very, very likely to be positive, which tells us a lot of what many of us already know, which is the longer we give our investment portfolio to work, the more likely it is to make money and to pay off And that investment pay off and the form of positive returns.

And sometimes highly positive returns. I mean, look at the range of outcomes for the 50/50 portfolio over 20 years even/ the worst scenario was a 5% annualized return. The best scenario was a 14% annualized return, which is obviously very impressive over that long period of time. So as we show that, it kind of just helps emphasize taking the long-term view, which we all hear over and over again. But sometimes it's easy to, well, number one, say, "Well, what even is long-term?" In some people's minds, six months, 12 months is long-term. But obviously, that investment principle-wise, when you want to think about long-term, you really need to be talking about five years or longer, preferably 10 years or longer to see the effects and the power of markets and compound interest to ultimately work to your advantage.

And so we always want to keep that long-term perspective, that big picture perspective, so everybody can stay focused on what is likely to be the highest chance of success when it comes to investing. And so the longer the timeframe, the better the chance that you're going to have success from an investment standpoint. So with that, I want to add one other thing here. At the end of the first quarter, many of you have already filed your 2022 tax return. And just as a reminder, if you could send us a copy of that federal and state tax return, that's extremely useful information for us to try and evaluate. Number one, to make sure that, as best as we can check, that the tax return is accurate. Number two, to look for planning opportunities to see if there's any way for us to save you money in taxes going forward.

And then number three, just to get a bigger picture and better, clearer understanding about all the moving pieces of your income, specifically if you are someone who is retired, to ensure we're using all the most accurate information as we project, how successful will your retirement be? Are you still on the right track? Do we need to make any adjustments? So if you could send along those tax returns, that would be extremely helpful. And with that, this has been the first quarter 2023 market commentary. I'm Steve Elwell, and we will talk to you in another three months.