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Market Commentary, First Quarter 2023

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Market Commentary: 3 Years On

In March 2020 financial markets were rocked as the nation and world entered a most fearful and unsettling time due to the onslaught of the COVID-19 pandemic. Normal business activity and commerce were interrupted, driving down the value of stocks. And as frequently happens in uncertain times, a "flight to safety" caused many investors to hold cash and drive-up demand for US Treasury securities, resulting in record low yields on those types of assets.

Too often emphasis is focused just on short-term results and trends. And while this year is starting out in positive return territory for most all asset classes, prudent long-term investors have learned it is best to measure and evaluate performance over longer periods of time. In fact, it has become industry standard to highlight total return experience at 3, 5 and 10, year marks.

As we close the books on the first quarter 2023, we see how impactful the start and end dates of a measurement period can be, and how volatile performance can be within a period of 3 years. By the end of March 2020 equity markets had begun to recover, rising significantly through the end of 2021, dropping significantly throughout the first 3 quarters of 2022, before recovering somewhat during the most recent two quarters.

This pattern of returns resulted in some impressive compound annual returns for the 3 years ended March 31, 2023. For example, the widely followed S&P 500 index returned 18.6%. Turning back the clock by just three months paints a much more modest 3-year return profile of just 7.7% for the period ending December 2022.

Positive three-year returns were not universal, however. As equity markets fluctuated, bond market returns were trending in one general direction – down – as interest rates rose from the lows of March 2020. Using the 10-year US Treasury bond as a benchmark, on March 31, 2020, the yield was in record low territory at 0.70%. By the end of March 2023, the yield had risen five-fold to 3.49%. Fortunately, since October 2022 we have seen the 10-year US Treasury bond yield drop from its then high of 4.25%. This correlates to an almost 3% total return as reflected by the Bloomberg U.S. Aggregate Bond index for the first quarter.

Experiencing a 3-year negative total return of 2.8% for the Bloomberg US Aggregate Bond index is indeed painful for the values of most bond funds within our portfolios. It does remind us though, of the over-arching benefit of portfolio construction to include both stock and bond funds at levels consistent with liquidity needs and risk profile.

In March, the financial markets and press focused on the failure of a couple of mid-sized banks, Silicon Valley Bank (SVB) and Signature Bank (SB). In response, volatility in both the stock and bond markets increased as investors grappled with the potential fallout in the general market. However, as we closed the quarter and as of this writing, we feel sustained impacts appear minimal . The actions of the Federal Reserve and others, while questionable to some observers, seemed to mitigate the possibility of a more adverse set of outcomes from what could have resulted in a more widespread "run on the banks".

As usual analysts, politicians, and pundits have been quick to play the blame game. Many focus on external factors like the sustained Federal Reserve interest rate hikes, extent or effectiveness of banking regulation, the limit of $250,000 on FDIC insured deposits, technology enabled rapid withdrawals, questionable clean external audit reports, crypto-currency, and even claims of "wokeness".

We must not overlook how decisions made by the banks led to this outcome, which were counter to standard risk management best practices. Important to banking and other financial service firms is the

appropriate matching of assets and liabilities. These banks chose to invest in long-term bonds while their customer deposit liabilities were subject to immediate withdrawal. While increased interest rates did reduce the value of their long-term bonds purchased in a much lower interest rate environment (although not the banks' "fault"), the degree to which bank management allowed such a mismatch to build or not elect to hedge that interest rate risk, was a business decision made to increase expected profits.

Another area where both banks failed to exercise prudent financial management practices was in portfolio diversification. Both by focusing on long-term bonds as mentioned above, but as was the case with SVB, also in acquiring a customer base that was so focused on one sector – technology. SB, on the other hand, focused on firms in the crypto-currency industry and real estate. And in the case of SVB at least, the problem was further amplified by requirements that "loan" customers maintain all cash balances exclusively with the bank. As a result, many customers had balances well above the $250,000 FDIC insured limit.

Any strain within the larger financial system can have an impact on our individual portfolios and naturally be of concern. We can't control external factors, but we can control how we build and maintain an investment portfolio, not unlike prudent practices for banks:

1. Construct a portfolio with a risk profile that reflects the anticipated amount and timing of withdrawals.

2. Make sure the portfolio is diversified among a wide range of asset classes and sub asset classes (US stocks, international stocks, large and small companies,

3. Use bond funds that encompass a range of maturity dates designed to manage your interest rate exposure and liquidity needs.

For a more detailed analysis of market returns, read the **First Quarter 2023 Market Commentary from Dimensional Fund Advisors**
As always, this newsletter provides a general overview of the market, but it may not fully reflect the construction and performance of your portfolio. That's why at a minimum, we initiate an annual review with you. These meetings allow us to discuss your situation to determine if any changes should be made. However, we welcome additional conversations. Please contact your advisor if you would like to discuss your portfolio in more detail.

Index	% Last Quarter Return 1/1/23-3/31/23	% Year-to-Date Return 1/1/23 - 3/31/23	% Cumulative 1 Year Avg. 4/1/23-3/31/23	% Cumulative 3 Year Avg. 4/1/20-3/31/23	% Cumulative 5 Year Avg. 4/1/18-3/31/23	% Cumulative 10 Year Avg. 4/1/13-3/31/23	% Cumulative 15 Year Avg. 4/1/08-3/31/23
Bloomberg US Aggregate Bond Index	2.96%	2.96%	-4.78%	-2.77%	0.91%	1.36%	2.71%
S&P 500 Index	7.50%	7.50%	-7.73%	18.60%	11.19%	12.24%	10.06%
S&P 500 Value Index	5.17%	5.17%	-0.16%	19.12%	9.47%	10.17%	8.10%
S&P Mid Cap 400 Index	3.81%	3.81%	-5.12%	22.10%	7.67%	9.80%	9.82%
S&P Small Cap 600 Index	2.57%	2.57%	-8.82%	21.71%	6.30%	9.87%	9.64%
S&P Small Cap 600 Value Index	3.05%	3.05%	-6.81%	25.26%	6.30%	9.45%	9.13%
MSCI EAFE Index	8.47%	8.47%	-1.38%	12.99%	3.52%	5.00%	3.00%
MSCI Emerging Markets Index	3.96%	3.96%	-10.70%	7.83%	-0.91%	2.00%	1.69%
Dow Jones US Select REIT Index	2.77%	2.77%	-20.98%	11.32%	4.66%	5.31%	5.57%
Bloomberg Commodity Index	-5.36%	-5.36%	-12.49%	20.82%	5.36%	-1.72%	-3.55%

Sources For This Commentary & Chart: YCharts, Wall Street Journal, Bloomberg, Dimensional Fund Advisors, Federal Reserve Bank of St. Louis, MSCI, S&P Dow Jones Indexes.

Green = best performing asset class
Red = worst performing asset class

Index returns are for illustrative purposes only, and do not reflect any management fees, transaction costs or expenses. The performance of an unmanaged index is not indicative of the performance of any particular investment. It is not possible to invest directly in any index. Past performance is no guarantee of future results.

Definitions and Disclosures:

Bloomberg US Aggregate Bond Index. An index managed by Bloomberg to track the general performance of the domestic taxable investment grade bond market.

S&P 500 Index. An index that measures the large-capitalization sector including roughly 500 leading companies representing over 80% of the largest market capitalization in the U.S. equity markets. It is a capitalization-weighted index from a range of securities chosen by Standard & Poor's for liquidity and industry group representation.
S&P 500 Value Index. Contains those securities from the S&P 500 Index with lower-than-average sales and growth rates and that generally reflect lower price-to-earnings and price-to-book ratios.
S&P MidCap 400 Index. An index that measures the mid-capitalization sector including roughly 400 leading companies representing about 7% of the U.S. equity market. It is a capitalization weighted index from a range of securities chosen by Standard & Poor's for liquidity and industry group representation.
S&P SmallCap 600 Index. An index that measures the small-capitalization sector including roughly 600 leading companies representing about 3% of the U.S. equity market. It is a capitalization-weighted index from a range of securities chosen by Standard & Poor's for liquidity and industry group representation.
S&P SmallCap 600 Value Index. Contains those securities from the S&P SmallCap 600 Index with lower-than-average sales and earnings growth rates and that generally reflect lower price-to-earnings and price-to-book ratios.
MSCI EAFE Index. An index developed by Morgan Stanley Capital International Inc. as an equity benchmark for performance of publicly traded securities in developed international markets.
MSCI Emerging Markets Index. An index developed by Morgan Stanley Capital international Inc. as an equity benchmark for performance of publicly traded securities in emerging markets.
Dow Jones U.S. Select REIT Index. This index tracks the performance of publicly traded REITs and REIT-like securities and is designed to serve as a proxy for direct real estate investment, in part by excluding companies whose performance may be driven by factors other than the value of real estate.
Bloomberg Commodity Index. An index managed by Bloomberg to provide a diversified, economically rational and liquid benchmark for commodities as an asset class. The index is currently composed of the prices of 22 exchange traded futures contracts on physical commodities.

Focus on Phillips:
Andy Parker, CFA®, CFP® Practitioner

When Andy Parker joined Phillips Financial at the beginning of 2022, his investment experience made him a perfect fit for the needs of the firm. In addition to his Finance Degree from Marquette University, Andy holds both the Chartered Financial Analyst ® (CFA®) designation, and the CERTIFIED FINANCIAL PLANNER™ certification.

At his prior firm, Andy served as the Chief Investment Officer, while focusing his practice on working with physicians. At Phillips Financial, in addition to working with clients, he serves on the Investment Committee, where he shares his expertise on indexing strategies as well as private equity and distinctive fixed income offerings.

While Andy still maintains his physician focus, he has expanded his clientele to include professionals from other industries who fit his career passion:

"My favorite part of the job is helping clients to see past the most typical uses of their resources (current expenses, retirement savings, etc.) to next level uses tied to their unique interests and passions."

Andy has three children with his wife Angie: Kensley, Lainey and Brooks. He enjoys exploring the outdoors. His favorite activities include skiing, snowmobiling, fishing, and backpacking.

One of Andy's most memorable experiences was backpacking through most of Europe during his college years.

"Travel (especially international travel) stirs up curiosity that remains with me long after the actual trip. It's much easier to comprehend news and events in a location that you've been to. It brings such great perspective to the rest of the world and helps us appreciate all the amenities that most of us are lucky to have in the United States."

A native of northeast Wisconsin, Andy still enjoys getting back to cheer on the Packers and spend time at the family cabin in the Northwoods.

Disclosures:
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