FLAGSTONE
FINANCIAL ADVISORS, INC.

MARKET REVIEW
FIRST QUARTER 2023

What Happened:
The market rebound that began in the 4th quarter of 2022 kept its momentum going through the first quarter of 2023. There were nice gains across many sectors led by advances in big tech stocks. For the six-month period since October 1, 2022, the S&P 500 Index returned an impressive 15%. This happy news was largely ignored by many investors, however, as inflationary concerns and recession worries dampened enthusiasm for the stock rally.

The Federal Reserve continued its program of raising rates at a blistering pace while also reducing the size of its balance sheet (qualitative tightening). This program seems to be taming inflation somewhat, but it is also slowing economic growth. That would suggest that at some time soon—assuming inflation continues to abate—the Fed will probably reverse course and lower interest rates again to stimulate the economy. The cyclical nature of our economy has never been so evident.

The risk of recession looms over our economy and the financial markets. The National Bureau of Economic Research has yet to make a formal declaration of recession, but most indications point in that direction. Should it come to pass, we expect the recession to be short-lived and relatively mild.

In March, we saw turmoil in the banking sector with the failures of Silicon Valley Bank and Signature Bank. These are large regional banks that cater to venture capital firms, start-up companies and a variety of wealthy individuals. A combination of poor investment management and their unique customer bases created a perfect storm for a run on the banks that led to their collapse. Thankfully, the U.S. Treasury along with some large financial institutions stepped in quickly to ensure the safety of the uninsured deposits at these banks which helped prevent a widespread panic. The circumstances that led to these bank failures seem unique to these banks. The banking system overall is on stable ground and we expect to see a return to normalcy.

On the lighter side, the history of presidential cycles gives us reason for optimism. According to CFRA, since WWII, the third year of the four-year presidential cycle has been the best for the stock market. In fact, stocks gained an average of 16% in the third year and rose in price 84% of the time. As you know, 2023 is the third year of the Biden presidency. The reason often given for this outperformance is that the incumbent president typically proposes legislation that will stimulate the economy, making reelection more likely.

First Quarter 2023 Performance:

S&P 500 Index (large stocks)	7.5%
Russell 2000 Index (small stocks)	2.7%
MSCI EAFE Index (international stocks)	8.5%
Bloomberg U.S. Aggregate Bond Index (bonds)	3.0%

Prognosis:
Despite all the uncertainty, we are optimistic about the future of the markets. The market is forward looking. Today’s problems and worries are already reflected in stock prices. While volatility and choppiness are likely to continue in the near-term, the long-term direction of the markets is up. As savvy investors, we all know that patience is the key to good returns. At some point soon, the market will look into the horizon and it will find more positives than negatives. When it does, we will see meaningful upside moves.

And, of course, we have the third year of the presidential cycle in our corner.

Wishing you all a wonderful spring season.

SCK