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Forza Investment Advisory, LLC

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April 11, 2023

2023 Q2 OUTLOOK LETTER & Q1 REVIEW

I hope you all had a nice Passover and Easter week. Baseball is underway and the Masters golf tourney ended yesterday with some great golf and a new champ. The playing inspired all of us wannabe golfers to go out and play over the weekend hoping for some of the magic to wear off on us only to realize those guys on TV are on a different planet. Although watching them struggle on Friday and Saturday against the weather elements made them seem human. But those that got comfortable with the uncomfortable elements rose to the top.

The first quarter was marked by continuing hot inflation, rising interest rates and troubles in the banking industry which rattled financial markets in March and sent bank stocks tumbling and then bond yields lower. But the markets showed their resiliency and somewhat oddly, investors gravitated to Mega Cap growth stocks as a flight to safety, along with more traditional assets like gold, and US Treasury Bonds… and Bitcoin?

Which brings me to this quarter's investment quote. ***"In investing, what is comfortable is rarely profitable." – Robert Arnott***. This quote is a good synopsis of what transpired in the first quarter of 2023. Stocks that got slammed in 2022 and clearly were uncomfortable to own, had a big Q1 and powered the S&P 500 to a gain of 7.0% while propelling the Nasdaq 100 to a run of 20.5%. But looks can be deceiving. In fact, if you took away the gains of 5 mega-cap stocks, the S&P 500 would have been flat. Those mega-caps that drove Q1 performance were Apple, Microsoft, Nvidia, Meta and Tesla. As an example, the equal-weighted S&P 500 rose 2.4% in Q1 compared to the regular cap-weighted index which climbed 7.0%. The Dow Jones Industrial Average rose just .38% in Q1. And the S&P 500 High Dividend Index fell -2.99%. Last year, each of these megacap stocks got hit hard including Apple (-27%), Microsoft (-29%), Nvidia (-51%), Meta (-64.5%) and Tesla (-65.4%). So, investing in these coming into 2023 was not comfortable. Yet, those stocks seemed to turn on a dime and kept rising against odds in Q1. Here are returns of several asset classes for Q1.

ASSET	% RTN	ASSET	% RTN	ASSET	% RTN
Bitcoin	72.8	Nikkei 225	7.5	Natl Muni Bond	2.1
Ethereum	53.3	S&P 500	7.0	**Euro**	**1.3**
Orange Juice	30.6	20+ Yr US Treas	6.8	Dow Jones Industrials	.38
Nasdaq 100	20.5	Ishare Inv Grd Corp	3.96	WSJ Dollar Index	-.34
FTSE MIB Italy	14.4	S&P Midcap 400	3.4	Russian Ruble	-5.5
CAC-40 France	13.1	Vang Tot Intl Bond	3.1	Nymex Crude	-5.7
DAX – Germany	12.3	Hang Seng	3.1	Platinum	-7.4
Euro Stoxx	11.5	Vang Total Bond	2.8	Lean Hogs	-14.2
Nymex Gasoline	9.8	Ishare HY Bond	2.6	Regional Bank Index	-24.9%
Comex Gold	8.2	FTSE 100	2.4	Nymex Nat Gas	-50.5%
Comex Copper	7.9	Russell 2000	2.3		
Dow Transports	7.8	**S&P Sm Cap 600**	**2.1**		

A few highlights – The Q1 big winner was Bitcoin, which rose 72.8%, this after declining -64.7% last year and was thought to be all but dead. Similarly, Ethereum jumped 53.3% following last year's -70.4% drop. Again, owning what was uncomfortable was profitable. International stocks put in a good quarter and finally outperformed US stocks with Italy, France, Germany, Japan, and the Euro Stoxx index doing better than the S&P 500. Gold was a safe haven and advanced 8.2% while crude oil declined 5.7%. Nat Gas was the big loser (-50.5%) due to the warm winter weather.

CAPITALIZATION AND STYLE

Growth stocks outperformed Value stocks across large- and mid- capitalizations. Small Cap Value bettered SC Growth by 1.2%. Large Growth was the top performing group returning 9.62%. In terms of size performance, Large Caps outperformed as the S&P 500 returned 7.46% compared to the Midcap 400 at 3.8% and Small Cap 600 returned 2.47%.

SP 500 Value	5.19%	SP 400 MC Value	2.54%	SP 600 Sm Cap Value	3.09%
SP 500 Growth	9.62%	SP 400 MG Growth	4.95%	SP 600 Sm Cap Growth	1.89%
SP 500	7.46%	SP MC 400	3.80%	SP Sm Cap 600	2.47%

SECTOR ANALYSIS - S&P SECTORS

Technology	21.49%	Basic Materials	3.75%	Utilities	-4.04%
Communic Svcs	20.18%	Industrials	3.03%	Health Care	-4.72%
Consumer Discretion	15.76%	Real Estate	1.04%	Energy	-5.57%
		Consumer Staples	.16%	Financials	-6.05%

Technology led the way thanks to Apple (+26.9%), Microsoft (+20.2%), Nvidia (+90.1%), and Salesforce (+50.7%). Communication services were led by Meta (+76.2%) while Tesla (+68.4%) led the Consumer Cyclicals. These are huge moves by big stocks which drove the market as discussed earlier. Energy declined with lower crude prices and financials stumbled due to the banking crisis.

ECONOMY AND KEY TAKEAWAYS LOOKING AHEAD

My arrow map of what is going on in the market is still pretty much the same. ***High inflation is triggering → aggressive Federal Reserve rate increases and tightening monetary conditions, this will hopefully reduce inflation but also → slow economic growth, which will in turn → lead to a recession, which means → lower corporate profits and lower earnings for the stock market***. Let's look at the individual components as they are mixed:

Inflation – Headline inflation numbers are coming down but still above 5%, down from 10%+ last year. CPI and other inflation data will still be THE KEY statistic that can drive both stock and bond markets.

Fed Rate Increases – The banking crisis caused the Fed to only raise rates by .25% last meeting and odds are that there will be only one more 25 basis point move upward before they pause. How long they pause and when they will cut will now dominate the conversation. For now, there is still a disconnect between what the Fed is saying (keep the Fed Fund rate above 5% thru 2023) and what the market expects (cut rates in 2nd half 2023). And any higher inflation than expected may force the Fed to make a tough decision on further rate increases vs a recession and the bank troubles.

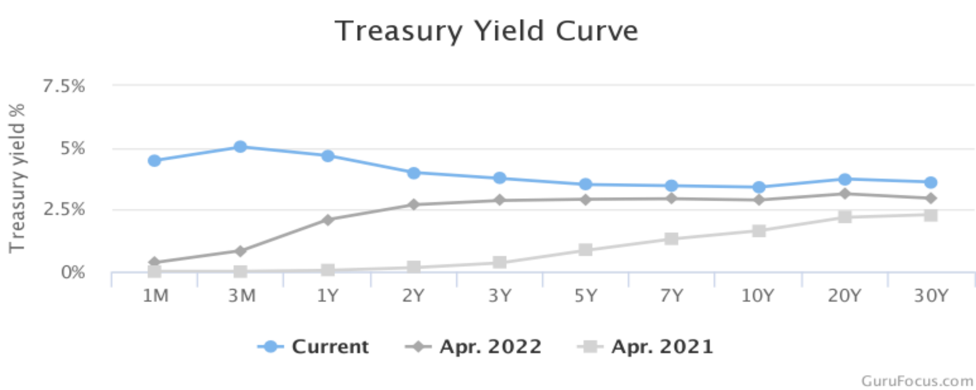
Economic Growth – Growth is slowing but still positive. The question is, will the next few quarters show the real effects of the rate increases and cause negative growth or deceleration. The labor market is showing signs of cracking with tech and manufacturing layoff announcements in the headlines. The ISM Manufacturing index declined to 46.3 in March (reading below 50 indicates a contraction) while the Services index fell to 51.2, still positive but cooling. Housing and construction indicators are mixed, but home prices are mostly lower than a year ago due to higher mortgage rates.

Recession – We are not in a recession by technical definition. Most economists feel that it is coming the next couple quarters but will be shallow. GDP is expected to have climbed 2% in Q1, down from 2.6% in Q4-22. The quarters to follow seem very likely to drop to negative or only slight positive growth. The chart below shows the odds of a recession are estimated at close to 60%. Anytime this has been above about 35% a recession has occurred.

<u>Lower Corporate Profits</u> – The current estimated decline for S&P profits in Q1 is -6.8%, which would be the largest since Q2-2020, and the 2nd quarterly decline in a row. Q2 is expected to decline by -4.6%, but growth is then forecasted for the 2nd half of the year at 2% in Q3 & 9% in Q4. For all of 2023 an increase of 1.2% is projected. Upcoming earnings reports will give a clue into profits for the rest of the year. Obviously, higher profits are key to higher stock prices and vice versa.

BONDS

Bonds came off an awful year in 2022 (worst in 35+ years) and even though the Fed continued raising rates, they produced a positive return for the quarter as the inverted yield curve helped longer-term bond prices to rise. The 10-Yr UST yield fell from 3.82% to 3.49%. The Barclays Bond Aggregate Index returned 3.2%. Shorter-term 1-3 year US Treasuries saw their yields stay fairly steady above 4% and above 5% for a short time which produced a positive return of about 1.6% in the quarter. Below is a view of the Yield curve and its inversion against 1 and 2 years ago.



<u>The yield curve inversion still shows that investors think a recession is coming and series of rate cuts will happen as early as the 2023 second half</u>. We continue to recommend short to intermediate bonds (1-3 Yr) for protection of principal and a decent yield (4%-5%) but would buy longer term bonds if those rates move back above 4%. Alternative fixed vehicles like preferred stock and short-term high yield bonds also can be owned. Muni bond yields should also be compared to taxable yields for taxable accounts. If the Fed is indeed going to be forced to lower rates either this year or early 2024, then bonds can produce an attractive return (5%+) over the next 12-18 months. However, the longer end of the yield curve is already anticipating this, so price returns might not be as great. Given the inversion we are still at a point where either short rates have to decline or long rates have to rise to return the curve to normalcy. Most likely short rates would decline further especially if we move into a recession.

EQUITIES

The stress of bank troubles seems to be diminishing. Big banks will report earnings this week and give us an outlook on their profits and balance sheets. Any good to stable news here could be positive for stocks. The contrarian play is to look to buy banks after they report. Beyond that, all eyes will be on big cap tech in the coming weeks. A lot of good news is baked into valuations for this group. Stock leadership has been very narrow as discussed earlier. From quarter to quarter, leadership rotates. I put odds high that some of the lagging sectors will bounce back, give tech a breather and lead in Q2.

Regarding valuation, stocks aren't cheap but also not expensive. Based on the current consensus estimates, the forward 12-month P/E ratio is 18.0, which is below the 5-yr average (18.5) but above the 10-year average (17.3). It ended 2022 at 16.7x. The E (Earnings) part of the equation is the key to driving the P higher or lower.

I still recommend a diverse portfolio with Large, Mid, Small caps and international stocks represented. Right now, large caps are on a roll as many lagging banks and energy companies are in the mid and small categories. If bank troubles continue to diminish, small and mid-caps can do better. But conversely, if the bank crisis intensifies, you want to own large caps. So, for now, I still like having exposure there. International stocks, specifically European equities, are still attractive to me on valuation and could continue to outperform US stocks in the near term.

On a sector basis I would own most sectors but think some of the lagging sectors could bounce back. We still want to own the most attractively valued stocks in the various sectors. Sector performance will be dependent on earnings and outlooks of the individual companies. I'm a bit surprised health care did poorly in Q1, and strong earnings here could produce a positive response. Investors seemed to sell healthcare to buy tech stocks – a typical risk on/risk off paired trade. Energy stocks are inexpensive but highly correlated to the price of oil.

FINAL THOUGHTS

Coming into 2023, the overwhelming consensus view for 2023 was that the first half of the year will be very difficult as the US heads to recession, rates rise, and corporate profits are lowered. As a result, stocks would tumble, possibly retesting prior lows. Then, the 2nd half would be better as the Fed stopped raising rates and possibly pivoted to lower rates as inflation stabilized and they stimulated the economy. Stocks would rally strongly and finish the year ahead of where we started. Last quarter I wrote " **Because everybody expects this to happen, I can almost guarantee this will not happen."** A funny thing happened on the way in Q1, many of the consensus views came true, but stocks rose anyway.

I think stocks and bonds are in a bit of a wait and see mode. Big banks' earnings this week are must-watch TV for investors as well as coming tech earnings. We will have the usual put and takes but historically April has been a good month for stocks. ***And there is an odd seasonality stat that the April before an election year has been the best month for stocks with an average 3.5% gain rising over 90% of the time!*** So, we recommend staying the course in April but might be inclined to take some profits into the summer.

I'd be remiss if I didn't point out that the government is running up against the debt ceiling and Congress and the President must get a deal done between July and September. As we creep closer to this deadline without a deal, markets may be poised to fall. I can speak of the ramifications in a later letter but know that we have not forgotten about this and think about it in our decision making.

Have a great spring and looking forward to warmer weather. As always feel free to call or email me with your thoughts.

Bob