SAWGRASS ASSET MANAGEMENT LLC

Financial Review & Outlook
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Equity Markets Charge Ahead Despite Short Circuits in Bonds and Banks

Sometimes, it just takes some interest rate volatility and threats to the banking system to get the market jumping. The S&P 500 rose 7.5% in the first quarter as investors piled into tech stocks while brushing off fears of extended rate hikes. The strength of tech giants propelled the market 6.3% higher in January but the Fed's pushback on the potential for 2023 rate cuts caused the market to claw back 2.4% in February. The second week of March brought news of some notable regional bank failures but the luck of St. Patty's Day prevailed as a combo of the Fed and other banks stepped in to prevent mass contagion. Investors responded positively, pushing stocks increasingly higher each of the following 3 weeks to end the month of March with a 3.7% gain.

After a very rough 2022, large cap tech-related names came back with a vengeance led by NVIDIA (+90%), Meta (formerly Facebook; +76%), and Tesla (+68%). The top ten stocks in the S&P accounted for 87% of the quarter's 7.5% gain. Let's explain that another way for additional dramatic effect. Growth stocks, led by those top 10 darlings, gained over 14.4% while value stocks barely broke even advancing only 0.9%. Value stocks were like the lazy classmate in a group project, they didn't hurt you but they didn't really contribute anything either.

One of the main reasons value stocks struggled to advance was the underperformance of the banking sector. News that Silicon Valley Bank and Signature Bank were failing due to massive bond portfolio losses sent shockwaves through the banking system. It also renewed doubts of a soft-landing for the economy should rate hikes continue. A change in Fed rate path expectations also introduced volatility into the market with thoughts swinging from optimism of second half 2023 cuts to debate over whether the next hike would be 0.5% instead of 0.25% (it ended up being the latter).

The other popular debate right now is whether the current market rally is legit. The tech/growth-heavy Nasdaq composite is now 20% off its lows which technically qualifies as entering bull market territory but perspective is needed. The recent earnings season was full of lackluster beats over extremely lowered growth expectations. In fact, S&P earnings are now expected to decline by 6% next quarter and the sectors estimated to report the worst year over year declines are the first quarter's market darlings, tech and communication services. With this earnings backdrop, rate path uncertainties, and still elevated inflation, the foundation to declare the end of the current bear market still seems shaky and investors should continue to exercise appropriate caution in navigating this market.

1st Quarter Scorecard		*Table 1*
Index	**Quarter**	**1 Year**
S&P 500	7.5%	-7.8%
iShares Russell 1000 Growth	14.3%	-10.5%
iShares Russell 2000 Growth	6.0%	-10.6%
iShares Russell 1000 Value	0.9%	-7.6%
Barclays Capital US Aggregate	3.0%	-4.8%
ICE BofA U.S. Corporate Index	3.4%	-5.2%

Source: Bloomberg, ICE

Put the withdrawal slip down and nobody gets hurt…

Fixed Income Markets Continue Volatile Movements

The 1st quarter saw a continuation of the drastic moves in interest rates that have transpired over the last year and a half, with volatility hitting levels not seen since 2008. The beginning of the quarter was driven by strong labor numbers and sticky inflation and the front end of the Treasury curve continued its upward trend. This came to a sharp reversal on March 10th on the announcement of the closure of Silicon Valley Bank. The fears over the banking system and possible contagion caused parts of the yield curve to come down dramatically, with the 2-Year exhibiting the largest move down of 85bps (graph 1) over the last 3 weeks. In fact, the 2-year posted seven consecutive days with a yield change of greater than 20bps, both up and down. A clear sign of elevated volatility and concern.

The increased volatility in interest rates also had a large impact on the shape of the yield curve. The hawkish sentiment early in the quarter caused an already inverted yield curve to become even more exaggerated, with the 2/10s Treasury curve inversion hitting its largest magnitude since 1981. This continued tightening and eventual inversion has been a trend over the last 2 years but started to show a reversal in March and ended the quarter 50bps steeper from peak inversion on March 8th.

These concerns caused large dislocations in segments of the corporate bond market as well. For the quarter, corporate bond spreads widened out by only 7bps but a majority of this movement occurred after the closure of SVB and other regional banks. Specifically, the US Banking Index gapped out by 43bps after this date with regional banks being hit the hardest. The worries about the banking system caused spreads on some issuers to widen out to levels not seen since the onset of Covid in 2020 and the subsequent credit crunch.

As rates increased throughout 2022, the yield opportunities on fixed income products became much more attractive, as evident by the yield on the Bloomberg Barclays Aggregate peaking above 5% at points (graph 2). With the higher yield and move down in rates, the AGG was able to deliver a return of 3.0% for the quarter. This was the 2nd quarter in a row of a positive return and a welcome sight considering the prior negative returns as the Fed was implementing its substantial hiking cycle. While steps have been taken to shore up the banking system, there are still many uncertainties regarding the economy and the path of rates going forward. We believe the importance of a high-quality approach is as important as ever in this environment.

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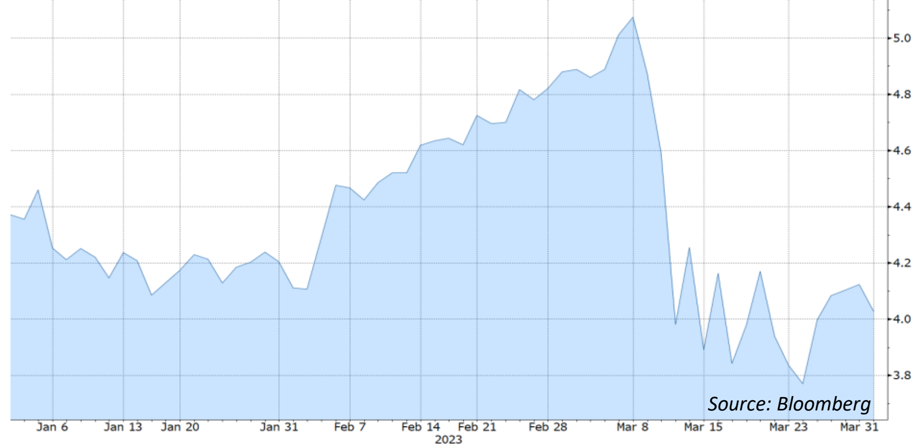
Graph 1 **2-Year Treasury**



Graph 2 **Bloomberg Aggregate Yield to Maturity**

Interest Rate Summary — *Table 2*

	3/31/2023	12/31/2022	3/31/2022	Quarter Change	12-month Change
3 Month T-Bills	4.7	4.3	0.5	0.4	4.2
5 Yr Treasury	3.6	4.0	2.5	-0.4	1.1
10 Yr Treasury	3.5	3.9	2.3	-0.4	1.1
30 Yr Treasury	3.7	4.0	2.5	-0.3	1.2
5 Yr Corporate (A)	4.7	4.8	3.1	-0.2	1.6
10 Yr Corporate (A)	4.9	5.1	3.4	-0.2	1.5
30 Yr Fixed Rate Mortgage	6.8	6.7	4.9	0.1	1.9

Source: Bloomberg (Graph 1, 2, 3 & Table 2)