FOURTH STREET
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# February 2023: Market Review

The global equity market rally seen in January lasted just one week into February before fresh economic data sent equities lower. Strong labor market data, firming inflation levels, an acceleration in consumer spending, and falling Q4 corporate profits and forward earnings guidance caused investors to price in a higher terminal rate of interest for global central banks. The labor market continues to gain momentum as the U.S. economy added 517,000 jobs in January and the unemployment rate declined to 3.4%, the lowest level in over half a century. Inflation cooled in January (+6.4% year-over-year versus +6.5% in December) but the pace of decline has started to slow. As expected, the Federal Reserve increased the Fed Funds rate by only 25 basis points to a range of 4.50-4.75%. Market participants' concerns are that the Fed will continue to raise interest rates at least into their summer meetings because the Fed's primary gauge of inflation, the Personal Consumption Expenditures (PCE) Price Index, rose +5.4% in January, accelerating from the 12 months ending in December. The Dow Jones Industrial Average sank -3.9% while the S&P 500 Index declined -2.4%. Technology stocks continued to outperform in February as the tech-heavy NASDAQ Composite (-1.1%) held up better than the other large-cap equity indices this month.

In domestic equity markets, growth stocks outperformed value across all market capitalization sizes. The Russell 1000 Growth Index was down -1.2% for the month versus the Russell 1000 Value Index return of -3.5%. The Russell Midcap Growth Index declined -1.0% while the Russell Midcap Value Index fell -3.2%. The Russell 2000 Growth Index detracted -1.1% whereas the Russell 2000 Value Index fell -2.3%. Gold posted losses in February as well, ending the month at $1,829 per ounce (-5.2% this month). WTI crude oil declined modestly (-2.5%), ending February at $77 per barrel.

Developed international equities modestly outpaced U.S. equities despite the strengthening of the U.S. dollar and an acceleration in inflation over the month. The MSCI EAFE Index returned -2.1% in February, while the MSCI ACWI ex USA Index (which includes emerging markets) was down -3.5%. Emerging markets fell -6.5% in February primarily due to China (-10.4%) as geopolitical tensions with the U.S. intensified and restrictions were placed on their semiconductor manufacturing industry. Weak relative results in other Asian markets such as Thailand (-9.5%) and Korea (-7.0%) also contributed to underperformance.

U.S. fixed income markets also posted losses in February as bond investors, similarly to equity investors, began to price in the potential for a higher peak in the Fed Funds rate. The Bloomberg Aggregate Bond Index posted a loss of -2.6% during the month while the Bloomberg U.S. Corporate High Yield Bond Index was down -1.3%. The inverted spread between the 2-year and the 10-year U.S. Treasury notes widened to -0.89% at month's end while the spread between the 3-month and the 10-year U.S. Treasury notes tightened to -0.96%. These inversions are some of the deepest the bond market has seen in over 40 years. Additionally, market participants are concerned about the possibility that the Federal Reserve could accelerate the size of rate hikes and raise short-term interest rates by 50 basis points next month due to the acceleration in the PCE Index reading in January.

Strong economic data, higher-than-expected inflation readings and weakening corporate profits guidance rattled investors and caused a modest sell off in both equity and fixed income markets. The Federal Reserve indicated that additional rate hikes may be necessary to bring inflation to their 2% target. This rhetoric, combined with the surprisingly strong economic data, disappointed investors as the expectation was that the Fed might pause interest rate hikes after the March meeting. This 'good news is bad news' market environment implies that markets remained focused on the actions of the Federal Reserve. As investors were reminded this month, the path to curbing inflation is challenging, and markets likely will remain volatile in the coming months as investors monitor economic data and inflation in an attempt to determine when and at what level the Fed will pause interest rate increases.

*See footnotes on the following page.*

# Disclosures

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