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1st Quarter 2023 Moreno Dye Cervantes
Wealth Management Group of Wells Fargo Advisors Quarterly Newsletter

As expected, the beginning of 2023 provided investors with plenty of excitement and we may finally be starting to see signs that the FED's aggressive monetary policy is slowing as some cracks have recently developed in the banking system. As you can see below, the financial markets performed admirably across the board and it is especially nice to see the international markets getting a long awaited boost.

	2022 Year-to-Date	2023 1st Quarter
Dow Jones Industrial Average	-6.86%	0.93%
Russell 1000 Growth Index	-29.14%	14.4%
Russell 1000 Value Index	-7.54%	1.0%
NASDAQ Composite Index	-33.10%	16.77%
S&P Mid Cap 400 Index	-14.48%	3.36%
S&P Small Cap 600 Index	-17.42%	2.12%
MSCI EAFE – International Index	-14.45%	8.47%
Bloomberg Barclays US AGG Bond	-12.03%	2.91%

*Wells Fargo Advisors Monthly Major Index Returns

As we have mentioned over and over, the Federal Reserve's interest rate policy is the primary driver of the economy and by extension the financial markets. After a full year of very assertive monetary policy, we seem to be at the precipice of the economic slowdown that the FED has been orchestrating in order to bring down inflation. Unfortunately, slowing the economy leads to economic pain and unexpected outcomes. We fully anticipated that an increase in layoffs and unemployment would be an eventual outcome of slowing the economy, so the layoff announcements we have seen throughout the first quarter of the year are not surprising. What did catch the financial markets off guard were the recent banking system problems that led to the failure of three regional banks and one European investment bank, which led to government intervention in order to prevent contagion.

At this point, we don't believe that the recent bank failures will lead to a full blown crisis, but additional bank problems that require government assistance is not at all out of the question. We feel that it is important to point out that the issues that led to the recent bank failures are very different from the 2008 financial crisis. These three bank failures were primarily as a result of the banks holding low coupon Treasury and mortgage securities on their balance sheet that have declined in value as a result of the Fed's interest rate increases. Additionally, these banks had very high percentages of their bank deposits that were over the FDIC insurance limit of $250,000 and became very vulnerable to deposits being moved away from their institutions (aka a run on the bank). What was startling and should serve as a warning to bank regulators was how fast money can leave a banking institution as a result of technological advancements over the last 10 years.

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Again, we do not view the recent banking issues as anything like the events that caused the 2008 Global Financial Crisis. The recent issues are not nearly as complex as 2008 and the immediate response by federal regulators was extremely fast and convincing. That does not mean that this will not cause negative repercussions to the economy. It is very likely that financial institutions will become more restrictive in how they decide to utilize their balance sheets, which could potentially reduce economic growth. Ironically, assuming that banks will be more judicious with their capital, the FED likely will not have to raise interest rates very much further, if at all.

It should go without saying, but the banking system is exceedingly important and why governments take such aggressive steps to protect the industry during times of stress. The banks have had a difficult time over the last twelve months as deposits have been leaving in order to purchase other safe, better yielding short-term investments like money market funds and U.S. Treasury Bills. Bank deposits are the life blood of lending when it comes to the availability of home mortgages and both commercial and industrial loans. Therefore, when the deposit base of a bank is reduced either by moving funds to another bank or purchasing other short-term securities, the lending capacity of an institution can be impaired. With the three banks that were forced into failure during the 1st quarter, deposits fled their banks and they no longer had enough deposit liquidity to function.

As we look forward over the next few quarters, we anticipate that economic data will reinforce that the economy is slowing and year-over-year inflation is in decline. Even if the recent banking issues do not spread to any additional banks, we believe that lending will be restrictive and as a result economic activity will suffer. Federal Reserve policy is a bit challenging to predict as the FED is verbally hell bent on making sure inflation gets back down to their 2% target rate. This would imply that even if the FED does not raise interest rates any further, they could very well keep them at current levels through the end of 2023 and into 2024. Complicating issues for the FED is that even with recent layoff announcements, the labor market is tight and consumer spending has remained resilient. We believe that these two issues will eventually weaken but until they do it gives the FED a reason to remain restrictive with monetary policy.

The stock market has effectively been in a trading range for the last twelve months, which is why investors are beginning to feel like they haven't made a lot of progress. Until we have convincing evidence that the FED is done raising interest rates and might need to possibly pivot towards a less restrictive policy, the stock market will probably remain in a trading range. In the long-term, having periods of consolidation is perfectly normal and will set the stage for the next bull market. Patience is key.

The bond market on the other hand seems to be very well positioned for a slowing economy with a greater possibility of recession later this year. The first quarter of this year rebounded nicely from the worst bond market in 40 years. We have recently seen that bond prices have strengthened as expectations for an economic slowdown has increased after the recent bank failures. Additionally, investors are much more interested in income investments with the Fed Funds rate near 5%. Our expectation is that the bond market will be much more stable throughout 2023 and has the potential for appreciation as the financial markets price in a higher level of economic uncertainty and the potential for the FED to begin loosening interest rate policy as early as next year.

Each and every year investor disciplines are challenged, but we are confident that maintaining a well balanced portfolio will serve you well. We will continue reaching out to discuss your portfolio over the weeks and months to come, but as always if you have any questions or concerns please do not hesitate to contact us. We can't thank you enough for all the support and trust that you have shown our team over the years and we hope that 2023 is off to a great start for everyone!

Sincerely,

Jose A. Moreno, CFP®	Michael B. Dye, CRPC®	Oliver A. Cervantes, CFP®, CRPC®, RICP®
Managing Director – Investments	Managing Director – Investments	Managing Director – Investments

Dividends are subject to change or elimination and are not guaranteed.

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The Dow Jones Industrial Average is a price-weighted index of 30 "blue-chip" industrial U.S. stocks.

The S&P 500/Barra Growth Index is an unmanaged capitalization-weighted index stocks in the Standard & Poor's 500 index having the highest price to book ratios. The Index consists of approximately half of the S&P 500 on a market capitalization basis.

The S&P 500/Barra Value Index is an unmanaged, market-capitalization-weighted index of the stocks in the Standard & Poor's 500 Index having the lowest price to book ratios. The index consists of approximately half of the S&P 500 on a market capitalization basis.

The NASDAQ Composite Index measures the market value of all domestic and foreign common stocks, representing a wide array of more than 5,000 companies, listed on the NASDAQ Stock Market.

The S&P Midcap 400 Index is a capitalization-weighted index measuring the performance of the mid-range sector of the U.S. stock market, and represents approximately 7% of the total market value of U.S. equities. Companies in the Index fall between the S&P 500 Index and the S&P Small Cap 600 Index in size: between $1-4 billion.

The S&P Small Cap 600 Index consists of 600 domestic stocks chosen for market size, liquidity (bid-asked spread, ownership, share turnover and number of no trade days) and industry group representation. It is a market value-weighted index (stock price times the number of shares outstanding), with each stock's weight in the index proportionate to its market value.

The MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada.

Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.