

Market Commentary
February 2023 Recap:

Inflation: Data released in February indicated a mild reacceleration of inflation during the month of January. Core CPI was +0.4% m/m for the second straight month, while Core PPI surprised to the upside at +0.5% m/m, accelerating sequentially by 20bp. Finally, the m/m change in the Core CPE Deflator (the Fed's preferred inflation gauge) rose 20bp to +0.6%. In addition, the December prints for all three metrics were revised higher relative to their original release.

Monetary Policy: As expected, the FOMC raised overnight interest rates by 25bp on February 1st. At the time, futures markets implied that only one more 25bp rate hike was expected at the March FOMC meeting before the Fed would pause and adopt a more neutral policy stance. However, after a very strong Nonfarm Payroll report (+517k) on February 3rd, and the aforementioned uptick in inflation data, futures markets finished the month with three additional 25bp rate hikes priced in before a pause, and implied virtually no chance of any rate cuts before year-end.

Economy: Incoming data in February suggests that the US economy is experiencing solid growth so far this year. As of month-end, the Atlanta Fed's GDPNow estimates an annualized real time GDP growth rate of +2.8%. Housing showed signs of stabilization in February, the labor market remains very strong, and several gauges of manufacturing activity moved from contraction to expansion. Consumer confidence is mixed, with signs of relief regarding inflation tempered by some anxiety about future prospects for the economy.

Bond Market: After a strong rally in January, bonds reversed course in February. Rates rose across the curve as investors recalibrated their expectations for inflation and Fed policy, pushing bond lower. The move higher in rates was especially pronounced in the front end, widening the Treasury yield curve inversion. Nearly 90% of curve points were inverted at month-end (i.e., shorter-term yields higher than longer-term yields), with the much-watched 3m/10y point inverted by 85bp, the deepest since late 1981. Credit spreads were largely stable on the month, so municipal and corporate bond prices declined roughly in line with Treasuries.

Stock Market: Equities were also stung by the February reversal in the inflation trend, as rising bond yields pushed up discount rates, causing mild P/E multiple compression. Q4 earnings season was also not especially kind to stockholders. Many companies issued conservative guidance for 2023, particularly regarding operating margins thanks to labor and input cost pressures, causing analysts to lower their forward earnings estimates.


Albion's "Four Pillars":

***Economy & Earnings** - The US economy enjoyed a strong second half of 2022, but corporate operating margins have been gradually falling as labor and input cost pressures bite. Albion's base case expectation is that the US economy will enter recession in 2023, putting downside pressure on earnings.

***Valuation** - The S&P 500's forward P/E of 18x is above the long run average. More predictive metrics like CAPE, Tobin's Q, and the Buffett Indicator (Mkt Cap / GDP) suggest that compound annual returns over the next decade are likely to be in the single digits. Most or all of 2022's P/E multiple compression was driven by rates, rather than an expansion of the equity risk premium.

***Interest Rates** - Rates rose across the curve in 2022 in response to a dramatic pivot in monetary policy. Fed Fund Futures are pricing in a total of four 25bp hikes in 2023, with a "terminal" Fed Funds policy rate slightly above 5% for this cycle.

***Inflation** - After reaching 40yr highs in spring of 2022, inflation moderated in the second half of the year. Goods inflation has fallen due to softening demand and excess inventory, while services inflation remains elevated, in part due to shelter costs which are somewhat lagged. Real-time inflation data ticked higher sequentially in February.

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Market Data

Equity Indices	Close	Index Total Returns (%)				
		MTD	QTD	YTD	1 Year	3y Cum.
S&P 500	3,970	-2.4%	3.7%	3.7%	-7.7%	41.1%
Dow Jones Indus. Avg.	32,657	-3.9%	-1.1%	-1.1%	-1.6%	36.6%
NASDAQ	11,456	-1.0%	9.6%	9.6%	-16.0%	36.9%
S&P Midcap 400	2,601	-1.8%	7.2%	7.2%	-0.6%	50.0%
Russell 2000 (Small Cap)	1,897	-1.7%	7.9%	7.9%	-6.0%	33.4%
MSCI EAFE (Int'l Dev Mkt Eq)	2,054	-2.1%	5.9%	5.9%	-2.6%	23.7%
MSCI EM (Emerging Mkt Eq)	964	-6.5%	0.9%	0.9%	-14.9%	4.1%
MSCI World	2,715	-2.4%	4.5%	4.5%	-7.3%	32.7%
S&P Global 1200	2,996	-2.8%	4.1%	4.1%	-6.7%	33.7%

Fixed Income	Yield	Index Total Returns (%)				
		MTD	QTD	YTD	1 Year	3y Cum.
10y U.S. Treasuries	3.92%	-3.1%	-0.1%	-0.1%	-14.0%	-17.1%
U.S. Bonds (Aggregate)	4.81%	-2.6%	0.4%	0.4%	-9.7%	-10.9%
Global Bonds	3.84%	-3.3%	-0.2%	-0.2%	-13.6%	-14.7%
U.S. Munis	3.62%	-2.3%	0.5%	0.5%	-5.1%	-4.7%
U.S. Investment Grade Corp	5.51%	-3.2%	0.7%	0.7%	-10.4%	-11.1%
U.S. High Yield Corporates	8.63%	-1.3%	2.5%	2.5%	-5.5%	4.1%

US Interest Rates	Levels (%)					
	2/28/23	1/31/23	12/30/22	12/30/22	2/28/22	2/28/20
2y Treasuries	4.82	4.20	4.43	4.43	1.43	0.91
10y Treasuries	3.92	3.51	3.87	3.87	1.83	1.15
30y Treasuries	3.92	3.63	3.96	3.96	2.16	1.68
Fed Funds (Effective Rate)	4.57	4.33	4.33	4.33	0.08	1.58
SOFR (USD)	4.55	4.31	4.30	4.30	0.05	1.60
30y Fixed Mortgage	6.66	6.02	6.41	6.41	3.89	3.45

Commodity Prices	Levels					
	2/28/23	1/31/23	12/30/22	12/30/22	2/28/22	2/28/20
Oil (WTI)	77.05	78.87	80.26	80.26	95.72	44.76
Gasoline	3.36	3.50	3.20	3.20	3.62	2.45
Natural Gas	2.75	2.68	4.48	4.48	4.40	1.68
Gold	1,827	1,928	1,824	1,824	1,909	1,586

Currency Crosses	Levels					
	2/28/23	1/31/23	12/30/22	12/30/22	2/28/22	2/28/20
\$ per €	1.20	1.23	1.21	1.21	1.34	1.28
\$ per ¥	1.06	1.09	1.07	1.07	1.12	1.10
¥ per \$	136.2	130.1	131.1	131.1	115.0	107.9
\$ per Bitcoin	23,147	22,951	16,579	16,579	41,655	8,671

Macroeconomic Data	Value	Date	Next Rel.	Cons Est	Data Sources:
Fed Funds Target (Lower)	4.50%	02/28/23	03/22/23	4.75%	Bloomberg, Factset
Inflation (Core PCE Deflator)	4.7%	01/31/23	03/31/23	-	
Inflation (Headline CPI)	6.4%	01/31/23	03/14/23	5.9%	
Unemployment (U-3)	3.4%	01/31/23	03/10/23	3.4%	
GDP Growth (Q/Q SAAR)	2.7%	12/31/22	04/27/23	0.5%	
ISM Manufacturing PMI	47.4	02/28/23	03/01/23	48.0	
Consumer Confidence	102.9	02/28/23	03/28/23	-	

Albion's Dashboard of Key Leading Economic Indicators as of 02/28/23

- Initial Jobless Claims (191k 4wk m/a) - Stronger: consistently below 200k in recent weeks
- Conference Board LEI (-5.9% y/y) - Weaker: has declined significantly since peaking in Feb 2022
- Building Permits (1,339k) - Steady: housing activity appears to have stabilized in early 2023
- Corporate Bond Spreads (115%) - Steady: stable near long-term average after tightening in Q4 '22
- Treasury Yield Curves (88.9% inv) - Weaker: most Treasury curve points are inverted
- Consumer Confidence (102.9) - Steady: rangebound (100-110) for the past 7 months
- Real Final Sales (+1.3% y/y) - Steady: below-trend growth in Q3 and Q4 of 2022

Legend: ● = All Clear; ● = Caution; ● = Strong Warning

February 2023 S&P 500 Total Return by Sector
