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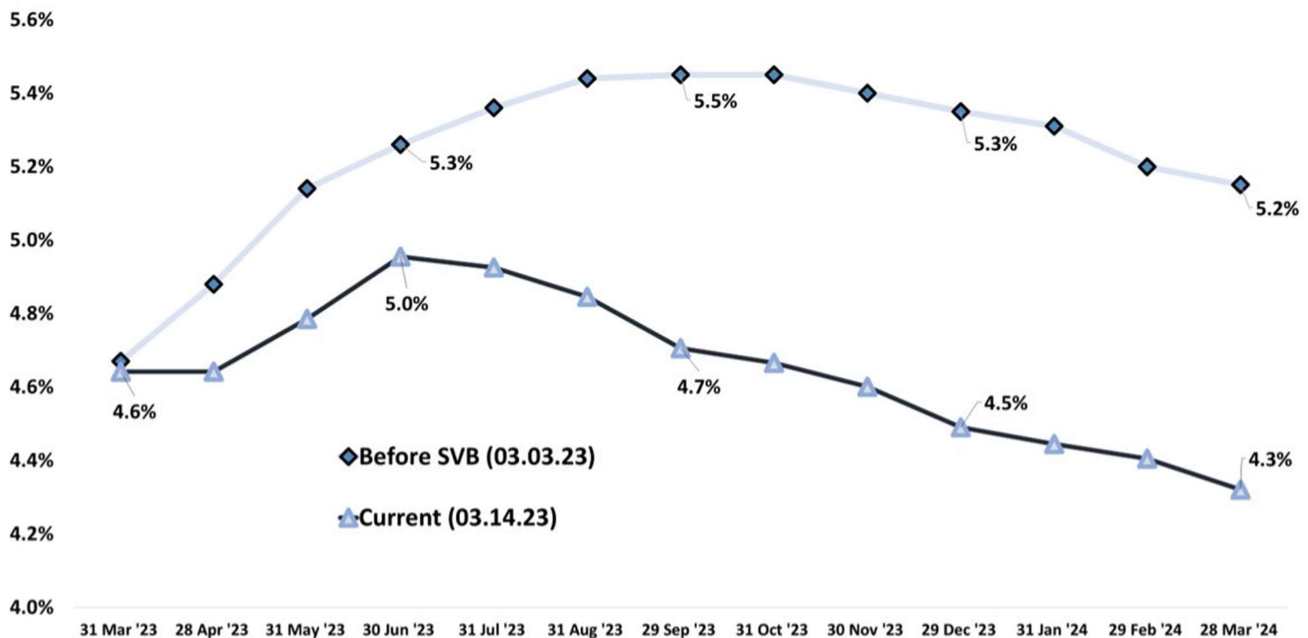
The first quarter of 2023 proved to be a turbulent period for the global financial markets as multiple macroeconomic events influenced the performance of various asset classes. Central banks globally have sought to tamp down stubbornly persistent inflation by raising interest rates and tightening monetary conditions. The Federal Reserve has been particularly aggressive in the inflation fight, raising the Fed Funds rate at the unprecedented pace of fifty and seventy-five basis point increments over a six-month period. The Fed's actions precipitated a mini banking crisis near the quarter's end. Absent the emergency intervention of the FDIC guaranteeing non-insured deposits, the run on Silicon Valley Bank had the potential to start a contagion in the banking system that may have become difficult to contain. All of the drama of interest rate hikes and bank failures was taking place against a backdrop of heightened geopolitical tensions, including a war in Ukraine, a cold war with China, and labor strikes in the UK, France, and the Middle East. From a macro perspective, markets are dealing with many more questions than answers.

The chart below is illustrative of the fluid nature of interest rate expectations and, by extension, market outlook:

Source: FactSet

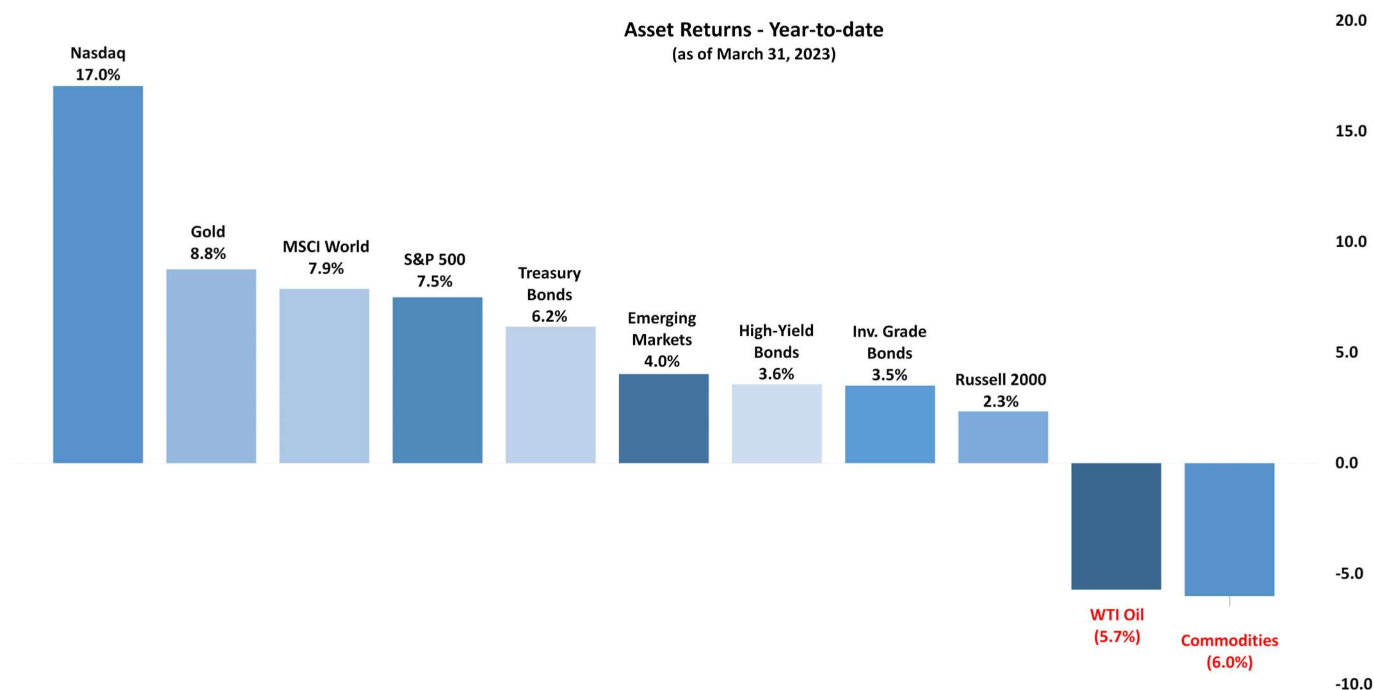


The chart is a graphic representation of schizophrenic financial markets that lurch between a belief in an economy running too hot with inflation persisting and one where recession is just around the corner. Needless to say, it is a challenging time to forecast market direction with any degree of confidence.

Market Performance and Q1 Returns

Despite the unresolved market issues, most major stock and bond indices posted positive returns in Q1 2023[1]. Stocks outperformed bonds as long-term rates declined, credit spreads stabilized, and PE multiples expanded. The S&P 500 generated gains of 7.5% in the first quarter, while the NASDAQ Composite Index returned 17.0%. International developed markets ex USA & Canada also performed well – returning 8.6%[2]. Emerging Markets lagged global benchmark returning 4.0%. Bond investors were rewarded for extending maturities while credit spreads on corporate bonds – Investment Grade & High Yield – were largely unchanged.

These returns are not indicative of underlying optimism about the economy. During the period, there were large shifts in sentiment, with value stocks performing well early in the period when interest rate increases were clearly expected. Growth stocks were stronger later in the quarter when concerns about small banks made more probable a hard landing for the economy. Emerging markets were strong at the beginning of the period on the expectation that the dollar would weaken against other currencies; the dollar's safe haven status asserted itself later in the quarter as financial system health became more of a global issue with the result that emerging markets pulled back. Gold benefited from the recent volatility, while Bitcoin itself became a safe haven asset during the period.



As a fundamental shop, we always rely on the outlook for earnings to anchor expectations. Beyond the macro, earnings were key drivers of stock prices in Q1 2023 in that that they came in better than feared. Most companies reported earnings that met reduced expectations, but their share prices were still pressured by inflation concerns and interest rate fears. The banking crisis in the United States also weighed on investor sentiment and contributed to market volatility. Within the U.S. equity market, financials were the worst-performing sector, while the large cap technology sector outperformed. Some standout performers in the technology sector were Apple, Amazon, and Alphabet. These companies delivered better-than-expected earnings reports and saw their stock prices recover as interest rates declined in the latter half of the period. At the same time, the financial sector struggled, with many banks reporting weaker-than-expected earnings and substantial mark-to-market losses on their long-duration bond investments – mortgage securities and treasury bonds.

[1] On a total returns basis.

[2] Based on MSCI EAFE index as of 3/31/23

Portfolio Activity during Q1 2023

During Q1 2023, SeaBridge continued to make adjustments to the portfolios in response to the changing macroeconomic environment. We increased our exposure to international equities, both broadly and in emerging markets specifically, as we believe that these markets offer better growth opportunities than the U.S. market at this time. We also continued to sell U.S. financials, as we remain underweight in this sector due to concerns about rising interest rates and credit losses.

Portfolio Positioning

We believe at the end of the first quarter, our portfolios were well-positioned to withstand market volatility. Our overweight allocation to international equities, particularly in emerging markets, in our global strategies provided us with exposure to some of the more dynamic growth markets in the world. Our underweight exposure to U.S. financials, combined with our increased allocations to cash and fixed income, provided us with a defensive posture and should provide some protection should the markets experience a significant correction. Our short-duration fixed-income positioning also allowed us to take advantage of the higher yields available, and avoid taking on increased credit risk.

Conclusion

Until there is clarity on the interest rate cycle, we expect markets to continue to be volatile. We expect a slowdown, the timing and depth of which are unknowable. Markets may be nervous in the near term. We, therefore, expect this volatility to create investment opportunities as some very good companies may be sold down in concert with negative market sentiment. We also believe that opportunities in the fixed-income markets will arise. As the year progresses, we intend to extend the duration of our fixed-income holdings and take on additional credit risk including below investment grade.

Best Regards,

The SeaBridge Team

If you'd like to discuss any of the strategy commentaries, or your individual portfolio, please let us know. Also, as always, we encourage you to contact us if there are any changes in your circumstances or goals that might suggest a change in the level of risk in your portfolio or in the investment strategy that we are managing for you. You can call (908) 273-5085 or email SeaBridgeTeam@SeaBridge.com.

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There are differences among portfolios managed by SeaBridge in each strategy based on client-specific factors. Not all portfolios hold the same securities. Not all stocks held in the portfolio perform similarly. Some client accounts may not have as much cash reserved as other accounts managed in the strategy due to client withdrawals or other issues. SeaBridge manages portfolios in several styles.

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Returns for various assets classes have been presented using broad market indices or similar. The NASDAQ Composite Index measures all NASDAQ common stocks, either domestic or international, listed on the NASDAQ and includes over 3,000 companies. The Russell 2000 is comprised of the smallest 2000 securities in the Russell 3000, adjusted annually, designed to measure the small-cap sector of the equity market. The iShares MSCI Emerging Markets ETF (EEM) tracks the MSCI Emerging Market index but excludes most small-cap and micro-cap firms while including South Korea. The Bloomberg US Government Bond Index is comprised of U.S. dollar denominated, fixed-rate, nominal U.S. Treasuries and U.S. agency debentures. The S&P 500 is a market-cap weighted index of 500 U.S. equities. The Russell 1000 Index is a stock market index that tracks the highest-ranking 1,000 stocks in the Russell 3000 Index, which represent about 93% of the total market capitalization of that index. The Bloomberg U.S. Corporate Bond Index is comprised of U.S. dollar denominated securities issued by U.S. and non-U.S industrial, utility and financial issuers and measures the investment grade, fixed-rate, and taxable corporate bond market. The Bloomberg U.S. Corporate High Yield Bond Index measures the U.S. dollar denominated, high yield, and fixed-rate corporate bond market. Securities with a Moody's, Fitch and S&P rating of Ba1/BB+/BB+ or below are classified as high yield for the index. The Gold (NYM $/ozt) Continuous (GC00-USA) includes the prices of near-term futures gold contracts traded on New York Mercantile Exchange. The Crude Oil WTI (NYM $/bbl) Continuous (CL00-USA) includes the prices of near-term futures WTI oil contracts traded on New York Mercantile Exchange. The SP GSCI Commodity (CME) Continuous (GI00-USA) includes the prices of near-term futures S&P GSCI contracts traded on New York Mercantile Exchange. The S&P GSCI is a composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities. The index consists of 24 commodities from all commodity sectors - energy products, industrial metals, agricultural products, livestock products and precious metals but its exposure to energy sector is much higher than other commodity price indices. The Morgan Stanley Capital International All Country World Index® ("MSCI") is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. SeaBridge does not attempt to match the country or industry weights of the index and holds a limited number of securities. There are no guarantees that the relationships shown will continue in the future.