Capital Market Review

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Despite a banking crisis and two more Federal Reserve rate hikes, the S&P 500 Index finished the first quarter 7.5% higher. Growth companies, which were the laggards in 2022, climbed 14% during the quarter, while their value counterparts rose just 1%. Opposite growth stocks, commodities were a top performer last year; however, they saw a reversal during the quarter and ended as one of the worst-performing asset classes throughout the first three months of 2023, with a loss of over 5%.

Rising interest rates were among the most significant factors leading to growth stocks' underperformance in 2022. With two additional 25 basis point rate hikes in the first quarter, it is fair to question why growth stocks did so well during the first quarter. It is important to remember that the Federal Reserve only has control over very short-term rates; the market controls everything else. So, although the Fed raised rates by 0.50% during the quarter, longer-term rates fell, providing a tailwind for growth companies.

Falling rates are one reason for the vast difference between growth and value stocks. Another was the regional banking crisis' negative impact on financial stocks, which tend to fall in the value style. While it is still early in the latest banking saga, it appears to be a contained crisis. Further regulation of the regional banks is expected, but, at least for the moment, market reaction has calmed, and concerns of just a few weeks ago are all but gone.

Technology stock's strong quarter was a primary factor in growth companies outperforming value. In fact, growth went from being the worst performer in 2022to the best in the first quarter of 2023. Not surprisingly, financials were the quarter's worst sector due to the volatility surrounding regional banks. Another laggard in the quarter was the energy sector, which was the best performer last year. These fluctuations, from best to worst and vice versa, are one of the reasons timing the market is so difficult. However, rebalancing a strategic allocation leads to selling high (energy in this example) and buying low (technology) to set a portfolio up to participate but not be overexposed when something cracks, like the regional banks.

Aside from a change in market leadership, another aspect we noticed during the first quarter was the divergence in returns between stock market sectors. Instead, we invest with skilled portfolio managers who buy stocks they feel are best positioned to outperform the index. The return differences we see among sectors and even among stocks within these sectors provide managers with opportunities to differentiate themselves from the index and set them up for potentially strong longer-term results.

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