Vestor Capital
INVESTMENT & WEALTH MANAGEMENT

Economic and Investment Outlook

April 5, 2023

Equity Market Update

Equity indexes have rallied sharply this year after a difficult 2022. Technology stocks, which were among the worst performers in 2022, have rallied the most this year. As a result, the NASDAQ composite index rose 17% in the first quarter. The developed large-cap international index has performed well, rising almost 9%. Emerging market stocks, due in part to weakness in Chinese equities, have not fared as well but still have posted gains of almost 4%.

While markets are off to a strong start in 2023, recent bank failures and rising oil prices have put a cloud over recent gains. Worries are growing that the long anticipated recession may finally be arriving, making investors nervous as we enter the second quarter.

Strong equity market performance in 2023 suggests that investors believe the world economy will not contract significantly in 2023 and a "soft economic landing" is possible. Recent banking issues and rising oil prices will certainly challenge this premise. We anxiously await first quarter corporate earnings reports over the coming weeks to hear what corporate executives say about current and expected economic conditions, which will likely dictate the direction of equites in the coming months.

Total Return Performance for the Major U.S. and International Stock Market Indexes	
Equity Index	*YTD March 31, 2023*
United States	
Dow Jones Industrial Avg.: 30 Stock Composite	**0.93 %**
S&P 500 Composite: U.S. Large Cap	**7.48 %**
NASDAQ Composite: Technology Heavy	**17.05 %**
S&P 600 Small Cap: U.S. Small Cap	**2.54 %**
International	
MSCI EAFE Large Cap: Europe, Asia & Far East Large Cap	**8.65 %**
MSCI EAFE Small Cap: Europe, Asia & Far East Small Cap	**5.10 %**
MSCI EM Emerging Market: Emerging Market Countries	**3.97 %**

Source: Bloomberg, L.P.

Economy

Bank failures over the past month have caused banks to tighten lending standards as shown in the graph below. Lending is the oxygen for corporate growth and consumer spending, and recessions are usually accompanied by tight lending standards as highlighted by the gray bars. We are also concerned that the ISM manufacturing survey highlights that manufacturing has now contracted for five straight months and continues to weaken. Households have slowed their savings rate dramatically and consumer credit outstanding is rising. Finally, recent oil price increases will add another headwind to the economy.

Inflation

The February 2023 consumer price index showed inflation rose 6.0%, which while still high, is the eighth straight month of slowing, and the lowest reading since October 2021. Despite this progress, monetary officials have repeatedly stated that they want inflation to return to 2%, where it resided over much of the last 15 years. We still have a long way to go to reach that threshold. Housing is a large component of CPI, and it is expected that home prices will begin to decline helping to lower CPI further.

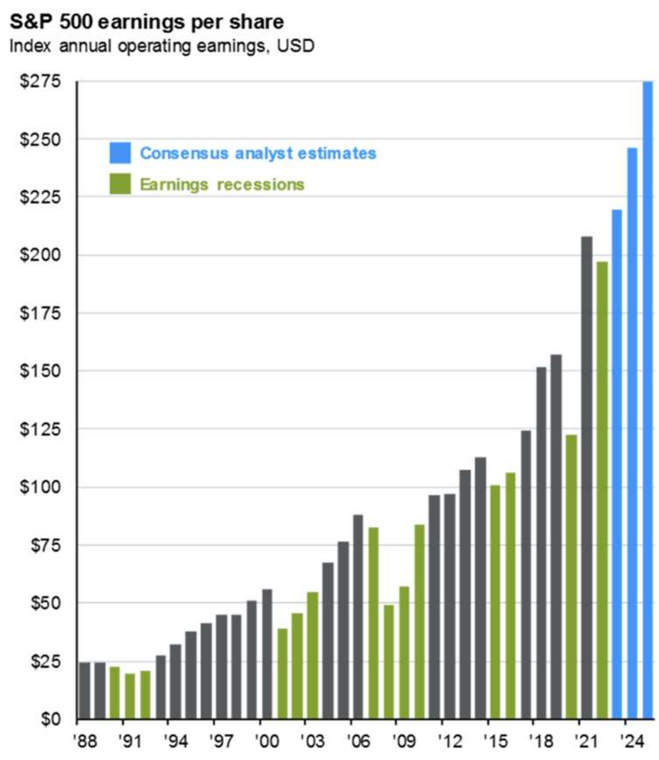
Growth in the money supply due to government actions during COVID has been the fuel to the fire of inflation. The money supply has been contracting, albeit slowly since the summer of 2022, which coincides with the gradual decline in inflation over this period. History shows that inflation tends to be pernicious and while we are encouraged by progress to date, it is evident that it will likely be a while before inflation returns to the 2-3% range.

U.S. Equity Market Outlook

Markets are always looking forward and discounting expectations to current prices. Market strength in 2023 would seem to indicate that current economic weakness will abate soon, and better times are ahead. However, many stocks have not participated in the 2023 market rally. Much of the strength is due to a handful of large technology stocks as the S&P 500 equal weighted index was only up 3% in the first quarter of 2023, versus 7% for the S&P 500 index. In fact, the S&P 500 equal weighted index was down through March 28th.

It appears that monetary officials are nearing the end of interest rate hikes, and this is why markets have firmed. We certainly expect market volatility to increase if economic conditions deteriorate, but we believe that if this weakness is accompanied by monetary accommodation in the form of interest rate cuts, this will help ameliorate investor concerns.

Uncertainty is at very high levels currently explaining the wide range of opinions by market and economic forecasters. For every analyst calling for future market weakness such as Mike Wilson of Morgan Stanley, there is another claiming the worst is behind for equities and better days are ahead. We do not claim to have a crystal ball, or any special forecasting ability. However, we do know that over time markets rise with corporate earnings and interruptions of earnings growth tend to be short lived as shown in the chart below. As Warren Buffett likes to say, over time it has not paid to bet against the U.S. economy.



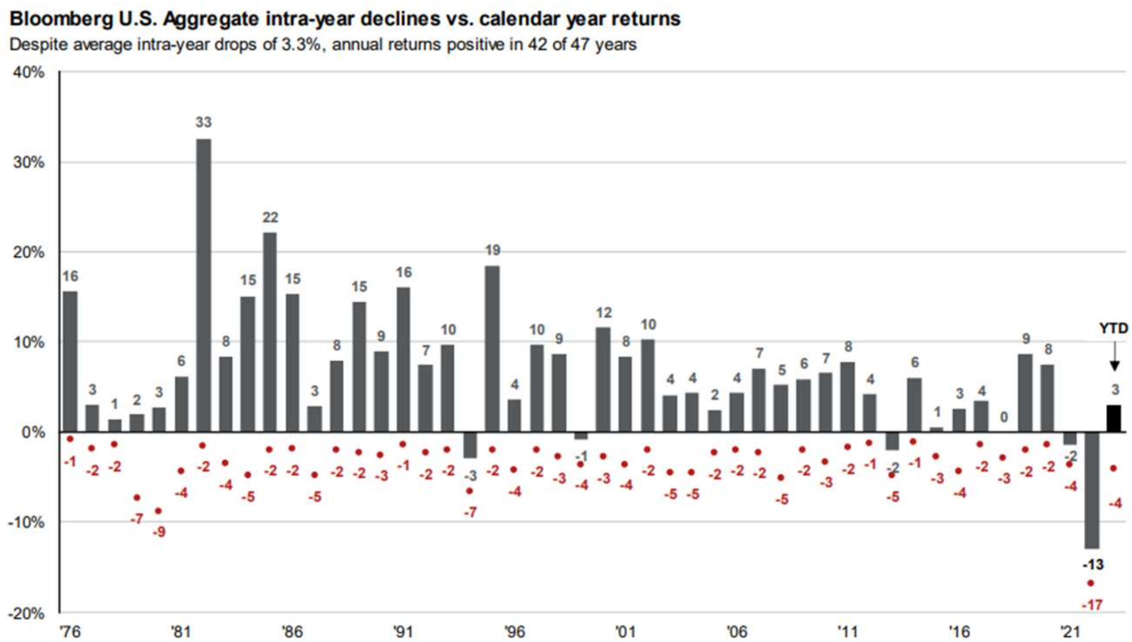
Source: JPMorgan Guide to the Markets 3/31/2023

International Equity Market Outlook

International equities have performed better than their U.S. counterparts in 2023, after an extended period of underperformance. Dividend distributions tend to be much higher for international equities than the U.S. We believe that the search for yield in a higher inflation environment has been one source of strength in international equities in 2023. Emerging markets have continued to lag we believe due to concerns over economic growth in China and associated geopolitical concerns. Until these are alleviated, we do not believe emerging market stocks will draw significant investor attention.

Fixed Income

The graph below highlights the painful fact that bond prices declined in 2022, due to a sharp rise in interest rates. This year is off to a strong start with bonds providing positive returns, which has been the case in 42 of the past 47 years. It appears that the FOMC is close to the end of the interest rate hike cycle which will be a positive for bond prices going forward. Even if rates do move higher causing bond prices to fall, the bond coupons will provide support to total returns.



Source: JPMorgan Guide to the Markets 3/31/2023

Summary

While 2023 is off to a good start for equites and fixed income there are a host of storm clouds lurking, which is keeping investors on guard. We believe that if the economy weakens as is expected, monetary officials will likely provide some form of support in the form of interest rate cuts or at the least a pause in rate hikes, which will be positive for high quality fixed income. Equities have likely already priced in a lot of forecasted economic weakness but may still fall in the event of a severe economic contraction. At a minimum, we would expect equities to remain somewhat range bound until we get more clarity on the direction of the economy and corporate earnings.

The last three years have been a wild ride for investors due to COVID, and the associated government fiscal and monetary interventions in the economy which have had many unintended consequences from bank failures to high inflation. The fallout has been painful, but we believe much of this is behind us now, although there are likely a few more bumps in the road before we make it to our destination. It pays to remember in times such as these that investing is always messy due to the wide number of variables that can surprise us. Despite these unforeseen negative events that occur more often than we would like, over the long-term patient investing is rewarded.