TC Wealth Partners
Trust Company
of Illinois

BUILDING YOUR FUTURE

QUARTERLY MARKET COMMENTARY
SPRING 2023

FROM THE DESK OF

Kevin Rice
Senior Investment Strategist

HURRY UP AND WAIT

During the first quarter asset prices remained volatile, following 2022's gyrations that saw both stocks and bonds simultaneously decline in value over a calendar year for the first time since stock and bond index measurement began. The current market environment includes questions about financial sector health, global interest rate policy and economic trajectory. Investors await answers to these questions, but we expect more waiting for definitive answers and likely more volatility ahead. In this market update we will recap the first quarter and what may be expected as we move forward.

Economy

While the banking crisis is coming off a boil, the markets' attention will likely turn to economic data to gauge the potential fallout from the stress in the banking system. The main transmission channel would be a tightening in lending conditions as banks focus on building liquidity. A possible decline in credit growth will potentially dampen economic growth and make a recession more likely, but also help bring inflation back to the Fed's target sooner.

An area of potential concern is commercial real estate. A wave of upcoming loan refinancing at much higher interest rates is coming at a time when vacancy rates in offices are significantly above their pre-pandemic rates. Smaller regional banks account for about 70% of all commercial real estate loans and are likely to tighten financing the most. While it is worth paying close attention to this sector as the next potential vulnerability, the impact of commercial real estate is small relative to the size of the U.S. economy, accounting for about 5% of GDP, according to the Commercial Real Estate Development Association.

OUR VIEW

The ongoing strength in the labor market remains a key supporting factor for incomes, confidence, and spending. But we expect some cracks to appear later this year as companies look for opportunities to right-size costs as demand slows. Weaker credit growth is an additional headwind, and our base-case scenario remains that a mild recession is likely to take shape this year. However, based on the starting point of the labor market and consumer finances, we doubt that it will turn into a deep or prolonged downturn.

Employment

The February U.S. employment report was mixed, with fairly strong payroll gains (311,000 jobs in February, 504,000 in January) and increases in the labor force participation rate (to 62.5% from 62.4%) and the unemployment rate (to 3.6% from 3.4%). These last two indicate that more people are coming off the sidelines, looking for work, and not finding it. Slower average hourly earnings growth in February indicated that the labor market is softening, but it should be noted that most of the easing in wage growth has been driven by layoffs in higher-paying industries. Moving down the income spectrum, wage growth remains relatively robust but still lags inflation.

OUR VIEW

We believe there is a limit to how much the unemployment rate could rise going forward, as U.S. businesses still face a structurally smaller labor force than prior decades. Diminished legal immigration, particularly over the course of the pandemic, and baby-boomers reaching retirement age have left the economy very short of workers. As such, the unemployment rate may only nudge slightly higher in the year ahead. However, wage growth should continue to moderate and help give the Federal Reserve confidence that inflation is sustainably coming down.

Inflation

After nearly two years of hot inflation squeezing consumer wallets and contributing to a swift rise in interest rates, a sustained inflation downtrend is now underway. Headline CPI inflation has come down from a peak of 8.9% last June to 6.0% in February. Energy and core goods – the major sources of inflation from the last two years – have now come down. After Russia's invasion of Ukraine sent global commodity prices soaring early in 2022, energy prices have been declining since the second half of last year. Further, improved supply chains combined with lower consumer demand have allowed inflation to decrease across core goods categories. While shelter inflation remains elevated, this reflects a lagged reality as rental increases have generally stalled for new transactions in the rental market. The remaining problem for inflation, therefore, is core services prices outside of housing, a measure Fed Chairman Powell has frequently quoted when referencing inflation pressures. This measure remains elevated due to labor market dynamics and the lagged effect of the same supply issues that impacted core goods prices.

OUR VIEW

We do not believe inflation will recede in a linear fashion, if history is any guide. Like subsequent waves of COVID, waves of inflation could be milder in their impact on the economy and markets, yet still cause investor nervousness by raising uncertainty about the direction of central banks' policy responses to economic growth and inflation. It's possible that any upticks in inflation coinciding with the recent wave of growth could delay central banks from declaring an end to rate hikes.

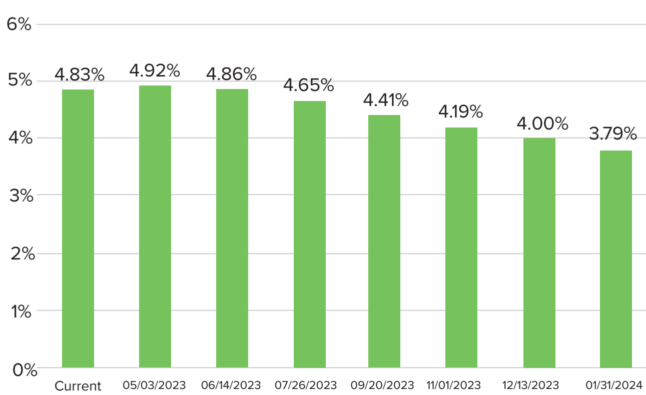
Federal Reserve

Just a year into tightening, the Federal Reserve has delivered an aggressive 4.75% in rate hikes in an attempt to reduce inflation. Despite concerns around the banking system, the Fed increased rates by an additional 0.25% at its March meeting and now seems closer to the end of its rate-hiking cycle. The FOMC maintained its outlook for a peak fed funds rate of 5.1%, implying that perhaps there may be one more future rate hike of 0.25%.

The Fed acknowledged that recent volatility in the U.S. banking system may weigh on the economy. In their March FOMC statement, they noted that "recent developments are likely to result in tighter credit conditions for households and businesses and to weigh on economic activity, hiring, and inflation. The extent of these effects is uncertain." This was also reflected in the Fed lowering its projections for economic growth in 2023 and 2024. Federal Reserve chairman Jerome Powell did note that the tightening in credit conditions has a similar impact as a rate hike, and thus the Fed may not need to do as many rate hikes if the banking sector continues to tighten financial conditions. However, if conditions improve and the crisis eases, the Fed likely remains poised to act as needed.

Overall, both the banking crisis and the recent Fed meeting have sparked a shift in market expectations on Fed rate hikes. Markets currently forecast no further rate hikes, and they expect the Fed to start cutting rates as early as the July meeting. In fact, as of April 5 there are now five rate cuts priced in for 2023, which would bring the fed funds rate to around 4.0%, well below the 5.1% indicated by the FOMC in the March meeting.

FED FUNDS FUTURES IMPLIED RATES



OUR VIEW

In our view, the Fed is certainly close to the end of its tightening cycle, perhaps with one more rate hike remaining. However, we don't yet see the scope for rate cuts, particularly as inflation is elevated and the labor market remains tight. The Fed will most likely cut rates or signal rate cuts when it sees inflation move meaningfully towards its 2% target or sees the economy and labor market sharply weakening, neither of which is in place today.

Equities

Volatility continued to challenge investors in the first quarter as financial sector weakness, elevated inflation and an uncertain outlook for monetary policy sent markets through twists and turns after a strong start to the year. Despite this, many sectors have managed gains year-to-date, a welcome development after last year's losses. Beneath the surface, however, some sectors are holding up better than others. Volatility during the first quarter specifically pressured U.S. equities while international markets are now outperforming. During the first quarter, all three major indices posted positive returns, with the Dow Jones Industrial Average up 0.38% the S&P 500 up 7.5% and the Nasdaq up 17.05%. Internationally, foreign developed markets represented by the MSCI EAFE returned 8.46% and emerging markets represented by MSCI EM returned 3.84%. Amid all the volatility, the S&P 500 is now up 5.5% over the past two years, led by value up 11.5%. Going back one more year, the S&P 500 is up 71% over the past three years.

OUR VIEW

We think that the bumpy ride will continue for a while longer as economic data possibly starts to underwhelm, reflecting a slowdown in economic growth. Yet equities can navigate a U-shaped recovery, with the right side of the U emerging in the second half of the year as inflation starts to moderate, the Fed pauses, and earnings estimates stabilize. We believe that the continued headwinds posed by above-average wage inflation, contracting margins, and slowing growth emphasizes the need for active management to identify the high-quality sectors and companies best positioned to weather a mild recession and deliver strong long-run returns.

Fixed Income

The first quarter saw a continuation of the drastic moves in interest rates that have transpired over the last year and a half. A broad measure of Treasury volatility, the ICE BofA MOVE Index, reached its highest level since the 2008 financial crisis, while a gauge of two-year yield volatility climbed to its highest in 40 years. The beginning of the quarter was driven by strong labor numbers and sticky inflation and the front end of the Treasury curve continued its upward trend. This came to a sharp reversal on March 10 after the announcement of the closure of Silicon Valley Bank. The fears over the banking system and possible contagion caused parts of the yield curve to come down dramatically. In one month, the 2-year U.S. Treasury yield has gone from a high of 5.1% to around 3.8%, and earlier in March it had its largest three-day drop since 1987. Increasing market expectations for Fed rate cuts later this year, along with investors seeking traditional safe-haven assets like government bonds, have put downward pressure on yields. With the move down in rates, the Bloomberg U.S. Aggregate Index was able to deliver a return of 3.0% for the quarter. This was the second quarter in a row of positive returns and a welcome sight considering the negative returns of the prior year.

OUR VIEW

We believe that fixed income continues to look very attractive. Amid concerns over an economic slowdown and the potential for rate cuts in the year ahead, bonds can offer income, capital appreciation and diversification benefits once again. In our view, we believe that active management is crucial right now because duration risk is elevated, yields are volatile and default risk remains elevated.

FINAL THOUGHTS

As always, all of us at TC Wealth Partners |Trust Company of Illinois are so appreciative to serve you through these turbulent times. Please rest assured that we remain dedicated to helping you successfully navigate this market environment. Every day we analyze our investment selections and strategize how to invest our clients' hard-earned assets, while remaining vigilant towards risks to the economy and your portfolios.

Please do not hesitate to contact us with any questions or comments, or to schedule a portfolio/financial plan review. Thank you for your ongoing confidence and trust.

RETIREMENT PLANNING INSIGHTS

TIME FOR A SPRING CLEANUP:

Organizing Your Financial Records and Guided Portfolio updates

The arrival of spring is always a good time to dust off the cobwebs that have built up in your home during the winter. It is also a suitable time to clean out and organize your financial records so you can quickly locate something if you need it.

KEEP ONLY WHAT YOU NEED

If you keep paperwork because you "might need it someday," your home office and file cabinets are likely overflowing and cluttered with nonessential documents. One key to organizing your financial records is to keep only what you absolutely need for as long as you need it.

Tax records. Keep all personal tax records for three years after filing your return or two years after the taxes were paid, whichever is later. (Different rules apply to business taxes.) If you underreported gross income by more than 25% (not a wise decision), keep the records for six years, and for seven years if you claimed a deduction for worthless securities or bad debt. It might be helpful to keep your actual tax returns, W-2 forms, and other income statements until you begin receiving Social Security benefits.

Financial statements. You generally have 60 days to dispute charges with banks and credit cards, so you could discard statements after two months. If you receive an annual statement, throw out monthly statements once you receive the annual statement. If your statements include tax information (e.g., you use credit-card statements to track deductions), follow the guidelines for tax records.

Retirement account statements. Keep quarterly statements until you receive your annual statement; keep annual statements until you close the account. Keep records of nondeductible IRA contributions indefinitely to prove you paid taxes on the funds.

Real estate and investment records. Keep at least until you sell the asset. If the sale is reported on your tax return, follow the rules for tax records. Utility bills can be discarded once the next bill is received showing the previous paid bill, unless you deduct utilities, such as for a home office.

Loan documents. Keep documents and proof of payment until the loan is paid off. After that, keep proof of final payment.

Insurance policies. Keep policy and payment documents as long as the policy is in force.

Auto records. Keep registration and title information until the car is sold. If you deduct auto expenses, keep mileage logs and receipts with your tax records. You might keep maintenance records for reference and to document services to a new buyer.

Medical records. Keep records indefinitely for surgeries, major illnesses, lab tests, and vaccinations. Keep payment records until you have proof of a zero balance. If you deduct medical expenses, keep receipts with your tax records.

These are general guidelines, and your personal circumstances may warrant keeping these documents for shorter or longer periods of time.

Personal Document Locator. A personal document locator is a detailed list of your personal and financial information that can assist others in the event of your death or disability. Typically, a personal document locator will include the following:

- Personal information – e.g., date of birth, Social Security Number
- Names and phone numbers of personal contacts
- Online accounts – with usernames and passwords
- Professional service provider contact information – banker, physician, attorney, tax preparer, financial professional
- Location of important legal and financial documents

SECURELY STORE YOUR RECORDS

You can choose to keep hard copies of your financial records or store them digitally. You usually do not need to keep hard copies of documents and records that can be found online or duplicated elsewhere.

Important documents such as birth certificates and other proof of identity should be stored in a safe place, such as a fire-resistant file cabinet or safe-deposit box. You can save or scan other documents on your computer, or store them on a portable drive, or use a cloud storage service that encrypts your uploaded information and stores it remotely.

A straightforward way to prevent documents from piling up is to remember the phrase “out with the old, in with the new.” For example, if you still receive paper copies of financial records, discard your old records as soon as you receive the new ones (using the aforementioned guidelines). Make sure to dispose of them properly by shredding documents that contain sensitive personal information, Social Security numbers, or financial account numbers. Finally, review your records regularly to make sure that your filing system remains organized.

TC Wealth Partners Trust Company

of Illinois

1901 BUTTERFIELD ROAD, SUITE 1000
DOWNERS GROVE, IL 60515
630-545-2200

1051 PERIMETER DRIVE, SUITE 1125
SCHAUMBURG, IL 60173
847-413-8545