WestStar
Wealth Management

Wealth Watch

For Managed Portfolios

2023 Q1 Review & Q2 Outlook

The Wild West

While working his family's Texas farm throughout his youth in the late 19th century, John Avery Lomax learned many frontier ballads and cowboy songs. He later majored in English Literature at UT Austin and, while earning his Master of Arts degree at Harvard, assembled the folk songs of his youth in a written collection. In 1910 he published it in his seminal anthology, Cowboy Songs and Other Frontier Ballads. His work inspired a great interest in the genre and he later founded the Texas Folklore Society.

This edition of the Wealth Watch commemorates the wild west legacy of Mr. Lomax with the titles and lyrics of some of the most acclaimed cowboy ballads guiding us through recent market and economic events.

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What You Need To Know:

- 2023 began with a market rebound
- All major asset classes were positive in the first quarter except for commodities
- Volatility remained heightened, particularly given developments in Fed hikes and bank challenges
- The path of future Fed hikes will likely end sooner and at a lower terminal rate than initially expected
- Banking issues primarily isolated to individual companies; overall industry remains healthy
- Recession possible, but likely mild and short if occurs; market could rally beyond it
- Adhere to long term diversified strategy despite near-term challenges

Asset Class Index Performance* Year-to-Date As of March 31, 2023

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- International Developed Market Stocks 8.47%
- US Large Cap Stocks 7.50%
- International Emerging Market Stocks 3.96%
- High Yield Bonds 3.57%
- International Bonds 3.06%
- US Investment-Grade Bonds 2.96%
- US Small Cap Stocks 2.74%
- Alternative Investments 1.20%
- Money Market (Cash) 1.14%
- Real Estate 1.04%
- Commodities -5.36%

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Q1 Market Performance: *"Back In the Saddle Again"*

Investors may have felt as though they had "fallen off the horse" amid the volatility of 2022 but those who remained invested were "back in the saddle" in the first quarter. We had cautioned against thoughts of liquidating late last year, explaining that such attempts at market-timing could severely impair longer-term results. Noting that prudence requires discipline amid tumult, we warned that exiting the market entirely could prevent participating in a subsequent rebound, which our research correctly indicated might soon develop.

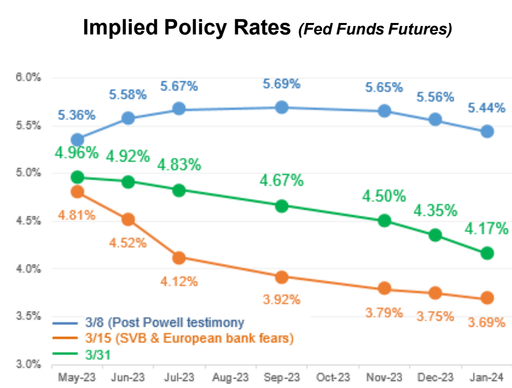
Nearly all major asset categories enjoyed positive performance in Q1, with the single best being International Developed Market Stocks followed by US Large Cap Stocks and International Emerging Market Stocks rounding out the top three. Coming off their worst year in history, bonds had a great quarter—our consultant Ned Davis Research noting performance at "more than 1.5 deviations above the monthly mean since 1976." The lone negative performer was Commodities, again in a reversal from 2022 results.

Tactical Strategy: *"Don't Fence Me In"*

A foundational component of our actively-managed investment philosophy is that one must consider not only how markets *should be* acting but also how they *are* acting. The ability to make proactive interim tactical adjustments based on prevailing conditions (i.e. not being "fenced in") can add value over time. In the first quarter our research suggested that modifying our tactical strategy was warranted. As mentioned in our last edition of the Wealth Watch we had accurately deemphasized stocks and bonds prior to 2022's decline and emphasized Real Assets (Commodities, Real Estate, etc.) and Alternative Investments prior to their strength. In January of 2023 we changed course from our 2022 positioning, increasing exposure to stocks in anticipation of a rally, increasing exposure to bonds to capture newly-available yield, and decreasing exposure to Real Assets recognizing inflation declining. Once again these actions were well-timed as stocks and bonds rallied while Real Estate and Commodities lagged. We remain ready to adjust as developments warrant—particularly given the many issues arising in March and the ways the Fed may calibrate in response.

The Fed & Interest Rate Hikes: *"Riders in the Sky"*

The eyes of investors have been squarely focused on the Fed's next maneuver, the potential impact of which evokes the song "Riders in the Sky" and its lyrics which state, "A bolt of fear went through him as they thundered through the sky, for he saw the riders coming hard and he heard their mournful cry." Indeed, investors had seen the Fed "coming hard" with their aggressive rate hikes throughout 2022 adversely impacting markets. Yet signs of diminishing inflation had prompted them to slow their pace in February. On March 7th, however, stronger-than-expected economic data triggered Fed Chairman Powell to suggest that a reacceleration and a higher terminal rate might be in order. The blue line in the chart below reflects the market's opinion of these factors at that time, expecting the Fed Funds rate to peak at 5.69% in September and settle at 5.44% next January. Yet only days later, the collapse of Silicon Valley Bank marked the second largest bank failure in US history. Markets immediately reversed, expecting future rate cuts and a Fed Funds rate about 1.75% lower by next January than it had expected on March 8th (orange line). A week later the Fed hiked by 0.25%, balancing its



Source: Ned Davis Research

*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Devel: MSCI EAFE Index; Int'l Emerg: MSCI Emerging Markets Index; Core Bond: Bloomberg Aggregate Index; Int'l Bond: Bloomberg Global Aggregate ex-USD Index; High Yield: Bloomberg US Corporate High Yield Index; Cash: BofA Merrill Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodity: Bloomberg Commodity Index; Alternatives: Wilshire Liquid Alternatives Index inflation battle with maintaining confidence in the banking system. By month-end markets expected a middle-ground rate path, suggesting the hiking cycle will end sooner and at a generally lower terminal rate (green line). We expect another 0.25% hike in May followed by a pause thereafter.

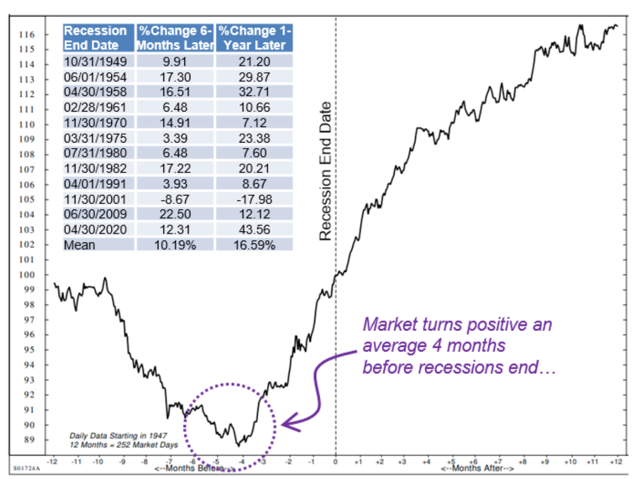
Recent Banking Challenges: *"Tumbling Tumbleweeds"*

A contributor to recent volatility has been the challenges facing the banking sector. Let us begin the discussion by noting the tumbling of Silicon Valley Bank, Signature Bank, et. all were due to issues that in many ways were unique to those institutions (depositor concentrations, deposit/securities mismanagement, crypto currency/industry concentration, etc.) While investors were understandably shaken by these events, there really is no need to worry that another 2008 is on the horizon and therefore no need to withdraw cash all together. As reflected on the chart at left, on the whole banks are well-capitalized and are in much better shape than in 2008 due in large part to regulatory reform following the global financial crisis of that era. It should also be noted that depositors of failed institutions are not "bailed out" by taxpayers; rather their deposits are covered by the FDIC's Deposit Insurance Fund ("DIF"), a private insurance fund which is funded by banks themselves through fees assessed quarterly. The DIF had over $100 billion in March—more than enough to cover the depositors of the recently-failed banks. Furthermore, the Fed created a new Bank Term Funding Program ("BTFP") which allows banks to borrow using their securities portfolios as collateral valued at par for up to one year, thereby addressing the issue of said portfolios' current loss positions resulting from Fed hikes in 2022. So while the industry remains much healthier than in 2008, banks are tightening their lending standards which may contribute to the potential for a near-term recession.

Potential Recession?: *"Bury Me Not on the Lone Prairie"*

It is not uncommon for investors to grow apprehensive amid times of turmoil, yet succumbing to the strain could be likened to "burying oneself on the lone prairie." One must remember that volatility, economic stress, and even recessions are a natural part of investing and are to be expected. There have, in fact, been twelve recessions since WWII, so we average one every 6.5 years. It is for this reason that we remind investors to not allow fear exacerbated by ratings-hungry media with sensationalist headlines to derail a prudently-structured investment strategy. While headlines may or may not ultimately be correct in prognostications of impending recession, data still indicate that should one occur it is likely to be mild and short-lived. The chart at right shows that since WWII the stock market turns positive an average 4 months before recessions end. If recession were to occur and it ended in the third/early fourth quarter, the time of this writing would be about when the market began to rally by historical standards. We also see that, on average, the market is up 10% six months later and 16% one year later. In other words, even recession wouldn't necessarily mean a prolonged down market.

S&P 500 Around Post-War Recession End Dates



Recession End Date	%Change 6-Months Later	%Change 1-Year Later
10/31/1949	9.91	21.20
06/01/1954	17.30	29.87
04/30/1958	16.51	32.71
02/28/1961	6.48	10.66
11/30/1970	14.91	7.12
03/31/1975	3.39	23.38
07/31/1980	6.48	7.60
11/30/1982	17.22	20.21
04/01/1991	3.93	8.67
11/30/2001	-8.67	-17.98
06/30/2009	22.50	12.12
04/30/2020	12.31	43.56
Mean	10.19%	16.59%

Source: Ned Davis Research

Investment Outlook: *"Home On the Range"*

In one of history's most well-known cowboy ballads "Home on the Range," the narrator longs for a place "where seldom is heard a discouraging word." Unfortunately in today's world investors must endure continual bombardment by gloom-and-doom headlines. They must remember, however, that the most effective way to address risk while in pursuit of returns is to remain in a place where a prudently-devised, well-diversified, fiduciary-guided strategy is followed. Adherence to a provident asset allocation range allows one to withstand near-term volatility and focus on the longer-term outcome. We remain committed to helping you cut through the noise and stay focused.

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The Team You Can Trust.

As true fiduciaries, our focus isn't on selling products to our clients. Instead, we focus on providing personalized service and real financial solutions.

Our team of wealth management professionals has the valuable depth of expertise you need to navigate life's events.

From retirement planning and investment management to trust services and estate settlement, we can help you devise the most effective plan to meet your financial goals.

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