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INVESTMENT MANAGEMENT

SLIMMON'S TAKE > TAKEAWAYS & KEY EXPECTATIONS

Equity Market Commentary

SOLUTIONS & MULTI-ASSET | APPLIED EQUITY ADVISORS TEAM | SLIMMON'S TAKE | APRIL 2023

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EVERYBODY IS FRUSTRATED!

The S&P 500 is frustrating the bears' prediction of an imminent retest of the October lows. That next leg down is proving elusive, given the S&P 500 is +6.9% YTD and +14.8% since the October 12, 2022 low *(as of 4/11/23).*

Unfortunately, I think the market will frustrate the bulls as well.

1. Let's start with the reasons I struggle to see the market pleasing the bulls.

   A. The S&P 500 currently trades at **18x 2023 estimates**.

   B. Can the P/E multiple really expand beyond that?

   Here are some headwinds:

- Uncertainty about the economy and recent weak data stoking fears of a recession.
- Uncertainty about the impact of tighter bank lending.
- Uncertainty of Fed action.

All of these items are causing 2023 earnings estimates to gradually move lower, which makes the P/E even richer.

2. With that said, ***why can't the bears get their wish?*** Why does the market not go down?

   A. My base case coming into 2023 was:

- The stock market had just experienced a horrendous 2022.
- Pessimism was rampant.

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- 2023 is a pre-Presidential year.

Each of these factors were bullish for equities.

B. This is all still true today.

   Very simply, the stock market has *already* incurred a lot of damage.

C. What makes this year so tricky is that many of the leading indicators that flash "warning" typically happen at market highs, not after a bad year, as we had in 2022.

   The inverted yield curve and implied message for equities is a great example.

3. A few final points:

   A. The only reason the S&P 500 is currently trading at 18x P/E is because the top ten stocks trade at 23.8x P/E while the other 490 stocks are trading at **15.8x P/E**.

      That's an epic difference, and I do think it offers opportunities below the surface.

   B. Since 1954, the S&P 500 has had 20 losing years. Of those 20 years, 11 rebounded with a positive Q1 for the following year. All 11 of those years went on to post further gains through the rest of the year, on average +14.7%.[1] Given the negative 2022/positive Q1 2023, will the rest of 2023 make it 12 out of 12?

4. Positioning:

   A. We believe that the longer the market goes without pleasing the bears, the more likely it will eventually break to the upside.

   - Therefore, a high level of defensive positioning could be dangerous if 2023 is, in fact, year #12. We continue to find attractively priced companies both in the value cyclicals <u>and</u> in growth names: infrastructure industrials, refiners, building materials, and semiconductors are some areas.

   B. Yet we also believe it is far too early to think the economy is past its slowdown risk.

   - Therefore, we are choosing to barbell the "risk-on" sectors with what we consider to be classic earnings stable stocks: utilities, discount retailers, and trash haulers.

Finally, we want to directly address two stocks that had a negative impact on Q1 performance of our strategies:

1. SVB Financial.

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[1] 1953 to present. Source: Bespoke, March 31, 2023.

A. SVB Financial was not one of the larger positions in any of our portfolios. It had appreciated so materially since its initial purchase, we had reduced the position in 2020 and 2021. But an almost complete wipeout in the stock was very costly.

B. SVB Financial was an "A" rated security by Moody's. It maintained that investment grade rating even on the day it halted trading.

C. The quality of their investment portfolio was attractive, hence why they had an investment grade rating.

D. However, this was overshadowed by the concentration risk of their deposit base within the venture capital world which caused a classic "run on the bank".

2. First Republic Bank.

   A. First Republic Bank was not one of the larger positions in Global Core and was not held in Global Concentrated. However, it was a more meaningful position in US Core.

   B. First Republic Bank was a traditional regional bank, with retail a high percentage of deposits. Very different than SVB Financial.

   C. While the First Republic Bank business model was different from that of SVB Financial, the commonality was that both were California banks. Like all California based regionals, they experienced significant deposit outflows as well. That dramatically depressed the First Republic Bank stock price.

Please watch our ***Q1 Portfolio Review & Equity Market Update*** webcast scheduled at 11:30 ET on Tuesday, April 25.

Andrew

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