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Investment Counsel, LLC

Ironwood Investment Counsel, LLC constructs and manages customized investment and wealth management programs designed to meet our clients' unique goals and objectives. Our distinctive process maximizes performance through return enhancement, risk reduction, tax efficiency, and cost containment.

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First Quarter 2023 Market Commentary

Despite unique and disruptive developments at the onset of 2023, equity and fixed income markets produced positive results for the first quarter of the year. As March came to a close, the S&P 500 posted a 7.0% return, as high-flying technology companies and other "risk on" trades came back in vogue. These growth companies outperformed those businesses considered value, as evidenced by the Dow Jones Industrial Average's mere 0.4% gain for the three-month period ending March 31st.

With regard to other asset classes, smaller companies in the United States also experienced positive results in the first quarter as the Russell 2500 advanced by 3.4%. The MSCI EAFE index, which tracks a broad group of publicly traded businesses domiciled outside of the United States, provided a 7.3% return. A recent tailwind for international stocks has been a weakening dollar. Even though the "greenback" has been extraordinarily strong the last few years, it weakened by nearly a percent in the first quarter of 2023.

Fixed income rebounded from the doldrums of 2022, as prices increased and yields declined. The 3-year Barclays Municipal Bond Index provided 1.4% for the quarter and the 1-3 year U.S. Aggregate increased by 1.5%. For much of 2022, the yield curve was inverted with shorter term bonds offering a greater yield relative to bonds maturing at a later date. Specifically, the spread or differential between the U.S. 2-Year and 10-Year Treasury Note stayed steady at -0.6% as of the end of the quarter.

Generally speaking, markets continued their rise from the final months of 2022 following a dismal year for both stocks and bonds. Positive returns for the quarter did not come without volatility. On March 10th, the FDIC seized control of both Signature Bank and Silicon Valley Bank. There were few, if any, warning signs of the banking collapse as each had $100 and $209 billion of assets, respectively, at the end of 2022. In the post-Depression age of deposit insurance and other government backstops, most investors thought a modern day "bank run" was not possible. While it is still not entirely clear what happened at these institutions, most indications point to the significant interest rate increases that occurred in 2022 coupled with costly managerial missteps as the main culprits in their demise.

Following the FDIC's takeover of the banks, the U.S. Treasury moved to guarantee deposits. As such, both insured and uninsured depositors received an explicit guarantee to have their cash returned in full. Such swift action appears to have calmed investors as markets stabilized over the subsequent weeks.

While there are negative aspects of the bank failures over the last quarter, there is some silver lining for investors in terms of markets and the economy. First, investors have speculated that the Fed seemed intent on moving interest rates higher until something in the economy broke, and these bank failures may be the evidence necessary for the Fed to curtail further rate increases. To be sure, lending standards for banking institutions will most certainly tighten following the FDIC's takeover of Signature Bank and Silicon Valley Bank. The Fed has indicated that such lending standards could serve as a form of monetary tightening. Tighter lending standards would reduce the availability of credit in the economy, which could slow economic growth and cool inflation. This outcome may give the Fed the cover it needs to pause rate increases despite inflation still being above its long-term target.

Second, with recent layoffs in the technology sector coupled with slowing growth, the number of open positions in the United States is declining. The Labor Department indicated that there were a seasonally adjusted 9.9 million job openings at the end of February. This reading marks the first moment open positions dipped below 10 million in a number of quarters and well off of the high of 12 million open positions in March of 2022. Typically, a decline in open job positions reduces wage pressure. Similar to tighter lending standards, it will be interesting to see if the Fed will respond to waning job openings by suspending its aggressive interest rates increases.

Lastly, while we believe higher rates and managerial missteps created much of the banking turmoil, these higher rates have translated to much better returns on fixed income relative to the last 15 years. Within fixed income, after a rapid increase in interest rates last year, current yield levels are attractive for fixed income. For example, A-rated corporate bonds yield 4.5%, preferred securities 7.8%, and tax-exempt municipals (tax-equivalent) 3.3%. It is also worth noting that there has never been three consecutive negative years for broad bond indices.

In unusual outcomes like markets experienced in the first quarter, we are reminded of how critical it is to maintain appropriate diversification across positions and different asset classes in a portfolio. Further, maintaining position sizes that do not make up more than 5% of a portfolio (at original purchase) is another risk management tool our firm subscribes to. Although portfolios still decline temporarily following these types of unexpected shocks to the financial system, they typically weather volatility much better relative to overly concentrated portfolios.

Opportunities often present themselves in such volatile periods. When fear and lack of conviction grip the market, high-quality asset prices decline along with those of more speculative issues. At such times, Ironwood reassesses current holdings to insure we are comfortable with our client portfolios and the return expectations and fundamentals. Furthermore, we use such times to look at new potential investments that may have declined in price without a commensurate decrease in strong fundamentals. We are not forecasters, nor do we attempt to time markets. Rather, we are investors and take a long-term view in allocating capital. Long-term investing necessitates exposure to periodic asset price declines to ultimately achieve success in meeting client return objectives. As Warren Buffet's mentor Ben Graham famously said, "Day to day, the stock market is a voting machine; in the long term it's a weighing machine".

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Despite the turbulence of the first quarter, we are thankful to see capital markets resume an upward trajectory following a challenging 2022. As the Ides of March give way to Spring and Summer, we wish you happiness and prosperity.

We appreciate the trust you have placed in us.

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