TFC FINANCIAL
The Financial Counselors

MARKET UPDATE
March 15, 2023

OUR VIEW

Silicon Valley Bank (SVB) failure was due to a mismatch of assets and liabilities.

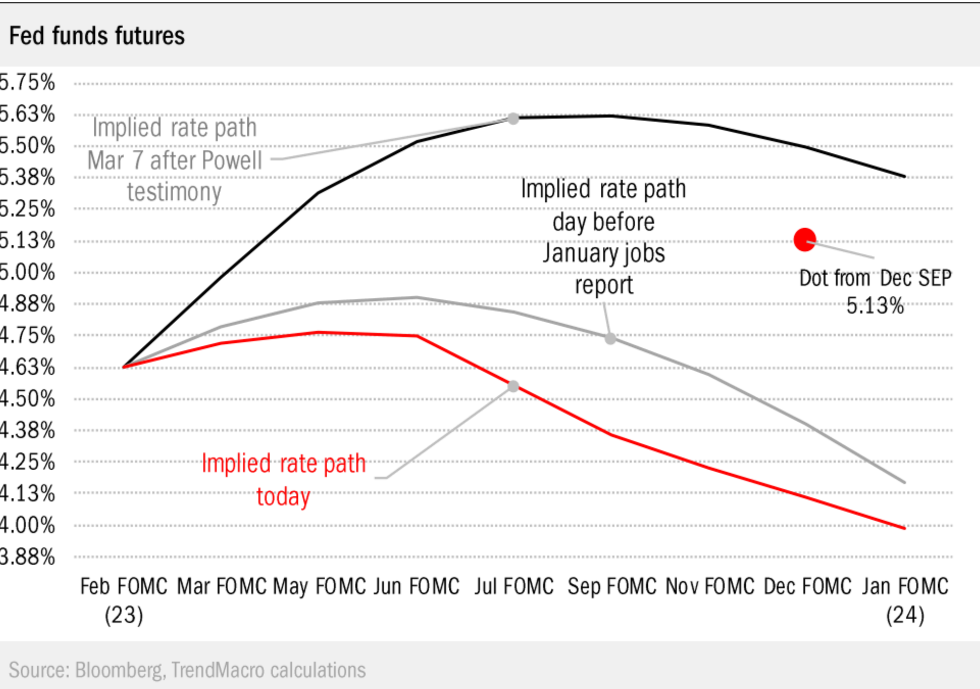
Recent Events

The sudden failure of Silicon Valley Bank offers an excellent opportunity to reflect on current central bank policy and to share our economic outlook and market expectations for 2023. We started the year with inflation and central bank policy at the top of most lists of investor concerns and advised that we would need to be patient as housing and employment inflation were not likely going to slow meaningfully until later in the year. Inflation has, indeed, remained stickier than central banks around the world might like and has created some conviction at the Federal Reserve that rates need to remain higher for longer to tame the inflation that robs consumers of purchasing power. After a long period of near-zero rates, businesses must once again operate with the kind of fiscal discipline that a more typical cost of capital demands.

What happened at Silicon Valley Bank?

The simplest explanation is that Silicon Valley Bank (SVB) mismatched its assets and its liabilities. The bank held longer dated securities but faced a deluge of short-term withdrawal demands as funding has dried up for the many start-up firms, venture partners, and other entrepreneurs that made up a significant portion of the bank's client base. When the Fed raised rates, SVB's longer dated securities lost more value than management expected. To meet immediate client cash needs, SVB was forced to sell securities at significant losses. These forced sales exposed just how mismatched SVB's portfolio was and led to a "run on the bank" that opened the withdrawal floodgates.

Investors responded to the shutting down of SVB with steep selling in financial securities, with a particular focus on regional banks like SVB that had seen regulatory requirements relaxed in the Trump administration. Concerned about potential contagion, investors took the approach "sell first, ask questions later". The good news and the bad news came from the Federal Reserve, Treasury Secretary and FDIC the weekend after SVB failed. The good news is that all deposits, insured or uninsured at SVB and Signature Bank (another failed regional bank) would be fully protected and accessible the next business day. They also put in place a liquidity facility, the Bank Term Funding Program (BTFP), that would lend banks cash for one year against assets valued at par – irrespective of their market value. This backstop gave confidence that the government recognized the critical value of a functioning banking system, and it offered banks liquidity and the time to reposition their investment portfolios over the next year. The bad news is that interest rates dropped precipitously with the announcement of the bank failure and the corresponding response from the Fed. These low rates are suggesting that the Fed's rapid interest rate increases and the breakage it is already creating at this point could trigger a recession in the U.S. The chart below shows the change in expected Fed Funds rates on Monday, March 13, 2023 after the Federal Reserve announced the BTFP.



Source: Bloomberg, TrendMacro calculations

Impact of the Federal Reserve's aggressive interest rate hikes now cooling inflation.

Global Outlook

Troubles in the U.S. are likely to have some impact on other lending institutions around the globe, but the first quarter has seen some resilience in foreign equity securities that have been trading at significant discounts to their U.S. counterparts. While the Russian invasion of Ukraine grinds on and looks to be evolving into a longer-term conflict, the winter disaster that was expected in an energy-starved Europe never materialized. European industry has been able to produce more capably than many thought possible. China continues to reopen – but at a slower pace than many had hoped. As China gains momentum, we suspect that global GDP will, once again, find some footing. Finally, with interest rates down from recent highs in the U.S., the U.S. Dollar will likely continue its slide from extremely high valuations against other major currencies around the globe. This would relieve pressure on many developing economies currently saddled with expensive, U.S. Dollar-denominated debt, so there is some reason to be encouraged by opportunities overseas.

Equity market valuations have corrected significantly through this global rate hike cycle, and we continue to see notable discounts in U.S. small company, European, and Chinese stocks. With the bond market signaling that the Federal Reserve may now need to cut rates before the end of the year, investors shouldn't be blamed for believing that rates in the U.S. have likely already peaked. On Tuesday, March 14, 2023, the Labor Department reported that the consumer price index increased 0.4% for the month of February, putting the annual inflation rate at 6%. Both numbers were in line with estimates and showed that consumer level inflation continued to decline. Further, just announced today, the Producer Price Index declined 0.1% for February and +4.6% from a year ago, vs. +0.4% for January and +6% for the preceding 12 months. All positive signs that the Federal Reserve's effort to slow inflation with higher interest rates is working. A mild recession in the U.S. is still possible, but taming inflation is the Fed's over-arching priority and mandate.

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TFC Portfolio Positioning

With financial market events dominating news and driving up investor anxiety, the normal behavioral impulse to react and take action is strong. This is a good time to remind ourselves of the long-term time horizon and investment objectives of our portfolios. Maintaining a balanced, globally diversified portfolio invested across a broad range of asset classes - bonds, stocks, real assets, real estate and select private investments with low correlations to publicly-traded securities – continues to be an effective, time-tested approach to successful long-term investing.

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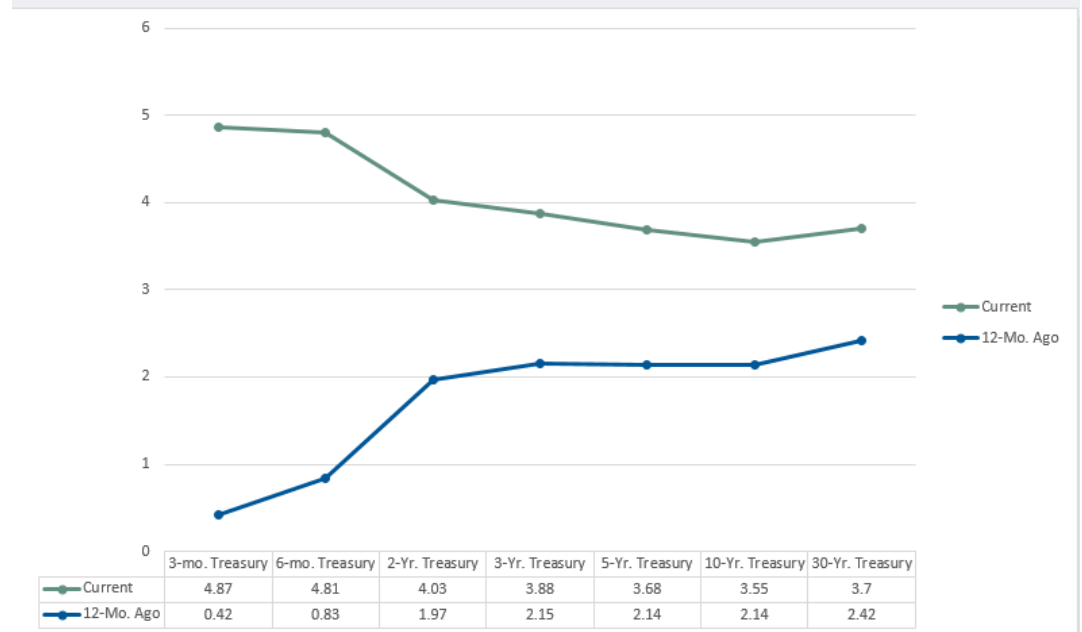
As we noted in our year-end investment letter, bond performance in 2022 was dismal resulting from the Federal Reserve hiking interest rates aggressively to dampen inflation. This year investors are expecting interest rates to peak soon, anticipating that the Federal Reserve will pause rate increases within the next few scheduled meetings.

Our fixed income portfolios are currently allocated to shorter duration, 3 to 3.5 years (weighted average duration), high-quality bonds, primarily in U.S. government, municipal and mortgage-backed securities bond funds. While yield curves are inverted, shorter duration bonds offer a higher yield and lower interest rate risk.

U.S. Treasury Yield Curve **3/14/2023**



	3-mo. Treasury	6-mo. Treasury	2-Yr. Treasury	3-Yr. Treasury	5-Yr. Treasury	10-Yr. Treasury	30-Yr. Treasury
Current	4.87	4.81	4.03	3.88	3.68	3.55	3.7
12-Mo. Ago	0.42	0.83	1.97	2.15	2.14	2.14	2.42

Global equity markets started off the year with optimism about slowing inflation and hope that the Federal Reserve would pause their interest rate hiking cycle by the spring. However, particularly in the U.S., the tight labor market, sticky inflation in services and shelter and an uncertain earnings outlook has curbed investor enthusiasm. The unexpected collapse of

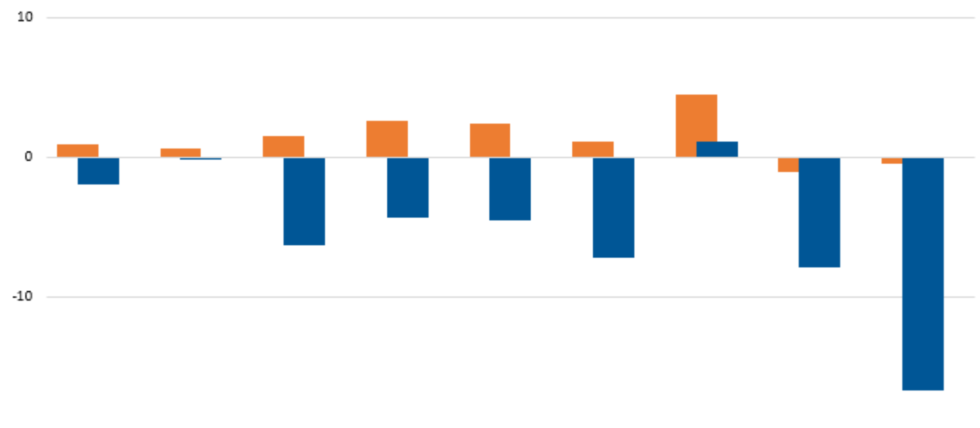
Silicon Valley Bank and Signature Bank, and potential contagion fears now spreading to European banks have increased market volatility.

(*Note: As of 3/15/2023, SVB was removed and replaced in the S&P 500 Index. The remaining position is in one of TFC's approximately 15 global equity fund holdings (in our model/policy portfolio), the DFA U.S. Marketwide Value ETF (DFUV). SVB is one of more than 1,200 holdings in this ETF, a negligible exposure in TFC's total global equity portfolio.)*

While we expect volatility to stay elevated with potentially more downside in the short term, we remain optimistic about the medium-term outlook for equities and positive for the long-term.

Investing in equities to earn their long-term growth potential takes patience and discipline at all times. TFC's equity portfolios are diversified globally, across industry sectors, company size and investment style (growth and value). Our investments in real assets provide some inflation protection and additional portfolio income. The global equity bear market in 2022 brought equity valuations back to reasonable levels in the U.S, and historically discounted levels for international equities. While we expect volatility to stay elevated with potentially more downside in the short term, we remain optimistic about the medium-term outlook for equities and positive for the long-term. No one can consistently and accurately time market peaks and troughs, and equity markets historically bottom and start rallying while the economy and news is still negative.

Quarter To Date Returns 3/14/2023



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	Short Term Bonds	Short Term Muni Bonds	Barclays Agg.	Global Equities	S&P 500	U.S. Small	Intl. Large Core	EM	Global Real Estate
QTD	1.0	0.6	1.6	2.6	2.5	1.2	4.5	-1.0	-0.4
12M	-1.9	-0.1	-6.3	-4.3	-4.5	-7.1	1.1	-7.8	-16.7
Full Cycle*	-0.6	0.0	-2.7	4.0	6.9	3.2	2.3	-2.5	-5.0

* Full Cycle is the annualized return from February 12th 2020 peak to present.

Account Custodian Safety

Understandably, bank failures create fear and anxiety about the safety of one's own accounts and assets. We have attached information from Charles Schwab and Co. and Fidelity Institutional on their customer account safety and protection policies and insurance coverage. Also attached is a recent financial and business update and press release from Charles

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Our next webinar will be on Thursday April 20th at 12 Noon EDT with Liz Ann Sonders, Managing Director & Chief Investment Strategist at Charles Schwab.

Schwab & Co. As fiduciaries, we are always concerned and vigilant about the safety and security of our clients' investment accounts, and we are not recommending any changes to your custodial arrangements.

Our next investment webinar will be on Thursday April 20th at 12 Noon EDT. We are excited to welcome Liz Ann Sonders, Managing Director and Chief Investment Strategist at Charles Schwab to join us for a discussion about the economic and market outlook. We will be sending an invitation with further details next week.

In the meantime, please do not hesitate to contact your TFC Advisor or me with questions or concerns. Thank you.

Sincerely,

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