"Seeking Accurate Information"

Market Commentary – March 2023

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The second estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 2.7% in the fourth quarter of 2022. This is lower than the advance estimate of 2.9% and the 2022 Q3 reading of 3.2%. Inflation is still running hot. The Consumer Price Index (CPI), a measure of inflation experienced by consumers, rose 6.4% year-over-year in January 2023. The U.S. Bureau of Labor Statistics spun this by pointing out it is the smallest 12-month increase since the period ending October 2021. This is technically a true statement, as CPI peaked at 8.9% in June 2022 and has trended lower each month since then. Still, 6.4% inflation on an absolute basis is very high, especially considering that CPI averaged only 1.5% from 2013 to 2020. Investors should also consider that the Federal Reserve's target for inflation is 2%.

On February 1, the Federal Open Market Committee (FOMC) raised its benchmark federal funds rate by 0.25% to a target range of 4.5% to 4.75%. The announcement on monetary policy stated that "ongoing increases in the target range will be appropriate…to return inflation to 2% over time." Futures markets now predict that the Fed will stop hiking rates around 5.4% by August 2023, which is 0.5% higher than predictions one month ago. This has been a major factor weighing on stock prices in February. Meanwhile, the Fed's balance sheet had $8.382 trillion in assets as of February 22, 2023, down $89 billion from a month earlier (close to the $95 billion monthly target). The next FOMC announcement on monetary policy is scheduled for March 22.

The annual treasure hunt for Banyan Asset Management begins in March! Once per year (usually in March and/or April), we update our "universe" of stocks by analyzing approximately 1,800 individual companies. This is a wonderful time of year for such an analysis because many firms have a fiscal year that matches the calendar year, and the annual 10-K documents for these firms have usually been recently filed with the Securities And Exchange Commission (SEC). Fresh annual SEC documents mean fresh annual data for our financial models. Professional money manager Nelson Kjos liked to say that investors seek "Accurate Information", which he referred to as "the original AI" (a pun on the more common interpretation of AI as "Artificial Intelligence"). Our financial models, armed with what we hope is AI, help us to determine which companies belong in our universe. The companies that make the cut are worthy of more detailed analysis (fundamental and technical) to decide whether they should be bought.

Technical factors of the market are bullish (more demand than supply), while fundamentals are fairly priced – therefore, we are mildly bullish on the market. The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) over the next 12 months is $219.71, which implies a price-to-earnings (P/E) ratio of 18.1 with the S&P 500 at 3,970. The earnings yield (E/P) of 5.53% represents fair value relative to the 10-year U.S. Treasury note yield of 3.92%. Over the past month, earnings estimates for 2023 have fallen while P/E has stayed flat, as the S&P 500's decline was in step with the lower earnings estimates.

The increase in the U.S. Treasury note yield in February should have resulted in a much lower S&P 500, but bullish technical strength offset much of that weakness. As we pointed out last month, the S&P 500 exhibited a "golden cross", where the 50-day moving average exceeded the 200-day moving average. The 50-day currently sits at 3,979 and the 200-day is at 3,940, both of which should provide support. The February high of 4,180 should be a corresponding area of resistance.

So far, 2023 has been less about growth vs. value and more about market cap (smaller is better). As measured by the various S&P total return indexes, small cap stocks are outperforming mid cap stocks, and mid cap stocks are outperforming large cap stocks. For large cap stocks, value and growth are roughly equal performers, while value is slightly outperforming growth for small and mid-cap stocks. We continue to prefer stocks of all sizes with low valuations, low betas, strong dividends, and low-debt balance sheets.