OCTAVIA
WEALTH ADVISORS

Economic and Market Overview

First Quarter 2023

Building a Lifelong Partnership

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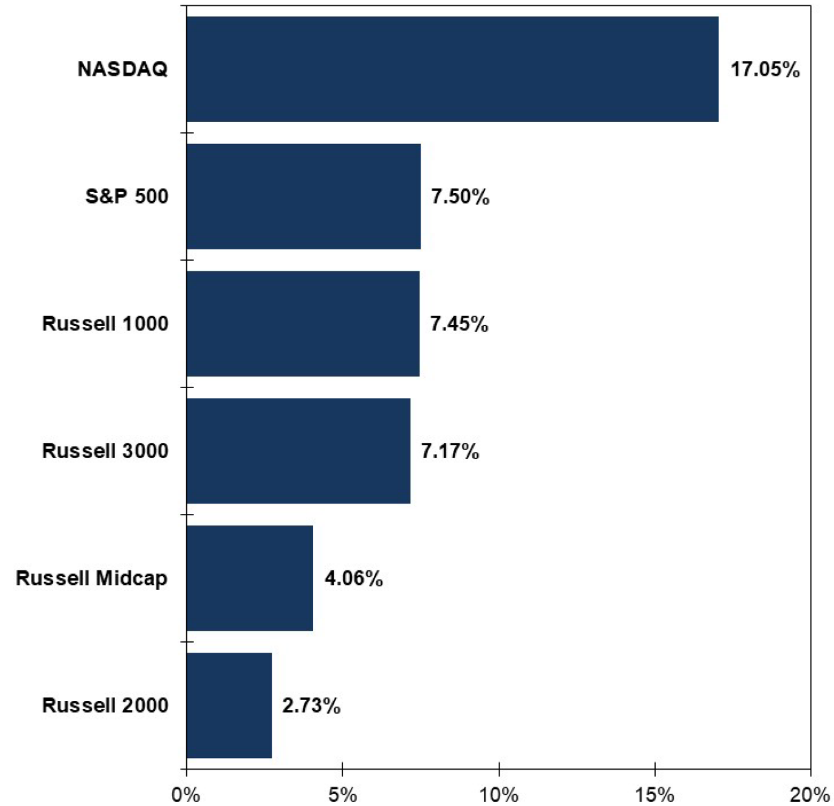
The Economy

The U.S. economy picked up steam in the second half of 2022 after declining in the first two quarters. Despite this recovery, the economy continues to struggle with rising interest rates. Against this backdrop, the Bureau of Economic Analysis released the third estimate of the fourth quarter 2022 real GDP, a seasonally adjusted annualized rise of 2.6%, slightly lower than the prior estimate, and a decline from the 3.2% increase in the prior quarter. The employment situation continued to exceed expectations in the quarter, as the labor market remained extremely tight. February's jobs report showed that employers added 311,000 jobs in the month, and that unemployment inched higher to 3.6%. The Federal Open Market Committee (FOMC), in its ongoing effort to aggressively battle stubbornly high inflation, raised its federal funds rate target range by 0.5% in the quarter, to 4.75%-5.00%, from a range of 4.25%-4.50%. The FOMC has raised the fed funds target rate range a total of nine times since March 2022.

Broad Market Index Returns

First Quarter 2023



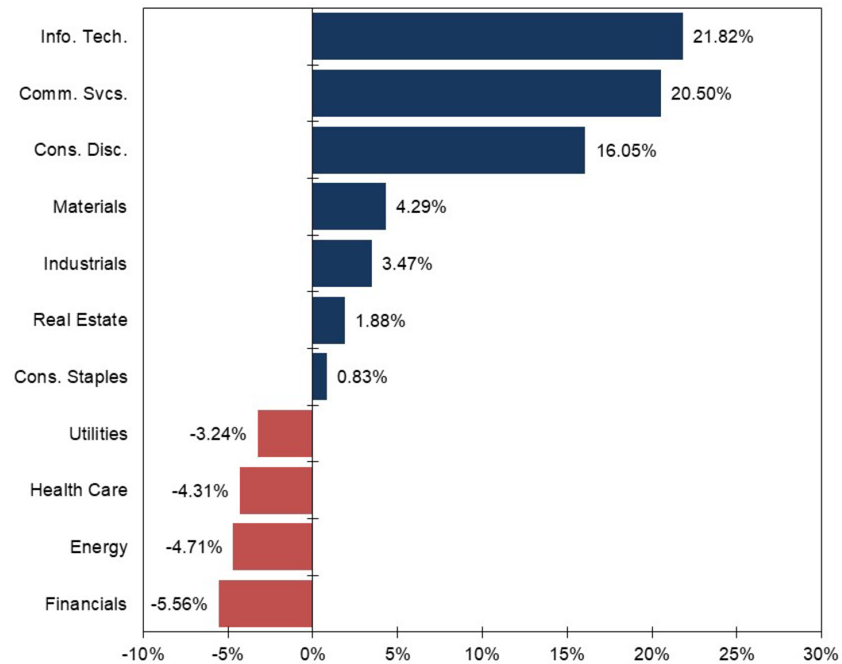
Source: Bloomberg

Highlights and Perspectives

GROSS DOMESTIC PRODUCT (GDP)

In the latest data available, the Bureau of Economic Analysis released the third estimate of the fourth quarter 2022 real GDP, a seasonally adjusted annualized rise of 2.6%, modestly lower than the prior estimate, and a decline from the 3.2% increase in the prior quarter. The modest growth in the second half of 2022 was a welcome recovery from the negative real GDP growth of the first two quarters of the year, but the economy is still grappling with the sharp rise in interest rates prompted by the FOMC's efforts to battle persistently high inflation. Primary drivers of the economy's gains in the quarter were consumer spending, nonresidential business investment and government spending. Consumer spending's contribution was not as robust as previous quarters, owing to a weakening in real income growth in 2022. Corporate profits declined by 2% (not annualized) during the quarter after falling by 0.4% in the prior period. Inflation expectations were in line with the prior quarter, but remain elevated.

U.S Equity Market Returns by Major Sector
(GICS Sectors in S&P 500, First Quarter 1Q23)



Source: Bloomberg

HOUSING

The housing segment finally saw an uptick in February after 12 consecutive months of declines, as the surge in mortgage rates have had a chilling effect for homebuyers. Existing-home sales for February (the latest monthly data available) jumped 14.5% to an annualized rate of 4.6 million units, down about 22.6% from year-ago levels. The inventory of existing homes declined to a level of 2.6 months of supply, down slightly from levels of the prior year. Existing-home prices in February decreased 0.2% from the prior year, the first year-over-year decline in existing home prices in over a decade. In the new-home segment, the NAHB Housing Market Index, a measure of homebuilding activity, ended the quarter at 44, up slightly from a reading of 42 in the prior month. After bottoming in December, the index has posted three consecutive months of gains, although it remains below 50, indicating that building conditions remain poor in the short term. The index has declined every month in 2022, and stands at a level reflecting the lowest confidence reading among homebuilders since 2012. In addition, the reading of below 50 indicates that building conditions are poor in the short term.

EMPLOYMENT

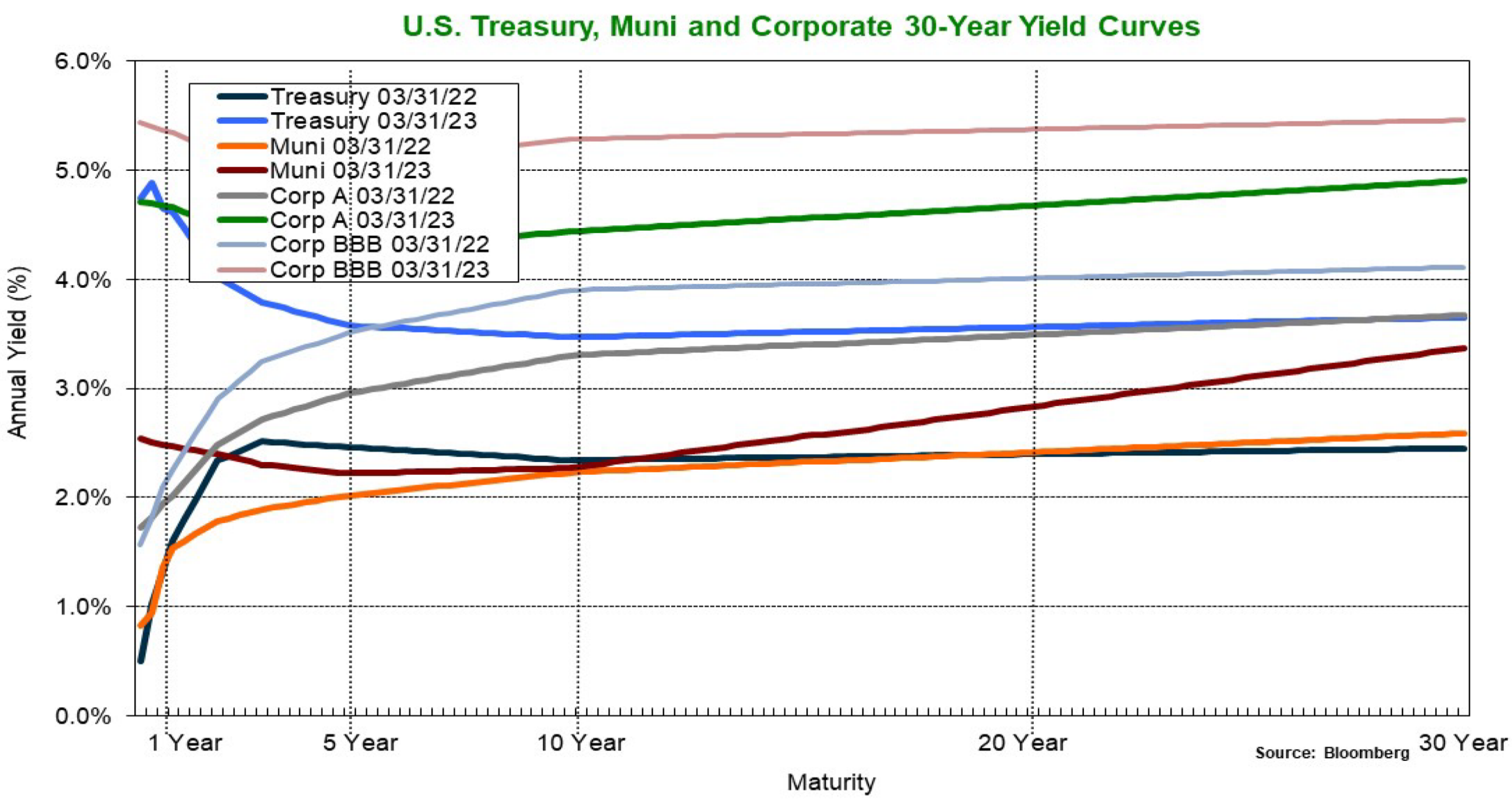
The February employment report (the latest data available) showed the labor market remains very tight, as gains once again outpaced consensus expectations. Employers added 311,000 jobs during the month, above the consensus expectations of a gain of 205,000. Analysts fear that the extraordinarily tight labor market may hinder efforts to subdue inflation and force the FOMC to be more restrictive than had been assumed previously. But some analysts point to lower-than-expected earnings growth as a sign that even though the labor market is tight, it is not resulting in wage inflation, meaning the FOMC may be able to take a wait-and-see approach before implementing further interest rate increases. The unemployment rate in February came in at 3.6%, and the labor force participation rate rose slightly to at 62.5%.

FEDERAL RESERVE POLICY

The FOMC moved to raise interest rates again in March in its attempt to bring inflation under control. Despite the FOMC's aggressive rate increases over the past year, inflation remains stubbornly high, and in an effort to further ease pressures, the FOMC raised its federal funds rate target range twice during the quarter, by 50 basis points, to 4.75%-5.00% from a range of 4.25% to 4.50%. The increase in March was the ninth increase in the past year, the most aggressive program implemented by the FOMC since 1980. Analysts noted that there was somewhat of a softening in the tone of the FOMC's announcement accompanying the March increase, likely as a result of the recent banking crisis. There has also been no change in the reduction of the Fed's balance sheet, as it continues to allow approximately $95 billion in securities to mature each month without reinvesting, which has the effect of siphoning liquidity from the system. In the latest release of its Summary of Economic Projections, the FOMC indicated that it expects that the fed funds rate peak will be only slightly higher than its current level.

INTEREST RATES

Fixed income securities' prices were, on balance, higher (and yields lower) during the quarter, as investors anticipated the worst of the FOMC tightening may be behind us. The FOMC was not quite as aggressive during the recent quarter as it had been over the prior three quarters, raising the fed funds target only twice, by 50 basis points. Also impacting bond prices in the latter half of the quarter was the banking crisis that affected Silicon Valley Bank and Signature Bank. Investors assumed the banking crisis raised the possibility of an economic slowdown, and such a slowdown would prompt the Fed to implement fewer rate hikes or rate cuts, which would cause yields to decline. The provision of liquidity alone would not lower yields.



As mentioned earlier, the FOMC raised the target range on the fed funds rate to 4.75%-5.00%, from the prior range of 4.25%-4.50%. The committee indicated that the fed funds rate is nearing its terminal target, but analysts warn that conditions can change very quickly, forcing the FOMC to continue to raise rates. The consensus among the committee is that the fed funds rate is expected to end 2023 at 5.1%.

The Treasury yield curve remained in the same inverted shape as compared to that at the end of the fourth quarter of 2022. Yields on the very short-term maturities of up to one year rose up to 40 basis points, while yields in the intermediate- and long-term segments of the curve changed between -15 and -35 basis points. By the end of the quarter, the yield on the benchmark 10-year US Treasury note was lower, ending at 3.47%, compared to 3.88% on December 31.

The yield on the 10-year Treasury began the quarter trending lower, bottoming out at 3.37% on January 18. It then climbed steadily higher for the next several weeks until it topped out at 4.06% on March 2, after which it once again meandered lower into the end of the quarter. The yield on the 3-month Treasury Bill settled at 4.75% at the end of the quarter, higher by 38 basis points from the previous quarter. The yield on the 5-year Treasury Note ended the quarter at 3.58%, compared to 4.01% on December 31, and as mentioned above, the yield on the 10-year Treasury Note settled at 3.47%, compared to 3.88% over the same period. The yield on the 30-year Treasury Bond was somewhat lower, ending the period at 3.65%, compared to its beginning level of 3.97%.

Total returns on fixed income securities were once again largely positive during the quarter, following up on the gains from the fourth quarter of 2022. The Bloomberg Treasury 5-7 Yr. Index rose by 3.0% for the quarter. The Bloomberg US Credit Corporate 5-10 Yr. Index added 3.6% during the three months. High yield securities, which often follow the performance of equities, were also higher, posting a gain of 3.6%. Municipals posted similar results in the quarter, as the Bloomberg Municipal Bond Index tacked on 2.8%. Prices of non-US fixed income securities posted solid gains in the quarter, as the Bloomberg Global Aggregate ex-US Index rose 3.1%. Emerging markets bonds also edged higher, with the JPM EMBI Global Index adding 2.3%.

EQUITIES

Stock prices were mixed in the quarter following the recovery in the fourth quarter of 2022. There was significant dispersion in returns across sectors. Many of the obstacles for corporate earnings remain in place, including persistently high inflation, the rise in interest rates, and an economy that some analysts believe will eventually encounter a recession in 2023. Stock investors seem to have discounted the negative news, and are anticipating an end to the FOMC's aggressive interest rate policy and an economy that lands softly rather than succumbs to recession. The S&P 500 began the first quarter on a strong note, rising steadily for the first month, gaining more than 9% by early February. The index then trended lower into mid-March, bottoming shortly after the situation surrounding Silicon Valley Bank and other regional banks calmed down, before rising modestly into the end of the quarter. When the quarter ended, the S&P 500 Index had advanced 7.5%.

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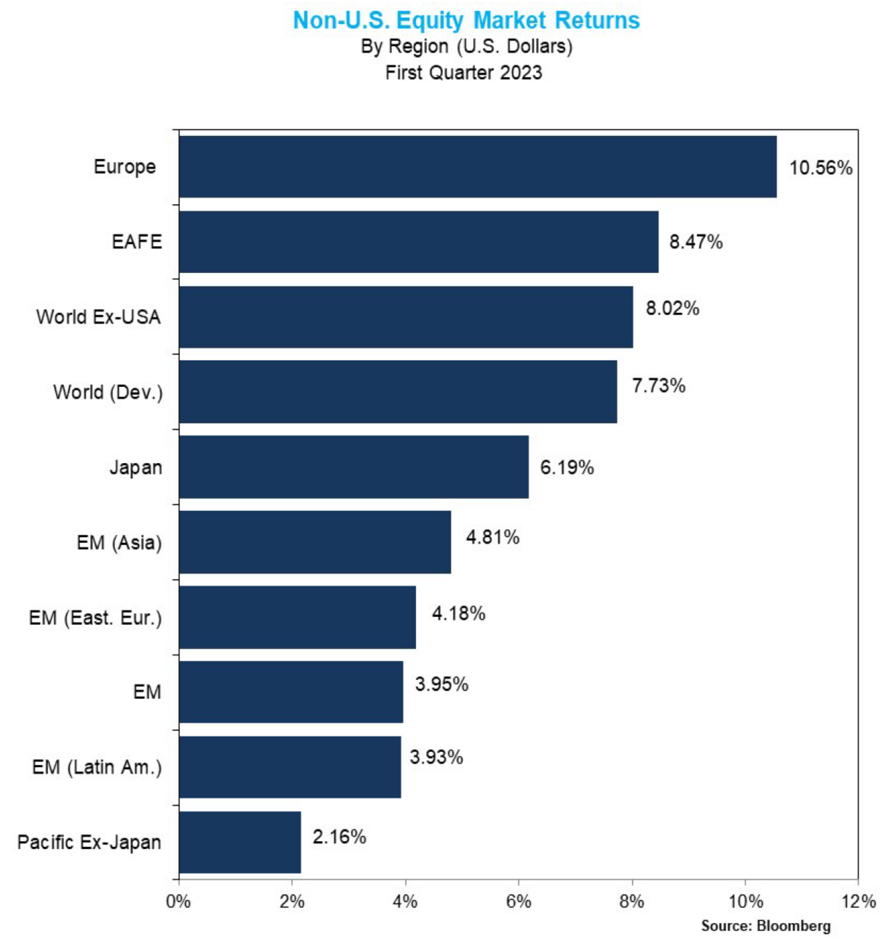
Performance of the 11 primary economic sectors was decidedly mixed during the quarter. Information Technology, Communications Services, and Consumer Discretionary were the strongest performers on a relative basis, generating returns of +21.8%, +20.5%, and +16.1%, respectively. The Financials, Energy, and Health Care sectors were the poorest relative performers, posting returns of -5.6%, -4.7%, and -4.3%, respectively.

The Russell 1000 Index of large capitalization stocks generated a 7.5% total return. Within the large cap segment, value stocks significantly underperformed growth stocks, by a total of more than 1300 basis points. Small cap stocks, as represented by the Russell 2000 Index, underperformed large caps, and finished the quarter with a total return of 2.7%. Small cap value underperformed small cap growth. The NASDAQ Composite, dominated by information technology stocks, finished the quarter with a strong gain of 17.1%. The Dow Jones Industrial Average of 30 large industrial companies eked out a gain of 0.9%.

Real Estate Investment Trusts (REITs) were lower during the quarter, with the DJ US Select REIT Index down 2.8%. Commodities posted large losses, with the Bloomberg Commodity Index declining by 5.4%.

International stocks generated positive results during the quarter, and generally outperformed US equities. The MSCI ACWI Ex-USA Index, which measures performance of world markets outside the US, advanced by 6.9%. The MSCI EAFE Index of developed markets stocks was higher by 8.5%. Regional performance was mostly positive for the quarter. Europe was the strongest performer on a relative basis, with a return of 10.6%. The Pacific ex-Japan region was the poorest relative performer, advancing 2.2%. Emerging markets stocks were slightly higher, as the MSCI Emerging Markets Index rose by 4.0%.



Outlook

The global economy continued to recover during the quarter following a shaky first half of 2022. Inflation remains persistently and painfully high, but the rate of inflation has eased a bit since the FOMC instituted the most aggressive program of interest rate increases in 40 years. The employment situation remains strong, with employers confounding analyst expectations of hiring. Such strong job gains can often lead to wage inflation pressures, but those have not yet been manifested in the data, giving economists some hope that a recession can be averted in 2023. In addition, FOMC policymakers expect that the fed funds rate will not need to be raised much more, as they estimate the rate will end 2023 at 5.1%. The banking crisis sparked by Silicon Valley Bank's collapse seems to have been contained with limited contagion effects, but an ensuing drop in deposits across both large and small banks may pose risks to the industry in the near future. Investors will be paying close attention to the debt-ceiling discussions over the next several weeks, and will also begin to turn their attention to the political landscape, as presidential candidates throw their hat in the ring, and as anticipation grows for the first debates later in the summer. Geopolitical issues are sure to grab the attention of investors as well, as relations between Russia and China (as well as Russia and Iran) warm, and those between the US and almost everyone else cools. In the end, analysts will be focused on fundamentals, and particularly expectations thereof. Stock prices are driven by earnings, and despite the negative reports across multiple fronts over the past couple of years, it seems quite possible that stock prices may have discounted the bad news.

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INDEX OVERVIEW

The **Dow or DJIA** (Dow Jones Industrial Average) is an unmanaged index of 30 common stocks comprising 30 actively traded blue chip stocks, primarily industrials, and assumes reinvestment of dividends. The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **S&P 500 Index** is an unmanaged index comprising 500 widely held securities considered to be representative of the stock market in general. The **DJ US Select REIT Index** is a subset of the Dow Jones Americas Select RESI and includes only REITs and REIT-like securities (The Dow Jones US Select Real Estate Securities Index (RESI) represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the US). The **Bloomberg Commodity Index** is a broadly diversified commodity price index that tracks prices of futures contracts on physical commodities on the commodity market, and is designed to minimize concentration in any one commodity or sector. The **MSCI EAFE Index** is recognized as the preeminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia, and the Far East. The **MSCI Emerging Markets Index** is a free float-adjusted market-capitalization index that is designed to measure equity market performance in the global emerging markets. The **MSCI ACWI Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indices comprising 23 developed and 23 emerging markets country indices. The **MSCI Emerging Markets (EM) Eastern Europe Index** captures large and mid cap representation across four emerging markets (the Czech Republic, Hungary, Poland, and Russia) countries in Eastern Europe. With 52 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in each country. The **MSCI EM (Emerging Markets) Latin America Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of emerging markets in Latin America. The **MSCI ACWI Ex-US Index** is a market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI) and designed to provide a broad measure of stock performance throughout the world, with the exception of US-based companies. The **MSCI China Index** captures large and mid cap representation across China H shares, B shares, Red chips, and P chips covering about 85% of this China equity universe. The **Bloomberg Barclays Municipal Bond Index** is an unmanaged index comprising investment-grade, fixed-rate municipal securities representative of the tax-exempt bond market in general. The **Bloomberg Barclays Global Aggregate ex-US Index** is a market-capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most US-traded investment-grade bonds are represented. Municipal bonds and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The Index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in the US. The **Bloomberg Barclays US 5-10 Year Corporate Bond Index** measures the investment return of US dollar-denominated, investment-grade, fixed-rate, taxable securities issued by industrial, utility, and financial companies, with maturities between 5 and 10 years. Treasury securities, mortgage-backed securities (MBS), foreign bonds, government agency bonds, and corporate bonds are some of the categories included in the Index. The **Bloomberg Barclays Capital US 5-7 Year Treasury Bond Index** is a market-capitalization-weighted index, and includes Treasury bonds issued by the US with a time to maturity of at least 5 years, but no more than 7 years. The **Russell 1000 Index** is a market-capitalization-weighted benchmark index made up of the 1000 largest US companies in the Russell 3000 Index (which comprises the 3000 largest US companies). The **Russell 2000 Index** is an unmanaged index considered representative of small cap stocks. The **Russell 3000 Index** is an unmanaged index considered to be representative of the US stock market, and measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The **Russell Midcap Index** is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The **Housing Market Index** (HMI) is based on a monthly survey of **NAHB** members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months, as well as the traffic of prospective buyers of new homes. The **JPMorgan Emerging Market Bond Index** (EMBI Global) tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the JPMorgan EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million. The **CBOE Volatility Index** (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index.

DEFINITIONS

The **Federal Open Market Committee** (FOMC) is the monetary policymaking body of the Federal Reserve System. The **federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **European Central Bank** (ECB) is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power, and thus price stability, in the euro area. The euro area comprises the 19 European Union countries that have introduced the euro since 1999. The **Gross Domestic Product** (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. The **Bureau of Labor Statistics** (BLS) is a unit of the United States Department of Labor. It is the principal fact-finding agency for the US government in the broad field of labor economics and statistics, and serves as a principal agency of the US Federal Statistical System. The **Bureau of Economic Analysis** (BEA) is an agency in the US Department of Commerce that provides important economic statistics, including the gross domestic product of the US. It is a governmental statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the American public, the US Congress, other Federal agencies, state and local governments, business, and labor representatives. The **PCE (Personal Consumption Expenditure) Index of Prices** is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data, including US Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures, and is essentially a measure of goods and services targeted towards and consumed by individuals. Sector performance is represented by the **Global Industry Classification Standard** (GICS) sectors, developed by Standard & Poor's and MSCI Barra.

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