



BLUE GRANITE CAPITAL, LLC

INVESTMENT COMMENTARY, APRIL 2023

Good morning, and best wishes for a happy Spring.

With all the confusion and strife from high inflation and rising interest rates, the last thing we needed was a curve ball thrown at us with two bank failures almost simultaneously, one of which became the third largest bank failure in U.S. history. Bank failures have occurred periodically throughout history and the world adapts and continues a path toward progress. However, the swiftness of these failures amid inflation-driven economic concerns came as quite a surprise. These banking incidents further weakened investor confidence. The concern now is whether this was an isolated incident or a systemic banking issue that runs deeper within the industry. If more banks fail, it could impact financial lending, consumer confidence and limit spending which ultimately hurts economic growth.

Stubborn inflation, rising interest rates and a slowing economy have hurt corporate earnings which in turn has pressured stock prices and valuations. Now concerns of bank stability have led investors to become even more cautious and opt to invest in bonds and gold in a flight-to-quality trade to protect their capital. The Fed and FDIC have attempted to alleviate concerns by providing an unprecedented credit facility to protect bank depositors. Summarily, the program allows banks to use their investments as collateral to borrow money to meet bank and depositor obligations. Despite considerable finger-pointing, both bank risk managers and state and federal regulators are to blame. Ironically, the responsibility may realistically fall on the Fed for keeping rates too low for too long and causing institutions to take unnecessary risk for additional profit. One certain outcome is regulation for all banking institutions will get stricter since the regulators and the government have been embarrassed enough by this recent incident.

While the Federal Reserve's aggressive monetary policy has helped inflation fall to more reasonable levels, evidence shows that it is also causing the economy to slow. The consumer and producer inflation reports for March showed a slowing inflation trend is beginning to develop. In many ways, the post-Covid consumer spending spree has abated, a big part of which is due to plummeting housing market sales activity which drastically skewed home prices and related rental markets. The economic indicators set up a good news- bad news environment. If inflation is slowing and the economy too, then the Fed should stop raising rates. The investment markets would view a Fed pause positively, however it's also an admission of weaker growth which may very well crimp corporate profits and their respective stock prices. Despite a desire to see the Fed pause, they appear committed to rate hikes as long as data supports their current inflation thesis.

In spite of the rapid climb in interest rates last year to 40-year highs, bond yields have fallen to seven-month lows influenced by slowing inflation, the recent regional bank crisis, moderating economic growth, and lower corporate earnings. Investors may be drawing their own conclusions - bond yields falling and bond prices rallying because rates are so attractive or because a recession is imminent, and investors seek a flight-to-quality strategy to protect their investment capital and opt into bonds until an economic downturn passes.

Despite the host of worrisome issues mentioned above, stocks have enjoyed an impressive 6-month rally. The S&P 500 Index has gained over 15% in the past 6 months, while the tech – heavy Nasdaq has gained more than 16% in the just completed first quarter. The swiftness of this rally and its depth, led by mega-cap growth stocks Apple, Microsoft, Amazon, Google and Metaverse, and leaving the other 495 S&P 500 stocks as minor contributors is concerning because of current conditions. We are pleased to see returns like these in any economic cycle, but with higher rates, stubborn inflation, and a slowing economy, we are worried that the stock market has come too far, too fast.

So, we remain cautious and choose patience rather than chasing stock prices that may be overdue for a pullback. The best place to weather this storm is with a balanced portfolio strategy. Bonds are earning a compelling return for the first time in decades and so is cash (Money Market instruments). The stocks in your portfolio are top quality, financially sound companies that pay dividends (95% do), which enhances performance as we continue through a challenging economic cycle.

Please give us a call if you have any questions or concerns.

Warmest regards,

Scott, John and Dave