FIRST QUARTER 2023

Matt's Market Update

IN THIS REPORT

Matthew H. McPhail, CFA
Chief Investment Officer

Market Review

The major global equity indices registered strong gains for March to finish a positive, but volatile, quarter. Growth stocks continued their rally that began in Q4 and powered the NASDAQ to a leading gain of +16.77% in Q1. The leaders from 2022, namely Value stocks and dividend payers, lagged during the quarter with the S&P 500 posting a +7.50% gain while the Dow Jones was flat at +0.93%. From a style perspective, the Morningstar Large Cap Growth peer group gained +14.79% on average while the Large Value peer group was barely positive at +0.18%. The Russell 2000 small-cap index lagged significantly in March and Q1 (-4.78% & +2.74% respectively). The various Value indices have significant exposure to the banking sector across all market caps. The collapse of Silicon Valley Bank (SVB) on March 9th was the trigger for heavy losses across the sector to close the quarter, which dragged down the Value benchmarks. Investors have been on alert since the Fed started its campaign of rate hikes that eventually "something would break." While the specific reasons for each event varied, the failure of three significant banks (SVB, Signature Bank and Silvergate Bank) was certainly aided and abetted by the Fed's interest rate tightening.

Banks are also under pressure as deposits are fleeing. In fact, deposits had fallen $363 billion since the beginning of March to $17.3 trillion by quarter-end. Money is rapidly leaving banks as depositors are fearful of uninsured deposits following the SVB failure. Perhaps more importantly, depositors are leaving banks in search of higher yields. While banks have been reluctant to raise deposit rates in line with the interest rate hikes of the last year, money markets and T-bills are now yielding well over 4% annualized. Per data from the Federal Reserve, there was a record-breaking shift of deposits out of small banks into the largest institutions. The 25 largest banks in the U.S. gained $120 billion in deposits in the days after SVB collapsed while smaller banks lost $108 billion over the same period. That was the largest weekly decline in smaller banks' deposits on record.

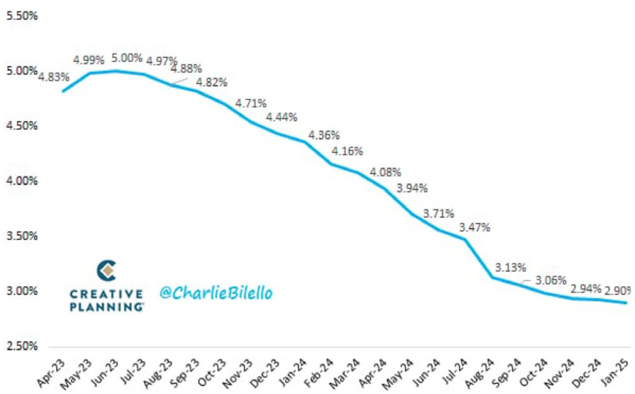
One issue for U.S. equity investors to keep an eye on is the top-heavy composition of the S&P 500 index. Just five stocks (Apple, Microsoft, Amazon, Nvidia & Alphabet) account for over 20% of the S&P 500's market cap. This is actually down from the nearly 25% of the index these stocks accounted for last year. By itself, Apple accounted for 20% of the index gain in Q1. With the fate of the index currently being driven by so few stocks, active managers (who prefer to spread their bets for diversification) are struggling to outperform the S&P 500. According to research from Bank of America, only one in three actively managed large-cap mutual funds beat their benchmarks in Q1. This was a big change from 2022, when 57% of active large-cap managers beat their benchmarks.

When Will the Fed Cut Rates?

This seems to be the most debated question in markets as we enter Q2. It's safe to say the rate hike cycle is nearing the end. The consensus predicts the Fed will hike rates by 25 bps at their May meeting. From there, the debate begins. The Fed Chair and other committee members have given no indication of rate cuts anytime soon. Going strictly by their word, a pause following the May meeting to assess the economy for the remainder of the year would be the best guess. The financial markets, on the other hand, are not seeing it that way. Based on where investors are placing their bets in the futures market, rate cuts are being predicted as early as July.

In looking at the chart below, we can see where the market is now expecting another 25 bps hike in May (to a Fed Funds range of 5.00-5.25) but then a reversal into rate cuts starting in July. By the end of 2024, the market is predicting that the Fed will cut rates back below 3%. It's very important to note that this is the market's expectation now to start Q2, but it will adjust and change. That being said, we've rarely seen such a divergence between the Fed forecast and market expectations.

MARKET EXPECTATIONS FOR FED FUNDS RATE (APRIL 2023 - JAN 2025)



Source: Creative Planning @ CharlieBilello, Powered by YCHARTS

What does the market see in its predictions that the Fed itself isn't predicting? We'd point to two things. First, the Fed isn't exactly known for precise future predictions. For example, "inflation will be transitory." The Fed's own predictions in early 2021 gave no hint of the aggressive rate hiking cycle to come in 2022. Second, the market may simply be looking back at the history of major financial and corporate failures as to what comes after. According to Rosenburg Research, following key events like the failure of Silicon Valley Bank in Q1, their response is almost always to cut rates. In looking at the chart here related to past financial failures, the timing may not be precise, but the action of the Fed is uniform. We won't hazard a precise guess as to when the rate cuts will begin, but for those who believe that the current elevated levels of rates are here to stay indefinitely, we'd remind you that the current market predictions and history disagree.

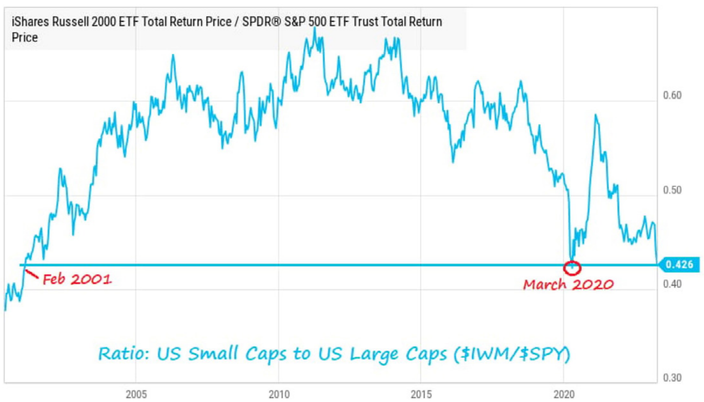
EVENT	FED ACTION
Franklin National, Oct. 1974	Fed cut rates that month
Penn Square, Jul. 1982	Fed cut rates that month
Continental Illinois, May 1984	Fed cut rates one month later
Lincoln Savings, Apr. 1989	Fed cut rates two months later
Orange County, Dec. 1994	Fed cut rates seven months later
Long-Term Capital, Sept. 1998	Fed cut rates that month
Global Crossing, Jan. 2001	Fed cut rates that month
Bear Sterns Hedge Funds, Jul. 2007	Fed cut rates two months later
Repo Market Dysfunction, Sept. 2019	Fed cut rates that month

Source: Rosenburg Research

Small Cap Opportunity?

As you'll note from the returns chart at the end of this report, a wide gap in average annualized returns over the trailing 5 & 10-year periods has opened up between large-caps (S&P 500) and small-caps (Russell 2000). In fact, the lagging performance of small-cap stocks relative to large-caps has rarely been larger as the chart on this page indicates. The ratio of small-caps to large-caps is nearing March 2020 levels, which was the lowest witnessed since February 2001. Over the last 10 years, small-caps have gained 115% (8% annualized) vs. 214% for large-caps (12% annualized).

There are a few ways to interpret this chart. The optimistic investor might contend that when the ratio of small-cap to large-cap reached these low levels in the past, small-caps went on to outperform (line on the chart moving up) as reversion to the mean took hold and returns across the market cap spectrum evened out. The pessimistic investor might contend that small-caps are more sensitive to the domestic economy, which by many measures is heading into recession. Therefore, large-cap outperformance is justified. Where do we stand on this issue? First, understand you'll never time the exact bottom of the market. The performance lag and comparative valuations have rarely been more attractive though. For the long-term investor who intends to have equity exposure across all market caps, it makes sense to see where your small-cap exposure currently stands. If it has fallen below your long-term target, dollar cost averaging to increase exposure would seem to make sense at these discounted valuations.



Source: Creative Planning @ CharlieBilello, Powered by YCHARTS April 6, 2023

INTEREST RATES & OPPORTUNITY COST

Wealth Management Corner

James Bremis, CFP®, CPFA™
Senior Financial Planner

The 2022 rate hike cycle was the fastest on record, reaching a 2.36% increase nearly twice as fast as the rate hike cycle of '88-'89. A change of that speed and magnitude can either wreak havoc or create significant opportunities in your financial plan. For individuals who have done little to no financial planning, these rapidly changing environments may force them to make decisions with their investments without time to gather information or consider consequences. If there has been any theme over the last few months in my client reviews, I have noticed discussions are increasingly focused around two topics directly affected by interest rates: cash and debt.

With this rapid rise in rates, we are finally being rewarded for holding cash. Our held-away cash solution announced that starting April 17, their top interest rate would be increased to 4.40%. For reference, their top rate on 5/18/2020 was 0.98%. When you're being rewarded for staying conservative, it can make you rethink your asset allocation. This brings us to the first question: How much of your assets should be in cash?

What you keep in cash is initially determined by when you plan to access the money. Emergency funds are held in cash because you need that money to be liquid in the event you need to access it. Beyond that, I would also include amounts you need in the next 12-18 months to be assets you want to keep liquid.

If you had a balance on a credit card or were looking to buy a home in the last year, you saw significant increases in the cost of debt. The average mortgage rate for a 30-year fixed is 6.96%, nearly double its 3.22% level in early 2022. Interest rates on credit cards continue moving up, with the national average APR at about 20 percent as of mid-March 2023, up from 16.34 percent in March 2022. This brings us to our second question: How do you manage debt with interest rates so high?

My answer brings me back to Economics 101: opportunity cost. To put it simply, think of it like this. The cost of borrowing is the interest rate you pay. The opportunity cost of debt is the return you could get on that money elsewhere minus the borrowing costs. To give an example, let's say I could get a hypothetical 9% return by investing in the stock market (looking at the S&P 500 for the years 1992 to 2021, the average stock market return for the last 30 years is 9.89%). Based on the average 30-year mortgage rate, my opportunity cost is close to 2%. If I have extra money at the end of the month, it would actually make more sense to invest that money than put it toward the mortgage. Now, credit cards are different. Because the 20% interest rate is higher than the 9% return I think I could get in the markets (negative opportunity cost!), it actually makes more sense to pay that debt down than to invest any additional dollars. Same thing applies to your cash holdings. If you have money in cash that exceeds the sum of your emergency fund and what you would need in the next 12-18 months, you need to consider the opportunity cost of holding cash. Cash is earning more now, but is it earning enough to justify not being in the markets?

The Financial Planners in Sentinel's Private Client Group run through these conversations every day, so if you're facing conundrums like this, be sure to reach out to your Financial Planner.

Matt's Market Update

Our Portfolio Strategy & Allocation Outlook

We made one significant change to our managed private client accounts in Q1. Within our foreign equity segment, we increased our weighting to large-caps while removing a small-cap manager. We remain fully diversified across equity styles and market caps with no large tilts. While 2023 has started off with positive global equity returns, we remain cautious. As we mentioned in last quarter's report, the index of Leading Economic Indicators (LEI) continues to decline. This broad-based indicator of economic activity continues to flash warning signs for a recession later this year or subdued growth at a minimum. This would imply we're set to continue witnessing declines in corporate earnings in the months ahead and potential downward pressure on equity prices.

As the quarter ended, the forward multiple on expected S&P 500 earnings was 18x. Well above the historical average of 15x. Despite the price declines of last year, the market remains far from cheap in aggregate. It would be fair to ask, if economic weakness and earnings declines are on the horizon, why are equities off to a strong start for the year? We think it comes down to two issues. First, the full impact of the Fed's rate hiking campaign hasn't been fully reflected yet in the economic numbers. More importantly, investors seem to be looking past the current economic weakness and placing more emphasis on the potential start of a Fed rate cutting cycle that could start later this year. In any case, our cautious positioning means we're neutral in terms of equity exposure. While the current momentum is favorable, the fundamentals suggest this is not the time to be overweight to equity.

Our outlook is relatively more optimistic for the other key segments of the portfolio: fixed-income and foreign equities. Coming off the worst year for fixed-income since the 1970s, yields have reset higher, inflation seems to have peaked and Fed rate cuts may be starting in the near future. This is a recipe for solid, but not spectacular, fixed-income performance. The short end of the market benefits from the inverted yield curve and superior yields on very short-term treasuries. For longer-duration bonds, they should benefit from lower inflation and declining bond yields. For foreign equities, there are still issues to worry about, but two factors are in the bull's favor right now. First, the dollar seems to have peaked relative to world currencies, which provides a nice tailwind to overseas earnings. Second, it comes down to valuations. Per a recent report from Brandes Investment Partners, "Over the last two years, large- and mid-cap European equities reached their largest-ever discounts relative to the U.S. on a sector-neutral basis. This was also true for international equities, which even reached the discount level that U.S. equities traded at relative to international equities during the late 1980s Japan bubble. The discount level recorded at that time preceded notable U.S. equity outperformance during the next three years." As you'll note from the chart on the following page, the valuation discount of foreign equities has rarely been larger. This doesn't guarantee immediate outperformance, but it does suggest a margin of safety is there for long-term investors.

Please let us know if you'd like to discuss your personal investing and financial planning needs.

Matthew H. McPhail, CFA
Chief Investment Officer

David Batchelder, CFA, CFP®
Senior Investment Officer

James Bremis, CFP®, AIF®, CPFA™
Senior Financial Planner

INTERNATIONAL VS. U.S. EQUITY VALUATIONS & RETURNS
SECTER NEUTRAL VALUATION OF MSCI EAFA VS. MSCIUSA

Source: Brandes

Market Scoreboard

Index Returns (%)	Q1 2023	YTD	1 Year	3 Year	5 Year	10 Year
S&P 500	7.50	7.50	-7.73	18.62	11.19	12.24
DJIA	0.93	0.93	-1.98	17.33	9.01	11.15
NASDAQ	16.77	16.77	-14.05	16.66	11.59	14.10
Russell 2000	2.74	2.74	-11.61	17.52	4.71	8.04
MSCI ACWI Ex USA	6.87	6.87	-5.07	11.81	2.47	4.17
Barclays Aggregate Bond	2.96	2.96	-4.78	-2.77	0.91	1.36

Source: Morningstar

Disclosure: This information is intended solely to report on investment results, strategies and opportunities identified by Sentinel Advisors. Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. References to specific securities are for illustrative purposes only and are not intended, and should not be, interpreted as recommendations to purchase or sell such securities. Past performance is not indicative of future results. Index information has been obtained from sources that we believe to be reliable; however, we do not guarantee the accuracy of such information.

Dollar cost averaging does not ensure a profit and does not protect against loss in declining markets. It involves continuous investing regardless of fluctuating price levels. Investors should consider their ability to continue investing through periods of fluctuating market conditions. This information is intended to be educational and is not tailored to the investment needs of any specific investor.

Diversification and asset allocation do not ensure a profit or protect against loss.

S&P 500 TR: A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the large-cap segment of stock market.

Russell 2000 TR: Consists of the smallest 2000 companies in the Russell 3000 Index, representing approximately 7% of the Russell 3000 total market capitalization often used as a proxy for the small-cap segment of the stock market.

Barcap Aggregate Bond TR: The Barclays Capital Aggregate Bond 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 U.S. traded investment grade bonds are represented. The index includes Treasury securities, Government agency bonds, Mortgage-backed bonds, Corporate bonds, and a small amount of foreign bonds traded in U.S.

MSCI EAFE NR USD: Widely accepted as a benchmark for international stock performance, the EAFE Index is an aggregate of 21 individual country indexes that collectively represent many of the major markets of the world.

DJ US Industrials TR USD: Computed by summing the prices of the stocks of 30 U.S. companies and then dividing that total by an adjusted value--one which has been adjusted over the years to account for the effects of stock splits on the prices of the 30 companies.

NASDAQ: Measures the performance of all issues listed in the Nasdaq Stock Market and is often used as a proxy for the large-cap technology segment of the U.S. stock market.

DJ/UBS Commodity: The DJ-UBSCI is composed of futures contracts on physical commodities and is often used as a proxy for broad-based exposure to the commodity markets.

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