GIA PARTNERS

1st Quarter 2023

Highlights

- **Optimism permeated markets for two months. Suddenly, a bank crisis erupted leading investors to radically adjust expectations. Our portfolios underperformed as "flight to quality" ruled in March.**
- **The bank crisis forced authorities into containment mode. In addition, economic data deteriorated in March suggesting a recession may be more probable and the Fed may soon pause.**
- **SVB's demise and the authorities' rapid decisions brought back the question of deposit guarantees. We believe demand deposits should be "guaranteed" by the banks, not the government.**

Markets

		Returns (%)			
GIA	Average Quality	1Q23 Gross	1Q23 Net	12 Months Gross	12 Months Net
Core Plus Composite	**(A)**	**2.87**	**2.78**	**-4.52**	**-4.86**
Global Investment Grade Composite	**(A-)**	**3.47**	**3.37**	**-5.02**	**-5.40**
Global Credit Plus Composite	**(BBB+)**	**2.41**	**2.28**	**-4.79**	**-5.26**
High Yield Composite	**(BB-)**	**3.02**	**2.88**	**-2.71**	**-3.25**
Emerging Market Corporate Debt Composite	**(BB+)**	**0.84**	**0.69**	**-4.64**	**-5.21**
Benchmark Bonds					
Bloomberg U.S. Agg. Index	(AA+)	2.96		-4.78	
Treasury	(AAA)	3.01		-4.51	
Corporate	(A-)	3.50		-5.55	
Mortgage	(AAA)	2.53		-4.85	
Government/Credit	(AA)	3.17		-4.81	
ICE BofA U.S. Corporate & Yankees	(A-)	3.31		-4.98	
ICE BofA U.S. Corporate	(A-)	3.45		-5.19	
ICE BofA U.S. High Yield	(B+)	3.72		-3.56	
ICE BofA EM Corporate Plus	(BBB)	2.12		-3.28	
ICE BofA Global Gov't ex-US	(AA-)	2.30		-7.65	
JPM Emerging Markets EMBI GD	(BB+)	1.86		-6.92	
JPM CEMBI Broad Diversified	(BBB-)	2.24		-1.62	
JPM GBI-EM Global Diversified	(BBB+)	5.16		-0.72	
Benchmark Equities					
S&P 500	NA	7.03		-9.30	
Nasdaq Composite	NA	16.77		-14.05	
Russell 2000	NA	2.34		-12.93	
MSCI EAFE	NA	7.65		-4.08	
MSCI Europe	NA	9.54		-0.83	
MSCI Japan	NA	4.62		-7.04	
MSCI Emerging Markets Equity	NA	3.54		-13.27	

* Please refer to the respective factsheets for the long-term composite and benchmark returns for each strategy.

Markets

Was everything too good to be true? A quarter that was progressing in a surprisingly resilient manner, considering the intensity of the Fed's policy restraint and widespread anticipation of recession, was suddenly derailed. In three mid-March days, the world became engulfed in a banking crisis that threatened global financial stability and led investors to scurry for cover. While equity markets experienced a moderate correction, fixed income markets saw a "flight to quality" that reversed participant expectations for monetary policy and economic activity. Yields along the curve declined precipitously, with the 2-year falling 130 b.p. between March 8 and March 24 and the 10-year declining 55 b.p. over the same period. Credit spreads widened, especially for banks and high yield, as investors gauged the implications of the crisis on the availability of credit. Rapid action from fiscal and monetary authorities helped contain the panic and restore calm as the quarter ended. Ultimately, the S&P 500 held on to earlier gains returning 7.48% (including dividends) while European stocks also affected by the crisis improved 9.74% (in USD) and emerging markets posted gains of 3.43%. The rush to safety in bonds brought yields down leading U.S. treasuries to a 3.01% return, the Bloomberg Aggregate Index delivered 2.96%, investment grade corporates 3.45% and mortgage-backed securities 2.53%. In isolation, these numbers appear relieving after last year's performance, but we believe the banking crisis set the stage for deeper scrutiny of lurking risks, including in private investments and real estate.

Investment grade credit posted strong absolute returns although spreads widened, especially in March. For the quarter, the investment grade corporate bond index, the ICE BofA U.S. Corporate Index (C0A0), was up 3.45% on the heels of lower rates and a better income contribution from higher yields. Corporate bonds generated a modest 20 b.p. of duration adjusted excess performance as the U.S. treasury index (G0Q0) returned 3.08%. Corporate option adjusted spreads (OAS) widened 6 b.p. to 144 b.p., while the yield to worst of the index declined from 5.50% to 5.24%. Investment grade issuance surged in the first two months, followed by a slower March as the banking crisis unfolded. For the quarter, issuance totaled a healthy $508.1 billion, which was comparable to last year's largest quarterly borrowing during the first quarter of $511.5 billion. As a further illustration of the bank crisis' impact, borrowers raised $254 billion in March 2022 and only $117.2 billion in the same month this year.

The high yield market had a volatile quarter as early economic optimism was truncated by the bank crisis on worries about the availability of credit, and a higher likelihood of recession. The ICE BofA U.S High Yield Index (H0A0) was up 3.72% for the quarter. At quarter-end, the spread to worst for the sector was narrower than year-end by 14 b.p., from 488 b.p. to 474 b.p., although that was meaningfully wider than the 431 spread at the end of February. By ratings, spreads were: BB 316 b.p., B 497 b.p., and CCC 1,108 b.p. Energy, the largest industry in the index, outperformed again, returning 3.96%. The decline in treasury yields lowered the yield-to-worst for the sector from 8.95% to 8.31%. The solid returns did not prevent high yield retail investors from withdrawing $16.0 billion during the quarter. However, in a significant shift in composition, ETFs accounted for 74% of the outflow compared to 19% in 2022's first quarter when investors withdrew a quarterly record $48.9 billion. During the quarter, there were $9.6 billion in defaults and distressed exchanges. The default rate including distressed exchanges rose to 1.91% from 1.65% at the end of 2022 (1.27% not including distressed exchanges) which remained well below the historical average of 3.2%. The new issue market showed signs of life early in the quarter but receded with rising rates and the bank crisis. Through March 31, 2023, new issuance totaled $40.5 billion, about $6.0 billion below last year's Q1 volume.

Despite significant events in many countries, emerging markets bonds took a back seat to developed markets as economic activity, monetary policy, and a banking crisis tightened financial conditions and set the tone for the global economy. China moved to fully reopen and lift constraints on many industries in an effort to reactivate the domestic economy. Unfortunately, China's leadership continued to antagonize western nations with bellicose rhetoric on Taiwan and a friendly embrace of Russia. In Latin America, left leaning policies of recently elected administrations were moderated by divided congresses, tempering the likelihood of radical outcomes. Early in the quarter a few sovereigns and corporates were able to access the new issue markets on reasonable terms. Despite nominally better news, emerging markets underperformed U.S. credit markets in Q1. For the quarter, the JPM Emerging Market Bond Index – Global Diversified (EMBIGD), a dollar denominated sovereign index, was up 1.9%, the JPM Corporate Emerging Markets

Broad Diversified Index (CEMBI BD) increased 2.2%, and the JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index, gained 5.2% with a significant contribution from a weakening U.S. dollar.

Economy

As 2023 started, a broad consensus had formed around a slowing economy, moderating inflation, and a nearing pause in the Fed's persistent rate hikes. After all, fourth quarter data disappointed, and the central bank's 425 bps of rate hikes were beginning to bite. This sober narrative was jolted by January data that suggested economic activity was stronger than forecast and inflation was not yet tamed. Furthermore, the Fed reminded everyone they were serious about containing it.

Just as the market adjusted to a more resilient economy and more restrictive monetary policy, a bank crisis erupted. The FDIC, Treasury, and the Fed were forced into rapid and decisive action to prevent systemic contagion. The event, although short in duration and small by historical standards (so far), altered everyone's forecasts for the economy and the Fed's future policy decisions.

As we start the second quarter, the outlook has become more muddled and the range of outcomes broader. The bank crisis raises questions about the health of smaller and regional banks and their ability/willingness to lend. Small businesses depend on these institutions to operate. Higher rates shined a spotlight on bank asset valuations, including real estate, private loans, and longer-term securities. This scrutiny may lessen liquidity and hinder the availability of credit. Mitigating these dour consequences, many companies accumulated ample cash during the pandemic and already started reducing expenditures in anticipation of a recession. Also, consumers did not spend all their pandemic savings and appear to be willing to deploy more on pent up demand for forgone services. Altogether, recent economic data confirms the economy is slowing while inflation containment is lagging. The Fed faces a delicate balancing act between its unwavering commitment to controlling inflation and acting judiciously to avoid excessive economic deterioration.

A review of various industries confirms the messages in the data. Manufacturing PMIs weakened further in March, which transportation companies acknowledge when reporting fewer goods shipments at reduced rates. Even auto manufacturers, who enjoyed strong demand and pricing, sold fewer units than before the pandemic. Industries experiencing robust demand include leisure and hospitality, airlines, and entertainment. Others like commodities and capital goods producers are benefiting from a boost related to China's reopening and Europe's "less bad than expected" winter. Consumer products manufacturers still have pricing power, although volume figures indicate that benefit is waning.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the U.S. economy growing about 0.5% to 1.0% at an annual rate in 2Q and 3Q, 2023. Data releases during the first quarter indicate the economy benefited from benign weather in the east and consumers continued their healthy spending on services. March data suggests the pace of economic activity is slowing and the bank crisis impact will likely take a few months to filter through. Furthermore, the Fed's continuing hikes will likely burden rate sensitive sectors for longer. While the slowdown may feel lousy, the financial health of consumers and corporations should enable the U.S. to escape a recession. Meanwhile the rest of the world will likely begin to recover with a boost from China, a non-recession in Europe, and some domestic monetary stimulus boosting emerging economies. PROBABILITY 50%

2. A second scenario has the economy slowing to a rate of -1.0% to -0.5% at an annual pace during the next six months. In this scenario, the Fed's rate hikes, including in May 2023, fallout from the Silicon Valley Bank failure, and consumer caution have a quicker and more debilitating impact on the economy. We expect the Fed to pause after a May hike and not cut rates during 2023. If this scenario materializes, the Fed will be pressed to cut as inflationary pressures will likely ease and unemployment will start rising. PROBABILITY 35%

3. A third scenario has the economy expanding at a more comfortable pace of 1.0% to 1.5% at an annual rate during the next six months. In this scenario, personal consumption remains robust aided by low unemployment and reasonable wage growth. Lower energy prices and easing housing prices boost consumer confidence and offset the Fed's efforts. While a 1.5% growth rate will not pressure inflation higher, the Fed may be tempted to raise rates further forcing the economy into a weaker state in 2024. PROBABILITY 15%

April 15, 2023

Important Information

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Index Definitions

Bloomberg U.S. Aggregate Index
The Bloomberg U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Bloomberg U.S. Treasury Index
This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Bloomberg U.S. Government/Credit Index
The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Bloomberg U.S. Corporate Index
This index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers. (Future Ticker: I02765US)

Bloomberg U.S. Mortgage Backed Securities Index
This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

ICE BofA U.S. Corporate & Yankees Index
The ICE BofA U.S. Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

ICE BofA U.S. Corporate Index
The ICE BofA U.S. Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

ICE BofA U.S. High Yield Index
The ICE BofA U.S. High Yield Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

ICE BofA US Emerging Markets Corporate Plus Index (EMUB)
The ICE BofA US Emerging Markets Corporate Plus Index is a subset of The ICE BofA Emerging Markets Corporate Plus Index including all securities denominated in US dollars.

ICE BofA Global Government Excluding the U.S. Index (N0G1)
The ICE BofA Global Government Excluding the U.S. Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency. N0G1 excludes U.S. government bonds.

Emerging Markets Bond Index Global Diversified (EMBI® Global Diversified):
The EMBI Global Diversified is a uniquely-weighted version of the EMBI Global. It limits the weights of those index countries with larger debt stocks by only including specified portions of these countries' eligible current face amounts of debt outstanding. The countries covered in the EMBI Global Diversified are identical to those covered by the EMBI Global.

JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI Broad Diversified)
The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. The CEMBI Broad Diversified limits the weights of those index countries with larger corporate debt stocks by only including a specified portion of these countries' eligible current face amounts of debt outstanding.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)
The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

S&P 500 Index
An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index
An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI Europe Index
The index is a free-float weighted equity index measuring the performance of Europe Developed Markets.

MSCI Japan Index
The index is a free-float weighted equity JPY index.

MSCI Emerging Markets Equity

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.