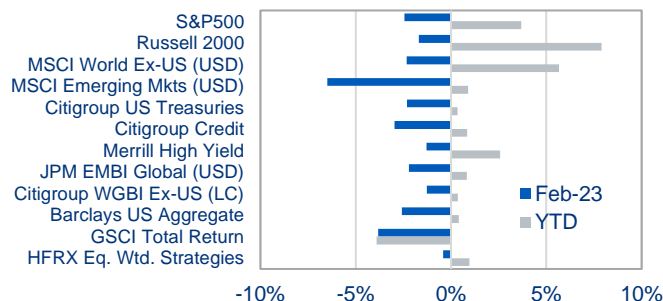


Global Market Review

Equity and credit risk premiums and inflation risk have been moving together over the past several months. Investors have been demanding more compensation for bearing equity and credit risk when inflation seems entrenched and less when price pressures appear to be easing. Signs in February of economic resilience, a robust labor market, and persistent price pressures led investors to reconsider the future path of monetary policy. The prospect that the Fed and other major central banks would remain tighter for longer sent global equities and bonds tumbling. Emerging equities, and especially the Chinese market, fell particularly sharply. The increase in inflation expectations sent yields on U.S. Treasuries and other sovereign securities higher. Corporate spreads widened as increased inflation risk led investors to demand greater compensation for bearing credit risk. Rising U.S. yields benefited the dollar, which appreciated against most currencies. Commodity prices fell.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



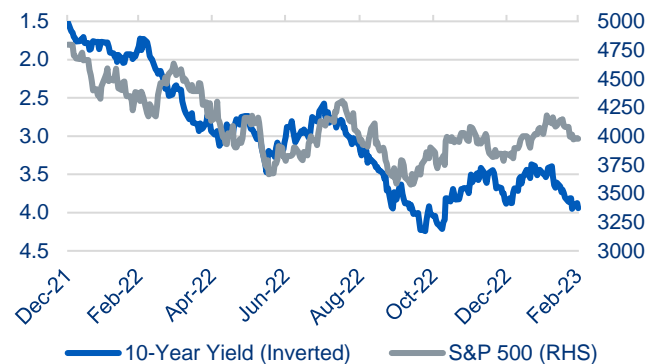
Inflation uncertainty undercuts equity and credit markets.

U.S. Equities Fall as Inflation Expectations Rise

Inflation risk and its impact on the path of monetary policy and bond yields have been dominant factors influencing equity market movements for the past several months. This dynamic is evidenced by the close inverse relationship between the yield on 10-year U.S. Treasuries and stock prices (Exhibit 1). The hopes for a soft landing that fueled January's U.S. equity rally were dashed in February. Signs that the U.S. economy was stronger and inflation more entrenched than previously hoped led investors to reassess their view that the Fed was fast approaching the end of its tightening cycle. The prospect of persistent inflation and relentless Fed hawkishness led investors to demand a higher equity risk premium, reversing part of the multiple expansion that helped underpin January's sharp rebound. Declining earnings forecasts and downbeat corporate earnings guidance further contributed to the reversal in sentiment.

Exhibit 1. Rising Bond Yields, Falling Stock Prices

Source: Bloomberg. 10-year yield in percent, S&P 500 index points.



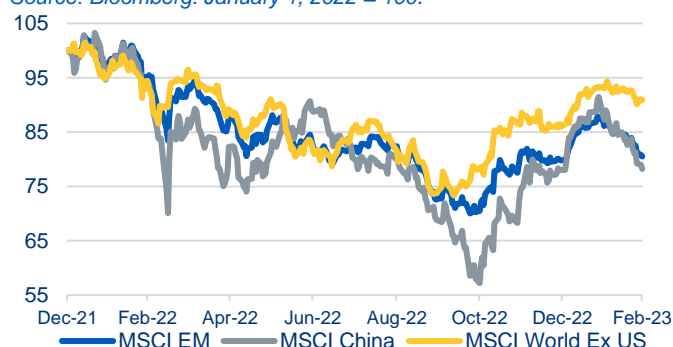
With this change in sentiment, January's strong bounce in equity prices was partially reversed in February, as the S&P 500 fell 2.4%. So far this year, however, the index remains up 3.7%. February's decline was broad based, with most style factors and sectors losing ground. Growth stocks, which had outpaced value in January's strong rally, also outperformed in February's decline, falling 1.2% versus the 3.4% drop in value. For the year as a whole, growth stocks are up 7.2% versus value's increase of 1.8%. Across sectors, energy and utilities stocks suffered the sharpest declines in February. The tech sector was alone in managing a small gain.

Non-U.S. Equity Markets Fall in February

Advanced non-U.S. equity markets followed the U.S. pattern, with a fall in February partially reversing January's bounce. The MSCI World ex-U.S. index lost 2.3% last month but remains up 5.7% so far this year. The decline of European equities was relatively muted – 0.6%. The European economy, which had been contracting for several months, seemed to stabilize in the fourth quarter, thanks largely to a sharp decline in natural gas and other energy prices. These price declines provided a welcome respite to firms and households squeezed by soaring energy costs and supply disruptions caused by Russia's invasion of Ukraine. Despite declining energy prices, European inflation remains high, and the ECB has promised to match February's 50 basis point rate increase with further similar rate increases until inflation has been tamed.

Exhibit 2. China Drags Emerging Equities Sharply Lower

Source: Bloomberg. January 1, 2022 = 100.



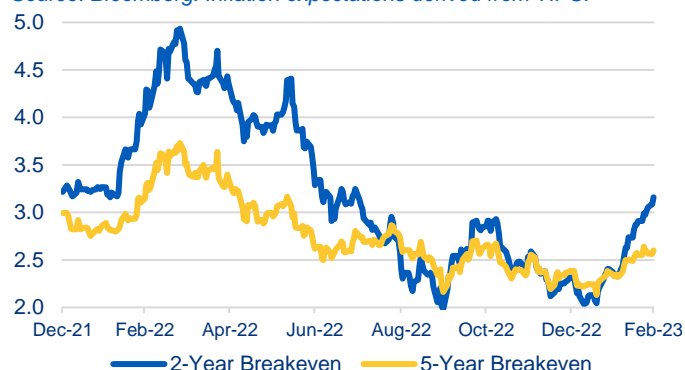
Emerging equity markets lost 6.5% in February, reversing all but 0.9% of January's gain. Bourses across Asia, Latin America, Europe, the Middle East, and Africa all lost ground in February. Asian emerging markets suffered especially steep declines, falling 6.9%. A severe retrenchment of Chinese equities, which fell 10.2% in February, was the main driver of the drop in the Asian emerging equity market index (Exhibit 2).

Inflation Expectations Rise

The month opened with rate hikes by the Fed, the Bank of England, and the ECB. Although the Fed slowed the pace of its rate increases to 25 basis points, its forward guidance warned that it remained committed to reducing inflation to its 2% target. Signs later in the month that price pressures were more entrenched than hoped sent short-term inflation expectations sharply higher, although longer term expectations remained reasonably well anchored (Exhibit 3). With the realization that price pressures were more deeply entrenched than expected, the yield on 10-year U.S. Treasuries climbed back to 4%. U.S. Treasuries as a whole lost 2.3% in February, while those with maturities of 10-years or more fell 4.7%. The real yield on U.S. TIPS rose about 21 basis points in February to 1.5%, as most of the increase in yields was driven by rising inflation expectations. The credit markets also lost ground, declining about 3% in February. The relatively short duration of the high yield sector shielded it from some of the impact of rising yields, limiting its losses to 1.3%. For the year as a whole, U.S. Treasuries are up 0.4%, while the investment grade and high yield credit sectors have gained 0.5% and 2.5%, respectively.

Exhibit 3. Short-Term Inflation Expectations Rise

Source: Bloomberg. Inflation expectations derived from TIPS.



Outside of the U.S. the WGBI ex-U.S. index of advanced sovereign bonds fell 4.1% in February, dragging its performance for the year to -0.7%. European sovereign bond markets led the broader index lower as yields on German benchmark bonds rose and the spreads of periphery European countries widened. The EMBI index of emerging market sovereign bonds also declined in February, losing 2.2%.

Rising Treasury Yields Drive Dollar Higher

Like the U.S. equity market, yields have been a major driver of the exchange rate of the dollar against major currencies. With the rebound in U.S. Treasury yields in February, the dollar resumed the appreciating trend that it had followed for much of 2022. This dynamic is significant mainly because of its impact on emerging economies which face tighter financial conditions and contractionary forces from three main sources. First, rising yields and declining global liquidity reduce the availability and raise the cost to emerging markets of external financing. Second, an appreciating dollar adds to the burden of servicing dollar-denominated debt. Finally, higher food and energy costs caused by the war in Ukraine have increased the import bill and amplified domestic price pressures in many vulnerable emerging economies. These forces compound the fragility created by the high debt levels of some emerging economies.

Part of these pressures have been alleviated by the decline in commodity prices in January and February. So far this year, the GSCI commodity index has declined 3.9%, largely reflecting the 4% fall in oil prices.

Performance of Major Market Indices through 2-28-2023

Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	-2.4%	3.7%	3.7%	-7.7%	12.1%	9.8%
Russell 2000	-1.7%	7.9%	7.9%	-6.0%	10.1%	6.0%
MSCI World Ex-US (USD)	-2.3%	5.7%	5.7%	-3.8%	7.1%	3.0%
MSCI Emerging Mkts (USD)	-6.5%	0.9%	0.9%	-15.3%	1.0%	-1.9%
Citigroup US Treasuries	-2.3%	0.3%	0.3%	-10.0%	-4.2%	0.4%
Citigroup Credit	-3.0%	0.8%	0.8%	-10.2%	-3.8%	1.1%
Merrill High Yield	-1.3%	2.6%	2.6%	-5.5%	1.2%	2.7%
JPM EMBI Global (USD)	-2.2%	0.8%	0.8%	-8.2%	-4.5%	-0.4%
Citigroup WGBI Ex-US (LC)	-1.3%	0.4%	0.4%	-11.9%	-5.7%	-1.6%
Barclays US Aggregate	-2.6%	0.4%	0.4%	-9.7%	-3.8%	0.5%
GSCI Total Return	-3.8%	-3.9%	-3.9%	-0.3%	16.6%	5.6%
HFRX Eq. Wtd. Strategies	-0.4%	1.0%	1.0%	-1.5%	2.1%	1.0%