April 2023

We hope everyone enjoyed a happy and healthy start to 2023. Within the stock market, last year's laggards have become this year's leaders across several market segments (sectors, value/growth, high beta/low beta, etc.). Market narratives have quickly evolved, and there has been no shortage of market-moving events in the year's first three months.

At this point, the challenges facing the banking industry, particularly smaller regional banks, have been well-documented. While each adversely affected bank had unique challenges (i.e., customer concentration, poor management decisions, uninsured deposits), the reality is that this environment creates significant headwinds for the entire sector. Banks' assets, often consisting of loans and longer-term Treasuries, have a much longer duration than their liabilities (deposits). Therefore, a significantly inverted yield curve, shown in *Figure 1*, presents no attractive options for most financial institutions.

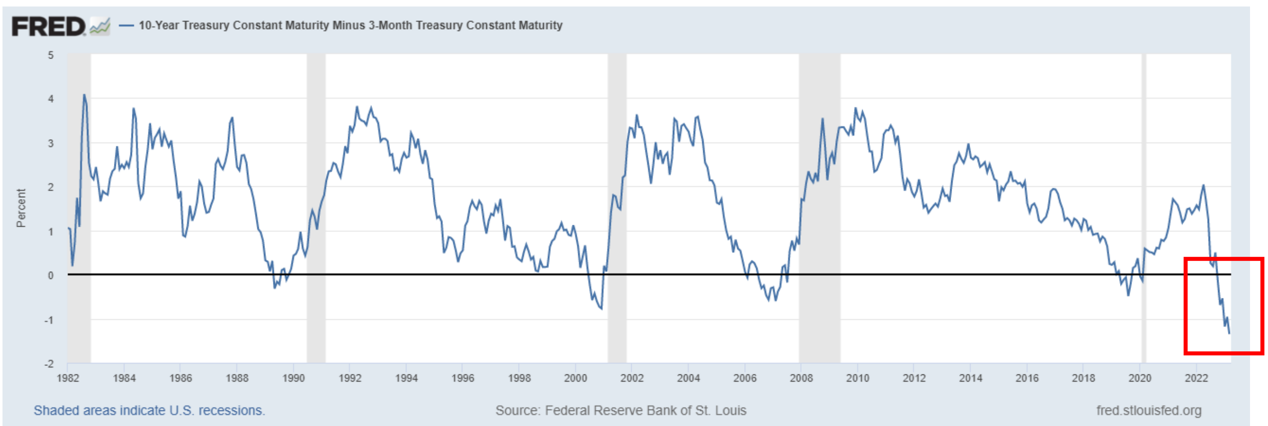

Figure 1 – 10-Year Treasury Constant Maturity Minus 3-Month Treasury Constant Maturity
Source: fred.stlouisfed.org

In this environment, banks can either 1) increase the interest paid on deposits, which would significantly impair profit margins, or 2) face the risk that deposits continue to depart for higher-yielding Treasuries and money market funds, which would lead to liquidating longer-term assets at a loss. At Aries, we have taken measures to diversify clients' cash exposures across a variety of strategies, including individual short-term Treasury bonds, money market funds, and cash sweeps, with the primary goal being safety and, secondarily, maximizing yield.

The Federal Reserve met last week and unanimously voted to raise the Fed Funds rate by 0.25%. In his press conference, Jerome Powell was explicit in his view that the recent stress in the banking system, which has and will likely continue to tighten credit conditions, effectively serves as at least one more rate hike. One narrative shift during the first quarter has been that related to a "soft landing." It is now clear to most that the probability of achieving a soft landing, one in which inflation trends down to 2% without any negative implications on the economy or markets, is unlikely. Many of the Federal Reserve's projections include assumptions that have *only* occurred within recessions.

The remaining questions likely involve the timing and severity of such an event and, from a market's perspective, to what extent it has been priced in. There is a wide range of opinions regarding the latter. However, in the years following earnings contractions (which began last year), long-term bonds have performed positively over 90% of the time. This should provide a buffer for balanced portfolios regardless of the path in equity markets.

We are also excited to share that we have moved our office! We have found a larger, more convenient place for clients and our team. There will be a transition period while we renovate, but we look forward to showing you the new space. Our new address is:

70 Center Street
2nd Floor
Portland, ME 04101

We look forward to speaking soon and wish everyone a joyful spring season.

- Jason, Micah, Matt, Tim, & Victoria