HIGHLAND

Highland Associates

Multi-Asset Solutions
Weekly Commentary
March 13, 2023

Stocks: Broad-Based Weakness As Risk-Off Dominates; Small-Cap Underperformance Worth Watching:

The S&P 500 gave back gains from the prior week, plus some, falling 4.5% amid a broad-based selloff as 'risk-off' took hold into the weekend. The financial services sector garnered headlines, falling 8.5% on the week as liquidity questions arose surrounding West Coast financial institutions with ties to the venture capital and/or cryptocurrency spaces, but there were few places to hide as the consumer discretionary, communication services, energy, industrials, information technology, materials, and real estate sectors all each fell 3.5% or more on the week as well. Defensive sectors such as consumer staples, health care, and utilities each held up better than the broader index but still turned-out weekly losses. Domestic small-cap stocks were notable laggards as the Russell 2000 fell 8% on the week as a sizable allocation to the banking industry weighed on the index. The technical damage done on Friday with the S&P 500 closing below its 200-day moving average at 3,940, viewed as a key level of support, should not be minimized, but as we get more clarity on the SVB situation over coming days/weeks and have a better handle on how regulators are likely to view such events, volatility should subside. However, the key question is, how quickly can/will investor sentiment recover?

- The elephant in the room last week was SVB Financial, also known as Silicon Valley Bank, which catered primarily to venture capitalist (VC)-backed early- stage technology and life sciences-related companies in Silicon Valley. The bank made headlines on Wednesday as liquidity concerns surfaced, which soured investor sentiment and contributed in a big way to the 8.5% weekly decline for the S&P 500 financial services sector. SVB's share price fell sharply on Thursday as the bank attempted to shore-up capital by issuing equity, an attempt that failed and on Friday the stock was halted as the bank entered FDIC receivership. At a high level, after experiencing sizable deposit outflows in just a few days' time, SVB was forced to sell securities held on its balance sheet to generate liquidity, taking sizable losses on sales of Treasuries and mortgage- backed securities (MBS) as it attempted to replace deposit outflows. The catalyst for SVB's demise appeared to be some prominent VC's recommending that their portfolio companies pull deposits from SVB, leading to a 'run' on the bank. SVB's woes led to questions surrounding whether this was an isolated issue, or a systemic one for the banking sector, broadly, or

other West Coast, tech-focused banks, specifically. SVB's situation appears to boil down to a far-too-concentrated customer base focused almost solely on corporate clients in the VC space, and poor risk management practices - simply put, the blocking and tackling of banking. Thus, we do not view SVB's issues as systemic in nature; however, the SVB situation could weigh on sentiment surrounding the financial services sector, broadly, and institutions tied to the venture capital and/or cryptocurrency spaces, specifically, will remain under the microscope, with some potentially forced to raise capital to shore-up balance sheets over the near-term. Over the weekend, regulators stepped in to ensure full access to deposits for customers of SVB and Signature Bank of New York, which it also shut down, and announced a one-year lending facility that will allow banks to swap Treasuries and mortgage-backed securities (MBS) to the Fed for cash at par value, in essence, ensuring easy access to liquidity. Actions taken were intended to instill confidence in the banking sector, but market participants will continue to test the resolve of both banks and regulators, and we would expect continued volatility surrounding the financial services sector as a byproduct of this process. This will likely prove to be a case of a few bad apples spoiling the bunch and babies being thrown out with the bath water in the banking space, presenting opportunities for active managers willing to dig in on bank balance sheets, but it will take time for cooler heads to prevail and the dust to settle.

Bonds: A Flight To Safety Forces Treasury Yields Sharply Lower On The Week; 25-Basis Point Hike Likely When The FOMC Meets Next Week:

FOMC Chair Jerome Powell appeared in front of the Senate last Tuesday and his comments quickly proved market moving as he stated that the terminal Fed funds rate might need to be higher than the Committee previously expected due to labor market strength and recent 'hot' inflation data. This admission spurred Fed funds futures to price-in a 75% chance of a 50-basis point rate hike when the Committee meets later this month, and a terminal Fed funds rate of 5.65%, up nearly 20 basis points from where it was before Powell's testimony. However, the upward bias to yields early in the week gave way to a flight to quality and rally in Treasuries maturing beyond 2 years on Thursday and Friday as liquidity in the banking sector was put under the microscope. The 2-year Treasury yield fell from 5.05% Wednesday to 4.60% Friday while the 10-year Treasury yield dropped 27 basis points on the week to 3.70% as market participants moved risk-off in unison and

drastically scaled back expectations for how much tighter monetary policy may need to be amid liquidity fears arising in some pockets of the banking sector. Fed funds futures have shifted meaningfully on the heels of the closure of SVB and Signature Bank and now favor the Fed standing pat when the FOMC meets next week. The range of potential outcomes from next week's meeting is as wide as it has been at any point in the past year, a dynamic likely to generate wild swings in Treasury yields in the interim.

- Prior to last week, the longer duration profile of the Bloomberg Corporate index had been a headwind as Treasury yields moved higher, but investment- grade (IG) corporate bonds were buoyed by the sharp move lower in U.S. Treasury yields across the curve last week, the index gaining 0.7% on the week. At the other end of the credit spectrum, the Bloomberg U.S. High Yield index lost 0.9% as a flight to safety led to some profit-taking in high yield, but price action failed to exhibit a 'get me out at any price' rush to the exits that one might have been expected given the pessimistic tone of news flow. We will be keying on corporate bonds, both IG and HY, this week to gauge just how fearful market participants are that SVB's issues will prove systemic.
- The difference between the S&P 500 earnings yield and yield on the 10-year U.S. Treasury, or the simplistic, albeit straight forward equity risk premium, approached a low level last seen during the Global Financial Crisis, implying that the 10-year Treasury held more relative appeal for investment dollars versus the S&P 500 than at any point in the last 13+ years. Historically stocks have maintained pricing power and earnings have outpaced inflation over longer-term periods, including the higher inflation regime of the 1970's, which makes earnings yield (projected earnings/price) akin to a real or inflation- adjusted metric. Thus, a true apples-to-apples comparison would be the S&P 500 earnings yield compared to intermediate-term TIPS as both are representative of a real yield. This relationship currently tells a similar story with the equity risk premium for the S&P 500 exceeding the yield on TIPS by 3.8%, well below the 15-year average of 5.5% but not yet down to a level where we can say bonds are a 'fat pitch' and should be favored relative to stocks. Competition for capital will heat up should Treasury yields across the curve rise further, but real yields likely need to narrow the gap more before bonds, broadly speaking, become a table-pounding buy.

What We're Watching:

- February Consumer Price Index (CPI) is released Tuesday with headline CPI expected to rise 0.40% month over month and 6.0% year over year, a deceleration from January's 0.50% and 6.4% readings. Core CPI, which excludes food and energy, is expected to rise 0.40% month over month, in-line with the January reading, and will likely be the most impactful data point for the FOMC to consider from the release.
- Eurozone industrial production for January is released Wednesday and is expected to show a 0.4% month over month rise after a 1.1% month over month decline in December.
- February Producer Price Index (PPI) is released Wednesday and is expected to rise 0.30% month over month, which would be a significant drop from 0.70% in January relative to December.
- The Philadelphia Fed Index for March is released Thursday and is expected to come in 'less bad' at -16.0 after a -24.3 reading in February. The index is calculated as the percentage of firms reporting an increase in manufacturing activity during the month minus the percentage reporting a decrease in activity.
- Friday brings with it the release of the Conference Board's Leading Economic Indicators (LEIs) for February and The University of Michigan Consumer Sentiment survey for March. LEIs for February are expected to come in down 0.20%, a modest improvement from -0.30% in January. The Consumer Sentiment Index is expected to remain static at 67.0 month over month.

HIGHLAND

Important Notes & Disclosures for Institutional Investors and/or their Representatives:

The content and any portion of this newsletter is for personal use only and may not be reprinted, sold or redistributed without the written consent of Regions Bank. Regions, the Regions logo and other Regions marks are trademarks of Regions Bank. The names and marks of other companies or their services or products may be the trademarks of their owners and are used only to identify such companies or their services or products and not to indicate endorsement or sponsorship of Regions or its services or products. The information and material contained herein is provided solely for general information purposes.

Regions does not make any warranty or representation relating to the accuracy, completeness or timeliness of any information contained in the newsletter and shall not be liable for any damages of any kind relating to such information nor as to the legal, regulatory, financial or tax implications of the matters referred herein. This material is not intended to be investment advice nor is this information intended as an offer or solicitation for the purchase or sale of any security or other financial instrument. Any opinions expressed herein are given in good faith, are subject to change without notice, and are only current as of the stated date of their issue. Regions Asset Management is a business group within Regions Bank that provides investment management services to customers of Regions Bank. Employees of Regions Asset Management may have positions in securities or their derivatives that may be mentioned in this report or in their personal accounts. Additionally, affiliated companies may hold positions in the mentioned companies in their portfolios or strategies. The companies mentioned specifically are sample companies, noted for illustrative purposes only.

The mention of the companies should not be construed as a recommendation to buy, hold or sell positions in your investment portfolio. Neither Regions Bank nor Regions Asset Management (collectively, "Regions") are registered municipal advisors nor provide advice to municipal entities or obligated persons with respect to municipal financial products or the issuance of municipal securities (including regarding the structure, timing, terms and similar matters concerning municipal financial products or municipal securities issuances) or engage in the solicitation of municipal entities or obligated persons for such services.

With respect to this presentation and any other information, materials or communications provided by Regions, (a) Regions is not recommending an action to any municipal entity or obligated person, (b) Regions is not acting as an advisor to any municipal entity or obligated person and does not owe a fiduciary duty pursuant to Section 15 B of the Securities Exchange Act of 1934 to any municipal entity or obligated person with respect to such presentation, information, materials or communications, (c) Regions is acting for its own interests, and (d) you should discuss this presentation and any such other information, materials or communications with any and all internal and external advisors and experts that you deem appropriate before acting on this presentation or any such other information, materials or communications. Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). BARCLAYS® is a trademark and service mark of Barclays Bank Plc (collectively with its affiliates, "Barclays"), used under license. Bloomberg or Bloomberg's licensors, including Barclays, own all proprietary rights in the Bloomberg Barclays Indices. Neither Bloomberg nor Barclays approves or endorses this material or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). BARCLAYS® is a trademark and service mark of Barclays Bank Plc (collectively with its affiliates, "Barclays"), used under license. Bloomberg or Bloomberg's licensors, including Barclays, own all proprietary rights in the Bloomberg Barclays Indices. Neither Bloomberg nor Barclays approves or endorses this material or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

Investment, Insurance and Annuity Products:
Are Not FDIC Insured | Are Not a Deposit | May Go Down in Value | Are Not Bank Guaranteed
Are Not Insured by Any Federal Government Agency | Are Not a Condition of Any Banking Activity

The information provided herein is for informational purposes only and is intended to report on various investment views held by Multi-Asset Solutions (MAS) and Highland Associates. Opinions, estimates, forecasts, and statements of financial market trends are based on current market conditions that constitute the judgement of MAS and Highland Associates and are subject to change. The information is received from third parties, which is believed to be accurate, but no representation is made that the information provided is accurate and complete. The information is given as of the date indicated and believed to be reliable. While MAS and Highland have tried to provide accurate and timely information, there may be inadvertent technical or factual inaccuracies or typographical errors for which we apologize. The information provided herein does not constitute a solicitation or offer by Highland or its affiliates, to buy or sell any securities or other financial instrument, or to provide investment advice or service. Nothing contained herein should be construed as investment advice or a recommendation to purchase or sell a particular security. Investing involves a high degree of risk, and all investors should carefully consider their investment objective and the suitability of any investments.

Research services are provided through Multi-Asset Solutions, a department of the Regions Asset Management business group within Regions Bank. Highland is a wholly owned subsidiary of Regions Bank, which in turn is a wholly owned subsidiary of Regions Financial Corporation.

Past performance is not indicative of future results. Investments are subject to loss.