DECATUR CAPITAL
MANAGEMENT INC.

Decatur View – First Quarter 2023 Update

Following a volatile first quarter, our outlook for 2023 remains cautiously optimistic.

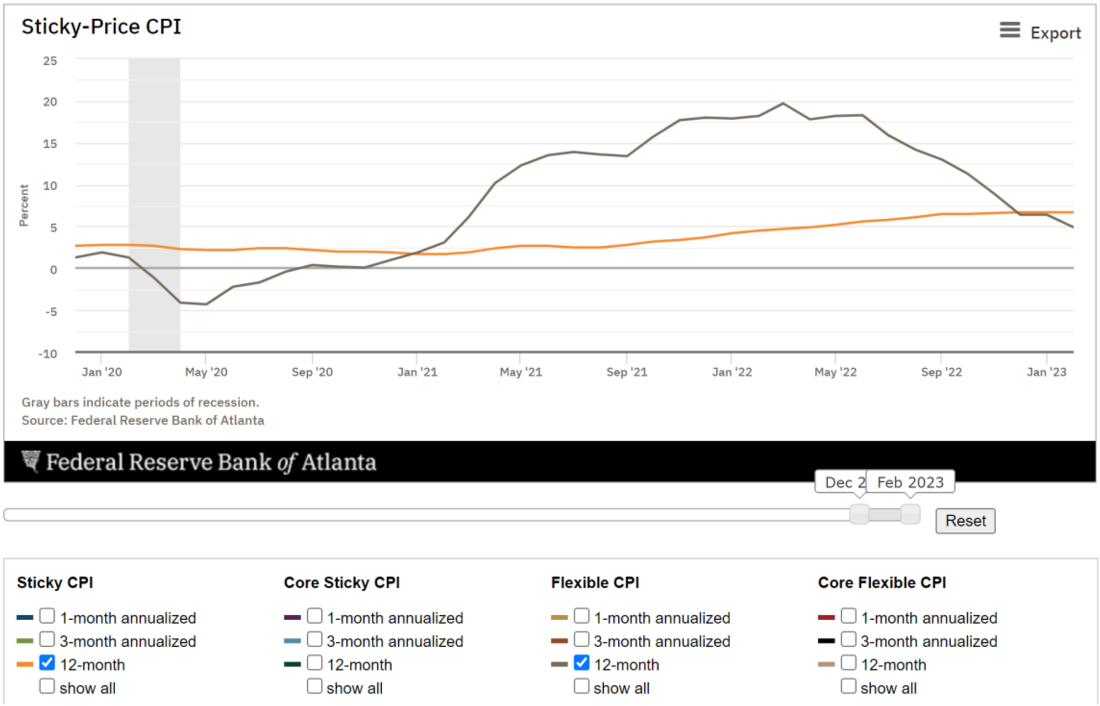
We began the year discussing that we are unable to identify all of the factors that may impact capital markets. One such event is the collapse of Silicon Valley Bank, Signature Bank and Credit Suisse.

Now, we have four drivers that will impact markets in 2023. The drivers are: 1) the Federal Reserve will control inflation, 2) global threats, 3) earnings expectations, and 4) isolated bank failures

The Federal Reserve and Inflation

Federal Reserve (Fed) will remain resolute in controlling inflation. Chart 1 shows the two aspects of inflation, the sticky and flexible consumer price index. The orange line represents the sticky price CPI, which as the name implies is hard to get rid of and sticks around, such as rents and medical care. The grey line represents the flexible CPI. The flexible CPI includes those costs that may rocket up as inflation builds but are more easily controlled by the Fed, such as hotel rooms costs, entertainment tickets and eating out.

Chart 1: Sticky and Flexible CPI



Gray bars indicate periods of recession.
Source: Federal Reserve Bank of Atlanta

Sticky CPI
☐ 1-month annualized
☐ 3-month annualized
☑ 12-month
☐ show all

Core Sticky CPI
☐ 1-month annualized
☐ 3-month annualized
☐ 12-month
☐ show all

Flexible CPI
☐ 1-month annualized
☐ 3-month annualized
☑ 12-month
☐ show all

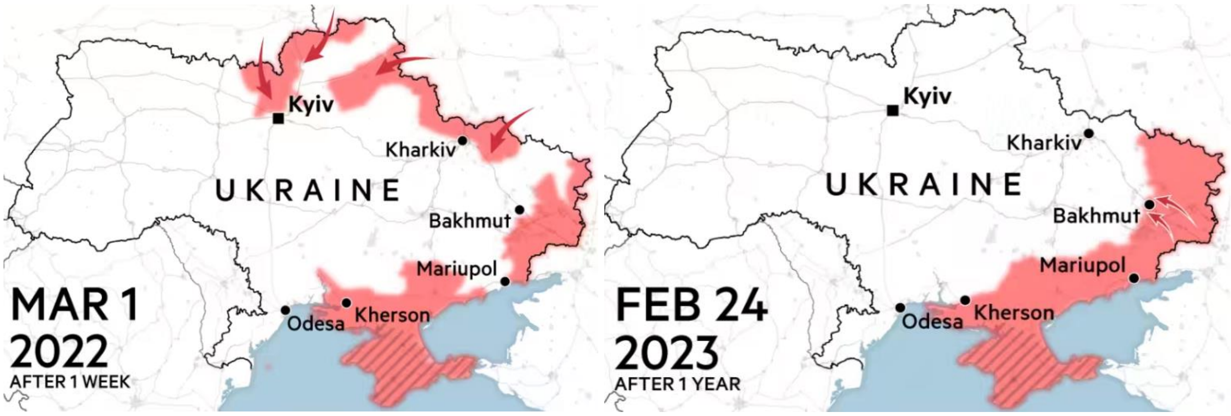
Core Flexible CPI
☐ 1-month annualized
☐ 3-month annualized
☐ 12-month
☐ show all

Take note that the lines have crossed, which means that the Fed is being successful in bringing down the flexible CPI and needs to continue to hike to control the sticky CPI. We are forecasting that most of the hikes are behind us and we should prepare for the pause. We forecast that markets trade in a range until the Fed pause and then we could see positive upside for the markets.

Global Threats

We continue to be concerned with global events, particularly, the Russia-Ukraine War. We know that the Russia-Ukraine War will continue but we do not know if the conflict will escalate or arrive at a peaceful resolution. Chart 2 shows the Russia controlled areas in Ukraine (in red) by March 2022, one week after the invasion and one year later, Feb 2023. After one year of fighting, Russia has consolidated their forces in the southeast corridor of Ukraine and have not successfully penetrated Ukraine's interior.

Chart 2: Russia – Ukraine War



Source: "Russia Invasion of Ukraine in Maps – Latest Updates. www.ft.com

This is a testament to the Ukrainian leadership, its citizens' will to fight for their country and the continuing support of NATO. The conflict has become a war of attrition with no foreseeable end in sight.

Our global allocation reflects the reality of the conflict. We remain cautious on market upside while maintaining an overweight to North America, underweight to Europe and increasing exposure to emerging markets, which includes China.

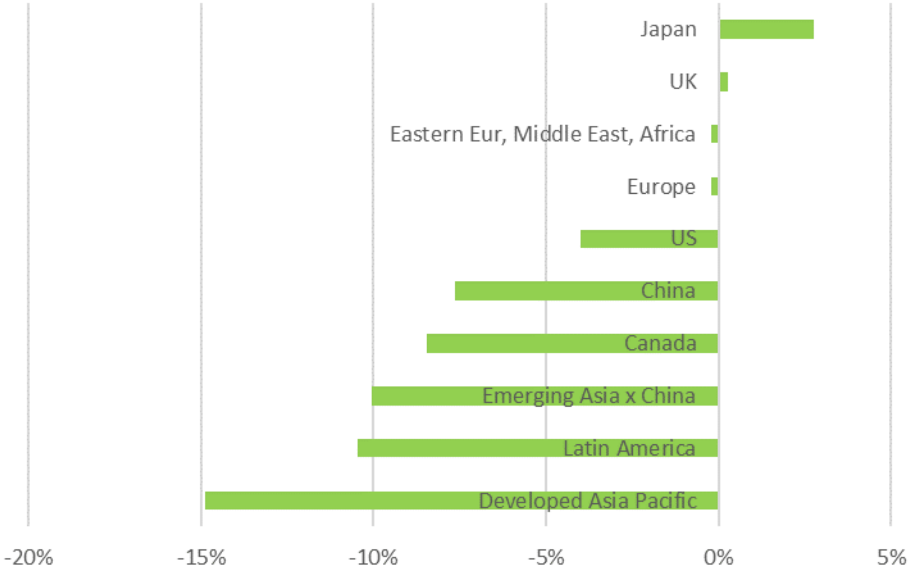
Earnings Revisions

Chart 3 shows the global net earnings revisions which provides a measure of market sentiment on the direction of earnings. The net analysts' revisions measure the number of analysts that are making positive changes to their earnings estimates compared to the number of analysts that are making negative changes to their estimates scaled by the number of analysts.

Japan is leading with a +3% net analyst revisions while US has remained approximately -4% net analyst revisions for the last two quarters.

The market's outlook on China is improving with -7% net analysts revising their earnings outlook, which is a positive change from last quarter when the measure was -21%!

Chart 3: Global 1 Year EPS Net Earnings Revisions



Source: FactSet, Zacks Investment Research, Decatur Capital Management

While most of the remaining emerging markets have better outlooks, we continue to be cautious in the region. We continue to overweight US, Canada, Japan, and Latin America.

The overall US net revisions is -4%, but there is a wide dispersion among economic sectors. The market outlook is improving for technology and healthcare, while the outlook for energy and power utilities has declined with the decline in commodity prices.

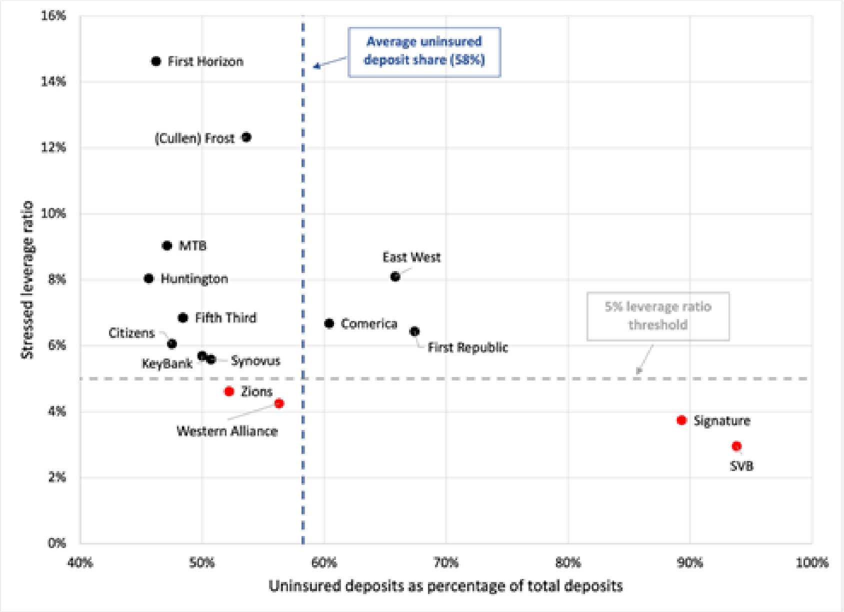
We continue to overweight healthcare in 2023 for two reasons. One, healthcare is recession resistant because consumers will still need medical care and two, our selected healthcare companies have sustainable competitive advantages.

Isolated Bank Failures

We forecasted that the bank closures would not have a contagion effect on the rest of the banking industry. However, we were surprised at the depth of the regional banks' decline fueled by negative market sentiment.

Chart 4 shows the stressed leverage ratio, a measure of bank solvency with a target of 5% or greater and the percentage of deposits over the FDIC insurance of $250,000. Silicon Valley (SVB) Bank and Signature Bank had approximately 90% of their deposits uninsured and were below the stressed leverage ratio of 5% - two warning signs of trouble in December 2022!

Chart 4: Stressed Leverage Ratio & Uninsured Deposits, December 2022



Source: www.moneyandbanking.com

The closures remind us that banks are built on trust and provide essential capital to fund home mortgages and business loans. Our regional bank holdings have stressed leverage ratios above 5% and their uninsured deposits are under 50% - much different than Signature and SVB. Towards the end of March, the regional banks' stock price began to recover and we will continue to monitor this situation.

We realize that there could be risks that we simply cannot plan for. Some events that fall into this category include the popping of a financial bubble, such as the Silicon Valley Bank failure. We address these risks by staying true to our investment discipline. We continue to focus on companies that will survive catastrophic events based on the firms' leadership and competitive advantage. So, sticking to our mantra of profitability, expectations of stable or growing earnings, and valuation is how we manage these unknown risks.

Note: Returns are measured in U.S. dollars net of fees. Decatur Capital Management, Inc. (DCM) is a registered investment advisor specializing in quantitative growth oriented investment management. The benchmark is the S&P 500 which is designed to measure the large cap firms within the U.S. The benchmark is market cap weighted. DCM claims compliance with the Global Investment Performance Standards (GIPS). To receive a list of composite descriptions of DCM and/or presentation that complies with the GIPS standards, contact Ralph J. Bryant, CPA at (404) 270-9838 or ralphb@decaturcapital.com or write to DCM, 150 E Ponce De Leon Avenue, Suite 150, Decatur, GA 30030.