April 2023 | Volume 8 | Issue 1

FINEMARK NATIONAL BANK & TRUST

FINE POINTS

The Quarterly Trust and Investment Publication of FineMark National Bank & Trust

First Quarter Review & Commentary

By Christopher Battifarano, CFA®, CAIA
EVP, Chief Investment Officer

"The stock market is a device for transferring money from the impatient to the patient."
—Warren Buffett, Chairman and CEO of Berkshire Hathaway Corporation

Warren Buffett is one of the world's foremost investors. He was born in and still resides in Omaha, Nebraska with an approximate net worth $104 billion, making him the fifth wealthiest person in the world.

BANK FAILURES, RATE HIKES AND MARKET MEAN REVERTS

As investment practitioners, we regularly encourage our clients to remain calm when reacting to unfavorable media reports about the economy or geopolitics. The first quarter of 2023's equity market performance (shown in Figure 1, below) exemplifies why such scenarios — and their accompanying dire reports — don't necessarily beget lower market prices nor should they cause an overreaction.

RETURNS (AS OF MARCH 2023)	MRQ	1 YEAR	3 YEAR
S&P 500	7.50%	-7.73%	18.60%
Dow Jones Industrial Average	0.93%	-1.98%	17.31%
Russell 2000	2.74%	-11.61%	17.51%
MSCI EAFE	8.47%	-1.38%	12.99%
MSCI EM	3.96%	-10.70%	7.83%
Bloomberg US Aggregate	2.96%	-4.78%	-2.77%
Bloomberg US Municipal 5 Year	1.93%	1.76%	0.70%
HFRX Equity Hedge	0.80%	-2.12%	9.72%
Barclay BTOP50	-3.85%	1.19%	9.27%

Source: eVestment

As the year began, we witnessed the failure of two U.S. banks: Silicon Valley Bank (SVB) of Santa Clara, CA and Signature Bank of New York City. At the time of receivership, SVB had $209 billion in assets and Signature Bank had $110 billion. SVB is the second-largest bank failure in U.S. history and the largest since Washington Mutual collapsed in 2008 — during the Global Financial Crisis — at $307 billion in assets. Interestingly, throughout 2021 and 2022, there were no U.S. bank failures.

Outside of the U.S., the 167-year-old Swiss bank, Credit Suisse, also suffered a crisis of confidence. In March, it was purchased by rival Swiss bank, UBS, in an emergency sale brokered by Swiss banking regulators.

As if the uncertainty brought to the banking industry by these failures wasn't enough, the market struggled to come to grips with the Federal Reserve's reluctance to pivot (despite Wall Street's hopes) after tightening 450 basis points last year. Instead, the Fed delivered two additional 25 basis-point rate hikes during the first quarter, along with comments that guided markets toward further restrictive monetary policy.

As we wrote in our Q4 2022 newsletter, we believe that the Fed will stop raising rates during the second quarter of 2023. The negative inflation data that began manifesting at the time is now obvious. Inflation appears to be abating quickly, demonstrating that the tighter monetary policy initiated by the Fed just over a year ago is having its desired effect.

(Continued)

Thus far, this stricter policy has not resulted in higher unemployment rates, the commonly associated adverse effect of higher rates. Instead, unemployment sits at 3.6% (virtually unchanged over the past year), a historically low level compared to the 5.73% average displayed since 1948. This current Goldilocks scenario, where the Fed can combat inflation without suffering the negative consequences in the labor markets, allows the Fed to remain hawkish for longer. The current Fed board is aware of the miscues by their predecessors of the 1970s and does not want to end up in a stop and go policy scenario which occurred then. This resulted in the Fed prematurely cutting rates, only to be forced to redouble their efforts and begin hiking again as the inflation menace was not vanquished during their initial hiking salvo. The current Fed wants convincing evidence that inflation is moving toward their 2% target before they relent.

GLOBAL IMPACTS

On the geopolitical front, matters felt even more dour as February marked the one-year anniversary of the Russian invasion of Ukraine with no resolution in sight. In fact, the conflict appears to be worsening as Western allies (including Canada, Germany, Poland, Portugal, Spain, UK, US, and others) agreed to send hundreds of battle tanks for Ukrainian defense. Meanwhile, a Chinese spy balloon detected over US airspace was shot down off the South Carolina coast, precipitating the cancellation of a previously scheduled visit to China by US Secretary of State, Antony Blinken.

Amid this bluster and consternation, the equity markets here and abroad posted high rates of return for the quarter. Although owning equity is not for the faint of heart, once again we're seeing it's impossible to know when positive performance will manifest, thus keeping emotions in check when making investment decisions is the largest determining factor in successful equity investing.

While market tones have calmed since the two U.S. bank failures in March, ramifications continue. We expect further regulatory scrutiny to occur in the industry soon and, unlike many issues today, this matter appears to have bipartisan support.

While we don't know what additional regulatory measures may be put in place, when combined with the existing tighter monetary policy (which has put downward pressure on bank profit margins and resulted in deposits leaving in search of higher cash yields), a credit contraction is likely.

This scenario will have a disproportionate, negative effect on both commercial real estate borrowers and small-to-medium-sized businesses that aren't large enough to access the public debt markets. To take advantage of this condition, we've sourced investment opportunities with private credit managers and non-bank lenders who can fill this void. Note: These investments are suitable for clients with both significant financial wherewithal and an ability to bear illiquidity risk.

INVESTMENT THEMES

In our prior letter, we reviewed investment themes including deglobalization, the end of zero-interest-rate policies, tepid economic growth, and the end of the current rate-hiking cycle. Since then, none of these themes have materially changed, so we will not spill more ink about them today. (If you missed our previous coverage, you can read our Q4 2022 newsletter here: https://www.finemarkbank.com/2022-q4-fine-points/.)

Today, we're adding one more theme to our current stable: the implications of artificial intelligence (AI) on the economy. The technological progressions we've witnessed in AI are staggering; we're entering a world where machine-created content will be indistinguishable from human-created content. As this technology achieves commercial viability, the labor market will face disruption as tasks currently completed by humans are replaced by machines.

According to the March 26, 2023, white paper entitled, "The Potentially Large Effects of Artificial Intelligence on Economic Growth," published by Goldman Sachs, generative AI could expose 300 million full-time jobs to automation. However, we don't believe this translates to 300 million people becoming completely redundant. Instead, as has occurred historically with other technological advancements, we expect that the nature of work will become more productive and will give rise to new occupations. Just as the dawning of the Internet created new careers (such as web design and digital marketing), AI will have a similar impact. Its economic effect will also be deflationary.

AI automation is likely to be used with administrative or clerical roles in corporate and legal environments rather than jobs requiring physical, outdoor work in the agriculture or construction industries. Broadly, we see it having a more significant impact on developed versus emerging markets given both the cost and structure of labor markets (though emerging markets will certainly be impacted, albeit to a lesser degree).

The timing of this development is fortuitous as most advanced economies, such as the US, but many others as well, are facing the same reality: a rapidly aging and shrinking workforce. Typically, the demographics in industrialized nations display fertility rates that fall below replacement levels. In the coming years, AI could offer a solution to a potentially massive labor shortage.

Further, we expect AI adoption analogs similar to those seen in personal computing following the advent of the graphical user interface, which utilized clickable on-screen windows, menus, and icons. This intuitive design style allowed users to see what they wanted and click on it versus typing commands in arcane computer languages. As a result, computers became accessible, enabling people to leverage the PC as a tool for increased productivity and paving the way for a technology fueled increase in productivity.

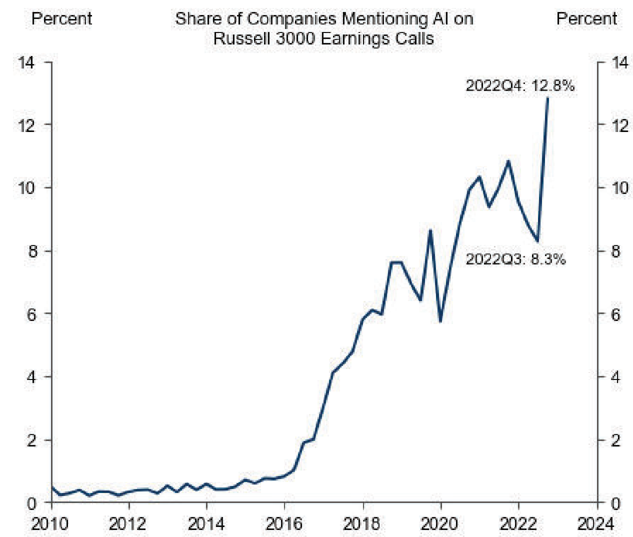
AI technology functions the way humans naturally communicate, through speech. Combined with its ability to include both video and audio, it is even simpler to adopt by the masses than even the graphical user interface. Tasks such as image classification and the ability of AI to comprehend and respond to highly complex questions make AI a significant advancement to current solutions.

Goldman Sachs estimates that AI could drive an annual increase of 7% (or $7 trillion) in global gross domestic product (GDP). The number of companies discussing AI's impact on business has risen sharply, with nearly 13% of companies reporting its effects in their Q4 earnings calls (see Figure 2). Companies are also actively trying to incorporate AI into their products and services.

For example, Intuit (INTU), creator of the tax preparation software Turbo Tax, is exploring ways AI can make their product more powerful. Soon, tax filers may be able to snap digital photos of their tax documents and AI technology will compile the return. The ability to complete high-value tasks (such as interpreting the 80,000-page U.S. Tax Code using an algorithm to determine whether a filer should use standard or itemized deductions) and then quickly prepare an individual's tax return will revolutionize the economy.

While the timing of this labor productivity boom is difficult to predict, its positive effects will likely be long-lasting. The rate of adoption will influence the speed of the productivity boost. ChatGPT, a chatbot developed by OpenAI, eclipsed 1 million users in just five days — the fastest a company has ever reached this milestone.

FIGURE 2



Source: GS Data Works, FactSet, Goldman Sachs Global Investment Research

Data Source: Joseph Briggs and Devesh Kodnani, "The Potentially Large Effects of Artificial Intelligence on Economic Growth," Goldman Sachs, 3/26/2023.

To best leverage AI, this investment theme will be implemented within our clients' portfolios as appropriate. Much like our investment platform, our approach will take various forms designed to meet each client's specific goals and objectives.

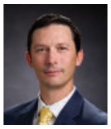
OUR CURRENT POSITIONING

Taking these themes and views into consideration, we've formulated our current tactical market perspective, as expressed in Figure 3, below. The only change in this positioning from our last quarterly letter was our decision to cut our overweight position in large cap US equities to neutral weight. This was done owning to both the run up in prices we saw both this quarter and last quarter and the headwinds we see for near term earnings. These two factors paint a valuation picture that is less attractive than it had been. Again, it's important to note that FineMark client portfolios are customized to suit each unique financial situation; therefore, these views may not be implemented in every portfolio in the same way.

FIGURE 3	Significantly Underweight	Underweight	Neutral	Overweight	Significantly Overweight
Cash & Equivalents				◆	
Fixed Income					
Investment Grade / Investment Grade Tax Exempt				◆	
High Yield / High Yield Municipal			◆		
Opportunistic Credit			◆		
Equities					
U.S. Equities - Large Cap			◆		
U.S. Equities - Mid Cap				◆	
U.S. Equities - Small Cap				◆	
Non U.S. Developed Equities		◆			
Emerging Equities		◆			
Alternatives					
Equity Long Short			◆		
Global Macro / Managed Futures			◆		

SPRINGTIME BLOOMS

As winter turns to spring, we know many of our seasonal clients will begin their annual journey to their northern homes. We wish you safe travels and remind you that, no matter where you may be, we're here to serve and support you. We appreciate the opportunity to assist you and thank you for your continued trust and confidence.



Common Financial Scams and How to Avoid Them

By Read Sawczyn
Senior Vice President & Private Wealth Advisor, Trust

I know what you're thinking, "I won't fall for any of those financial scams I hear about because they are so obvious." While that may have been true in the past, scammers are continually improving their craft and devising more sophisticated scams. Just as social media employs engineers to increase our use of social media, scammers continue to find new and better ways to prey on consumers. In fact, according to the Federal Trade Commission, people lost nearly $8.8 billion dollars to financial scams in 2022. This is a 30% increase over 2021 and the numbers will likely continue to grow.

Here are the top frauds of 2022 and ways to avoid becoming a victim.

IMPOSTER SCAM

In this scenario, an individual pretends to be a relative or business associate in some form of distress or your financial advisor in need of information to prevent some harm to your account. They say they need money immediately or they need your bank or investment account information to ensure your account is safe. To prevent this type of fraud, either delete the email or text or hang up on the caller. If you think this might be a legitimate issue, ask the scammer something only the individual they are pretending to be would know and never provide any of your personal financial information. If the imposter claims to be your financial institution, don't respond to the request. Instead, call your bank on a known number to determine if the request is real.

ONLINE SHOPPING FRAUD

This happens when scammers spoof a legitimate shopping website or create a fictitious shopping site where you may pay for merchandise, but then you never receive it. To prevent this type of fraud, only shop at reputable companies and ensure the website you are on is the company's actual website.

PRIZE, SWEEPSTAKES OR LOTTERY SCAM

This scam happens when you are told you have won a prize, sweepstakes or lottery; however, to receive your prize, you must send payment for taxes, processing fees or cover some other expense. The scammer may request that you purchase gift cards and then ask that you read the card's PIN number to the scammer as payment. Or they may ask you to write a check or provide your personal bank account information. The telltale sign that this is a scam is the request for payment before you can collect your winnings. Any legitimate prize will come to you without you having to pay for it. Examples of this scam are fake Publisher's Clearinghouse prizes and the Nigerian (or other country) lotteries.

INVESTMENT SCAMS

Generally, fraudsters offer a seminar that will teach you how to make money quickly and easily or with an investment that promises high returns for little to no risk. It usually involves high pressure sales tactics whereby you must "act now" or you will miss the deal. As we know, all investments involve risk and learning how to invest in different assets takes time and effort. To determine if the investment is a scam, use the old adage, if it sounds too good to be true, it probably is. If you are still interested in pursuing it, ask a third party financial advisor or investigate the investment using materials from unaffiliated parties and proceed with caution.

BUSINESS/JOB OPPORTUNITY SCAMS

These are often presented as an opportunity to work from home and "be your own boss." This scam takes a few forms, but generally you are hired for a job and then requested to accept checks and then transfer the funds to someone else. For the service, you get to keep a portion of the funds. The check you receive, however, is fraudulent and the scammer hopes you send the funds before learning that the deposited check has bounced. To avoid this scam, research the potential employer or discuss the job with someone you trust. Also, remember, no legitimate business will ask you to deposit a check and then transfer proceeds on behalf of the business.

If you are unsure if a call, text, email or website is a scam, please do not hesitate to contact your FineMark financial professional (using their known phone number or email address). We have seen many variations of scams and continue to assist clients in navigating these unfortunate and difficult experiences.