Financial Markets Review

After years of zero interest rate policy (ZIRP), cracks in the financial system began to emerge in early March. You would never know it by the positive performance seen in the S&P 500, as the large-cap index climbed 3.67% in March 2023. However, stress amongst small and mid-size regional banks was apparent within the small-cap index, as the Russell 2000 fell 4.78% during March. The real excitement though was in the land of interest rates, as yields across the entire Treasury curve declined in response to a brewing banking crisis.

March started out innocently enough as stronger than expected economic data dominated headlines. Over the past year, it has been hotly debated whether the blistering path of interest rate hikes by the Federal Reserve would result in a hard or soft landing for the economy. With inflation slowly coming down at the same time the economy seemed to hold steady amidst strong job growth, the narrative then switched to “no landing”. At this point, it’s hard to envision a scenario where “no landing” is remotely possible.

As Fed Chair Powell hinted at a possible acceleration to the pace of rate hikes, the short end of the Treasury curve lurched ever higher. At one point the 6-month and 1-year Treasury bills had a yield of 5.3%. A month ago, we wrote that the direction and speed of change in rates matters a lot for the equity market. Well, it appears that going from essentially 0% to 5% in just over a year may not be all that healthy, particularly, for banks.

In a matter of days, we went from “no landing” to shades of the 2008 Great Financial Crisis. Not to get too deep in the weeds, but the banking crisis in March was very different from the one we experienced in 2008. For starters, the current banking crisis is one of liquidity, whereas in 2008 it centered around solvency. But that is ultimately not the point that I wish to drive home. What we should all take away from the last few weeks is a reminder of what I wrote about in February:

“The only thing one can be certain of at this point is to expect the unexpected.”

Very few people came into March expecting the collapse of Silicon Valley Bank and Signature Bank, which happened to be the second and third largest bank failures in the history of the United States, respectively. What happened to these banks was unexpected, which is why we believe we should expect more of the same. Remember, we just came out of a period of unprecedented fiscal and monetary stimulus. Two years ago, there was over $18 trillion in negative yielding debt across the globe. In the U.S. alone, nearly $5 trillion was dispersed as fiscal stimulus. These numbers are staggering, and it would be foolhardy to think that absolutely no consequences would stem from the policies enacted over the past several years. So, we now can chalk up soaring inflation and a couple of bank failures as consequences. But what’s next?

There are a significant number of conflicting signals in the marketplace today. Broadly speaking, equities are painting the picture that everything may turn out OK. First quarter earnings will come into focus over the next few weeks and expectations are for a year-over-year decline of 7%. However, earnings are expected to resume growing again in the back half of this year. Through the recent upheaval in regional banks and an ensuing corporate earnings recession, equities have remained rather resilient. The Treasury market is saying the complete opposite. The spread between the 3-month and 10-year Treasury yields is pointing to a recession. This part of the curve is the most inverted it has been going back to the late 1970s and it's one that has best predicted a recession over the past 50 years. The market's expectations of the Fed Funds rate also shows the likelihood of another rate increase in May followed by cuts as early as July and throughout the remainder of the year, which would be expected if the economy falls into a recession. However, Fed Chair Powell most recently pushed back against market expectations saying that the Fed does not generally expect to be cutting rates this year.

So, one of these signals is going to be correct. However, given the dichotomy between these signals, we believe the likelihood of heightened volatility in all financial assets moving forward is increasingly probable. Most recently, we've seen this volatility play out in the Treasury market, as the 2-year Treasury note hit a high yield of 5.10% and then subsequently dropped to 3.44% in the span of two weeks, and back to 4% as of this writing. We believe It is likely only a matter of time before volatility creeps into equities and other assets, as well.

Castle Tandem Fund Update

As we outlined above, most of the volatility experienced within financial markets over the past month was seen within the banking sector and Treasury markets. Outside of that, most equities held up rather well given all of the noise, which caused us to remain a little more patient than we would have otherwise expected.

In March, we added to our core position in Brown-Forman (BF.B) which is among one of the Fund's original holdings. Brown-Forman produces and distributes whiskey, scotch, tequila, vodka and wine under the following brands – Jack Daniel's, Woodford Reserve, Old Forester, Finlandia, Diplomatico, Herradura and Korbel.

We often say and write that volatility breeds opportunity. It is my belief that given the nature of the economy and financial markets, we will likely have opportunities to invest cash in the coming quarters. We will also likely have some opportunities to reduce our exposure in overvalued companies, as volatility works both ways. But one thing that volatility can do is spark emotion and it tends to make individuals do the wrong thing at the wrong time. Shareholders in the Castle Tandem Fund have experienced less volatility than the broader market. As of March 31, 2023, the Fund has had a three year beta of 0.68 versus the S&P 500. Our approach to equities has produced a less-bumpy ride that we believe helps investors to stay invested, while keeping their emotions in check. One of the most important aspects to staying emotionally grounded during highly volatile times is to know and understand what it is that you own. Bob Michele, CIO of JPMorgan Asset Management summed it up well in a interview with Bloomberg on March 31, 2023:

"If we've been taught anything this past month, you may see it coming or you may not. You don't know exactly where it's going to hit. But once it hits, whatever you own, you own, and you have to hope that you own the stuff that recovers."

William "Billy" L. Little, Jr., CFA
Senior Vice President
19 Years of Investment Experience

Billy Little is a shareholder, Senior Vice President, and Portfolio Manager for Tandem Investment Advisors, Inc. Mr. Little began his career in the investment industry in 2004, as a Financial Advisor with Ameriprise Financial in Baltimore, Maryland. Mr. Little joined Tandem in 2006. Mr. Little oversees Tandem's corporate financials, including business planning, budgeting, and vendor negotiations. Mr. Little also directs Tandem's quantitative and fundamental research. He is a regular member of the CFA Institute and past President of the CFA Society South Carolina. Mr. Little graduated from the College of Charleston with a Bachelor of Arts in Business Administration with a concentration in Finance.

The opinions expressed are those of the Fund's Sub-Adviser and are not a recommendation for the purchase or sale of any security.

The Standard & Poors 500 Index (S&P 500) is an index of 500 stocks. The Russell 2000 Index measures the performance of the small-cap segment of the US equity universe.

Beta is a measure of the Fund's sensitivity to the market.

As of March 31, 2023 the Castle Tandem Fund held the following positions mentioned in this report: Brown-Forman Corporation (BF.B, 1.39% of Fund total net assets). The Fund does not have a position in Signature Bank or Silicon Valley Bank.

The investment objectives, risks, charges and expenses of Castle mutual funds must be considered carefully before investing. The prospectus for each Fund contains this and other important information about the investment company, and it may be obtained by calling 1-877-743-7820, or visiting www.castleim.com. Read it carefully before investing.

Important Risk Information

The risks associated with the Fund are detailed in the Fund's Prospectus. Investments in the Fund are subject to common stock risk, sector risk, and investment management risk. The Fund's focus on large-capitalization companies subjects the Fund to the risks that larger companies may not be able to attain the high growth rates of smaller companies. Because the Fund may invest in companies of any size, its share price could be more volatile than a fund that invests only in large-capitalization companies. Fund holdings and asset allocations are subject to change and are not recommendations to buy or sell any security.

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