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The equity markets were nothing if not resilient in the first quarter of 2023. Investors were able to effectively navigate inflationary concerns and fears of a possible banking contagion after the collapse of three high profile banks. As a result, the equity markets posted strong gains, with the technology-laden Nasdaq jumping 17 percent and the S&P 500® rising approximately 7.5 percent.

Unlike the last three years, whereby macro events and dominant themes directed the markets, investors were more discerning of fundamentals during the quarter. Those stocks that performed best earned their return by posting good results coupled with a compelling outlook. Faced with a tighter lending backdrop, investors also appear to be seeking companies that can still thrive if access to capital becomes increasingly restricted.

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The Federal Reserve remains at the forefront of investor minds. Forecasting the Fed's actions is nearly impossible. At its core, the Fed may feel it needs to continue increasing interest rates to combat inflation; ending their rate hike cycle prematurely risks reigniting inflationary pressures. However, the rapid pace of increases over the past year is primarily responsible for the ongoing banking sector tumult, and the Fed may not desire to exacerbate an already tenuous situation. These competing factors make it exceedingly difficult for the central bank to chart a predictable path forward with respect to interest rates, the size of its balance sheet, and the provision of liquidity to banks.

The fact that the market did so well in a less than hospitable environment underscores the virtues of low expectations. Following a lackluster 2022, investor hopes were modest for this year. In the first quarter, some elements, like corporate earnings, were stronger than originally feared. The widely anticipated recession has yet to materialize. Despite some high-profile layoffs in the technology sector, the jobs market has remained strong. While inflation does remain stubbornly high, it has shown signs of moderation. Overall, the economic and investment landscapes are demonstrating resiliency.

The first quarter displayed encouraging signs for longer-term investors. Many growth companies were relatively punished in 2022 during a rapidly rising interest rate environment that heavily favored shorter duration assets. For the time being, this trend has reversed. Two primary factors caused longer duration growth stocks to perform well in the first quarter. The first was that many of these fundamentally sound companies reported solid earnings and issued decent guidance. Secondly, longer duration assets benefited from the perception that we are nearing the end of the Fed tightening cycle. Conversely, energy sector stocks, which performed so well in 2022, have struggled thus far in 2023.

As our clients are aware, Riverbridge invests only in companies we believe possess the ability to internally finance their growth, meaning they are not forced to borrow money to grow their business. This investment discipline is of paramount importance during these types of economic environments. Should borrowing costs remain high and access to capital restricted, we will sleep well at night knowing our companies will be minimally impacted. The same cannot be said for companies that are more economically sensitive, carry significant debt on their balance sheets, or must borrow to finance their operations. In short, internally financed companies control more of their own destiny, which generally reduces investor risk.

While the rest of 2023 remains uncertain from a macro perspective, we are encouraged about the prospects of our portfolio companies. They continue to compound their earnings power without the reliance on debt. Furthermore, should the economic landscape deteriorate, our portfolio companies should be relatively well positioned as they tend to be less economically sensitive.

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