Madison FUNDS®

Madison Funds Quarterly Newsletter

Spring 2023

Economic Review

Evidence began accumulating midway through the first quarter that the way out of our confusing strong-labor, sticky-inflation, rising-rate economic cycle was unlikely to be straightforward or swift. This recognition took the wind out of the optimism that had produced strong stock returns in the last quarter of 2022 and in January. The S&P 500® Index dipped -2.4% in February, and by mid-March another drop of a similar amount put the year-to-date return near zero.

The initial optimism of 2023 saw bond yields rise early in the quarter as the 10-year Treasury yield broke 4%. The sentiment shift hit the bond market in March as a flight to safety pushed the 10-year yield back below 3.5%. Unemployment reports in February showed a drop to 3.4%, the lowest rate in 53 years, while the reports for monthly core Personal Consumption Expenditures (PCE) inflation over the previous year edged up from 4.6% in December to 4.7% in January. Adding to the concerns was the upward revision for GDP for the fourth quarter and what appears to be solid GDP expansion so far this year. Consumer spending remained strong in January, though we see growing indications that this spree might be on a shaky foundation as consumer savings diminished and credit card debt increased. This trend is less concerning than in other bear markets since employment remains robust, a key element in sustaining the vital consumer spending segment of the economy. Another crack in what had been a resilient-looking economy was the collapse of Silicon Valley Bank in March, demonstrating the kinds of pressure the rapid rise in Fed Funds rates have put on financial institutions, particularly smaller banks. This particular case should not invoke memories of the 2008 financial crisis, as this appears to be an idiosyncratic issue with how one regional bank handled a massive influx of deposits from mostly venture capital-backed firms. Since the financial crisis, stress tests and banking policies have put larger institutions on much more solid ground.

Federal Reserve Chairman Powell and his governors have been broadcasting their intent to keep raising rates and to maintain them for "some time." The wishful thinking has seen these statements as positioning needed to keep expectations and financial markets dampened. However, the recognition that underlying inflation may be showing stubborn persistence has convinced more investors that perhaps we should take them at their word. One result has been a reckoning that upcoming raises in the Fed Funds Rate may actually be more aggressive than previously anticipated. By early March the Fed futures trading indicated an increased possibility of a half-point bump coming at the Fed's next meeting rather than just another quarter point. At the same time, the economic trends revealed during the quarter have diminished hope that the Fed may pivot before the end of 2023.

Another interesting development during the quarter was a reversal of year-over-year M2 money supply expansion, the first decline since 1981. This is a sign that the Fed's tightening policies are finally gaining traction. However, even with December's M2 contraction, the total M2 money supply is still up 39% compared to pre-pandemic levels.

The average bear market has historically lasted around 300 days, a threshold we surpassed in the first quarter of 2023. But as mentioned earlier, not much about this current cycle is ordinary, suggesting the unique circumstances of emerging from an unprecedented pandemic. With the stock market hovering about -20% off its record high hit back in early January 2022, we are close to the historic average bear market stock decline. Should inflation trends improve, we could see the Fed on the sidelines for the latter parts of 2023, possibly setting the stage for a more buoyant market in the second half of the year.

While we are clearly closing in on the end point of rate hikes, it appears the consensus has concluded we can anticipate higher rates for longer. The likelihood of sustained high rates will likely demand continued patience from investors as the lagging effects of rate increases slowly reverberate through the economy. We are already seeing corporate earnings predictions for the calendar year dropping and it wouldn't be a surprise to see this trend continue. As we've stated in the past much of what we are experiencing is unprecedented, including the steepest Fed Funds increases in history. This creates uncertainty. Uncertainty, along with shifts in inflation readings or other key indicators, could create additional sentiment swings and more volatility. In the past, bond investments have helped investors through rocky stock markets, and with investment-grade corporate bond yields rising to the 5% level, investors could once again gain some support from their fixed income allocation as we find ourselves marking the first time since 2008 that bond yields are on parity with the earnings yield on stocks.

News You Can Use

New Investor Account Online Access

The enhancements to investor online account access have been released. The new site will make it easier for you to view your portfolio and manage your account at home or on the go with compatibility to your mobile phone, tablet, laptop or desktop computer.

EXISTING USERS – PLEASE READ

Your username and password to login will not change. However, for your security, you will be prompted to take the following additional steps the first time you access the site:

- Enter your current username and password in the section titled Existing User.
- Next, you will be prompted to enter the last four digits of your social security number (SSN) and your Madison Funds account number, which can be found on the enclosed investor statement.
- On the following screen, enter your preferred mobile phone number or email address.
- We will immediately send a security code to your chosen device or email address, along with instructions for entering it into the website. Successful completion of this step will verify your identity.

NEW USERS. If you are new to online access, and don't have a username and password, follow the steps under the New User section to create a username and password and initiate the two-factor authentication process.

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If you have any questions or need assistance accessing your account, please call Madison Funds Monday through Friday from 8 a.m. to 7 p.m. CT at 1-800-877-6089.

Prospectus Update

In March, a summary prospectus was mailed to your household with updated information on the fund(s) you own. The summary prospectus contains the fund's investment objective and principal investment strategies, fees and expense, and historical return information. We encourage you to review the document(s) so you understand your investment. The Madison Funds statutory prospectus, statement of additional information (SAI) and annual report are available online at madisonfunds.com.

Tax Forms

A reminder that IRS Form 5498 which reports contributions made to an education savings account ("ESA") (Form 5498-ESA) or an individual retirement account ("IRA") (Form 5498) will be mailed by April 30, 2023 and May 31, 2023, respectively. The tax form reports contributions made to the respective accounts through April 18, 2023 for the 2022 tax year and the fair market value of such accounts as of December 31, 2022. This information is furnished to the Internal Revenue Service and the form should be kept for your record.

Individual Retirement and Education Savings Account

You have until Monday, April 18, 2023, to make 2022 ("prior year") contributions to an IRA or an ESA (as April 15 falls on a weekend). Contribution limits for 2022 are up to $6,000 for an IRA, with additional $1,000 catch-up for owners aged 50 and over, and $2,000 for an ESA. For 2023, the annual IRA contribution limits are up to $6,500 (with additional $1,000 catch-up for those aged 50 and over, and $2,000 for an ESA. Please consult with your tax adviser or financial advisor, as IRA and ESA contribution limits phase-out with higher income levels, and for individuals who are age 50 and over there are "special catch-up" contribution rules for IRAs.