BULLS&BEARS

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Sayonara 2022

A year like 2022 reminds us that staying unemotional about investing is easier said than done. To put the year into perspective, 2022 bore witness to the worst year for stocks since the Great Financial Crisis with Global Equities down -18%, and arguably the worst year for bonds on record with the U.S. Aggregate Bonds down -13%. The usual diversification benefits between stocks and bonds (which typically zig as the other zags) essentially broke down and a traditional 60% stock / 40% bond portfolio ("60/40 portfolio") fell -16% during the year as each component posted a negative return for the first time since 1974.

There are multiple culprits to blame for this historic sell-off: for starters, inflation became public enemy number one as it rose to its highest levels in over 40 years, and central banks responded with the fastest ever rise in interest rates. Tack on geopolitical unrest, ongoing lockdowns in China, and a meltdown in speculative assets (e.g., cryptocurrencies, SPACs, unprofitable technology stocks) – and voila – a recipe for unprecedented financial market weakness was created.

While we're happy to put 2022 in the rearview mirror, we remain of the view that market volatility will persist into the first half of 2023 as the Fed attempts to get inflation back down to reasonable levels without tipping the economy into a recession. However, the silver lining to a historically challenging year for financial assets is the historically attractive setup now presented to long-term investors.

Seize the Opportunity

We often hear investors talk about "timing" the market, waiting for a Fed move or hovering in anticipation of some event they "know" will happen. Fixed income allocation involves long term planning for many investors. Buy and hold practice means that interim price movement, geopolitical events, central bank action or political tremblings have little or no effect on a fixed income holding's income, cash flow or time when the face value is returned to the investor. This is why bonds can meet the primary purpose of protecting principal. Right now, there's more. In addition to helping preserve capital, fixed income is providing income levels not seen in well over a decade. Seize the fixed income opportunity while it still exists!

Recession

We expect a mild recession in 2023, as swift Fed tightening (450bps of hikes in 2022) acts with a lag on the economy. The effects are already showing up in some areas, i.e., the housing market where mortgage applications are now at 25-year lows (due to the surge higher in rates). Bank lending is becoming tighter, CEO confidence is low, economic leading indicators are negative, the yield curve is inverted, and layoffs/hiring freezes are being announced. While recessions are painful, we do believe it will be mild- i.e., we do not see widespread excess on corporate and consumer balance sheets, supply has been hard-pressed to meet demand this cycle (inventory levels are low), and banks are very well-capitalized. Moreover, we believe inflationary pressures will ease.

This economic weakness will result in earnings weakness, and we take a below consensus view on 2023 S&P 500 earnings ($215 estimate vs $230 current consensus). However, stocks also discount the future, and we believe a lot of negative news has been priced in already. On average historically, recessionary bear markets have resulted in a 33% S&P 500 decline over 13 months. Early October's low saw the markets down approximately 25%.

Equities are likely to bottom in advance of the economy and fundamentals. For example, earnings bottom 8-9 months after a recession ends historically, while valuations bottom 2-6 months prior to a recession's end (often when headlines and sentiment are worst). The question now becomes is this rally we've seen since October simply a bear market rally, or is it possibly the start of the new bull?

Please contact us at 1-855-829-7192 if we may be of assistance.

Market Indicators

12/31/22	Year-to-Date Change
S&P 500	-18.11%
NASDAQ	-32.54%
Russell 2000	-20.44%

Interest Rates	12/31/22	6/30/22
10-Year Treasury Note	3.88%	3.01%
3-Month Treasury Bill	4.42%	1.67%

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