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WEALTH & WELLNESS
GROUP

2023: Will Markets Deflect Higher?

2022 was a disruptive, unpredictable year thanks to sticky inflation, aggressive rate hikes from the Federal Reserve, war in Ukraine, supply chain issues, and political polarization that affected the entire globe. It was the worst year for markets since 2008 but was also very different because it wasn't just the equity markets that were hit hard. Adding to the pain, the bond markets were also problematic, with some segments seeing their biggest annual losses in history. The issue is that bonds typically help cushion stock market losses but that was not the case for 2022.

In other words, it was a double whammy unlike any other performance year. We couldn't even muster a typical Santa Claus rally at year end. As a result, the Dow finished the month down 4.17%, the S&P 500 was off 5.90%, and the Nasdaq dropped 8.73%. For the full year, the Dow fared the best, dropping -8.8%, while the S&P 500 sank -19.4%, and the tech-heavy Nasdaq tumbled -33.1%.

The 10-year Treasury yield skyrocketed over 100% from the start of the year. It opened January at 1.5% and surged to over 4.3% by October. Thankfully they ended the year lower at 3.86%, but the Feds inability to see inflation as more than transitory, pummeled portfolios in more ways than typical losses in annual growth. The major bond index like iShares Core U.S. Aggregate Bond dropped -13% and one Long-term Treasury Index was down 30%.

While the turn of the calendar year offers elements of hope and optimism, it doesn't make the factors that drove market losses in 2022 automatically go away. However, it does offer us an opportunity to think about how the economy and the markets will evolve in the year ahead. As the joke goes, it's hard to make predictions, especially about the future. But it's possible to look at existing trends, geopolitical situations, demographics and other dynamics to get a sense of where things may be headed.

Keep in mind that the headlines don't always tell the full story. Many people are calling for an ugly first half of the year that will result in an official recession. Measures like an inverted yield curve, corporate layoffs, and the fact that the Fed is actively shrinking its balance sheet suggests a recession is imminent. However, the reality is, measures of monetary value, credit availability, wealth accumulation, and labor markets say otherwise.

Banks are lending freely while interest rates which are up from historically low levels, aren't deterring borrowing by consumers or businesses. The M2 money supply which is the money in checking, savings and CDs for example is over $21 trillion, versus $15 trillion before Covid-19 struck.

Despite 2022's drops in stock, bond, and home prices, consumers' net worth is $145 trillion, up from a pre-pandemic $115 trillion. Average home prices are down from a couple years ago but the current measure of about $300,000 is still way above the $230,000 pre-pandemic level. Furthermore, the November jobs report showed the economy gained 263,000 jobs and the unemployment rate holding steady at 3.7%.

Did You Know?
"New Year Resolutions"

Why go with a common or popular New Years Resolutions when there are so many other great options to consider like:

1) Perfect your favorite celebrity impression.

2) Learn a card or other magic trick

3) Stay at an interesting Airbnb's like a treehouse, teepee, or Airstream

4) Find out what treasures are in your house and sell them for a charitable cause.

5) Order every drink on the Starbucks Menu.

6) Flamingo a friend's yard for a birthday or anniversary.

7) Perfect your charcuterie board skills.

8) Stop drinking your morning coffee AFTER you brush your teeth.

9) Celebrate Hallmark's Countdown to Christmas, in July!

10) Exercise…your right to Taco Tuesday!

11) Learn the "Thriller" dance by Halloween

12) Create a playlist you loved as a kid

Source: CountryLiving.com

Trivia

1) In a bingo game, which number is represented by the phrase "two little ducks"? ?

2) According to Greek mythology, who was the first woman on earth?

3) How many of Snow White's seven dwarfs have names ending in the letter Y?

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2023: Will Markets Deflect Higher… continued

Additional insight that goes beyond the headlines comes from a recent Goldman Sachs report which suggests that there's only a 35% probability that the U.S. tips into a recession. Well below the median of 65% among forecasters in a Wall Street Journal survey. Their main point is, "The U.S. may avoid a downturn in part because data on economic activity is nowhere close to recessionary," and we agree.

Now that doesn't mean it's easy money from here or that we are facing years of hard labor. Elevated inflation and interest rates will persist. There is no fast fix to a post-pandemic economy which was induced by low interest rates and fueled decades of high growth, . However, patience and persistence is needed and will be rewarded. Right now, we see opportunities with:

- Companies who generate solid free cash flow
- Higher and stabilizing bond yields
- Demographic trends for long-term growth

When market conditions tighten up and competition for supplies, talent, and pricing power run through an industry or sector, companies with strong fundamentals, the ability to defend their margins, and can generate high levels of free cash flow, are positioned well to maintain or rise in value. That free cash flow factor is important to us because it represents money that companies can use to pay and raise dividends, buy back shares, or expand through acquisitions. An especially useful tool during a slow growth period.

Bond yields are finally giving investors a solid rate. Previously you could earn more money on the S&P 500 dividend (average of 1.80%) than you could get holding a Two-year or Ten-year Treasury Bond. That has flipped with rising yields so that both the "2" and "10" currently yield above 4%. In other words, bonds are sitting at the "cool kids table" as they offer attractive levels of income with defensive credit characteristics that will shine if the economy slows more than expected in 2023.

Finally, we see some technical opportunities in demographic data. First, it appears like the worst for the Chinese economy is behind them. Covid infections have dropped and government policies are improving. Moreover, since large segments in certain areas have been recently infected, there is a degree of immunity that should reduce future out-breaks and help productivity increase in crucial regions.

Additionally, millennials are not only the largest cohort (outnumbering baby boomers) but they are also well-educated, and in their prime earning years. In other words, they have plenty of money and credit (as well as personal and financial support from their mostly baby boomer parents). That means the tech sector will not only eventually recover but will like also be a key factor in leading markets higher.

Overall, we are excited to be on this journey with you as we start 2023. The year ahead will likely bring some interesting twists and turns which is why our goal will be to remain steadfast in not only monitoring markets, economic reports, and your personal holdings, but also taking steps to be out front in communicating those factors and the strategies we believe we help us make the most of both market highs and lows.

Trivia Answers

1) 22

2) Pandora

3) Five: Dopey, Grumpy, Sneezy, Sleepy, Happy. *Extra Credit: name the other 2 dwarfs?*

Source: ThougfhtCatalog.com

Answer: Bashful & Doc