MARKET REVIEW & OUTLOOK

JANUARY 2023

BREAKING NEWS:

- The Fed met today 2/1 and announced another 25bps increase in the Fed funds rate.
- The market continues to believe the Fed already did the "pivot" as seen in the chart below. Financial conditions have eased over 175 bps since mid-October, against rate hikes of 1.5%.

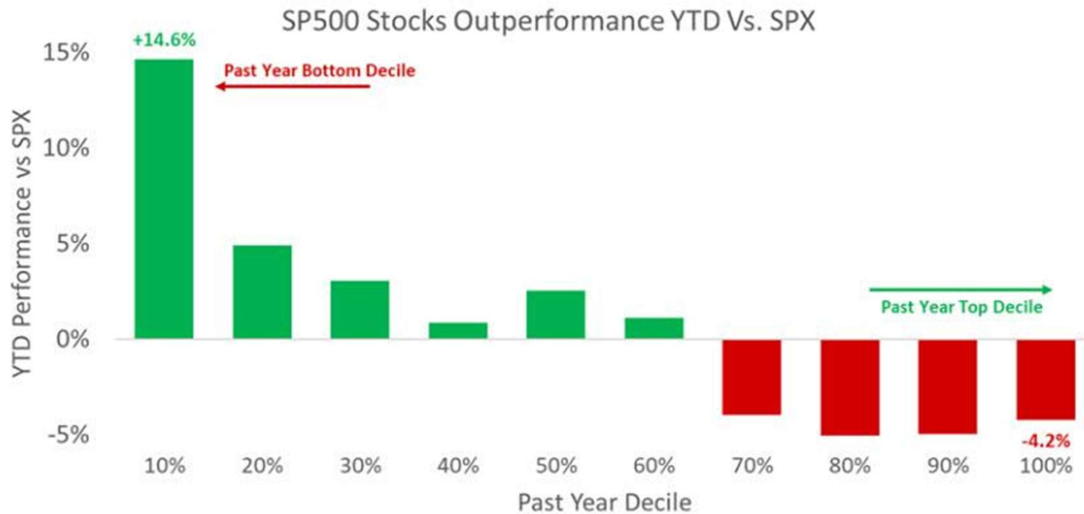
Source: https://www.zerohedge.com/markets/powells-dovish-presser-sparks-bid-bonds-big-tech-bitcoin-bullion

Back to our regularly scheduled programming…

KEY TAKEAWAYS as of January 31, 2023

- The equity markets were very strong, seeing what they wanted, lower inflation, a "soft-landing" and a Fed "Pivot" coming soon, tomorrow?
- The bond market was also very strong, seeing what they wanted, lower inflation and increasing risk of recession.
- The one message that was very clear, chart on the following page, was a massive risk-on rally.

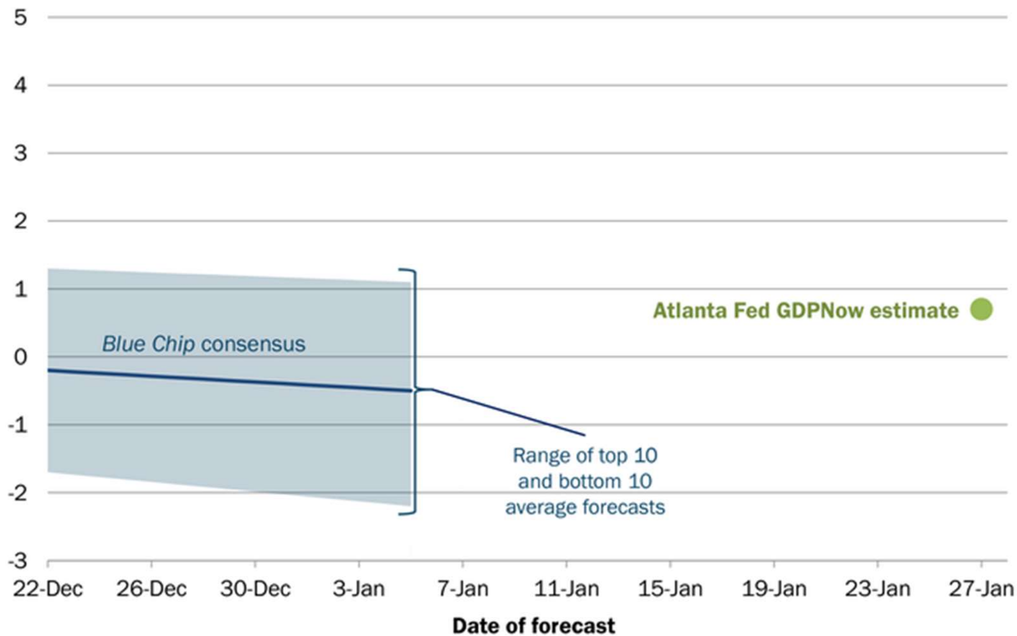
The following chart shows that the worst performing decile of 2022 had the best performance in January 2023, i.e., the "animal" spirits were alive and well.



Source: https://www.zerohedge.com/markets/big-tech-bitcoin-bullion-best-january-decades-yield-curve-crashes-record-inversion

The U.S. Economy

The first look at 4th quarter GDP came in stronger than expected at +2.9% vs. expectations of +2.6%. The first estimate for 1st quarter GDP from GDPNow came in at just under 1% while the Blue-Chip consensus came in just under 0%, as shown in the chart below. The Fed is likely content with the slowing forecast, but probably isn't ready to "pivot" with the strong finish to 2022 and continues to say remaining higher for longer with no rate cuts for 2023, the markets are flat-out saying, we don't believe you!



Source: https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

Interest rates started heading down with the turn of the calendar but hit the lows for the month by mid-month. The drive lower was softening inflation data and continued weak economic reports. The mid-month stall was driven by the counterbalance of China reopening to provide economic support, but also potentially reigniting inflation. The Fed meets tomorrow and is expected to raise interest rates another 25 basis points, but will they finally "pivot"? The decline in yields provided a nice tailwind for High Quality fixed income to start the year, which as measured by the iShares US Aggregate Bond ETF jumped 3.25% for the month. The U.S. 10-year Treasury bond yield ended the month at 3.53%, bouncing off the mid-month lows of 3.38% and down significantly from December's close of 3.88%.

The Dow Jones Industrial Average increased +2.83%, the S&P 500 rallied +6.18%, and the small cap Russell 2000 soared +9.69%. The international markets again traded stronger relative to the U.S., with continued weakness in the U.S. Dollar. The MSCI EAFE iShares Core International Developed Markets ETF Index jumped +8.49%, and the MSCI Emerging Markets iShares Core ETF Index popped +8.33%.

January had some very strong performance and a few modestly in the red.

The best performers were…

- Consumer Discretionary: +15.13%
- Communication Services: +14.77%
- Real Estate: +9.91%

The worst performers were…

- Utilities: -2.00%
- Health Care: -1.83%
- Consumer Staples: -1.09%

Source: https://www.sectorspdr.com/sectorspdr/tools/sector-tracker

Oil Report

The oil market was relatively stable and jogged around the $80 mark most of the month. China's surprise removal of their Zero-covid policy continued to buoy hopes for increased demand. That strength was counterbalanced with increasing supplies as demand has been waning on thoughts of a slowing economy. More sanctions on Russia oil start this month, which may provide additional support for Crude oil. The current NYMEX WTI Crude Oil futures settled at $78.87 posting a loss of almost 2% from the prior month close of $80.26 a barrel. The decline in crude oil was countered with refining constraints and saw RBOB gasoline with a gain of almost 4% vs December's close. The relative stability of Crude's price suggests that the market is in balance and awaiting a catalyst to drive prices out of the current range.

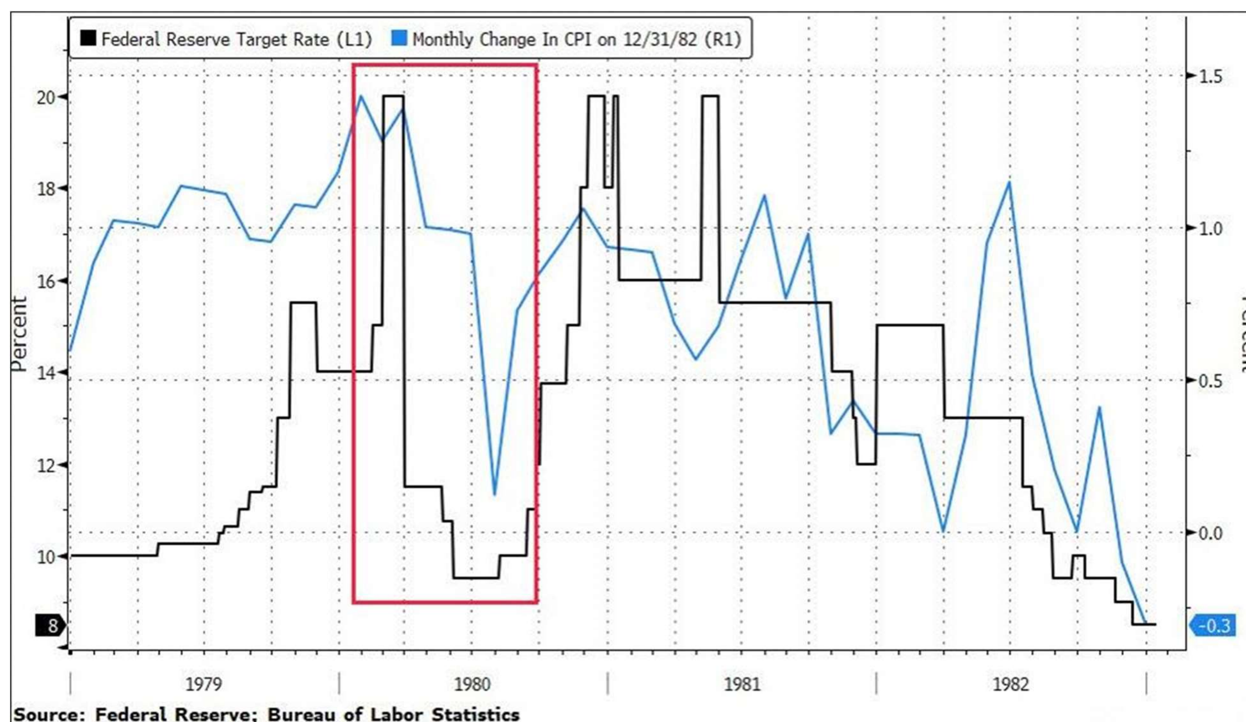
The Rest of the Data

The December ISM Manufacturing Index decreased to 48.4 from November's reading of 49.0. Additionally, the ISM Services Index, joined the sub-50 reading, plummeting to 49.6 in December from November's print of 56.5. The prices paid component for Services held steady and remained at high and elevated levels, but for Manufacturing the number is far below 50. Any reading below 50 generally indicates deteriorating conditions. Consumer confidence eased to 107.1 in December, which compares to an upwardly revised figure of 109.0 in November. The unemployment rate fell to 3.5%, and the economy added another solid 223,000 jobs in December, which beat expectations of 202,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) decreased by 0.1% in December, on a seasonally adjusted basis, the lowest monthly reading in over 12-months. Over the last 12 months, the All-Items Index rate decreased to +6.5% on a non-seasonally adjusted basis, which was again below expectations. The CPI ex Food and Energy, eased further to 5.7% over the last year. The economic data continues to get more mixed, the labor market is still strong and commodity prices have been rallying recently against broader easing of inflationary pressures. The manufacturing and services indices are now both in contractionary territory and Tech has been announcing a lot of job cuts. As we have mentioned previously, a lot of the larger inflationary pressures stem from capacity constrained issues that the government is currently not addressing. It seems Fed Powell, though not saying it, seems to realize those underlying inflationary pressures are not gone. We will continue to monitor economic activity in concert with inflation reports and how that may impact Fed policy.

Summary

The markets started the year off strong with equities making big moves up and bonds seeing prices rallying strongly as market interest rates came down. The economy continues to chug along, especially the 2nd half of 2022. Inflations persistent thrust up has moderated and come down the last few months, but the structural issues remain. The chart on the following page is what Fed head Powell is referencing when he says, "we have learned from the mistakes of the '70's". The chart is a little hard to follow, but in late 1979, Fed head Volcker rapidly raised rates from 10% to 20%, with a full 5% increase in early 1980. A few months later as inflation rolled over, Volcker cut rates even faster only to see inflation quickly regain steam. The result was rates rising to 20% even faster than before and leaving the Fed funds rate in the high teens for much longer than before. Thus, the markets are using the post 2000

playbook, that the Fed will crack the second economic data gets weak, vs. the Fed saying they are using the 1980 playbook to hold rates higher so to not allow inflation to flare up again. The Fed keeps doing what they say, but the market continues to move to the next scene, i.e., rate cuts.



Source : https://www.zerohedge.com/markets/boj-beijing-brussels-leave-banks-bonds-big-tech-bitcoin-bullion-mixed-after-long-weekend

As always, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. waning growth expectations, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. The markets have continued rallying and our defensive mechanisms have all been reversed. The last transition was U.S. Large Cap equity on Monday, joining U.S. Mid-cap and International equity markets shifting allocations back to equity. The tactical allocations remain in Floating Rate Treasuries but will be evaluated again in March to see if the markets "risk-on" posture looks to have staying power.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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