# MARKET REVIEW & OUTLOOK

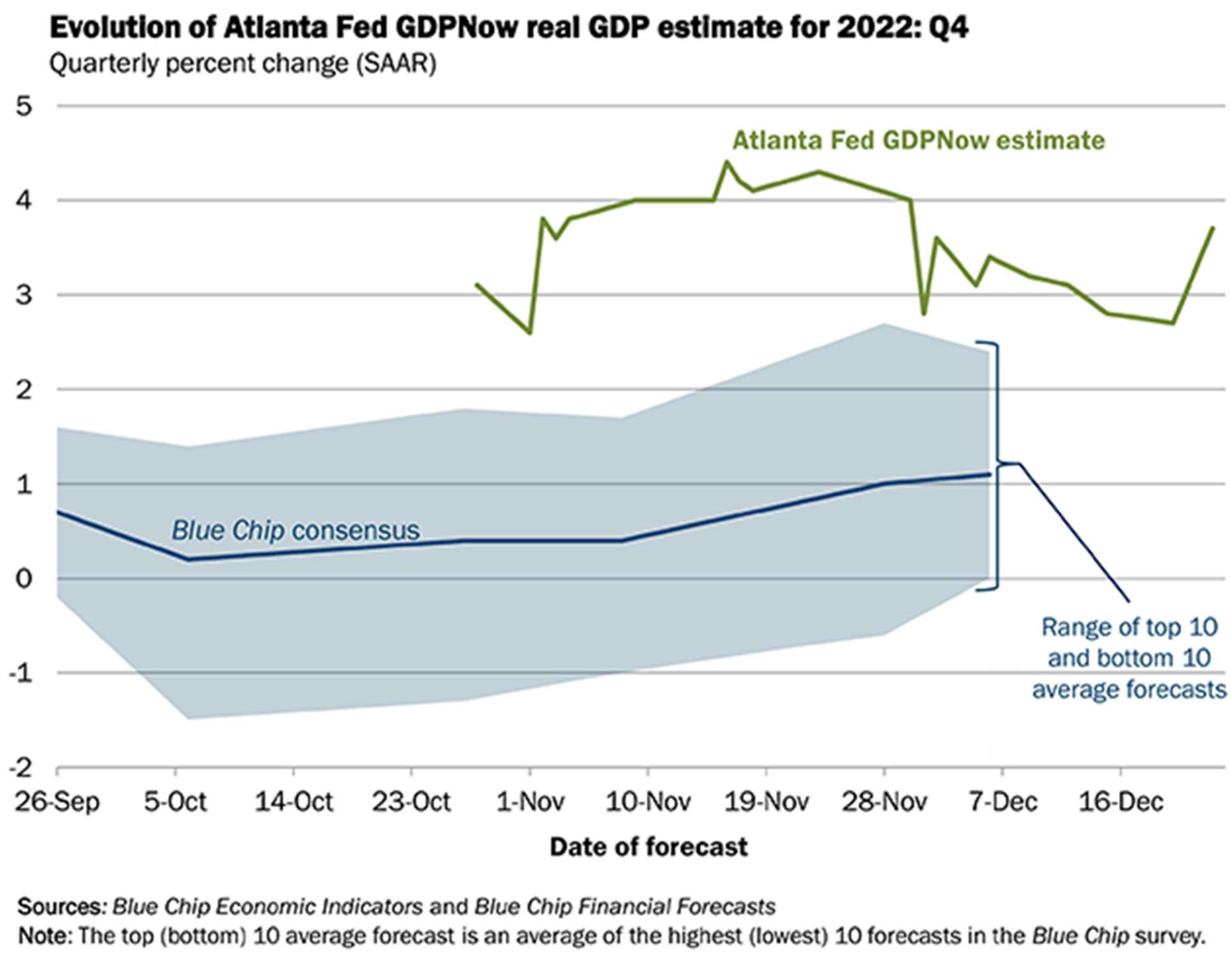
**DECEMBER 2022**

**KEY TAKEAWAYS**

- The equity markets, especially Technology had a rough month on realization that the Fed "Pivot" is **not** imminent.
- Interest rates abruptly reversed on the above mentioned not imminent Fed "Pivot". Not even cooling inflation data could hold back rates.

**The U.S. Economy**

The final look at 3rd quarter GDP was again better than expected, coming in at 3.2%. The 4th quarter estimate from the GDPNow estimate, dipped, but returns to near 4% growth, and the Blue-Chip consensus moved just over +1%. The second half GDP certainly isn't telling the Fed to make a "pivot" to dovishness. The Fed is saying more rate hikes and no rate cuts for 2023, the markets are reluctantly pricing in that possibility.




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

**Stocks and Bonds**

Interest rates continued late last month's decline, but after a couple of days to digest the Fed rate hikes, yields rose through the rest of the month to finish near the highs of the month. The Fed did raise rates less than previously, at 50 basis points, but continued to state higher for longer. The perceived "pivot" fell flat as the markets repriced to higher for longer. The rise in yields did create a headwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF lost 0.64% for the month, but the higher yields helped to minimize the damage. The U.S. 10-year Treasury bond yield ended the month at 3.88%, basically the highs of the month, closing far above the early month lows of 3.40% and up meaningfully from November's close of 3.70%.

The Dow Jones Industrial Average fell -4.17%, the S&P 500 slid -5.90%, and the small cap Russell 2000 dropped -6.64%. The international markets continued to trade stronger relative to the U.S., on the back of continued U.S. Dollar weakness. The MSCI EAFE iShares Core International Developed Markets ETF Index increased +1.11%, and the MSCI Emerging Markets iShares Core ETF Index climbed +1.53%.

December flipped the script from the previous 2 months and every sector finished in the red.

The "best" performers were…

- Utilities: -1.30%
- Health Care: -2.28%
- Consumer Staples: -3.42%

The worst performers were…

- Consumer Discretionary: -11.64%
- Technology: -8.47%
- Communication Services: -6.83%

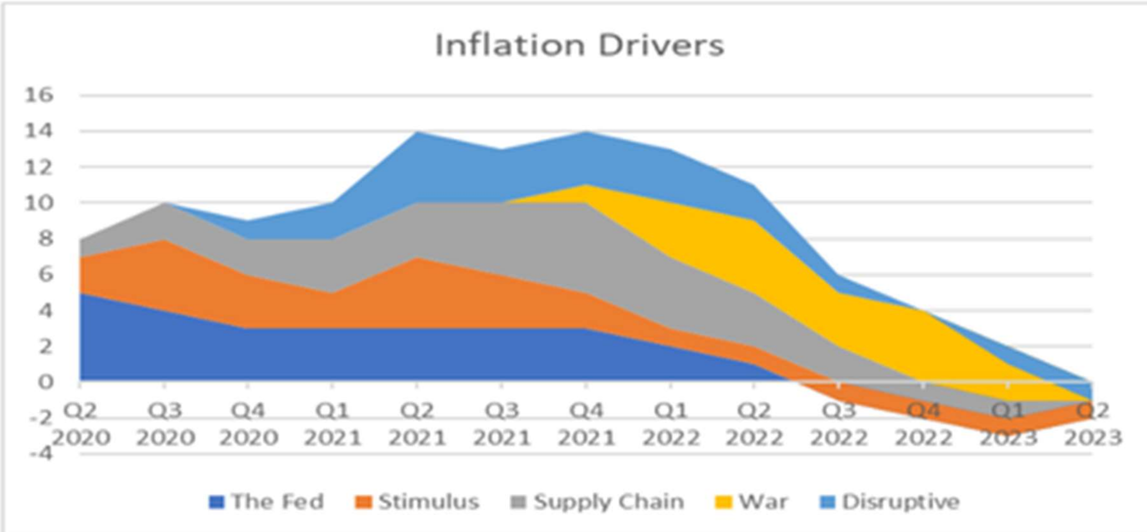

Source: https://www.sectorspdr.com/sectorspdr/tools/sector-tracker

**Oil Report**

The oil market continued selling off on China's Zero-covid policy, but in a surprise late month move, China scraped almost all of their covid restrictions. In combination with additional restrictions on Russia Oil kicking in, sent the markets back to where they began. The reduced oil supply from Russia and the presumed increase in oil usage from an open China provided the tailwind, but concerns of how strong global demand remains kept the rally at bay. The current NYMEX WTI Crude Oil futures settled at $80.51 basically where it started and posted a loss of 0% from the prior month close of $80.55 a barrel. The flatness of crude oil also impacted RBOB gasoline, except the last day of the month, which resulted in a gain of almost 5% vs November's close. We now seem to be in the winter lull and other energy markets are drawing more attention, particularly Europe where the question remains if they have enough stockpiles to make it through winter still able to keep warm.

**The Rest of the Data**

The November ISM Manufacturing Index decreased to 49.0 from October's reading of 50.2, falling below 50 generally indicating deteriorating conditions. However, the ISM Services Index increased to 56.5 in November from October's print of 54.4. The prices paid component for Services held steady and remained at high and elevated levels. Any reading above 50 generally indicates improving conditions. Consumer confidence jumped to 108.3 in November, which compares to an upwardly revised figure of 101.4 in November. The unemployment rate held at 3.7%, and the economy added another solid 263,000 jobs in November, which beat expectations of 200,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) increased at +0.1% in November, on a seasonally adjusted basis, the lowest monthly increase since August. Over the last 12 months, the All-Items Index rate decreased to +7.1% on a non-seasonally adjusted basis, which was again below expectations. The CPI ex Food and Energy, eased further to 6.0% over the last year. Please see the chart on the next page which provides some insight into the drivers of future inflation. The economic data continues to be positive except for weakness creeping into manufacturing data. The inflation data is moderating but remains above the Fed funds rate. The 1970's illustrate the tough spot the Fed continues to be in and the likely challenge. Both Fed Burns and Volker at one point thought they had licked inflation and cut rates when recession started. Burns turned the problem over to Volker who on the second attempt did finally stop inflation with very high rates and a very severe recession. Fed Powell continues to argue that he will not make that mistake again. Thus, the stance of higher interest rates for longer, but as the economic data shows, he has not had to endure the pressure of holding rates in the face of a recession. Of course, the economic data currently does not show much stress from all of the Fed rate hikes, so Powell has more runway before holding steady with a wobbly economy. We will continue to monitor economic activity in concert with inflation reports and how that may impact Fed policy.




Source: https://www.zerohedge.com/markets/rise-and-fall-inflation-risk-factors

**Summary**

The markets have weakened as the economy continues to be resilient driving fears that the Fed will continue to raise interest rates. As we head into the new year, the equity markets will be weighing the continued extent of interest rate increases. If, or is that when, interest rates start slowing the economy, potentially pushing into recession, equites will also need to weigh the potential impact to earnings. The short end of the Treasury curve, as measured by the 2-year Treasury, continues to price in more rate hikes, though still not to the level the Fed has stated, i.e., suggesting interest rate cuts within 2 years. The long end of the Treasury curve is pricing in either more persistent inflation or a potential "soft" landing that does not materially hurt economic growth. Thus, the markets continue to send a variety of signals that don't all line up with a clear direction. The next month and quarter will hopefully provide more clarity on the path forward for markets.

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. If the markets continue to decline, we will reallocate the overweight that occurs in Fixed Income back into equities. The relative strength of U.S. Mid-cap and International equity markets rules-based trigger has moved their respectively allocations back to equity. Additionally, the strategic asset allocation changes, have insulated some of the fixed income allocation from continued Fed rate hikes. Further, if the equity markets get too extended on the downside, some of the vehicles will reallocate some capital back into their respective equity exposures.

These dynamic tools have been engaged, a couple of times during the increase in volatility. At month end a portion of equity remained shifted to Treasury Bills for U.S. Large. The tactical allocation remains allocated to Floating Rate Treasuries.

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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**Institutional Asset Management adapted for Private Wealth**™

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