Northport Investment Management, LLC
A Registered Investment Adviser

Market Commentary – 4th Quarter 2022

What a difference a year makes. 2022 was a setback for U.S. stocks, after three consecutive years of big gains. Better performance in Q4 could not prevent U.S. equities from having their worst year since 2008. For the fourth quarter, the Dow climbed +15.4%, the S&P 500 gained +7.1%, and the NASDAQ Composite lost -1.0%. For the year, the Dow declined -8.8% and the S&P 500 fell -19.4% (-18.1% with dividends). The NASDAQ Composite plummeted -33.1% in 2022, as mega-cap-tech growth stocks experienced the most carnage. The market faced multiple challenges in 2022: the supply-chain crisis, inflation, the war in Ukraine, Chinese COVID-19 lockdowns, and the Fed's aggressive interest rate hikes. The S&P 500 finished 2022 with just one record close, the lowest tally since 2012. 2022's last closing high was back on January 3rd, the first trading day of the year. December 2022 marked the twelfth month of the current bear market for U.S. stocks. The current low for the S&P 500 was -25.4%, recorded on October 12, 2022.

Mid-cap, small-cap, international, and emerging market equity categories, all had double-digit losses for 2022. Mid-cap and international did slightly better than the S&P 500 for the year. Small-cap and emerging markets did slightly worse. Ten of the eleven S&P 500 sectors closed the year lower. Energy (+59.0%) and Utilities (-1.4%) were the best sectors. Communication Services (-40.4%) and Consumer Discretionary (-37.6%) were the worst sectors. In the Dow 30, Chevron (CVX) was the best 2022 performer (+53.0%), and Intel (INTC) was the poorest performer (-48.7%). The S&P 500 Value Index outperformed the S&P 500 Growth Index by more than 20% in 2022.

Bonds notched record setting losses for 2022, shocked by the Federal Reserve's ratcheting up of interest rates, at a historically rapid pace, in its effort to rein in inflation. The Fed raised interest rates by a cumulative 4.25% in 2022, starting in January with a range of 0%-0.25%, and ending in December with a range of 4.25%-4.5%, the largest increase since 1980. Further interest rate increases are expected in 2023. The benchmark ten-year Treasury note yield closed the year at 3.83%, up from its 1.52% yield at year-end 2021. Cash is no longer trash, as our non-sweep money market fund is currently yielding 4.3%. Current bond yields may make increasing the fixed income allocation for some conservative accounts an attractive option, as we end a four-decade era of falling interest rates.

Stock market performance in 2023 will depend upon the path of interest rates and upon the strength of the U.S. economy. We are in the early innings of the economy truly experiencing the impacts of tighter financial conditions. Whether or not the Fed can achieve a soft economic landing remains uncertain. The bear stock market is here, but whether it will precipitate a future economic recession is an unanswered question. The consensus (which got it very wrong in 2022) is overwhelmingly predicting that the U.S. will enter a recession in 2023. There is more of a split in anticipating how severe it might be, and whether it might prompt the Fed to begin cutting interest rates. Although a bear market doesn't always equate to an economic slowdown, the inverted yield curve, as discussed in prior letters, indicates to me that we will experience a recession in 2023. Current economic conditions indicate to me that it will be a relatively shallow one. The average bear market since World War II lasted 14 months and resulted in a 30%+ decline from the former high. At roughly twelve months, and down 20%, the current bear market appears to be close to two-thirds of the way through the typical bear market cycle. Historically, on average, bear markets do not bottom until after a recession begins, and they do bottom before a recession ends. The current bear market appears to be following this historical pattern.

Despite many negative statistics, there are some potential positives that are worth mentioning. Statistics show that it is relatively rare for the stock market to have consecutive down years. A high degree of negative sentiment can also be a contrary indicator. Several bubbles, such as mega-cap growth stocks, non-profitable stocks, crypto currencies, and zero interest rates/bond prices, burst in 2022. Demand for autos, housing and food, remains strong. The labor market appears resilient. Inflation is a problem, but there are solid signs that inflation has peaked, and it's coming down. 2022 was a miserable year for investors, but put in perspective, stocks enjoyed a massive bull run from 2009 to 2021. Even after its plunge in 2022, the S&P 500 returned over 8% per year over the past three years. Bonds paled in comparison. After trailing for the past decade, Value investing significantly beat Growth investing in 2022. This trend should continue, making this decade a good one for Northport portfolios. The low interest rate environment was artificial and unsustainable, in effect a tax, and a headwind, for savers and long-term investors. Yields and valuations are clearly more attractive than they were a year ago.

Mentioning potential positives does not indicate an ignoring of the potential risks. In 2023, the range of potential outcomes for capital markets remains wide. It is important to make sure that one's asset allocation is aligned with one's time horizon and risk tolerance. Let's discuss.

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