December 2022 Market Update

Special points of interest:

- **Major domestic market indices declined while bond yields rose in December.**
- **However, employment remains robust, and the unemployment rate dropped to 3.5%.**
- **The Fed is still in the driver's seat and will keep interest rates higher for longer.**
- **Consider leaning into bonds and value stocks, but expected continued volatility.**

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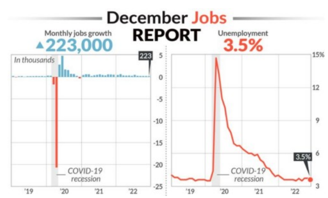
The Markets in December 2022

One could be forgiven for thinking that markets are engaged in a giant game of tug-of-war recently, with bulls and bears trading ascendancy on an almost-daily basis from rapid and ongoing economic changes. Each month also seems to end as a mirror image of the prior one. This time, it was the turn of November's strong market gains to face their opposite. For the month of December, the Dow Jones Industrial Average lost 4.2% while the broader S&P 500 index fell 5.9% and the Nasdaq dropped a starker 8.7%.

Bond yields generally rose in the month, with the 10-year Treasury bond rate increasing to 3.879% from 3.703% at the end of November. Other markets were more sanguine. Crude oil prices on the NY Mercantile exchange ended the month at $80.26/barrel, little changed from $80.55 at the end of the prior month.



From a silver lining perspective, despite recurring news of layoffs in the tech industry, employment remains robust. According to the U.S. Bureau of Labor Statistics, our domestic economy added 223,000 new jobs in December—the smallest increase in 2 years but much better than feared. The unemployment rate dropped to 3.5% from 3.6% the month prior.

Still, pessimism is running high as most economists still expect a recession to develop in 2023 and the Fed has reiterated that it is not yet done raising rates.

The Fed continued raising interest rates in December, this month by 50 basis points to a range of 4.25-4.50%.

The Look Ahead

Will there be a recession in 2023? At the moment, the Fed is still in the driver's seat, asserting its collective resolve in December to continue pushing interest rates higher in 2023, albeit at a much slower pace than in 2022. The fundamental issue is that the market does not yet fully trust the Fed. Based on interest-rate derivative prices, investors are betting that the Fed's benchmark rate will be around 4.6% by the end of 2023 vs. the Fed's forecast of 5.1%. Clearly, at 4.6% (not much higher than where we ended 2022), there is a better chance of avoiding a recession … stay tuned! On the pessimistic side, home and auto sales are clearly down and likely not coming back soon. However, the labor market has been surprisingly resilient, and wage growth still supports consumer spending. It's a toss-up at the moment.

Recession or not, rates are higher now so it's finally time to lean into bonds. Even with a mild recession, equities with a value tilt will also be worth a closer look in 2023. Expect continued volatility in the first two quarters, though, and keep your investing time horizon and goals in mind.

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