2022 Q4 IN REVIEW

Q4 saw some relief after a disappointing three quarters of 2022. While equity markets had a modest rally towards the end of the year and the S&P GSCI Index had positive performance bolstered by higher prices in industrial and precious metals, bond yields continued to rise (prices fell) as the Fed continued on its path towards higher and higher rates. In contrast to equity performance, the US dollar parred back its yearlong rally, while still ending 2022 roughly 8% higher than it ended 2021.

Mixed news abroad had a large effect on market performance in Q4, as the war in Ukraine rages on and Europe continues to see rising energy prices, China made an abrupt move to end its zero-covid policy and reopen following widespread protests across the nation.

On the domestic front, December brought some positive news with respect to inflation and the labor market. The December CPI print came in at 6.5% year over year, slowing for a sixth consecutive month and seeing its lowest level since October 2021. Core CPI, which excludes energy and food prices which tend to be more volatile, fell to 5.7% year over year, down from 6% the previous month. As inflation eased, and while the tech and financial sectors continue to see widespread layoffs, there only minor signs of broad labor market weakness. With the economy adding roughly 800,000 jobs in Q4 alone, the total number of jobs created in 2022 rose to 4.5 million and the unemployment rate fell to 3.5%, its lowest level in 53 years. Many of the leading indicators, such as PMIs, suggest the job market will weaken more substantially in Q1, but widespread job losses are unlikely.

With China moving towards reopening its manufacturing, and inflation continuing to ease, the outlook for 2023 looks slightly brighter than it did at the end of Q3. Although it is likely that we still have volatility ahead of us in the first half of 2023, especially Q1, continued improvements in inflation reports may inevitably lead to a fed pivot as early as mid-Q2 2023.

See our recommendations and the economic forecast below for Q1. Or subscribe to our **Premium Newsletter** [here](#) to get up-to-date quality analysis on market conditions and stock ideas weekly.

RECOMMENDED PORTFOLIO WEIGHTINGS

AS OF JANUARY 1, 2023

EQUITY SECTORS

OVERWEIGHT	NEUTRAL	UNDERWEIGHT
Energy	Consumer Staples	Technology
Industrials	Financials	Health Care
Materials	Utilities	Consumer Discretionary
REITs		Communications

ASSET CLASSES

OVERWEIGHT	NEUTRAL	UNDERWEIGHT
U.S. Small Cap Equities	Long-Term Investment Grade Bonds	U.S. Large Cap Equities
Intermediate-Term Investment Grade Bonds	Cash Alternatives	International Developed Equities
Resource Commodities	Short-Term Investment Grade Bonds	Emerging Market Equities
Precious Metals	U.S. Mid Cap Equities	
Agriculture Commodities		
High Yield Bonds		

FIXED INCOME

OVERWEIGHT	NEUTRAL	UNDERWEIGHT
Corporate Bonds	Mortgage-Backed Securities	U.S. Treasuries
	TIPS	Agency Securities
	Municipal Bonds	Preferred Securities
	Bank Loans	

INDEXES

DATA POINT	CURRENT	YEAR-END PROJECTION
S&P 500	3,840	4,000-4,200
NYSE	15,184	16,500-17,500
10-Year Treasury Rate	3.88%	4.50-4.75%
WTI Crude Oil	$76.58	$95-100
Gold Priced in Dollars	$1,814	$2,200
Trade Weighted Dollar	121.51	110-115
Effective Fed Funds Rate	4.33%	4.75-5%

2023 Q1 ECONOMIC & MARKET OUTLOOK

01. Equities

Stocks closed the year on a more positive note, but uncertainty reigns supreme as a New Year begins

Equities finished 2022 stronger after a disappointing year. The Russell 3000 Total Return Index, which broadly measures the US Market's top 3000 companies, closed Q4 up 7.18%, but down 19.21% on the year. The value premium, measured by the difference in return of securities with low price-to-book ratios and those with high price-to-book ratios, came in at a massive 9.87% for the quarter (difference between Russell 3000 Value Total Return Index and Russell 3000 Growth Total Return Index), continuing the strong recent performance of value securities, as the full calendar year 2022 saw a value premium of 20.99%.

Across sectors, Q4 performance was mostly positive, as Energy dominated on the back of record profits from Chevron and Exxon, with industrials and materials rounding out the top 3. The sharp decline in Tesla over the quarter negatively impacted consumer discretionary performance as it was the only sector with a negative return in Q4.

Although Q4 performance and economic data was positive, and in some ways surprising, there is still a looming threat of an earnings recession going into 2023. As banks point to shrinking profits, continue to lay off employees, and strengthen their balance sheets, the question does not seem to be around if earnings will shrink, but how persistent that downturn will be. Moving forward, we expect continued relative strength in sectors that form a bulwark for US economic activity (Energy, industrials, materials). As rates continue to rise for the foreseeable future and baby boomers continue to retire and take their consumption with them, we expect the cost of capital to continue to increase and growth securities to continue to underperform value securities. It is important to emphasize portfolio allocations to companies with strong cash flow and balance sheets who have put themselves in a position to weather the coming economic headwinds.

02. Fixed Income

A Fed Pause is near which puts the market in wait and see mode

In the face of hawkish Fed policy rates trended lower throughout the 4th quarter. There is increasing odds that the Fed will likely pause their rate hiking cycle by the end of Q1, which will bring a period of wait and see from policy makers. They must answer the question, have fast rate hikes sufficiently quelled inflationary pressures through a more balanced labor and goods market? The answer will tell the market a lot about what their next move will be, which is why the inflation reports are so widely followed. Overall, we expect treasury rates to be range bound for most of the year with the potential to break out in either direction if the economy breaks to the downside or inflation breaks back to the upside. Credit spreads remain range bound as a major bankruptcy cycle remains elusive due to strong corporate margins, low debt carrying costs and a lack of a major earnings recession. We do expect credit events to build this year which will create buying opportunities in the corporate space. Mortgage bonds will remain weak as the collateral loses value, especially in the commercial markets. We see any major pullback in rates as an opportunity to sell off long duration assets and move maturities closer. For new positions we are looking in the intermediate part of the curve while taking moderate credit risk.

03. Commodities

The Dollar has Turned from a Headwind to a Tailwind

The close of the year brought much of what colored the start of 2022, which was higher commodity prices. The difference was that this was helped by a weak dollar after it strengthened consistently for most of the year. We enter 2023 with clear breakouts from many parts of the natural resource space as China reopens and drives speculation that they will be stimulating their economy to help move on from their zero-COVID nightmare, especially copper which has surged on expected stimulus in the Real Estate sector. This adds demand to a situation of structural undersupply due to Russia slowly being exiled from the global trade markets. Gold and silver are now in clear uptrends, while oil found support at critical levels around $70. The weakest commodity domestically has been natural gas as we have had a seasonally warm winter, but that all could change with a likely cold snap building in the Arctic. Most agriculture prices have rebounded as well, except for wheat as exports our of Russia and Ukraine have beaten expectations. Overall, we see commodities as a strong place to allocate capital as the recent uptrends have taken hold.

CONCLUSION

We enter 2023 with many headwinds in the headlines, but underneath the surface many crucial industries are entering a cycle of investment that will drive earnings and employment. The tech wreck of 2022 leaves some investment opportunities in growth names, but there remains many that are overvalued or with broken business models. The value side of the market is the most attractive place to allocate capital, but growth will ultimately get bounces as sentiment is close to washed out. The Fed remains a crucial variable for asset prices this year as rate direction and trajectory will be vital to determining economic growth and valuation multiple trends. Geopolitics still leaves a cloud over the head of investors as the Ukraine war enters its second year and China looks to strengthen its position in the face of bad demographics and poor leadership under Xi. The story of 2023 will ultimately be about economic growth in the face of a slowing housing market and tech sector layoffs. Inflation is likely a story for 2022 for now, but we have not seen the last of its wrath decade, for a deglobalizing economy will bring structurally higher prices. While we expect this year to be better than the last for asset prices, that is not saying much, and if equity markets can eek out modest gains we should be happy about those results. We remain in a challenging environment which will bring more opportunities as well as risks than most investors have been used to. It is more important than ever to stay vigilant and do you proper due diligence in a world that is returning to valuing substance over style.

DISCLAIMER

There is no assurance that any of the target prices or other forward-looking statements will be attained. Any market prices are only indications of market values and are subject to change. Past Performance is a no guarantee of future results.

The prices of small and mid-company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.
Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

There are special risks associated with investing in preferred securities. Preferred securities generally offer no voting rights with respect to the issuer. Preferred securities are generally subordinated to bonds or other debt instruments in an issuer's capital structure, subjecting them to a greater risk of non-payment than more senior securities. In addition, the issue may be callable which may negatively impact the return of the security. Preferred dividends are not guaranteed and are subject to deferral or elimination.

Income from municipal securities is generally free from federal taxes and state taxes for residents of the issuing state. While the interest income is tax-free, capital gains, if any, will be subject to taxes. Income for some investors may be subject to the federal Alternative Minimum Tax (AMT).

Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline of the value of your investment. Investing in fixed income securities involves certain risks such as market risk if sold prior to maturity and credit risk especially if investing in high yield bonds, which have lower ratings and are subject to greater volatility.

All fixed income investments may be worth less than original cost upon redemption or maturity.

Although Treasury Inflation-Protected Securities (TIPS) are considered free from credit risk, they are subject to other types of risk. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate, and deflation risk, which may cause the principal to decline and the securities to underperform traditional Treasury securities. TIPS have special tax consequences, generating phantom income in the "inflation compensation" component of the principal. A holder of TIPS may be required to report this income annually although no income related to "inflation compensation" is received until maturity.

The yield, average life and the expected maturity of mortgage-backed securities are based on prepayment assumptions that may or may not be met. Changes in prepayments may significantly affect yield, average life and expected maturity.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging markets.

Investments in the energy sector are subject to the adverse economic events within that industry. A downturn in the energy sector of the economy, adverse political, legislative or regulatory developments or other events could have a large impact on a portfolio's investments in this sector.

Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks.

Real Estate investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions.

Additional information available upon request.

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