Wealth Advisory Market Update

January 5, 2023

Market Update

Equities

Equity markets ended the year on a down note. Actually, down might be an understatement in analyzing the year end numbers. The market, measured by the S&P 500, finished down 5.8% for the month of December, pushing the market to -18.09% for 2022, *its worst yearly return since 2008*. Overall, this was bad news. Yet, we did see a bright spot this past year with energy as the only sector finishing higher on the year. As discussed with our clients throughout the year, we believed the amount of uncertainty surrounding the markets was going to increase volatility. We also believed that a global economic slowdown coupled with rising rates made for an unfavorable risk/return profile for the equity market. This proved especially true for the pandemic-favorite tech companies who had their worst year since the tech bubble popped. Our strategy for 2022 was to stick with market dominant players with pricing power. Our analysis during this volatile year provided us a winning strategy relative to the market.

Moving into 2023, many of the uncertainties faced in 2022 still remain. We do, however, see a few recent positive indicators that are significant. One for example, is China. For all intents and purposes, China has ended their zero-Covid policy and is now actively injecting liquidity into their financial system in hope of jump-starting their economy. This is a big deal for many reasons, most notably that China is the second largest economy in the world and has a huge impact on global growth aspirations. They are also one of the biggest links in the global supply chain. Reopening their economy should have a positive effect on bringing inflation down around the globe.

As we look down the road in 2023, we believe the themes from last year will continue to hold in the first quarter. With the addition of new economic data and a clearer Federal Reserve policy, our strategy will adapt if needed. We are looking for a short squeeze in January, as last year's losers outperform to start the year (January Effect), although we believe this will give way to lower prices further ahead.

Monetary Policy and Economic Indicators

The Federal Reserve raised rates 50 basis points in December and their message has remained steady over the last few months. They continue to expect a slower pace of rate hikes moving forward. The terminal rate however may be higher than original expectations. Chairman Powell reiterated that any notion of a pause was premature. The Fed Funds rate now stands at 4.25-4.5% which is the highest since the financial crisis. Inflation numbers have come in better than expected over the last few months, although they still remain elevated. Payrolls were once again strong in December and wage growth remained stubbornly high. In our opinion, the Fed will continue to raise rates through at least May, with the final rate hovering around 5.0-5.25%. We presently do not expect a rate cut until 2024, but this could change rapidly. Based on economic numbers, the Federal Reserve is telling us they want to hold rates higher a bit longer. They fear easing too soon could be disastrous.

Even though the midterms are over, there still remains major political risk in 2023, with the debt limit likely the greatest political risk. It could rival the 2011 episode, where the financial markets fell dramatically in the Fall of that year. That said, we do not expect Congress to enact major fiscal changes. Republicans might press for spending cuts in a debt limit deal, but in general, we do not expect substantial cuts next year. We also do not expect major spending increases in 2023, as a split congress will make getting any deal done difficult.

Geopolitical risks continue to be a major concern. China has eased its zero-COVID policy which should be a boost to overall growth and ease supply chain constraints, but in Europe, the war in Ukraine is ongoing and doesn't seem to show signs of ending anytime soon. Europe's energy crisis looks like it may worsen, as sanctions on Russian oil have started to take effect along with Russia suggesting a 1million barrel per day cut to production, which would drive prices even higher. There continues to be global unrest among numerous countries, and this too will continue for the foreseeable future. We expect the markets to remain vulnerable to some of these unstable situations.

Strategy

As of now, our trends seen in 2022 are expected to carry over to 2023, as many of the uncertainties that we faced are still in place. We remain overweight value and quality over growth. As the global economy continues to slow and monetary policy tightens, owning companies with strong cash flows and coverage ratio's is important. This continues to push us to the market dominant players that have more inelastic demand for goods.

We began adding duration to our fixed income portfolios as we mentioned in our last letter. So far, this has paid off as the 10-year bond yield has moved from 4.33% just a month ago to 3.7% as of today. We believe it is a great opportunity to start averaging new capital into the bond market. We still seek high quality in this space.

As always, we continue to navigate this difficult environment to the very best of our ability. We at AMB thank you for your support and for allowing us to partner with you in reaching your financial goals.

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