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Wealth Advisory Market Update

February 8, 2023

Market Update

Equities

The equity markets started the year on a strong note, especially when compared to the unpleasant 2022 posting of -18.09%, measured on the S&P 500. So far, 2023 is already up 8.5%. We are not surprised on what's leading the market. As we stated in last month's *Market Update*, *"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*." The market played out the first part of our prediction in this exact fashion, with the most beaten down stocks outperforming the market by a wide margin. The pandemic favorites, which were last year's losers, have suffered a massive short squeeze. Looking at Goldman Sach's non-profitable tech index for example, it tripled the return of the overall market to start 2023. Multiple factors drove this uptick, including the Federal Reserve and its newer, dovish rhetoric, the rise of zero-day-to-expiration options (this creates leverage and drives extreme moves), and the aforementioned January Effect.

The squeeze in the technology sector has pushed its forward multiple up to 24x earnings, which is the highest since April 2022. In our opinion, this move was a technical one and devoid of fundamentals. It becomes evident that fundamentals are playing no part in the current tech sector when we look back at fourth quarter 2022 earnings. Only one sector has seen an increase in earnings expectations for 2023 and that is the utility sector. All other sectors have seen earnings estimates cut, along with the aggregate earnings number for the market which over the first month of the year has been cut by 2.5%, *the largest reduction since 2016*.

To pull this all together, we see the market moving higher, while at the same time earnings expectations have been cut. Economic numbers are deteriorating in the middle of the fastest rate hike cycle in history. It is also important to restate, as we have many times in our commentary, that over the short run, the market is a voting machine. Meaning, the market can stay irritational longer than anyone expects. Over the long run though, fundamentals will eventually come into play as we witnessed at the end of 2021 through 2022.

Monetary Policy and Economic Indicators

The Federal Open Market Committee (FOMC) raised rates 25 basis points in January, slowing the pace from 50 basis points in December. In our opinion, the biggest takeaway from the meeting was the shift in tone from Fed Chair Jerome Powell. In September of last year, Powell's speech was filled with fire and brimstone. Since then, he has often repeated his fear of stepping off the gas too soon, which could allow inflation to become entrenched in the economy. He said he would raise rates until the job was done and confirmed that we should expect economic pain. Powell's rhetoric changed though in his last two speeches, one just yesterday. Instead of fire and brimstone, he sounded wishy washy. Powell's most important statement, in our opinion, was regarding financial conditions. In his speeches he stated that financial conditions had tightened over the last few months, however we don't see it that way. As we looked at the financial conditions index, we concluded that we have eased back to levels seen at the beginning of 2022. The market took his remarks as a dovish sign and so the risk-on appetite has ramped up dramatically. Unless things change, it seems the FOMC is going to take a wait and see approach, which could spark rising inflation once again.

The debt limit remains the greatest political risk of 2023. So far, negotiations have gone nowhere except that both sides agree to disagree on nearly every issue. Despite the political rhetoric, as of right now, we expect a deal to get done before the US Treasury special operations runs out. Even though we expect some kind of deal on the debt ceiling, we do not expect Congress to enact major fiscal changes. Republicans may press for spending cuts in the debt limit deal, but in general, we do not expect substantial cuts this year. We also do not expect major spending increases in 2023, as a split congress will make getting any deal done all the more 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. In Europe, however, the war in Ukraine is ongoing and doesn't seem to show signs of ending soon. There continues to be global unrest among various countries, and the Chinese balloon incident over the US adds to the instability that we believe will continue for the foreseeable future. We expect the markets to remain vulnerable to some of these volatile situations.

Strategy

As of today, the trends seen in 2022 are expected to carry over into 2023, as many of the uncertainties that we faced are still in place. These trends have not developed quite enough yet. The squeeze in growth stocks has continue into February and will likely last longer., We do believe, however, that the tide will change and market participants will once again move back into high quality stocks in the back half of the first quarter. For this reason, we remain overweight in quality over growth. As the global economy continues to slow and monetary policy tightens, owning companies with strong, free cash flows is important. These factors continue to push us to the market dominant players that have more inelastic demand for their goods.

Fixed income markets had a terrible year in 2022, but they have seen a reprieve at the start of 2023 as rates have been trending down. We began adding duration to our fixed income portfolios in the third quarter of last year. So far, this has paid off as the 10-year bond yield has moved from 4.33% just a month ago to 3.67% 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 too.

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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