Fourth Quarter
REVIEW & COMMENTARY

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2022 Wrap Up

Unless things change in the next few days, 2022 will be one of the worst equity markets in recent history. As of December 27, the S&P 500 index ("S&P 500") has fallen 18.02%. The last drop of this magnitude was in 2008. It was an especially bad year for growth stocks, with the Russell 1000® Growth index down 28.90%, and a less bad year for value stocks with the Russell 1000® Value Index off 7.69%. Bonds, long viewed as a safe haven in times of volatile equity markets, weren't. The iShares Barclays 20+ year Treasury ETF (TLT) has fallen 30.8% from its December 31, 2021 price while its comparable 7-10 year ETF (IEF) has fallen 15.8%.

The reasons behind the plunge in markets are well-known. Covid-related supply chain issues, the Russia-Ukraine war, massive government spending and artificially low interest rates caused inflation to rise well-into 2022. As a result, Federal Reserve bankers pushed interest rates significantly higher.

Markets suffered as a result. The question we face in this last week of 2022 is what happens next?

It seems clear that 2023 may be weaker than 2022 in several ways: consumers may curb spending, businesses may react to this with layoffs. Higher interest rates may hurt both groups. But all this is already anticipated by markets. Of course, we face three economic scenarios: "better than expected," "about as expected" and worse than expected." Markets can do well in "better than expected" environments and can be hurt in "worse than expected" ones.

Key things to look for in 2023:

- How much earnings estimates for 2023 come down.
- Whether the Fed raises interest rates a few more times before deciding enough has been done.
- Whether inflation comes down.
- Is a recession likely when employment remains very strong.

Historically, markets rise more than they fall. From 1928 until 2021, markets rose 73% of the time and fell 27% of the time. A down 2022 won't change this statistic significantly. Moreover, over this period, there have been four cases of markets dropping more than one year in a row. They include the depression years of 1929-32, the World War II years of 1939-41, the OPEC-driven inflationary period of 1973-74, and the tech bust of 2000-2003. Today's situation is most like the inflationary period of 1973 and 1974 when the S&P 500 first had a down year of 14.3%, followed by a bigger down year of 25.9%.

As a result, we advise long-term investors to stay mostly in equity markets. However, it is wise for all, especially those with significant (over) near-term expenditures, to have enough cash and short-term investments to meet these expenditures. Now that short-term rates are above 4.0%, this is not as painful as it was a few years ago. Unless you expect a significant drop in interest rates, long-term bonds don't seem attractive at current rates. The key point is to have an investing plan that you can live with in various environments that doesn't force you to sell equities when markets are down.

Between now and next December, there will be many surprises, some positive, some negative. In some ways 2023 predictions are moot already – the world will soon look to see if 2024 brings both an economic and earnings recovery. One of the key attributes to successful investing is to remain flexible and remember that the only prediction that is always true is that the future is unpredictable.

Here's to a successful 2023 for all.