

## Markets Look to Rebound from a Volatile 2022

December did not bring the good tidings investors wished for – and typically see in the final month of the year – as most major asset classes struggled at the end of an especially volatile year for the capital markets.

December is historically the third-strongest month for the S&P 500 Index, but the blue-chip stock index declined 9.4%, among its worst December returns since the early 1930s. For the year, the Index was down 19.4%.

Fixed income offered little reprieve from equity struggles. Given the sharp rise in yields, the bond market experienced its worst year since 1975. It was a rare synchronized drop for equities and bonds, which are typically noncorrelated.

“Hopefully, this poor performance for both markets will be isolated to 2022,” Raymond James Chief Investment Officer Larry Adam said. “Our forecasts and outlook for 2023 reflect more positive, albeit more muted returns.”

There are signs inflation is slowing, though some indicators suggest stubborn resilience to efforts by the U.S. Federal Reserve (Fed) to cool the economy. Despite seven rate hikes for a total of 4.25% in 2022, inflation remains elevated.

Before we get into other noteworthy topics, let’s take a look at how we ended the year.

	12/31/21 Close	12/30/22 Close*	Change Year to Date	% Gain/Loss Year to Date
DJIA	36,338.30	33,147.25	-3,191.05	-8.78%
NASDAQ	15,644.97	10,466.48	-5,178.49	-33.10%
S&P 500	4,766.18	3,839.50	-926.68	-19.44%
MSCI EAFE	2,336.07	1,943.93	-392.14	-16.79%
Russell 2000	2,245.31	1,761.25	-484.06	-21.56%
Bloomberg Aggregate Bond	2,355.14	2,048.73	-306.41	-13.01%

\*Performance reflects index values as of market close on Dec. 30, 2022.

## U.S. economy remains resilient

Inflation has continued to slow, with the U.S. Consumer Price Index beating consensus expectations with an increase of only 0.1% in November. The housing market and demand for goods have also slowed as the effects of higher financing costs have affected consumers. The service sector, however, has continued to defy attempts by the Fed to cool overall economic activity. Employment data also remains strong, with an unemployment rate of 3.7% in November approaching historical lows.

### **Policy debate awaits newly split Congress**

The year-end passage of key defense and funding bills removed a degree of uncertainty around U.S. fiscal policy for the year ahead, though the bigger story could be which policy priorities were not addressed. The omnibus government funding bill did not include riders for technology/antitrust scrutiny, energy permitting reform, cannabis legislation, accelerated research and development expenses or the potential extension of a modified child tax credit – leaving these issues without a clear path forward. Headwinds for near-term Congressional action will further increase with the power shift in the House to a Republican majority, which will narrow the legislative pathway to must-pass consensus policies.

### **Renewed support for Ukraine**

Ukrainian President Volodymyr Zelensky's visit to Washington, D.C., underscored that U.S. support for Ukraine's defense will continue for the foreseeable future as the conflict with Russia shows no signs of a shift toward a peace settlement. As such, risks of escalation will persist and global macro headwinds will continue to be a significant overhang, at least into the first half of 2023.

### **Europe keeps the heat on**

Europe is avoiding the worst-case scenario of the energy crisis: there are no natural gas shortages this winter. After starting the heating season with average European Union gas storage at 95% capacity, reserves remained at 83% in late December, roughly the midpoint of winter. The relief from having enough gas to get through the winter is reflected in, among other things, the euro's partial recovery versus the dollar: the EUR is at 1.07 USD, up from 0.95 USD just a few months ago.

### **China shifts from strict COVID stance**

China's National Health Commission issued updated guidelines in late December, significantly easing the country's strict pandemic measures as they relate to both domestic infections and inbound international travelers. The challenge facing the country's medical services increased at a time when infection rates are soaring. Temporary labor shortages, coupled with supply chain disruptions, seem likely to hamper China's economic recovery after a subdued 2022.

### **Strikes disrupt United Kingdom economy**

The United Kingdom is thought to have entered a recession. The country is experiencing labor unrest as workers push for higher wages as a result of soaring inflation and squeezed household incomes. More than 300,000 union workers, roughly 1% of the workforce, walked out in December during a series of strikes across a range of significant sectors. The loss of roughly 1.5 million working days could amount to as much as 0.5% off gross domestic product in a worst-case scenario.

### **The bottom line**

Additional interest rate increases likely will occur early in 2023. While inflation is expected to moderate over the coming year, it will take time for the Fed's actions to take full effect. Once they do, indicators

point toward a mild recession in the latter half of the year. While much of this discomfort has already been priced into the markets, headwinds could persist.

By the end of 2023, the outlook for economic growth is expected to improve.

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