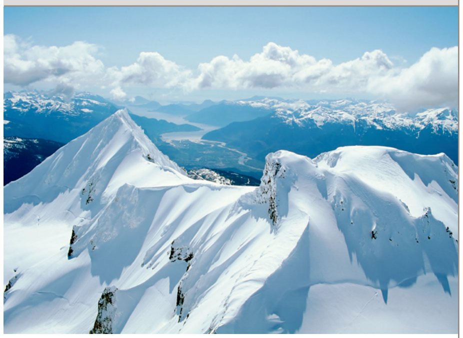
RAYMOND JAMES®

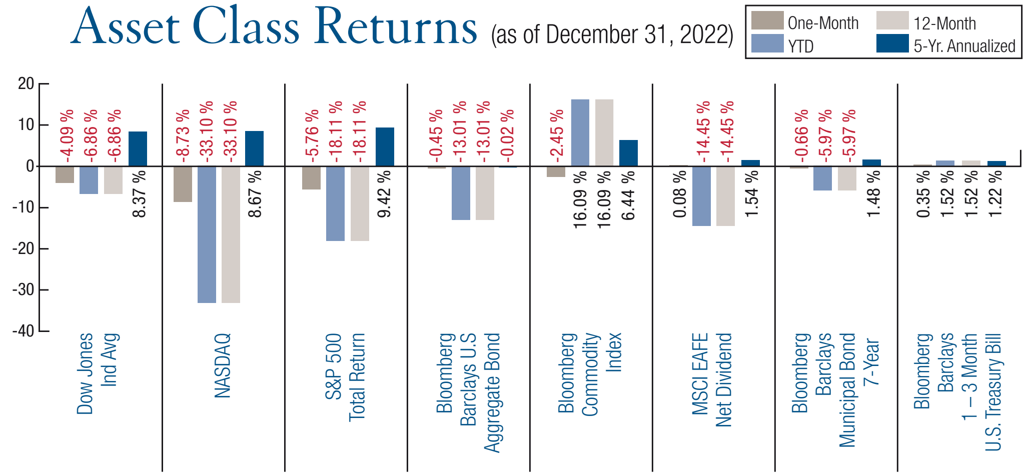
market update

From the Office of Jeff Sgroi, CFP®



“Success is not final, failure is not fatal:
it is the courage to continue that counts.”
– *Winston Churchill*

Asset Class Returns (as of December 31, 2022)



Market & Economic Synopsis

- Both equity and fixed-income markets ended 2022 in the red, with the S&P 500 shedding 18.11% and the Bloomberg U.S. Aggregate Bond Index down 13.01% on the year. Energy was the top performing sector for the year, up 66% for its best year in more than two decades.
- U.S. inflation cooled in November, showing signs that it may have peaked. While it was still up 7.1% year-over-year, the deceleration might indicate a slower tightening pace for the Fed.
- Crypto exchange FTX filed for Chapter 11 bankruptcy after failing to meet a spike in customer withdrawals. Founder Sam Bankman-Fried has been charged with eight criminal counts, including conspiracy and wire fraud.
- House Speaker Nancy Pelosi announced that she will not seek re-election as House Democratic leader, ending a two-decade run. Pelosi stated that she will remain a member of Congress and serve out her term.
- China lifts its zero tolerance COVID policies, leading other nations to impose travel restrictions.
- Lionel Messi led Argentina to its third FIFA World Cup, defeating France in a thrilling match decided by penalty kicks.

2022 Recap and 2023 Outlook

Flipping the calendar provides us a fresh start in so many respects. The markets, however, tend to have an indifferent view to the new year; as such, momentum from the prior year-end may or may not follow through into January. Recent trends provide perspective on what to expect for the near term – below are thoughts and data shared by Raymond James’ Chief Investment Officer Larry Adam.

Recent Trends in the Economy

- The U.S. economy was stronger than previously thought in the third quarter, rising 3.2%.
- The housing market is in the midst of its deepest slump since 2008.

Recent Trends in Equities

- U.S. equities delivered their worst calendar-year performance since 2008.
- Growth stocks underperformed value stocks by their widest margin (over 20%) since 2000.

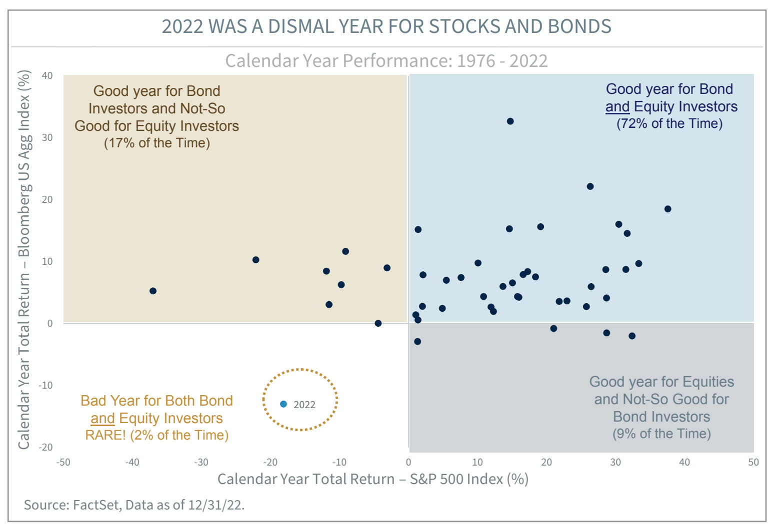
Recent Trends in Fixed Income

- The Fed hiked rates into further restrictive territory, lifting the fed funds rate to 4.25% – 4.50%.
- Global bond yields climbed due to a hawkish ECB and a surprise yield-curve twist from the Bank of Japan.

Recent Trends in Commodities & Currencies

- The U.S. dollar fell to a six-month low as cooler inflation paves the way for a less hawkish Fed.
- Global growth worries are keeping a lid on oil prices, but China’s re-opening pose upside risks.

Not to dwell on the past, but as we look forward to 2023, 2022’s market movement is important from a historical perspective. Here is one last look at 2022 returns and data before we shift to the future. At the top of the next column is a chart of relative stock and bond performance.



Despite all the challenges that 2022 brought, we have many reasons to be optimistic going into 2023. Again, Mr. Adam offers projections for the upcoming year and 2023 year-end targets for several indices and key economic data points.

Economy – 2023 U.S. GDP: ~ 0.0%

We expect GDP growth to slow to 0.0% in 2023, as the lagged impact of the Fed’s past tightening restrains economic activity. The recession should be mild as few imbalances are in the economy and the consumer is still supported by excess savings and a strong jobs market. Jobs growth will slow in the coming year, with the unemployment rate rising to a peak of 5.0%. Inflation pressures will continue to decline, with headline inflation falling to 2.4% by year-end 2023.

Bond Market – 2023 10-Year Treasury: 3.00%

Moderating inflation and a normalizing jobs market will allow the Fed to move to the sidelines after lifting the fed funds rate to a peak of 4.75% – 5.0% in early 2023. While we don't expect the Fed to cut rates in 2023 as inflation remains elevated, bond yields will decline in anticipation of the turn in the cycle. With bond yields at their highest levels in over a decade, we prefer to remain up-in-quality and favor Treasurys, munis and investment-grade debt over high-yield debt.

Equities – 2023 S&P 500: ~4,400

The global backdrop may remain challenging; however, the risk/reward has improved considerably given the sharp declines experienced in 2022. With a lot of the bad news already priced in, we have an ~4,400 price target on the S&P 500 for year-end 2023. This assumes a $215 EPS forecast and ~20.5x multiple. We continue to favor U.S. over international equities in the near term.

Dollar Direction – 2023 EUR/USD: 1.05

Some of the tailwinds supporting the U.S. dollar (i.e., Fed hawkishness, favorable yield advantage) have faded. This should benefit undervalued currencies, like the euro and Japanese yen. We expect the euro to be range bound in 2023. The euro could get a lift to 1.10 as interest rate differentials turn in Europe's favor as the ECB plays catch up to the Fed in 2023. However, lingering economic concerns, potentially exacerbated by spiking energy prices, could drive the euro to parity.

Oil – 2023 Oil: ~$100/barrel

Global growth concerns have pushed oil prices near the lowest levels in nearly a year. Despite concerns about a recession, we think oil demand will remain robust in 2023. We expect oil prices to average around ~$100/barrel in 2023. Declining Russia production, increased demand from China from the reopening and continued capital discipline from U.S. oil producers will lift oil prices back to our target.

Volatility – 2023 Volatility: LOWER

Volatility should recede in 2023 now that election uncertainty is out of the way, China is dismantling its zero-COVID policies, and the Russia-Ukraine war is no longer front-page news. The Fed moving to the sidelines in early 2023 should also help. However, the market may experience interim bouts of volatility until the earnings, inflation and the growth outlook becomes clearer in the coming months.

In short, our belief is that the economy and markets work like a pendulum. Drastic moves in either direction tend to come back to center (think normalized) with time. Since financial markets have reset to lower values over the past twelve months, history leads us to believe that they will swing back to the upside over the next year.

From the Officefront

I attended my perennially favorite conference, the Advanced Planners Study Group (APSG), in Vail in December. It was the 24th consecutive year I've attended this event (even in 2020, virtually!), and it was as strong a lineup of speakers and presenters that I can recall.

One of my all-time favorite presenters, at any conference, is Phil Orlando, Chief Equity Strategist with Federated Hermes. In his hour-long slot at APSG, Mr. Orlando's comments and viewpoints included the following: we (the U.S. government) have a spending problem, not a tax problem, which will be exacerbated by the higher cost to finance due to rising interest rates; the Federal Reserve's first rate hike typically precedes the next recession by several years; historical 2/10 Treasury spreads and spiking oil prices (both of which occurred in 2022) have historically been strong precursors for impending recessions; the two years following midterm election cycles (i.e., 2023–2024) have historically been strong periods for domestic equity markets.

Sam Korus, Director of Research with ARK Invest, shared incredibly interesting insight in his presentation titled "The Future of Electric Vehicles and Opportunities in Space Exploration." His comments included how the pace at which dollars are feeding battery innovation is likely to accelerate EV use sooner than the general public expects. Interestingly, Mr. Korus is bearish on the use of hydrogen cell vehicles, asserting that the application is very localized.

Other takeaways included stimulating conversations around private equity, how legislation in Washington continues to broadly guide financial markets, and virtual reality implications for the financial services industry.

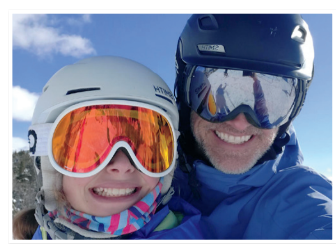
From the Homefront

Christmas and New Year's were exciting for the Sgroi household, albeit in a different way this year. Our family has been displaced for the past three months due to a (scheduled) interior remodel. Fortunately, we have been able to stay close to home, with neighbors opening their doors to us when they have been out of town or traveling. As such, we didn't experience some of our regular holiday and year-end activities (hosting Christmas Eve dinner for family and friends, skating on our rink on New Year's Eve), but still managed to make the most of the holidays. My favorite comment before Christmas came from Lily (youngest twin sister), who asked if Santa would know where to find us. "Of course he does," I told her, "but only if you have been good!"

Being out of our normal routine nudged us toward outside activities a bit more than past years. The girls are aiming for 50 ski days this season, though that goal does seem a bit lofty! Hannah and Lily discovered Aspen Mountain last year and love the gondola ride to the top.

Stella pushes herself to stay ahead of her younger sisters on the ski slopes, but still prefers the more relaxed pace at Buttermilk. Due to a broken toe earlier this fall, she wasn't able to perform in Aspen Santa Fe Ballet's "The Nutcracker" this year. She has since healed up well enough to get into a ski boot and is back in the studio working hard toward this spring's upcoming dance recital.

Our family made a few New Year's resolutions for 2023 as well. They are mainly wellness related (who's aren't!?!?!?!?!) – exercise, stretching, fitness and diet. It should be interesting to see who keeps their promises to themselves the longest, but my bet is on Hannah!



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