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Clear Direction in a Complex World

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Quarterly Insights – January 2023

For 2022, the equity markets had to deal with the Ukraine War, inflation, an oil price shock, rising interest rates, China lockdowns, supply chain disruptions, a recession risk, hawkish Fed guidance, disappointing economic data, and rising global bond yields. The S&P 500 finished 2022 down -18% for the 4th worst performance year since 1945 and the worst year for the index since the Global Financial Crisis in 2008.

The Nasdaq suffered the worst year of underperformance (-32%) since 2002. The U.S. 10-year Treasury bond returned -16%, their worst year on record. It was only the third time since 1926 that both stocks and bonds went down during the same year, the other two times were in 1931 and 1969, punctuating just how disappointing the year was for investors.

Q4 and Full Year 2022 Performance Review

Unlike the first three quarters of 2022, when all four major indices saw quarterly declines, performance was mixed during the fourth quarter as the Dow Jones Industrial Average rose sharply, while the S&P 500 and Russell 2000 were solidly higher. Like most of 2022, however, the Nasdaq lagged and fell slightly in the fourth quarter. Expectations for higher rates, slowing economic growth and underwhelming earnings weighed on the tech sector in the fourth quarter, which was the case for much of 2022. Conversely, less economically sensitive companies that trade at lower valuations than tech stocks outperformed again as investors continued to shift towards defensive sectors amid growing recession fears. On a full-year basis, all four major indices posted negative returns, with the Dow Jones Industrial Average relatively outperforming while the Nasdaq badly lagged the other major indices.

By market capitalization, large-caps slightly outperformed small-caps in the fourth quarter, but modestly outperformed throughout 2022. Concerns about future economic growth and higher interest rates (which can impact small-caps disproportionately due to funding needs) were the main drivers of large-cap outperformance and small-cap underperformance throughout 2022. Small-cap stocks did show some resilience in the fourth quarter with the Russell 2000 index registering a solid gain as investors' hopes for a peak in inflation and ultimately interest rates, led to some dip buying in the segment.

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From an investment style standpoint, value outperformed growth all year and that trend continued in the fourth quarter. Underwhelming earnings weighed on tech stocks in the final three months of the year, while concerns about slowing economic growth combined with rising bond yields hit richly valued tech stocks throughout 2022. Value stocks, meanwhile, were viewed as more attractive in the market environment of 2022 due to lower valuations and exposure to business sectors that are considered more resilient than high-growth parts of the market.

On a sector level, 10 of the 11 S&P 500 sectors finished the fourth quarter with a positive return, although only two of the 11 ended 2022 with gains. Energy outperformed other sectors not just in the fourth quarter but for all of 2022. In the fourth quarter, energy stocks were helped by progress on the post-Covid economic reopening in China which increased energy demand expectations, while a falling dollar was an added tailwind for commodities including oil and gas. More to that point, the other strong sector performers in the fourth quarter were industrials and materials, which also benefitted from an improving Chinese demand outlook and a weaker U.S. dollar. For the full year, energy was, by far, the best-performing sector in the market as an early-year surge in oil and natural gas prices in response to increased geopolitical risks and reduced Russian supply helped push energy stocks sharply higher. Defensive sectors, specifically utilities and consumer staples, were the next best-performing sectors finishing the year with small gains and losses, respectively, again as investors rotated towards less economically sensitive corners of the market amid rising recession risks.

The tech sector and those sectors with overweight exposure to high-growth companies badly lagged in the fourth quarter and over the course of 2022. In the fourth quarter, communication services were only fractionally positive while the consumer discretionary sector posted a negative return on weakness in high-growth internet and consumer stocks. For the full year, those same two sectors posted the worst returns in the S&P 500, as investors shunned richly valued, growth-oriented tech companies.

S&P 500 Total Returns by Month in 2022											
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
-5.17%	-2.99%	3.71%	-8.72%	0.18%	-8.25%	9.22%	-4.08%	-9.21%	8.10%	5.59%	-5.90%

Source: Morningstar

US Equity Indexes	Q4 Return	2022 Return
S&P 500	7.56%	-18.11%
DJ Industrial Average	16.01%	-6.86%
NASDAQ 100	-0.04%	-32.38%
S&P MidCap 400	10.78%	-13.06%
Russell 2000	6.23%	-20.44%

Source: YCharts

Internationally, foreign markets handily outperformed the S&P 500 in the fourth quarter thanks to a large bounce in Chinese stocks as Beijing ended its “Zero-Covid” policy and commenced an economic reopening, while a falling dollar boosted global economic sentiment. Foreign developed markets outperformed emerging markets in the fourth quarter thanks in part to a large bounce in U.K. shares following the resignation of PM Truss and the abandonment of her fiscal spending and tax cut plan. For the full-year 2022, foreign developed markets registered solidly negative returns, but thanks to the fourth-quarter rally, relatively outperformed the S&P 500.

International Equity Indexes	Q4 Return	2022 Return
MSCI EAFE TR USD (Foreign Developed)	17.40%	-14.01%
MSCI EM TR USD (Emerging Markets)	9.79%	-19.74%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	14.37%	-15.57%

Source: YCharts

Commodities saw gains in the fourth quarter as both oil and gold logged positive returns. A falling dollar paired with an improving outlook for Chinese demand as the government moved towards reopening their economy pushed oil higher throughout the quarter. Gold, meanwhile, saw steady gains in the final three months of the year thanks primarily to the decline in the U.S. dollar. For 2022, commodities posted a large, positive return due to the significant gains in oil futures and other energy commodities that came in response to geopolitically driven supply concerns following Russia’s invasion of Ukraine. Gold, however, saw only a slightly positive return for 2022 as sharp rises in the U.S. dollar and Treasury yields midyear weighed on the yellow metal, limiting gains.

Commodity Indexes	Q4 Return	2022 Return
S&P GSCI (Broad-Based Commodities)	3.44%	25.99%
S&P GSCI Crude Oil	1.20%	5.06%
GLD Gold Price	9.85%	0.42%

Source: YCharts/Koyfin.com

Switching to bond markets, the leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) realized a positive return for the fourth quarter but declined sharply for the full year of 2022, as more-aggressive-than-expected Fed rate hikes combined with decades-high inflation pressured most bond classes.

US Bond Indexes	Q4 Return	2022 Return
BBgBarc US Agg Bond	1.87%	-13.01%
BBgBarc US T-Bill 1-3 Mon	0.89%	1.52%
ICE US T-Bond 7-10 Year	0.98%	-14.90%
BBgBarc US MBS (Mortgage-backed)	2.14%	-11.81%
BBgBarc Municipal	4.10%	-8.53%
BBgBarc US Corporate Invest Grade	3.63%	-15.76%
BBgBarc US Corporate High Yield	4.17%	-11.19%

Source: YCharts

Q1 and 2023 Market Outlook

The losses in stocks and bonds were driven by decades-high inflation, a historic Fed rate hike campaign and geopolitical unrest. But while those factors were clear negatives for asset prices in 2022, it's important to note that as we enter 2023, the market is approaching a potentially important transition period that could see each of these headwinds ease in the months ahead.

First, inflation has shown definitive signs of peaking and declining. The Consumer Price Index has fallen from a high of 9.1% in June to 7.1% in November, while other metrics of inflation have registered similar declines. Now, to be clear, inflation remains much too high in an absolute sense, but if price pressures ease faster than expected, that will present a positive surprise for markets in the first several months of 2023.

Second, after a historically aggressive rate hiking campaign in 2022, the current Fed hiking cycle is likely nearly complete. In December, the Federal Reserve signaled that it expected the peak interest rate to be just 75 basis points higher than the current rate. That level could easily be reached within the first few months of 2023 and the Fed ending its rate hike campaign will remove a significant headwind from asset prices.

As we start the new year, we should expect financial media commentary to be focused on the 2022 losses and current market risks, including earnings concerns and recession fears. But the market is a forward-looking instrument, and while there are undoubtedly economic and corporate challenges ahead in 2023, some of those best-known risks are partially priced into markets already, and the truth is that there are potential positive catalysts lurking as we start a new year.

More broadly, market history is clear: Declines of the magnitude we saw in 2022 are usually followed by strong recoveries, not further weakness. The S&P 500 has logged successive down years only twice since the early 1940s ('73 - '74 and '00 - '02). Not by coincidence the current bear market has been compared to those periods more than others, as inflation and Tech underperformance have been the

main drivers of downside equity price action. Bonds, represented by the Bloomberg U.S. Aggregate Bond Index, have never experienced two negative consecutive years. And that reality underscores an important point, that market declines such as we witnessed in 2022 have ultimately yielded substantial long-term opportunities in both stocks and bonds.

The stagflation of the 1970s and sky-high interest rates of the early 1980s eventually gave way to the strong economic growth and market rally of the 1980s. The dot-com bubble burst of the early 2000s was followed by substantial market gains into the mid-2000s. The global financial crisis in 2008 was followed by strong rallies in the years that followed, and not even the worst global pandemic in over 100 years could result in sustainably lower asset prices.

As such, while we are prepared for continued volatility and are focused on managing both risks and return potential, we understand that a well-planned, long-term-focused, and diversified financial plan can withstand virtually any market surprise and related bout of volatility, including multi-decade highs in inflation, historic Fed rate hikes, geopolitical unrest, and rising recession risks.

At Zick Whitted Taub Investment Strategies, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. Successful investing is a marathon, not a sprint, and even intense volatility is unlikely to alter a diversified approach set up to meet your long-term investment goals.

Therefore, it's critical for you to stay invested, remain patient, and stick to the plan, as we've worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.

We remain vigilant towards risks to portfolios and the economy, and we thank you for your ongoing confidence and trust. Please rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,



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