WEEKLY MARKET RECAP | December 27, 2022

Week in Review

Equity Markets:

The equity market saw mixed results last week. Value names led the way upward while growth companies lagged. The S&P 500 ended the week down 0.2%. The S&P 500 sits ~20% below its all-time high, which is nearly a full year ago. If there is not a strong rally in the upcoming week, this will be the worst annual performance since 2008. This year was characterized by a strong style shift from growth to value and the DJIA is down half of the S&P from its all-time high.

Most CEOs have warned of an economic slowdown in 2023, so the next couple of earnings seasons will be very important for the markets. Consensus estimates have come down roughly 10% from the beginning of the year. Q4 earnings results will kick off in the next few weeks. Earnings declines of 2.8% are expected.

Fixed Income Markets:

This has been a historical bear market for bonds. According to Bloomberg data, 2022 has been the worst bond market sell-off since records started in 1926.

Treasury yields rose this week as US Bonds sold off following a multi-decade trend reversal by the Bank of Japan. The Bank of Japan slightly tightened and is allowing their sovereign bond yields to drift in a larger range. On the news, the US bond market saw a sell-off and a slight steepening in the yield curve. The 2/10 spread has tightened to -0.57%. This is well below the -.83% high early this month.

Following months of deepening inversions on the yield curve, although still heavily inverted, a normalizing of the yield should come as a positive sign for investors. The bond market has historically led the equity market. If the trend continues into the new year, it could be a sign that the start of a new bull market is closer than most investors think.

Economic:

Core PCE, a preferred inflation gauge by policymakers, rose 0.2% from last month and 4.7% year-over-year. The monthly reading was above forecasts while the latter was in line with estimates. The University of Michigan Consumer Sentiment Index was revised higher to 59.7 from the preliminary reading of 59.1. New Home sales rose 5.8% and the median home value rose 9.5% year-over-year. New home inventory declined to 8.6 months. The housing market cooled very quickly on the shock of doubling the 30-year mortgage rate in a year. The cool off is expected to continue but as mortgage rates stabilize, it could come in a slower manner.

Looking Ahead

Equity Markets:

Diversification is a steadfast rule for most investors. This can include diversification within an asset class or diversification across asset classes. On one hand, this rule has led investors down a rough road so far this year. The 60/40 portfolio has had one of its worst years since the Great Depression, according to data from Morningstar.

On the other, investors who relied on a heavy concentration on growth names for a stellar performance during the last bull market were pummeled. The growth-heavy NASDAQ is down 34% from its all-time high, while the Dow is down 10%.

Diversification should be a focus for long-term investors. Market shifts and trends can take hold out of nowhere, for reasons that may not make logical sense. Developing a long-term investment strategy, and staying committed can help investors avoid costly mistakes.

Fixed Income Markets:

We are currently looking at two heavily-favored, major outcomes that, in our opinion, propose a solid backdrop for bonds in 2023.

The Fed is nearing the end of its rate hiking cycle and will likely conclude by Q2, if not sooner. We feel this is the biggest reason to believe the worst is over for the bond market. We believe that when uncertainty regarding monetary policy is removed from the market, the extreme volatility should also be reduced. With a sense of stability returning, we believe that current yields in the fixed-income markets will be attractive to bond investors. This supports a price jump, as bond yields and prices are inversely related. It is our view that the 4.25%+ rates we reached this year are the top of the cycle. It is still possible to see a move in the 4% range, especially since the Fed has indicated there are more rate hikes likely to come. But we believe as we move into the latter half of 2023 the yields on the 10-year treasury will likely be closer to 3% than 4%

It seems a recession is ultimately likely, especially considering the breadth of yield curve inversions and the trends in Leading Economic Indicators as example cues. If this is the outcome, we believe the negative correlation of treasuries should return. This will be a 180-degree shift from what was experienced this year. The drawdowns in the markets this year have been in large part because of policy. If equity market weakness continues, it is likely due to a slowing economy. Where current yields sit, the treasury once again appears to be a safe haven for equity investors to flock toward.

Economic:

Housing will take a major part in the week's economic calendar. We will see numbers for the S&P CoreLogic Case-Shiller Home Price Index, pending home sales, and mortgage applications. The Chicago PMI and regional manufacturing data out of Dallas and Richmond will provide a look into the economy before we start the new year.

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