KRILOGY

WEEKLY MARKET RECAP | January 3, 2023

Week in Review

Equity Markets:

The final trading day for 2022 is in and the S&P 500 had a price return of -19.4%. After posting two monthly gains in a row, major indices ended the final month on a weaker note. The style shift that dominated the year held true in December with the Dow ending down 4% while the NASDAQ finished down 9%.

After a decade-plus of underperformance, value regained substantial ground against growth in 2022. Large-Cap value fell a mere 8% compared to its growth counterpart which fell 29%. In a year dominated by uncertainty and volatility in both the fixed income and equity markets, investors flocked to quality companies that entered the year at steep discounts relative to history.

The disparity among sector returns was very noticeable this year. The energy sector led the way with a total return of 65%. The outperformance was supported by the inflationary environment and the unforeseen invasion of Ukraine which disrupted global energy supplies. Sectors that were solid anchors in the previous cycle faltered. Communication services ended the year down nearly 40% with consumer discretionary not far off with a -37% return.

Fixed Income Markets:

Bond yields remained relatively flat for the week. Volume in the market was light due to the holiday week. The real story is where yields ended the year. The 10-year Treasury yield closed out the year at 3.88%. This is well below the intra-year high of 4.25%. Despite the compression in the final quarter of the year, the yield jumped 145% for the year. The move in yields was historic, and not surprising considering the historic rate hiking campaign by the Fed.

Economic:

The Chicago PMI improved in December but remains in contraction territory. The index rose to 44.9 which is a large increase from November's reading of 37.2. The Cash-Shiller Home Price Index continued its monthly decline but still has strong annual gains. It is important to note the lag in the index, as the most recent release was for the month of October. On a monthly basis, the index decreased by 0.5% but saw an annual increase of 9.2%.

Looking Ahead

Equity Markets:

We are moving into the new year with a cloud that remains over the market. Despite the struggles experienced for investors in 2022, we must look forward and evaluate the environment. This may be a new year, but the present environment is little changed. The Fed is likely to hike a minimum of one more time. Economic growth will still be hard to find, and inflation remains present. Long-term investors have not historically benefited from waiting until the all-clear signs appear. The three points above have historically troughed after the stock market begins its recovery.

Cautious optimism could be a good mindset as we move into 2023. The Fed has signaled the end is near for rate hikes and inflation has cooled significantly. Following a tough year for nearly all asset classes, we believe that investors should stay focused on the long term. 2022 is in the past and we believe there are value opportunities for investors that can withstand the likely volatility in the first half of 2023.

Fixed Income Markets:

The volatility in the bond market in 2022 was very significant and was the worst year for the Bloomberg Aggregate Bond Index since 1976, which was the first year of data. The index ended the year down 12.5%. Monetary policy was at the core of the bond (and equity) market weakness this year. The Fed took rates from 0% to over 4% in seven months. This was the swiftest rate of hikes in history.

With the Fed indicating a policy shift within the first half of the year, we believe it could be a strong set-up for the bond market. Until the Fed actually pivots, we could see rates move in the 3.5-4% range, but we still believe the 4.25% peak in October will be the ultimate high for the current rate cycle. Bond investors are being rewarded with a yield that hasn't been seen in over a decade, and at the core, the security of the principal is a very attractive component of bonds. There is still uncertainty regarding the economy and the stock market so we believe in a focus on high-quality bonds.

Economic:

ISM and S&P Global will release their reports on the manufacturing and services sector. An in-depth look at the labor market is slated to report on Wednesday with the JOLTS report, followed by the ADP National Employment Report on Thursday.

**** *See Important Disclosures on following page*

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