W A I N W R I G H T   I N V E S T M E N T   C O U N S E L , L L C

FINANCIAL MARKETS HIGHLIGHTS

Fourth Quarter 2022

Summarizing the capital markets in one word can be tricky, but for 2022, that word is volatility. Sticky inflation, the resultant rapidly rising interest rates, and war in Ukraine caused immense disruption in the capital markets, causing the worst year for the S&P 500 since 2008, and the third worst year *ever* for the prototypical "balanced" portfolio of stocks and bonds, based on data compiled by NYU[i].

During the fourth quarter capital markets rebounded, though, with most segments of the stock and bond markets posting gains. The S&P 500 Index of large and mega-capitalization stocks finished the quarter +7.6% and -18.1% for the year. The Russell 2000 Index of small-capitalization stocks was +6.2% for the quarter and -20.4% for the year. The international MSCI EAFE and MSCI Emerging Markets Indices returned +17.3% and +9.7% for the quarter, respectively, and -14.5% and -20.1% for the year.

Value stocks outperformed growth stocks during the quarter, a recent trend, and for the year as a whole. The broad Russell 3000 Value Index returned -8.0% during 2022 compared to -29.0% for the Russell 3000 Growth Index. This reverses a decade long trend during which growth stocks outperformed value stocks by more than six percentage points per annum. As we have written prior, the major factors affecting stock prices over time are corporate earnings and interest rates. Discounting future corporate cash flows with higher interest rates (as we have now) results in lower present values, and hence can cause lower price/earnings multiples on stocks, particularly those growth stocks whose earnings forecasts are well out into a cloudier future. Further, if the economy does slide into some form of a recession, which is possible, corporate earnings forecasts will decline. The S&P 500 Index currently trades at 17x forward earnings, compared to 21x one year ago, based on data compiled by Refinitiv[ii].

From a sector standpoint, the year ended as it began, with Energy and Industrial stocks performing best, and Technology and Consumer Discretionary stocks worst. The previously vaunted growth stocks of Facebook (Meta), Apple, Amazon, Netflix, and Google all ended the year down more than 25%, after years of leading the market higher.

Like the equity markets, the bond markets rebounded during the fourth quarter. The Bloomberg U.S. Aggregate Bond Index returned +1.9%, but ended the year -13.0%. This was the worst year *ever* for the index, which dates back to 1976. Its second worst year was 1994, when it was *only* -2.9%. On the corporate bond front, the Bloomberg High Yield Index returned +4.2% during the fourth quarter and -11.2% for the year.

For years, the capital markets benefitted from low interest rates and subdued inflation. It was a "Goldilocks" scenario, but ultimately COVID and the resultant snarled global supply chains and unprecedented fiscal stimulus (which notably included a lot of free money), made the porridge too hot. Runaway inflation ensued and, to combat it, the Federal Reserve's Federal Open Market Committee ("FOMC") raised the

Selected Index Returns (%) as of December 31, 2022 (Source: Morningstar Direct). 3, 5, 10 year returns are annualized.

	Oct.	Nov	Dec.	QTR	YTD	1 Year	3 Year	5 Year	10 Year
S&P 500	8.10	5.59	-5.76	7.56	-18.11	-18.11	7.66	9.42	12.56
S&P 400	10.52	6.12	-5.54	10.78	-13.06	-13.06	7.23	6.71	10.78
Russell 2000	11.01	2.34	-6.49	6.23	-20.44	-20.44	3.10	4.13	9.01
Wilshire U.S. REIT Index	4.13	5.84	-5.59	4.05	-26.81	-26.81	-0.49	3.35	6.31
MSCI EAFE	5.38	11.26	0.08	17.34	-14.45	-14.45	0.87	1.54	4.67
MSCI Emerging Markets	-3.10	14.83	-1.41	9.70	-20.09	-20.09	-2.69	-1.40	1.44
Bloomberg U.S. Aggregate Bond	-1.30	3.68	-0.45	1.87	-13.01	-13.01	-2.71	0.02	1.06
Bloomberg High Yield	2.60	2.17	-0.62	4.17	-11.19	-11.19	0.05	2.31	4.03

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short-term Federal Funds interest rate seven times during 2022, the most recent raise being 0.50% on December 14. Having begun the year in a range of 0.00% to 0.25%, the Fund Funds rate popped champagne at 4.25% to 4.50%, an unprecedented move.

As a reminder, higher interest rates have two powerful effects on the economy – they induce savings and inhibit credit-based investment. These result in a slowing of consumer spending and capital investment, thus slowing the economy, which in turn leads to the present concerns over a possible recession. For its part, the FOMC is far less concerned with a recession than it is with inflation. On that front, inflation has begun to creep lower, so there is progress. The read on the Consumer Price Index ("CPI") in November showed a 7.1% year-over-year increase, down from a peak of 9.1% in June. Excluding volatile food and energy prices, prices rose 6.0% year-over-year, down from September's peak reading of 6.6%. The FOMC targets inflation around 2%, so work remains, which is why the median projection for the Fed Funds rate amongst FOMC participants for year-end 2023 is 5.00% to 5.25%, signaling further rate increases.

On the commodity front, West Texas Intermediate ("WTI") oil closed the year at $80 per barrel, down from $124 per barrel in March, but 7% higher for the year. Gold rallied +8.5% during the quarter and ended the year modestly higher. Bitcoin, once considered by some to be digital gold and an inflation hedge, returned -14.8% during the quarter and crashed -64.3% for the year. The dollar declined dramatically during the quarter, -5% compared to a broad index of currencies compiled by the St. Louis Fed, which was a boon for U.S. investors holding assets overseas (see MSCI EAFE and MSCI Emerging Market returns above).

Humbug to 2022, we say, and warm welcome to 2023. As always, we urge you to maintain investment exposure in a thoughtfully constructed asset allocation, suitable to your objectives and constraints. From the Wainwright Family to yours, wishing you a happy and healthy 2023.

[i] https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html

[ii] Refinitiv "S&P 500 Earnings Scorecard" dated January 7, 2022 and January 6, 2023.

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