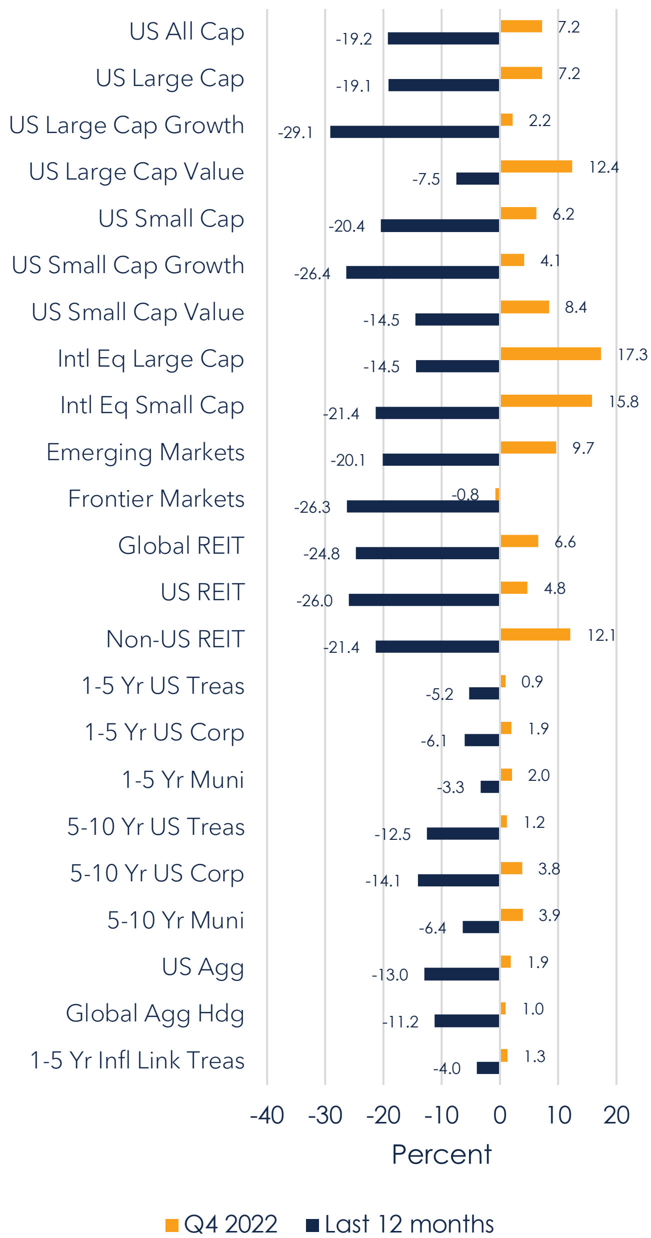
AegleWealth
WEALTH MEETS WELL-BEING

INVESTMENT RECAP - 4Q 2022

PERIODIC RETURNS



Source: Morningstar; Russell, MSCI, Dow Jones, Bloomberg, ICE BoA ML benchmarks shown; past performance is not indicative of future results

KEEPING A BALANCED APPROACH

Summary:

- Even with a strong Q4, annual returns across stock and bond (and gold and cryptocurrency) categories were weak.
- At the beginning of 2022, no one predicted rates would rise as fast and as high as they did, nor did anyone predict Russia would invade Ukraine. What surprises will 2023 bring?

Positive Signals:

- ✓ Inflation appears to be fading
- ✓ Outlook for investing in fixed income is brighter for 2023 as current yields are the highest they have been in years; plus with inflation receding, it's expected that the Fed has completed the majority of their interest rate hikes.
- ✓ Economic data, in particular labor force data, suggests we are not in a recession.

Reasons for concern:

- ? Globally, inflation is still stubbornly high, recently coming more from services than from goods.
- ? With a yield curve currently quite inverted, low consumer confidence, and more potential rate hikes, is a recession looming?
- ? What will the impact be of China ending their zero-covid policies?

2022 in one word: inflation

Before we jump into a review of the last year or even last quarter, let's take the way-back machine to 2020, a year defined by Covid. Moving towards 2021, we were still dealing with Covid, but the related economic and monetary policy impacts became a reality as businesses were booming but policies remained accommodative. The potential for inflation was certainly there, but it was expected to remain relatively low and temporary. Even going back to early 2022, the President and CEO of the St. Louis Fed stated he expected **only four** rate increases for the year. Not only was he short by three, but as Exhibit 1 shows, four of the seven increases were consecutive 75 bps a piece, something we had never seen before.

Exhibit 1

FOMC Meeting Date	Rate Change (bps)
3/17/22	+25
5/5/22	+50
6/16/22	+75
7/27/22	+75
9/21/22	+75
11/2/22	+75
12/14/22	+50

Source: FederalReserve.gov

Exhibit 2

As we have previously noted, inflation is not an issue in just the US, but one that is problematic globally. Central banks across the globe have been increasing interest rates, even in Japan whose central bank raised rates by 25 bps in December. To put the pace of central bank rate increases into perspective, Exhibit 2 shows us the annual policy rate hikes and cuts (in bps) for the central banks overseeing the top ten most traded currencies. As you can see, the only relative comparison, in magnitude though not direction, is 2008, where rates were cut by just over 2,500 bps.

The good news? In the US, inflation appears to have peaked in June with a headline CPI reading of 9.0%. Since then, year over year inflation has fallen to 6.5% in December. As such, we saw the furious pace of Fed increases somewhat slow in December as the Fed "only" increased rates by 50 bps.

Unfortunately, with a target inflation of 2%, current numbers are still too high, which means more interest rate hikes are expected, at least partially into 2023.

Where does the Fed go from here? Well, so far, they have been quite deliberate in stating their goal to drive down inflation by any means necessary. As previously noted, the pace of rate increases has been fast and furious. It is expected that the Fed will need to see continued decreases in inflation before hitting the pause button on rate increases.

Will they go too far in increasing rates? It is certainly possible, and they have said they would rather overshoot vs. the alternative, so don't expect a pivot to rate cuts anytime soon. Remember, too, the Fed can only control so much but cannot control the inflationary impacts caused by external forces like the war in Ukraine.

<u>Are we in a recession?</u>

This is the same question we asked ourselves last quarter as Q1 and Q2 GDP numbers were negative, considering that the financial media often defines two consecutive quarters of declining GDP as a recession. In more positive news, real gross domestic product (GDP) increased at an annual rate of 3.2 percent according to the most recent quarterly data available.

Looking deeper into the more complex definition and calculations the NBER uses to officially determine recessions, the data is compelling that we are not currently in a recession.

<u>Of course, this doesn't mean we couldn't move into a recession at some point in 2023. However, we would strongly caution against trying to time any market events by changing your allocation or investment approach</u>.

Market predictions are often wrong

What is going to happen to stocks in 2023? Well, if you know us by now, you know we are not going to be making our own prediction. Regardless of how much time and energy is put into an estimate, there are too many unknowns that happen each year which impact market returns. Nonetheless, that doesn't stop many major financial institutions from trotting out their annual estimates, even though they are consistently wrong, in both direction and magnitude. Exhibit 3 shows the 2022 estimates made by several well-known firms. A few items that jump out are 1) only Bank of America and Morgan Stanley had the S&P 500 falling in 2022, the rest predicted increases, 2) not one estimate is within 10% of where the S&P ended, and 3) four of the six estimates are over 20% away from where the S&P finished in 2022.

Exhibit 3

Firms	2022 S&P 500 Forecast	% Difference from Actual
Oppenheimer	5,330	28%
Credit Suisse	5,200	26%
JP Morgan	5,050	24%
Bank of America	4,600	17%
Goldman Sachs	5,100	25%
Morgan Stanley	4,400	13%

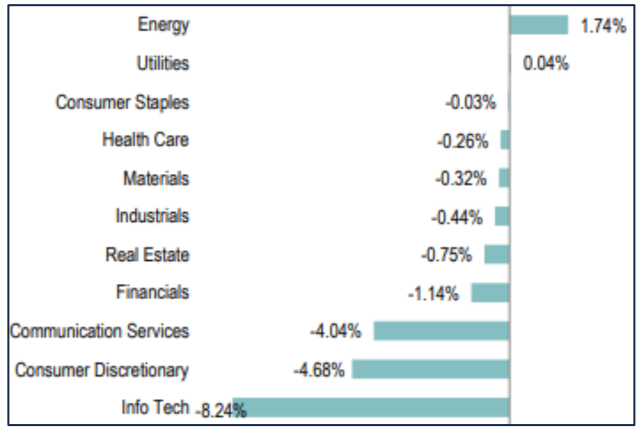
Source:https://news.yahoo.com/stock-market-equity-outlook-2022-193659328.html, note the targets provided are price targets. The S&P 500 started 2022 at 4766.18 and ended 2022 at 3,839.50.

U.S. Equity

The fourth quarter of 2022 was a fairly positive one for US equities, though the R1000 and R2000 still fell by -19.1% and -20.4%, respectively, for the year. Unlike the last several years where tech and growth stocks saw the glory, they were hampered in 2022 with the reality of higher interest rates lowering their expected future earnings. In the large cap space, value outperformed growth by 21.6% and by 11.9% in small cap.

For the year, as Exhibit 4 shows, only the energy and utilities sectors (which are both considered more value-oriented) provided positive contributions to the S&P 500 while more growth-oriented sectors like information technology, consumer discretionary, and communication services all experienced the worst returns.

Exhibit 4



Source: S&P Global, the percentages show how much each sector contributed to the S&P 500 return of -18.1% in 2022

Non-U.S. Equity

International developed large cap (17.3%) and small cap (15.8%) outperformed their US counterparts over the quarter. One of the reasons for the recent outperformance can be attributed to the decline of the US Dollar, something that had been a serious headwind earlier this year but became a tailwind this past quarter. For the year, international developed large caps outperformed their domestic counterparts while international small caps were roughly equivalent to US small cap.

Emerging markets gained 9.7% over the last quarter but still fell by -20.1% for the year. As we know, China has an outsized impact on the overall results of emerging market returns. With China rolling back their roughly three years of zero-covid lockdown policies, we are not exactly sure what their experience will be, either from a healthcare or economic perspective.

From a country perspective, all major developed countries in the MSCI World All Country IMI index outperformed the US during the quarter. For reference, Germany advanced 24%, France grew by 22%, and the UK was up 17%. In the emerging markets, China remains the largest country exposure by far, at roughly one-third of the entire index. China also outperformed the US with a 14% return over the last quarter. Source: Dimensional Fund Advisors, Country returns are the country component indices of the MSCI All Country World IMI index

Global REITs

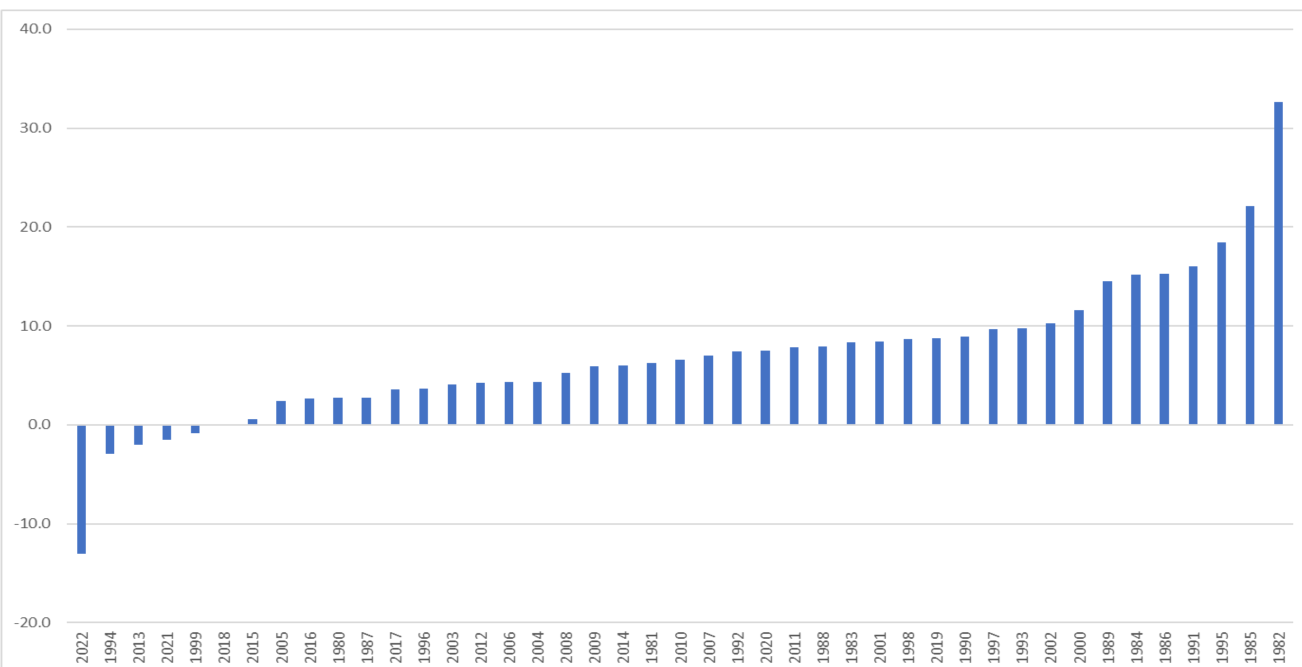
Global REITs, as represented by the Dow Jones Global Select REIT, gained 6.6% for the quarter but declined by -24.8% for the year. Non-US REITs outperformed their US counterparts over the quarter and year.

Diving deeper into the YTD sector returns for the FTSE NAREIT US index (a REIT index that provides sector returns publicly), all of the sectors show negative returns for the year with the specialty REIT sector performing the best (examples of specialty REITS may include movie theaters and casinos), declining -0.8%, while office REITS were the worst performing REIT sector, dropping -37.6%. Source: [NAREIT]

Global Fixed Income

The fixed income indices we follow were mainly positive for the quarter but outside of the 3-month Tbill, all were negative for the year. To see how poor of a year 2022 was for fixed income investment returns, look no further than Exhibit 5.

Exhibit 5



Source: Morningstar, data is for the Bloomberg US Aggregate Bond Index TR USD, past performance is not indicative of future results

This chart shows the range of calendar year returns from 1980-2022 of the Bloomberg US Aggregate Bond Index TR USD, better known as simply the "Agg." We show the annual returns from lowest, on the left, to the highest on the right. It is easy to see that 2022's return of -13.0% was far worse than the next-worst year, 1994, where the Agg only fell by -2.9%. Also notice that in the 43 years of data shown, there are only five years where returns were negative, and two of those years were 2021 and 2022. Of the 43 years shown, returns have been between zero and 10% roughly 66% of time, and with returns > 10% just over 20% of the time.

Over the past several years, when interest rates were low, the acronym of TINA (there is no alternative) became very popular as some investors shunned fixed income due to their paltry levels of income and return. However, with yields where they are now, the new acronym is TARA (there are real alternatives). **Going forward, the outlook for fixed income is brighter to start 2023 vs. when we started 2022. For one, starting yields are the highest they have been in years. Plus, with inflation fading, it's expected that the Fed has completed the majority of their interest rate hikes.** Even if rate hikes continue as they are expected to do, there is at least more coupon income to offset the corresponding price depreciation that would come with rising rates.

Municipal bond performance was also positive for the quarter across the municipal yield curve. However, like other fixed income indexes, muni returns were in the negative for the year as well, though they did outperform their Treasury and Corporate counterparts across the curve.

We continue to view fixed income as a method of reducing overall portfolio risk (as measured by standard deviation), given that equities are expected to have much higher volatility. Our portfolio's focus will continue to be on high quality bonds with an emphasis on short to intermediate duration government and corporate bonds, where default risk has historically been relatively low. The shorter duration nature of our allocations proved to be a significant relative benefit vs. the Agg over the year.