As we near the end of the first quarter, we wanted to take a look back at where we ended 2022 and refresh our outlook for the remainder of 2023.

2022 Fourth Quarter Recap

The fourth quarter capped off a very tumultuous period as all major indices ended firmly in the red for 2022. For stocks, the *S&P 500 Index* was down -18.1% making it the worst performing year since 2008 and putting it in the top five worst years in history. For bonds, the flagship *Bloomberg US Aggregate Bond Index* was down -13.0% marking its worst year on record since its inception in 1971. This massive underperformance was driven by severe macroeconomic headwinds relating to inflation, geo-political risk (Russia/Ukraine) and the subsequent policy response of the Federal Reserve (Fed), i.e., record interest rate increases.

Returns (%) as of 12.31.22 [1]			**Trailing (Annualized)**		
	Dec %	**QTD %**	**1-Yr %**	**3-Yrs %**	**5-Yrs %**
U.S. Equity					
S&P 500 Index	-5.8	7.6	-18.1	7.7	9.4
DJ Industrial Average Index	-4.1	16.0	-6.9	7.3	8.4
Russell 1000 Index	-5.8	7.2	-19.1	7.3	9.1
Russell Mid Cap Index	-5.4	9.2	-17.3	5.9	7.1
Russell 2000 Index	-6.5	6.2	-20.4	3.1	4.1
Non-U.S. Equity					
MSCI EAFE Index	0.1	17.3	-14.5	0.9	1.5
MSCI Emerging Markets Index	-1.4	9.7	-20.1	-2.7	-1.4
Fixed Income					
Bloomberg US Agg. Bond Index	-0.5	1.9	-13.0	-2.7	0.0
Bloomberg US Int. Corporate Index	-0.1	2.5	-9.1	-1.2	1.1
ICE BofA US High Yield Corp Index	-0.8	4.0	-11.2	-0.2	2.1

[1] Source: Morningstar

Macroeconomic

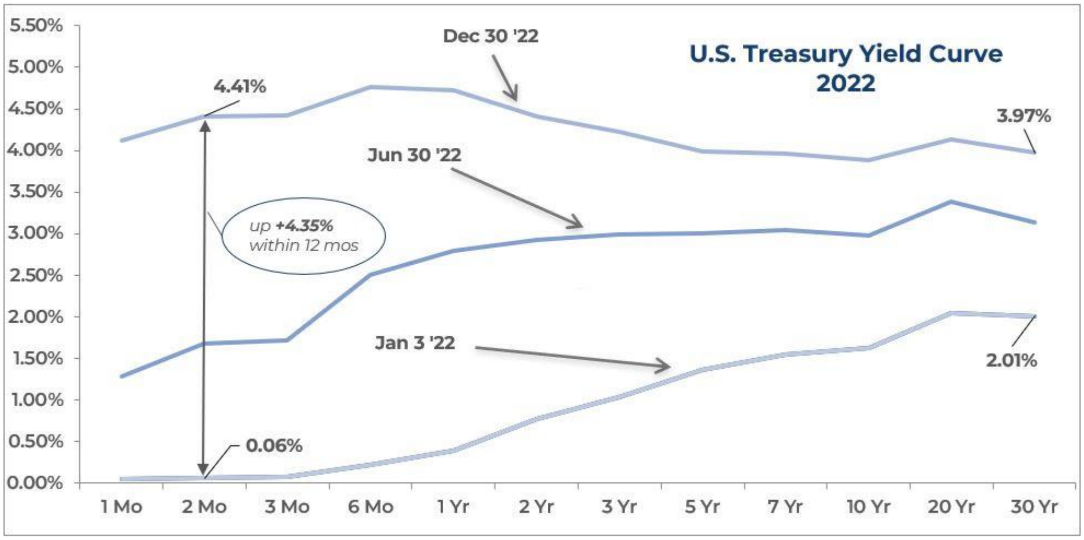
During the year, inflation rose to levels not seen since the 1970s as supply chains labored to make up ground after essentially coming to a halt in 2020. To combat higher prices, the Fed took steps to dampen economic demand by hiking the policy rate, i.e., fed funds rate, at its fastest pace in history. This was a major shock as U.S. corporations and investors had become accustomed to near-zero interest rates since the Global Financial Crisis of 2008.

In addition, the war between Ukraine and Russia continued to complicate the economic picture and hamper efficiency in regional supply chains utilizing crude oil, fertilizer and grains. Any positive advancement in de-escalating the conflict in the region could be seen as a positive by global financial markets.

The Fed raised rates 25 basis points (0.25%) to start 2023 while the rest of the year will likely be plagued with uncertainty around the quantity and magnitude of additional hikes. As of this publication, the futures market appears to be pricing two or three more 25 basis points hikes before the Fed ends its tightening cycle later this year. However, given the data dependency of their policy response, it remains to be seen if they will actually stop hiking which is weighing on investor sentiment.

Further, the yield curve remains inverted suggesting an economic slowdown or even recession later in 2023 or 2024. Market performance is heavily reliant on the Fed and, as they continue to wax and wane in their battle against inflation, volatility will likely remain persistent for most of this year.

We expect domestic growth to continue slowing and bordering on a recession with risks continuing to rise in favor of the latter. This would inherently bring interest rates down as investors flee to the safe haven of bonds and present a possibility of the Fed cutting rates to moderate the severity of any slowdown. In the meantime, any economic slowing could lead to lower commodity prices, a decline in the value of the U.S. dollar, a spike in unemployment, and declining stock market valuations.



Source: U.S. Dept of The Treasury

Equities

The selloff in stocks was driven by two distinct variables: 1) declining long-term economic growth prospects and 2) a higher overall level of interest rates.

As the market began to digest declining inflation trends and an end to interest rate hikes by the Fed, stocks bounced significantly in the fourth quarter. Overall, it was a tale of two periods as the quarter ended well in positive territory while the full year ended deep in negative territory. For example, the *S&P 500 Index* was up +7.6% during the fourth quarter while being down -18.1% for the year.

Full Year
In the U.S., while all market capitalizations and styles were negative on an absolute basis, there were clear winners and losers on a relative basis. Growth was by far the worst performer with the Information Technology sector (down -28.1%) being the largest detractor as it was hit the hardest by higher interest rates.

Large Cap Growth was the worst performer followed by Mid Cap Growth and Small Cap Growth. Value handily outperformed its Growth counterparts with Large Cap Value leading both Mid Cap Value and Small Cap Value.

International equities fared slightly better with non-U.S. developed markets outperforming non-U.S. emerging markets with similar style dispersion to its U.S. counterparts with non-U.S. value outperforming non-U.S. growth by almost 4x.

Returns (%) as of 12.31.22[1]			Trailing (Annualized)		
	Dec %	QTD %	1-Yr %	3-Yrs %	5-Yrs %
U.S. Large Cap Equity					
Russell 1000 Growth Index	-7.7	2.2	-29.1	7.8	11.0
Russell 1000 Value Index	-4.0	12.4	-7.5	6.0	6.7
U.S. Mid Cap Equity					
Russell Mid Cap Growth Index	-6.0	6.9	-26.7	3.9	7.6
Russell Mid Cap Value Index	-5.1	10.5	-12.0	5.8	5.7
U.S. Small Cap Equity					
Russell 2000 Growth Index	-6.4	4.1	-26.4	0.6	3.5
Russell 2000 Value Index	-6.6	8.4	-14.5	4.7	4.1
International & Emerging Market Equity					
MSCI EAFE Index	0.1	17.3	-14.5	0.9	1.5
MSCI EAFE Growth Index	-1.1	15.0	-22.9	0.5	2.5
MSCI EAFE Value Index	1.3	19.6	-5.6	0.6	0.2
MSCI Emerging Markets Index	-1.4	9.7	-20.1	-2.7	-1.4
MSCI ACWI ex. U.S. Small Cap	0.2	13.3	-20.0	1.1	0.7

[1] Source: Morningstar (all ex. blended)

Bonds

2022 was arguably the worst year for bonds since the Great Depression and by far the worst year for the *Bloomberg US Aggregate Index* (down -13.0%) since its inception in the early 1970s. Other sectors performed similarly with lower quality, junk bonds, also known as high yield, being down -11.2% while the worst performer was non-U.S. emerging market debt ending down -17.8%.

The mounting global macro headwinds forced major central banks to pivot to a much more hawkish monetary policy stance suddenly and sharply. For instance, the Fed had to dramatically shift course and continually adjust its rate-hike expectations higher throughout the year. After starting the year only anticipating the need to raise the fed funds rate by 75 basis points in 2022, it ended up raising rates by a total of 425 basis points, which culminated in the fastest pace of rate hikes in a single year since the 1980s.

The lack of diversification in the market—as the traditional diversifying correlation of stocks/bonds broke down in 2022—presented an additional challenge for investors. Historically, asset allocations, i.e., 60% stocks/ 40% bonds, have leaned on the diversification benefits of bonds to reduce volatility in portfolios. This has served as a more effective approach than simply cutting positions or going to all cash.

However, portfolio diversification requires negatively correlated assets to be used together in a portfolio. Correlation refers to the movement of one asset price to another either up or down or in opposite directions, e.g., if a stock's price goes down then a corresponding bond's price should go up. For example, US Treasury bonds historically have exhibited a negative correlation to risk assets in most market environments. However, during most of 2022, almost all assets were positively correlated and sold off at the same time. In short, there was no safe place to hide. This does not happen often but when it does it is very painful as shown by the dismal performance during the year.

Outlook & Positioning

As goods and service input costs continue to rise from inflation along with higher financing costs for working capital and long-term debt, corporations must adjust by raising prices, slowing down production, laying off workers, and cutting operating costs. On the other side of the coin, as consumers feel the pinch of higher prices and higher mortgage and credit card interest rates, they decrease spending thus further exacerbating the effects of the headwinds. This perfect storm of cutbacks from both corporations and consumers bleeds into all corners of the economy leading to a slowdown in growth.

Based on economic data coming from large cap companies, inflation woes will likely persist as retailers continue to see higher than normal production and delivery costs of goods. The stickiness of these higher costs is likely the reason for the Fed's bullish approach to interest rates so far this year.

The labor market is still boasting more job openings than workers creating a silver lining of increased wages for those working and those seeking jobs. However, the labor demands for qualified workers in some industries could possibly prolong the high costs of goods and services well into 2024.

We continue to focus on our long-term strategy and take advantage of short-term opportunities where possible. In stock allocations, we remain focused on higher quality and value with an underweight to growth and technology. In bond allocations, we are taking advantage of the higher yield levels not seen in decades while focusing on higher quality and longer maturity/duration bonds.

We believe easing inflation and lower interest rates will support longer-duration investments such as growth equities, government and corporate bonds, and other risk assets. However, we are anticipating a bumpy road until lower inflation is realized and we are remaining defensive for the time being.

Looking Ahead

We are optimistic about 2023 and will provide updates as new economic and corporate data makes it way into the news cycle. We appreciate your continued support and partnership. In the meantime, stay disciplined- stay invested.

If you have any questions or want to discuss further, please reach out at info@eamoncap.com

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