Dave Hutchison, CERTIFIED FINANCIAL PLANNER™

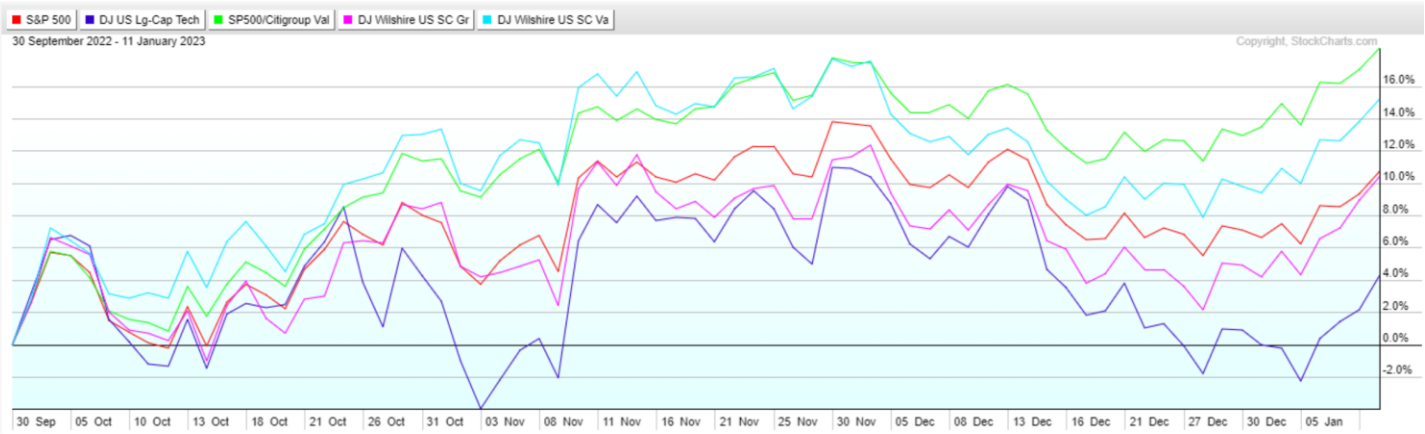
1720 E Calle Santa Cruz
Phoenix Arizona 85022

HUTCHISON INVESTMENT ADVISORS
Registered Investment Advisor
Founded on a CPA Firm Background
(602) 955-7500

E-mail:dave@hutchisonria.com
website: www.hutchisonria.com
Fax (602) 955-1458

January 2023 Update:
Earnings, Higher Interest Rates, Sticky Wage Inflation & "The Bostic Bombshell"

Index Chart since 9/30/2022 as of 1/11/2023. See the comparative table below



As of 1/11/2023 Index	Since 9/30/2022	2022 Return
S&P500	10.7%	-19.6%
DJ US Technology	4.2%	-35.1%
SP500 Large Value	18.4%	-7.4%
DJ Sm-Cap Growth	10.4%	-25.9%
DJ Sm-CAP Value	15.2%	-15.5%

Earnings the Key to Stock Performance

Overall corporate earnings forecasts for 4th quarter 2022 vs. a year ago: Overall earnings were down 2.2%. However, tech stocks are expected to be down 9% as wage costs balloon, demand slows, and semiconductors remain in a downturn. Barron's 1/9/2023 quoting IBES data. Growth companies (including tech) discount future earnings growth to present value, which makes their equity valuations vulnerable to higher interest rates vs. more steady earnings and historically lower relative valuations for the overall value sector. All 4th quarter actual earnings will not be reported for a few months.

While earnings growth rates are expected to decline in 2023, they are still reasonably high - at least for now. There is debate about whether the current 2023 earnings growth estimates are fully adjusted for the "higher-for-longer" Fed interest rate policy.

On the positive side, some believe earnings reductions are already priced into the market and may not be as bad as some fear in 2023, especially with many companies' massive job cuts and reductions in capital expenses planned for 2023. Inflation can actually benefit revenue growth and earnings if profit margins can be maintained. At least for the first half of 2023, value stocks continue to have the best potential outlook.

Are S&P 500 Stocks Poised To Bounce Big In 2023? - Bottom line from Benzinga summary 1/4/2023: Uncertainty concerning the Fed rate trajectory and the economic and inflation outlook that weighed down on the equity market for much of 2022 has not been resolved. Morgan Stanley analyst Andrew Slimmon, however, sounded upbeat: "The economy is proving too resilient, causing the 'looming

collapse' in earnings to remain elusive." This, along with continuing improvements on the inflation front, could lead to a strong first-quarter performance, Slimmon added.

Credit Suisse, meanwhile, sees 2023 as a tale of two halves. As the market's focus remains on the "higher rates for longer" theme, equity market performance is expected to remain muted, the firm said. Against this backdrop, the firm expects sectors and regions with stable earnings, low leverage, and pricing power to fare better. (More typical of the value sector). "Once we get closer to a pivot by central banks away from tight monetary policy, we would rotate toward interest-rate sensitive sectors with a growth tilt," Morgan Stanley said.

Though inflation has shown a let-up, it must demonstrate a sustainable downtrend for the Fed to relent, given its obsession with bringing down inflation. The market outlook remains highly uncertain, with many variables involved in turning things around. The only certain positive catalyst is the depressed present valuation of stocks following their dismal performance in 2022.

Benzinga's poll of fourteen major investment firms shows 2023 estimates of S&P500 returns range from a negative 11.5% to a positive 23.7%.

Further, the US economy continues to be one of the stronger of major countries, many of which have even higher inflation than the US. Much of Europe has massive energy price increases as well as food shortages and cost increases in Africa etc., due to the Ukraine War and either massive flooding or droughts due to the warming climate. Russia and Ukraine are big exporters of gas, oil, coal, fertilizers, wheat, corn, and seed oil. Brookings Institute "Inflation could wreak vengeance on the world's poor."

Higher For Longer Interest Rates

The aggressive rate hikes by central banks globally to battle historic high inflation pushed interest rates up and both bond and equity markets into a tailspin. As we enter 2023, inflation has likely peaked. The Fed is nearing the end of its most aggressive tightening path, and the rate hike conversation has shifted from "how fast" to "how much higher for how long?" The US Fed rate is now at 4.75% - up from a range of zero to 0.25% in March 2022. On 1/9/2023, San Francisco Fed President Mary Daly said she expects the Fed to boost interest rates above 5% to get inflation down to the 2% target year-over-year.

"The Bostic Bombshell" 1/9/2023 CNBC

The latest ISM data shows that the services sector is contracting, and the 5-month annualized inflation is at about 2.5%. Raphael Bostic, President of the Atlanta Federal Reserve, said the Fed is willing to go too far if that is what it takes to take inflation down on a 12-month basis. After those comments, solid broad market gains reversed quickly on 1/9/2023. The market seems out of step with the statements of the Fed with the bond market pricing in a cut in rates in 2023, while the Fed says current intentions are no rate cuts until at least 2024. The critical concern for the Fed is not current lower inflation, but it fears inflation could reaccelerate without higher rates, which is why they are willing to overshoot. The Fed is willing to risk a shallow recession to avoid raising rates much higher in the future, which could plunge the economy into a much deeper recession.

Based on current conditions, Bostic told CNBC's Steve Liesman that the Fed projects no rate cuts through 2024 but will consider slower 0.25% increases based on ongoing CPI data.

Yet as CNBC pointed out, the current so-called "Fed dot plot" still has a 1% rate reduction projected for 2024 and GDP accelerating. There is disagreement in the Fed's forecasts since future inflation/employment data is impossible to forecast accurately.

Barron's comments on 1/9/2023: "After its failed "transitory" inflation forecast two years ago, the nation's central bank must close its credibility gap. For now, its dual mandate (high employment, low inflation) makes its course unequivocal. Inflation is far above its 2% target, while the jobless rate is at a historic low and below the Fed's estimate of full employment. Still, the markets remain skeptical that [Fed chairman] Jerome Powell & Co. will keep tightening."

- **Continued next page** -

Sticky Inflation - Wages

While many inflation readings have declined, the most "sticky" inflation factor seems to be wages and the current unexpectedly high jobs growth. While there have been massive layoffs in many larger companies, especially technology, these have been largely offset by gains in service providers, especially in the leisure and hospitality industry. ADP Report 1/5/2023

Higher minimum wages in some states will contribute to wage inflation. Wages for employees who remained in the same job climbed 5.5% in November from the previous year, according to new data released 1/2/2023 from the Federal Reserve Bank of Atlanta. That marks the highest increase since the bank began tracking wage data 25 years ago. Meanwhile, workers who switched jobs saw even bigger gains of 7.7%, according to the Atlanta Fed. The Labor Department reported there are roughly 1.7 posted jobs for every unemployed worker. Part of the significant labor shortage is due to early retirements and the loss of needed immigrant labor. The headline from the Wall Street Journal 1/2/2023: "Stay for Pay? Companies Offer Big Raises to Retain Workers. Recent record-high wage gains for workers who remain in their jobs contribute to inflation."

"The wave of layoffs in tech that continue to mount has felt like a shocking and sharp turnabout for an industry that stood on top of the world just a year ago. Tech's reputation for driving economic growth has always been founded on its ability to deliver productivity gains. Tech has always followed a boom-bust rhythm. But the most recent boom ran so long that many forgot it would have to end someday. Yes, but: This is not the dot-com bust, especially for the biggest companies. While the job cuts are significant, large tech companies are still vital to the economy and still making lots of money. The layoff numbers suggest retrenchment rather than collapse." Axios 1/9/2023

Marketwatch 1/9/2023 quotes Ricardo Reis, an economist at the London School of Economics: "The key going forward is the path of wages. Workers need to increase their wages because their paychecks have not kept up with inflation. So, the Fed will have to gauge if the rise in wages is too much, just right, or too little. If wages do not rise much, inflation can quickly return to the Fed's 2% target. If wages rise in line with productivity, the Fed will not have to raise too much, and inflation will come down to 2% in a few years. If wages spike, this would probably cause companies to continue raising prices, kicking off a wage-price spiral. There is a scenario where rates go up 'much more,' But there is a range — it could be 'much much more' or 'much more' or 'just more.' Reis said he was sympathetic to the idea that raising the unemployment rate to 5.5% was not a terrible outcome if it means a return to low inflation."

Budget Cuts Proposed by the New Republican House Could Slow Inflation and the Economy

The defense sector may face significant cuts. Rep. Jim Jordan, an incoming Republican, seeks to drastically cut spending, saying "everything is on the table," including the military and $45 billion in aid to Ukraine and NATO allies. This cut would reverse the support passed by the past Congress in 2022 to fight the War in Ukraine.

At the same time, Yevgeny Prigozhin, the boss of the Russian mercenary army Wagner, is positioning himself as a rival to the Russian regular army. He assured that Russia will be victorious. "Once we conquer our internal bureaucracy and corruption, we will conquer the Ukrainians and NATO, and then the whole world. The problem now is that the bureaucrats and those engaging in corruption won't listen to us now because, for New Year's, they are all drinking champagne." CNN 1/10/2023

Prigozhin runs many diverse businesses out of his Concord Catering group in St. Petersburg, AFP reports. One is the Internet Research Agency, the notorious St. Petersburg internet "troll farm" that conducted a massive online operation to interfere with the US elections to help then-presidential candidate Donald Trump in 2016. Prigozhin and several others in the operation were indicted in the US in 2018. Just last month, he boasted of the operation: "We interfered, we are interfering, and we will interfere," he said. Kyiv Post | December 23, 2022,

The Wall Street Journal reports that many conservatives want to block the increase in the nation's debt ceiling that will have to be made to avoid default this summer without accompanying spending cuts. If the US defaults on its debt, interest rates could surge.

- Continued next page -

Summary

The market is forward-looking, typically with valuations based on expected earnings looking forward 6-12 months or more. What impact higher-for-longer rates will have on economic growth and corporate profits is the key. And, of course, this is the big unknown. I continue to recommend a balanced portfolio for those with a moderate growth/moderate risk long-term outlook that includes both our specific value, growth, and "participate yet protect" investment recommendions.

Market Recommendations

Annuity rates have been so low I have not recommended any for a few years. However, with their current higher rates, they may now make sense for the most conservative part of a portfolio.

I continue to recommend from previous pdf reports on hutchisonria.com:

Reasons to Stay Invested in Volatile Times https://dhutch.news/StayInvested2022

Include Value and Growth in Portfolios: https://dhutch.news/ValvevsGrowth2022

A Strengthening Case for Small Cap Stocks: https://dhutch.news/SmallStockCase