

Trumbower Financial Advisors, LLC

4th Quarter 2022

Investment Market Commentary

Volatility Reigns Supreme

Equity markets staged a broad rally during Q4 following 3 harrowing quarters of protracted declines. US equity benchmarks recouped 6.2% (Small Cap) to 10.8% (Mid Cap). Foreign equities jumped 17% (Developed) and 9.7% (Emerging) in Q4.

Despite the last-minute fanfare, stocks finished 2022 solidly in the red. The S&P 500 dropped -18.1%. Mid and Small Cap US equities fell -13.1% and -20.4%, respectively. It was the worst yearly falloff for US equities since the Great Financial Crisis of 2008. Developed and Emerging International equities lost -16.8% and -20.1%.

Catapulting higher by 22.8% and 65.7%, Energy stocks took first place in both Q4 and 2022. Value style sectors like Consumer Staples, Industrials and Financials lorded over their Growth comrades throughout the year ending in a 20% spread.

Consumer Discretionary and Communication Services stocks were left out of the Q4 rally. 2022 dealt punishing blows to these Growth style sectors that finished the year down -37% and -39.9%. Technology rich NASDAQ Composite plunged -32.5%. Ousted royals in the NYSE FANG+ Index shed -40%.

A supposed bastion of safety, the 1-5 Year US Treasury Index dropped

-5.3%. The Bloomberg US Aggregate Bond Idx set a blistering record loss of -13%. 2022 hosted the worst bond sell off in history closing the correlation gap between equities and fixed income. Rapidly advancing short-term interest rates crowned Cash king.

The 2-year US Treasury yield vaulted higher by 407 bps, peaking at 4.8% in November before finishing the year at 4.43%. The 10-year Treasury jumped 237 bps and ended 2022 at 3.88%. The yield curve inverted in April and the spread compressed to -0.84% in early December, the deepest upending since 1981. Investors seem to think inflation may be running its course

Selected Benchmark and Category Average Returns

Large Cap Equity

	(Total Return)	
Benchmark Indx & Category Average*	4 th Q 2022	12 Mos.
S&P 500 Growth	1.45	-29.4
Large Cap Gr Avg	2.98	-31.1
S&P 500 Value	13.59	-5.22
Large Cap Val Avg	12.77	-5.48
S&P 500 Index	7.56	-18.1
Large Cap Blnd Avg	8.5	-17.0

Mid Cap Equity

	(Total Return)	
Benchmark Indx & Category Average*	4 th Q 2022	12 Mos.
S&P MC 400 Growth	8.75	-18.96
Mid Cap Gr Avg	5.29	-28.06
S&P MC 400 Value	12.75	-6.93
Mid Cap Val Avg	12.27	-7.26
S & P 400 Index	10.78	-13.06
Mid Cap Blnd Avg	9.11	-15.88

Small Cap Equity

	(Total Return)	
Benchmark Indx & Category Average*	4 th Q 2022	12 Mos.
Russell 2000 Growth	4.13	-26.36
Small Cap Gr Avg	3.69	-29.57
Russell 2000 Value	8.42	-14.48
Small Cap Val Avg	11.35	-10.44
Russell 2000	6.23	-20.44
Small Cap Blnd Avg	9.18	-16.46

International Equity

	(Total Return)	
Benchmark Indx & Category Average*	4 th Q 2022	12 Mos.
MSCI EAFE	17.00	-16.79
Intl Equity Avg	16.98	-17.59

* **Category average** calculated using Morningstar Direct. Fund universe screened to include funds that meet the following criteria:

- M-Star Category consistent with designated asset class and management style.
- M-Star Style Box consistent with designated management style.
- Fund's Objective consistent with asset class.
- Excludes Index Funds.

We have not independently verified Morningstar data.

4th Quarter Equity Market Results

	4 th Qtr. % Chg.	12-mo. % Chg.
S&P 500	7.56	-18.11
S&P 400	10.78	-13.06
Nasdaq	-0.79	-32.54
Russ 2000	6.23	-20.44
MSCI EAFE	17.00	-16.79
MSCI Emg	9.70	-20.09
Mkt		

evidenced by diminishing longer-term rates. It remains to be seen if they can call it right.

The US Dollar Index raged ahead 20% into September before an abrupt fall from grace to end 2022 ahead of the others by just 8%. Despite its retrenchment, the USD still trades near a 20-year high in nominal terms. Casualties of its ascent include the euro's break through parity in July, the pound's touch down to historical lows during September and the yen - clobbered to a 30-year low.

Inflation crested at a 40-year high of 9.1% in June, spawned by a perfect storm of ultra-stimulative fiscal and monetary policies, COVID-induced supply chain disruptions and pent-up demand, China's locked down economy and food/energy price pressures caused by Russia's invasion. There have been a handful of well publicized mega rifts but employment and wage gains remained robust. The Fed has yet to move the unemployment needle above its 3.5% 50-year low. There are signs that persistence may "pay off" in the form of slower growth, weakened earnings, job losses and resulting constraints on consumer spending – apparently the unavoidable cost of inflation control. Is the cure worse than the disease?

Spurred by accusations of tardiness, the Fed launched into the most aggressive tightening mode in 40 years. The Fed Funds rate shot up from virtually nothing to 4.25% during 2022 and now stands at its highest level in 15 years. Chair Powell insists the central bank isn't close to slaying inflation. Granted some prices have softened recently, but wages and rents have yet to capitulate, the former capable of sparking the infamous wage/price spiral and the latter, ironically, a direct by-product of the Fed's impact on mortgage rates. The median expectation among FOMC members is a range of 5% to 5.25% by year-end 2023. If so, the velocity of hikes must slow down.

Is recession in the cards? Traditional signals send mixed messages. The inverted yield curve has yet to crimp credit growth; M2 money supply remains well above pre-pandemic levels; even after 2022 devalued financial assets and home prices, consumer net worth still tops pre-Covid readings, according to *Evercore ISI*. While rosy data points could foretell a less severe recession, they could also encourage the Fed to overtighten the screws.

80 other central banks have joined the fight with tighter monetary policies. The ECB raised rates 2.5% and President Lagarde says they have more ground to cover and will continue the quest. The Bank of England boosted rates 3.25% but expressed concerns that the Brits may already be in the throes of a recession. One thing is sure, the days of negative yields on sovereign bonds are finally over.

The year of the tiger hasn't been a good one for China, and they are leaping into a year of the Rabbit filled with obstacles. Trading partners have been forced to look elsewhere chipping away at export growth. Speculative building has saturated the real estate market for the time being. The private sector isn't likely to ramp up investment in a slowing global growth environment, and years of credit-financed activity has banks churning unproductive loan portfolios. President Xi claims GDP grew at 4.4%, but outsiders estimate the rate is closer to 3% and tough structural reforms are needed to get the juice flowing in 2023.

The poster child for volatility is cryptocurrency, although, to be fair, it wasn't the coins or technology that broke FTX's back. A regulatory vacuum fostered fraud that eclipsed Enron in scale. FTX, an offshore-based exchange, siphoned billions from customers into a private company engaged in speculative, illegal and unethical endeavors. FTX's own crypto currency was used as collateral for loans and it all came crashing down when customers demanded their cash. Bankruptcy trustees are stymied by the absence of basic internal controls and paper trails. While the FTX experience won't shut crypto down, it highlights the need for regulation and enforcement when it comes to virtual money.

So, what can we expect? The consensus among economists is a mild US recession. There have been 13 recessions since WWII. The unemployment rate rose 3.6% on average which, from the current low would take it to 7.1%. The last time it hit that level was in 2013 when the S&P 500 rose 32%. While a repeat is unrealistic, some positive volatility would be welcome. In the meantime, we are taking advantage of changes in interest rates to reestablish short-term ladder portfolio allocations to meet liquidity needs the next time volatility reigns supreme.