IM&R Economic and Market Review Q4 2022

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WEALTH ARCHITECTS

Economic Review

How high and for how long? The Federal Reserve raised interest rates at a blistering pace in 2022, with the Federal funds rate climbing from zero to 4.25%-4.50%. The Fed remains committed to choking inflation by hiking further, with another increase anticipated at the upcoming February meeting.

The Bureau of Labor Statistics December Consumer Price Index (CPI) release showed headline inflation has fallen from its recent peak to 7.1%. Among index components, energy soared 13.1% and food jumped 10.6% over the past year. Core CPI, (ex food and energy) rose 6.0% over the same period.

After declines in the first two quarters, real gross domestic product (GDP), a key indicator of economic activity, increased at an annual rate of 3.2% in the third quarter according to the Bureau of Economic Analysis. The Atlanta Fed GDPNow model estimate for the fourth quarter GDP is 3.7% as of December 31.

The Conference Board Leading Economic Index (LEI) fell sharply in November, continuing the slide it's been on for most of 2022 after peaking in February**.** Labor market, manufacturing and housing indicators all weakened, reflecting serious headwinds to economic growth. Despite the current resilience of the labor market and consumer confidence improving in December, the U.S. LEI suggests the Fed's monetary tightening cycle is curtailing aspects of economic activity, especially housing. As a result, The Conference Board projects a U.S. recession is likely to start around the beginning of 2023 and last through mid-year.

Pending home sales recorded the second-lowest monthly reading in 20 years as interest rates, which climbed at one of the fastest paces on record this year, drastically cut into the number of contract signings to buy a home, according to the National Association of Realtors. Falling home sales and construction have hurt broader economic activity.

Consumer confidence bounced back in December, due to consumers' more favorable view regarding the economy and jobs. Inflation expectations retreated in December to their lowest level since September 2021, with recent declines in gas prices a major impetus. Vacation intentions improved but plans to purchase homes and big-ticket appliances cooled further. This shift in consumers' preference from big-ticket items to services should continue in 2023.

Financial Markets Review: Domestic Stock Market

While the fourth quarter gave some relief, the S&P 500 experienced its worst performance since 2008, falling 19.44% (ex dividends) for the year to 3,839.50. For the quarter the S&P 500 gained 7.08%. The Dow Jones Industrial average (DJIA) returned 15.39% for the quarter and -8.78% for the year to 33,147.25, and the NASDAQ fell -1.03% for the quarter and -32.40% for the year to 10,466.48.

Among the 30 DJIA companies, Boeing rocketed 57.33% in the fourth quarter, followed by Caterpillar vaulting 46.73%, and Nike jumping 41.18%. The worst performers were The Walt Disney Company losing -7.90%, Sales Force dropping -7.82% and Apple down -5.82%.

Among the 11 S&P 500 sectors, energy continued to outperform in the fourth quarter, up 22.81%. Industrials advanced 19.22%, and materials gained 15.05%. Trailing sectors included consumer discretionary falling -10.18%, communication services slipping -1.38% and real estate advancing 3.82%.

Of the 24 industry groups, consumer durables and apparel gained the most for the quarter rising 28.03%, followed by capital goods up 23.77% and energy ahead 22.81%. Laggards included automobiles and components crashing -44.54%, retailing sinking -6.99% and media sliding -3.26%.

Value stocks outperformed growth stocks in the fourth quarter. The Russell large cap value index returned 12.42% compared to 2.20% for large cap growth.

According to FactSet, the estimated earnings growth rate for 2022 is 5.1%, which is below the trailing 10-year average earnings growth rate of 8.5% (2012-2021). Most of the year-over-year earnings growth for CY 2022 occurred in the first half of 2022. For Q1 and Q2, the S&P 500 reported earnings growth of 9.4% and 5.8%. However, the index reported earnings growth of 2.5% for Q3 and is projected to report an earnings decline of -2.8% for Q4. For 2023, analysts are projecting earnings to advance 5.3%.

As the new year begins, the headwinds that faced the market in 2022 are still blowing. The Federal Reserve continues to increase interest rates to fight inflation, recession worries are on the rise across the globe and an ongoing war in Ukraine continues to bring instability to Europe and the rest of the world. But the headwinds could turn to tailwinds if the consumer stays resilient, employment remains robust, the Fed orchestrates a "soft landing" and China successfully reopens from three years of COVID lock down. Currently, we remain cautious and expect more volatility as we navigate through a challenging year ahead.

	Total Returns* (12/31/22)			Annualized Returns (12/31/22)		
Category/Style	**4th Quarter**	**Year-to-Date**	**One Year**	**Three Years**	**Five Years**	**Ten Years**
S&P 500	7.56	-18.11	-18.11	7.66	9.42	12.56
S&P Midcap 400	10.78	-13.06	-13.06	7.23	6.71	10.78
S&P Small Cap 600	9.19	-16.10	-16.10	5.80	5.88	10.82
Russell 1000 Large Cap Growth	2.20	-29.14	-29.14	7.79	10.96	14.10
Russell 1000 Large Cap Value	12.42	-7.54	-7.54	5.96	6.67	10.29
Russell 2000 Small Cap Growth	4.13	-26.36	-26.36	0.65	3.51	9.20
Russell 2000 Small Cap Value	8.42	-14.48	-14.48	4.70	4.13	8.48

Source: Standard and Poor's, Frank Russell Company * returns include reinvested dividends

International Stock Markets

December saw the downturn in the global manufacturing sector continue. Although the rate of decline in production eased slightly, the level of new business fell at a sharper pace. The four-largest industrial economies – mainland China, the U.S., the euro area and Japan – all saw output and new work contract. Against this backdrop, the MSCI EAFE Index of developed markets still soared 17.34% in the fourth quarter to shrink the loss for the year to -14.45%. The MSCI Emerging Markets Index returned 9.40% (-20.09% YTD), while the MSCI Frontier Markets Index slid -0.83% (-26.34% YTD).

In the Eurozone the Ukraine Russia war remains the key threat to stability in the region. Manufacturing prospects have brightened amid signs of healing supply chains and a marked softening of inflationary pressures, as well as a calming of concerns over the region's energy crisis, thanks in part to government assistance. Major European markets climbed significantly in the quarter with the Stoxx Europe 600 Index jumping 9.55% to 424.89. In local currencies, Germany's DAX Index leapt 14.93% to 13,923.59, France's CAC-40 was up 12.34% to 6,473.76, and the United Kingdom's London FTSE 100 advanced 8.09% to 7,451.74.

In Asia-Pacific markets, Japanese manufacturing firms continued to struggle in the face of subdued demand conditions and severe inflationary pressures with the latest flash PMI reading the lowest since October 2020. In local currency, Japan's Nikkei stock index edged up 0.06% to 26,094.50.

In emerging markets, China ended its COVID lockdown and the China Shanghai Composite Index gained 2.14% for the quarter to 3,089.26. The Indian manufacturing industry remains resilient amid a deteriorating outlook for the global economy. The S&P BSE Sensex Index rose 5.94% in the quarter to 60,840.74.

The WSJ Dollar Index dollar retreated 7.11% in the fourth quarter to 96.56. For the year the index gained 7.82%. The dollar fell 9.40 % against the yen in the quarter to $131.12 (JPY/USD) and was 9.19% lower vs. the euro at $1.0703 (USD/EUR).

World Bond Markets

It was a horrific year for bonds as Central banks restrictive monetary policies plunged the markets to their worst year ever. In the U.S., the 3-month/2-yr. treasury spread and 2-yr./10-yr. spread have inverted significantly. These have historically been reliable precursors of pending recessions. The U.S. 10-year treasury yield closed the fourth quarter at 3.83%, the 2-year stood at 4.37% and the 3-month T-bill was 4.42%.

The Bloomberg U.S. Aggregate Bond Index gained 1.87% for the quarter but plunged -13.01% for the year. Likewise, the Bloomberg Municipal Index rose 4.10% for the quarter (-8.53%YTD) and the Barclays U.S. Treasury TIPS Index was higher by 2.04% (-11.85%YTD). Money market yields marched higher to end the year at 4.05%, according to the Crane 100 Money Fund Index.

According to Value Line, yields on 10-year government bonds ended the year at 3.64% in the United Kingdom, compared to 4.50% in the previous quarter and 0.97% one year ago. Canada bonds yielded 3.18% and German bonds were 2.51%. Japanese bond yields climbed to 0.46% after the Bank of Japan surprised the markets and relaxed yield controls.

Commodities

Commodities moved higher in the fourth quarter, rising 4.43% to close at 1,048.69 according to the DJ Commodity index. Oil prices were flat quarter over quarter, gaining 0.97% to $80.26/barrel. The national average price of gas dropped $0.57/gallon to $3.22 according to AAA, a decline of 15.14%. And gold climbed $156.30 for the quarter to $1,819.70/troy oz., an advance of 9.46%.

Mutual Funds/Exchange-Traded Funds

Assets of all exchange-traded funds rose in November by $448.06 billion, or 7.1% to $6.75 trillion according to the Investment Company Institute. Over the past 12 months, ETF assets decreased $145.19 billion, or 2.1%.

Mutual funds increased by $958.09 billion, or 4.4% to $22.83 trillion. Long-term funds (equity, hybrid, and bond funds) had a net outflow of $108.32 billion in November, vs. an outflow of $124.20 billion in October.

MUTUAL FUNDS OVERVIEW AS OF DECEMBER 31, 2022

	Total Returns		Annualized Returns			
Category	**4th Quarter**	**Year-to-Date**	**One Year**	**Three Years**	**Five Years**	**Ten Years**
Municipal Bond Interim-Term	3.37	-8.20	-8.20	-0.83	0.96	1.60
Short-Term Taxable Bond	1.21	-5.23	-5.23	-0.41	0.91	1.05
Interm-Term Taxable Bond	1.57	-13.23	-13.23	-2.71	-0.14	0.89
Long-Term Taxable Bond	3.46	-24.44	-24.44	-5.30	-0.72	2.02
High Yield Bond	3.89	-10.09	-10.09	-0.22	1.73	3.19
Global Bond	5.39	-13.84	-13.84	-4.03	-1.84	-0.93
Small-Cap Blend	9.10	-16.24	-16.24	5.14	4.84	9.08
Mid-Cap Blend	9.62	-13.98	-13.98	6.15	6.28	9.81
Large-Cap Blend	8.33	-16.95	-16.95	6.87	8.26	11.31
Global Stock Large Blend	10.61	-16.71	-16.71	4.06	4.90	7.87
Foreign Large Blend	16.05	-15.79	-15.79	0.55	1.14	4.25
Natural Resources	13.05	-2.82	-2.82	13.58	6.61	5.20
Real Estate	3.91	-25.70	-25.70	-0.92	2.92	5.80

Source: Morningstar Category Returns, Morningstar, Inc.

Important Definitions and Disclosures

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The information shown does not constitute investment advice and does not consider the investment objectives, risk tolerance or financial circumstances of any specific investor. The information provided is not intended to be a complete analysis of every material fact with respect to any portfolio, security, or strategy and has been presented for educational purposes only. Data obtained from the sources cited is believed to be reliable and accurate at the time of compilation. Nothing contained herein should be construed as a recommendation to buy or sell any individual securities. It should not be assumed that an investment in any of the securities identified was or will be profitable.

The Bureau of Economic Analysis (BEA) of the United States Department of Commerce is a U.S. government agency that provides official macroeconomic and industry statistics, most notably reports about the gross domestic product (GDP) of the United States and its various units such as states, cities, towns, townships, and villages. **Gross Domestic Product** (GDP) is a measure of output from U.S factories and related consumption in the United States. It does not include products made by U.S. companies in foreign markets. **Real Gross Domestic Product** (real GDP) is a macroeconomic measure of the value of economic output adjusted for price changes (i.e., inflation or deflation). The **Atlanta Fed GDPNow** estimate is a model-based projection not subject to judgmental adjustments. It is not an official forecast of the Atlanta Fed, its president, the Federal Reserve System, or the Federal Open Market Committee. **Consumer Price Index (CPI)** measures prices of a fixed basket of goods bought by a typical consumer, widely used as a cost-of-living benchmark, and uses January 1982 as the base year. **Purchasing Managers' Index™ (PMI™)** is a survey-based economic indicator designed to provide a timely insight into business conditions. **The Conference Board Leading Economic Index® (LEI)** for the U.S. are the key elements in an analytic system designed to signal peaks and troughs in the business cycle. The leading, coincident, and lagging economic indexes are essentially composite averages of several individual leading, coincident, or lagging indicators. They are constructed to summarize and reveal common turning point patterns in economic data in a clearer and more convincing manner than any individual component – primarily because they smooth out some of the volatility of individual components. **Personal Consumption Expenditures** (PCE) is a measure of price changes in consumer goods and services and consist of the actual and imputed expenditures of households; the measure includes data pertaining to durables, non-durables and services. The **ISM Manufacturing Index** is based on surveys of more than 300 manufacturing firms by the Institute for Supply Management (ISM). The ISM Manufacturing Index monitors employment, production, inventories, new orders and supplier deliveries. A composite diffusion index monitors conditions in national manufacturing and is based on the data from these surveys. The **Federal Reserve System** (also known as the Federal Reserve, and informally as the Fed) is the central banking system of the United States. The Federal Reserve System is composed of 12 regional Reserve banks which supervise state member banks. The Federal Reserve System controls the Federal Funds Rate (aka Fed Rate), an important benchmark in financial markets used to influence the supply of money in the U.S. economy. The **Federal Open Market Committee** (FOMC), a committee within the Federal Reserve System is charged under United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of United States Treasury securities). The **unemployment rate** percentage of total workforce who are unemployed and are looking for a paid job. Unemployment rate is one of the most closely watched statistics because a rising rate is seen as a sign of weakening economy that may call for cut in interest rate. A falling rate, similarly, indicates a growing economy, which is usually accompanied by higher inflation rate and may call for increase in interest rates. Labor force participation rate is the percentage of working age population that is part of the labor force. It is a measure of what proportion of a country's population is employed or actively looking for employment. The index of leading economic indicators is intended to predict future economic activity. Typically, three consecutive monthly LEI changes in the same direction suggest a turning point in the economy. **Inflation** is the rise in the prices of goods and services, as happens when spending increases relative to the supply of goods on the market. Moderate inflation is a common result of economic growth. Hyperinflation, with prices rising at 100% a year or more, causes people to lose confidence in the currency and put their assets in hard assets like real estate or gold, which usually retain their value in inflationary times. **Treasury Yield Curve** is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. **The Michigan Consumer Sentiment Index** was created in the 1940s is conducted by the Survey Research Center and consists of at least 500 telephone interviews posed to a different cross-section of consumers in the continental U.S. each month. The survey questions consumers on their views of their own personal finances, as well as the short-term and long-term state of the U.S. economy. The **International Monetary Fund (IMF)** is an international organization that was initiated in 1944 at the Bretton Woods Conference and formally created in 1945 by 29-member countries. Each survey contains approximately 50 core questions, and each respondent is contacted again for another survey six months after completing the first one. The answers to these questions form the basis of the index. An **exchange-traded fund (ETF)** is a security that tracks an index, a commodity or a basket of assets like an index fund, but trades like a stock on an exchange. Indexes are unmanaged and investors cannot invest directly in an index.

Morningstar Category Returns are composed of the average return for the funds in each Morningstar category over the indicated time period. Categories are defined by Morningstar based on holdings statistics. The category returns are adjusted for survivorship bias, meaning they include all investments even if liquidated, merged or otherwise now obsolete. The returns also include funds that were in a given Morningstar category, but have since changed to another category.

Benchmark Definitions

The **S&P 500 Index** is an index of 500 of the largest exchange-traded stocks in the U.S. from a broad range of industries whose collective performance mirrors the overall stock market. The **Dow Jones Industrial Average** is a widely watched index of 30 American stocks thought to represent the pulse of the American economy and markets. The **NASDAQ** is an index that tracks the cumulative results on a market capitalization basis of all stocks trading in the NASDAQ system. An investment concentrated in sectors and industries may involve greater risk and volatility than a more diversified investment. **Russell Large Cap Growth Index** measures the performance of those Russell 1000 Index securities with higher price-to-book ratios and higher forecasted growth values, representative of US securities exhibiting growth characteristics. **Russell Large Cap Value Index** measures the performance of those Russell 1000 Index securities with lower price-to-book ratios and lower forecasted growth values, representative of US securities exhibiting value characteristics. **MSCI EAFE Index** is a market capitalization-weighted index of the leading stocks in Europe, Australasia and Far East. Membership of the index is selected by MSCI and designed for leading stocks roughly to match market sector weights. The **MSCI Emerging Markets Index** is an index created by Morgan Stanley Capital International (MSCI) that is designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index that consists of indices in 21 emerging economies: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. The **MSCI Frontier Markets Index** provides broad representation of the equity opportunity set while taking investability requirements into consideration within each market. MSCI classifies 34 countries as Frontier Markets, 26 of which are included in the MSCI Frontier Markets Index. The **STOXX Europe 600 Index** is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. The **CAC 40 Index** is a benchmark French stock market index. The index represents a capitalization-weighted measure of the 40 most significant values among the 100 highest market caps on the Paris Bourse (now Euronext Paris). The **DAX Index** is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The **FTSE 100** is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. The **Nikkei Index** is a stock market index for the Tokyo Stock Exchange (TSE). The **Shanghai Composite Index** is a stock market index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. **S&P BSE Sensex index**, is the benchmark index of the Bombay Stock Exchange (BSE). It is composed of 30 of the largest and most actively-traded stocks on the BSE, providing an accurate gauge of India's economy. **Bloomberg Aggregate Bond Index** is made up of the Lehman Brothers Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Based Securities Index, including securities that are of investment grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $100 million. The **Bloomberg Municipal Bond Index** is a market value weighted index of investment grade municipal bonds with maturities of one year or more. The **Barclays Capital U.S. Government Inflation-Linked Bond Index** (U.S. TIPS) measures the performance of the TIPS market. TIPS form the largest component of the Barclays Capital Global Inflation-Linked Bond Index. Inflation-linked indices include only capital indexed bonds with a remaining maturity of one year or more. Treasury notes (T-notes) are intermediate securities with maturities of 1 to 10 years. Denominations range from $1000 to $1 million or more. The notes are sold by cash subscriptions, in exchange for outstanding or maturing government issues, or at auction. The **10-year Treasury** Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market. The **Crane 100 Money Fund Index** measures the average yield of the 100 largest taxable money market funds. **Barclays Capital Global Aggregate ex-U.S. Index** measures the performance of the global bond market, excluding U.S. securities. **The Dow Jones Commodity Index**℠ is a broadly diversified index that allows investors to track commodity futures through a single, simple measure. The index is designed to minimize concentration in any one commodity or sector. Due to market fluctuation, the commodities represented by this index may experience loss of invested principal and are subject to investment risk. The **Wall Street Journal Dollar Index (WSJ Dollar Index)** is an index of the value of the U.S. dollar relative to 16 foreign currencies. The index is weighted using data provided by the Bank for International Settlements on total foreign exchange trading volume. The index rises when the U.S. dollar gains value against the other currencies, and falls when the U.S. dollar loses value against the currencies.