January 10, 2023

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Market Stats & Commentary

Market Vital Signs as of 12/31/2022

Stock Indexes	December	YTD	1 Year
S&P 500	-5.76%	-18.11%	-18.11%
Dow Jones Industrial Average	-4.09%	-6.86%	-6.86%
NASDAQ Composite	-8.73%	-33.10%	-33.10%
Russell Mid Cap Index	-5.40%	-17.32%	-17.32%
Russell 2000 Small Cap Index	-6.49%	-20.44%	-20.44%
MSCI EAFE Developed Int'l Index	0.08%	-14.45%	-14.45%
MSCI Emerging Markets Index	-1.41%	-20.09%	-20.09%
Bond Indexes			
BBgBarc US Aggregate Bond Index	-0.45%	-13.01%	-13.01%
BBgBarc US Corp High Yield Bond Index	-0.61%	-11.15%	-11.15%
Interest Rates	**12/31/22**	**12/31/21**	**12/31/2021**
Fed Funds Target Range	4.25 - 4.50%	0.00%	0.00%
10 Yr U.S. Treasury Rate	3.87%	1.51%	1.51%

Data courtesy of Raymond James

December was a tough ending to a tough year. Equity markets across the board were quite negative with the notable exception of the developed international index, which I find interesting. The developed international index is heavily weighted toward Europe which has been dealing with energy shortages, Ukrainian refugees, and inflation that is higher than that of the U.S. And yet it finished the year a few percent less bad than the S&P 500. Granted, it was the disparity in December performance that got the MSCI EAFE above the S&P 500 for the year, but it still ended that way and that seems pretty remarkable to me. Do I think the MSCI EAFE does better than the S&P 500 in 2023? As of January 10th it is. I don't think that is sustainable though, given the issues the continent is dealing with. It will also be interesting to see how emerging markets perform. They are off to a very quick start so far in 2023, fueled by China suddenly abandoning its zero COVID policy. Unfortunately, the tone and outcomes of the Communist Party convention a couple months ago still keeps me quite cautious on China for the foreseeable future. I do, however, see real opportunity for the rest of the EM countries from the diversifying of manufacturing away from China and prospect of a weaker dollar over the course of the year.

As for interest rates, the Barclays Aggregate Bond Index had its worst year on record. The historic size of interest rate raises along with the pace of those rate hikes did far more damage to the bond market than anyone would have guessed this time last year. There was an expectation of a mildly negative year – but nothing like what actually occurred. This time last year my view was – you tell me what the 10 yr U.S. Treasury yield does and I will tell you what the stock market does. Well, the Treasury yield went up more than expected so stocks went down more than expected. In 2022 it was pretty much that simple.

2023 Outlook

Now that 2022 is officially in the books it is time to look forward. The labor market is still expected to be tight, with the Fed currently projecting the unemployment rate to average 4.6% in 2023. This is higher than the current 3.7%, but given the extraordinary interest rate hikes we have experienced, it is still a low level. The Fed is also currently forecasting GDP for 2023 to be at +.5%, indicating some sort of mild and relatively short recession during the year. Remember though, the stock market is typically about 6 months ahead of the economy. So, before investors get too worried about what a recession might mean for stocks in the coming 12 months they need to remember that the market has likely already digested much of that possibility.

Interest Rate Outlook

The Fed Funds futures market is currently pricing in a .25% rate hike in February and a .25% hike in March. After March, the futures market probabilities currently reflect the view that the Fed stops raising rates in March, with some possibility of a rate cut at the September meeting. A rate cut is not the current odds on favorite (currently the probabilities are still weighted to no change) for the September meeting, but it has been gaining a little momentum recently.

Assuming the futures market is at least in the ball park on rate forecasts, mortgage rates should stay in the 6% range, with a very real possibility to be lower than that in the second half of the year. This would be supportive to the housing sector and to the economy in general.

Equity Market Outlook

The RJ Portfolio and Technical Strategy team recently published its 2023 outlook for the U.S. equity market and as usual there is a base case scenario, blue sky scenario, and gray sky scenario – along with probabilities assigned to each.

80% probability that a recession (either mild or more long-lasting will transpire in 2023

			Probability Weighted	
	S&P 500 Year End 2023 Price Target	Probability	Year End 2023 Price Target	2023 S&P 500 Return*
Upside	4,935	20%		
Base	4,300	70%	**4364.5**	**12.9%**
Downside	3,675	10%		

*2023 S&P 500 Return based off our 2022 probability weighted 2022 price target of 3865

Source: RJ Equity Portfolio & Technical Strategy

As you can see, there is a 70% probability assigned to their base case scenario, which seems like a fairly high degree of confidence to me. If the S&P 500 does in fact end up somewhere in the 4,300 range, I think most investors will be more than happy - particularly given how 2022 went. But the probability that the S&P 500 ends 2023 at exactly 4,300 is roughly akin to the probability of winning Powerball, so I think it is more important to focus on the range of possibilities and the probabilities of those outcomes rather than a single point.

The S&P closed 2022 at 3839.50, so the team's base case scenario would yield a gain of +12% for 2023. The gray sky scenario would yield a loss of just over -4%. Their blue sky scenario would yield a gain of a little over +28%. Given that the probabilities assigned to each outcome are heavily skewed to the upside, this strikes me as a pretty favorable distribution curve.

Yes, there are definitely still economic and political uncertainties out there. *However,* history is on our side. There have only been two periods of back to back annual losses for the S&P 500 since WWII – 1973 & 1974 and 2000 to 2002. Positive does not necessarily mean stable though. Even if markets are solidly positive this year I still see volatility being higher than normal until there is real clarity on interest rates.

David