INVESTMENT STRATEGY UPDATE

MARKET REPORT
JANUARY 2023

ASCENTIAL WEALTH ADVISORS

MARKETS BROADLY LOWER FOR 2022

December 2022 closed out the worst year for portfolios since the Global Financial Crisis in 2008. Despite a rally for stocks in the fourth quarter, all major market indices were in the red for the year. The Nasdaq lost the greatest percentage, down -33.10%. Additionally, it was the worst year on record for bonds, which fell sharply in response to rising interest rates, offering investors no relief. The combination resulted in even diversified portfolios experiencing double-digit losses. It is uncommon for stocks and bonds to fall in unison, but both came under pressure from worries over the potential negative impact that inflation and rising interest rates might have on the global economy. These concerns appear likely to continue influencing markets into 2023.

There has been some softening in economic data going into year end, and while inflation seems to be cooling, it remains well above the level considered acceptable. In addition, several factors that have been driving inflation are still in play.

Energy prices have fallen substantially from their highs, but the war in Ukraine persists, creating the potential for further price spikes, particularly in Europe. China's primary problem has shifted from restrictive zero-Covid policies to new waves of infection, which may continue to impact their economy and global supply chains. The strong US labor market has been a double-edged sword, thus far preventing the economy from entering recession but simultaneously fueling inflation by exerting continued upward pressure on wages and supporting high consumer demand.

Global central banks raised interest rates multiple times in 2022 to fight inflation at the risk of tipping economies into recession. The US Federal Reserve raised rates seven times throughout the year and is expected to increase rates further in 2023 and hold rates at higher levels until inflation subsides. Areas of the economy that are most interest rate sensitive are suffering.

Index	*2022 (through 12/31)*
S&P 500	-18.11
DJIA	-6.9
MSCI EAFE	-14.45
BC US Aggr. Bond	-13.01
Dow Jones Relative Risk Benchmarks	
Conservative	-13.33
Moderate	-14.97
Aggressive	-16.96

For example, housing has slowed considerably as rates on mortgages have essentially doubled. It will take time to assess the broader economic impact of higher rates, but most economists are now predicting a recession in 2023, with few still hoping for a "soft landing." We anticipate continued volatility for the near term, therefore, a slightly more defensive posture feels appropriate at this time.

OUR VIEW

FIXED INCOME:
Bonds experienced their worst year in history with double-digit losses. After a decade of ultra-low interest rates, the US Federal Reserve increased the Fed Funds rate by 4.25% in 2022. Markets are expecting additional modest rate increases in 2023 before the Fed pauses to assess the ramifications of higher rates. As disappointing as bond performance has been, yields are now fairly attractive and bonds looks poised to offer better returns and ballast to portfolios going forward, particularly if the interest rate environment stabilizes or a recession takes hold. There is an outside risk that rates will need to move higher than currently anticipated or stay high longer, and we feel shorter-duration, high credit quality bonds offer a good risk return profile given current yields around 4%. Fixed income alternatives have performed better than bonds in the rising rate environment, but as we near the end of the hiking cycle we are in favor of reducing them in exchange for more traditional, short duration fixed income.

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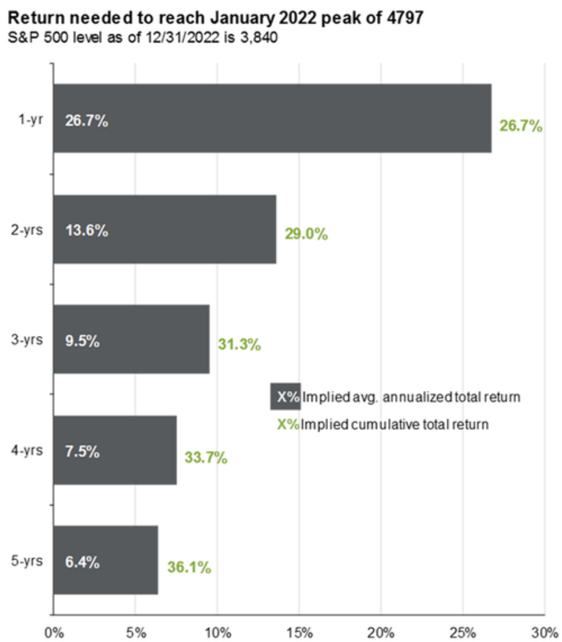
US EQUITY:

US stocks fell into bear market territory on the prospects of a slowing economy. Equity valuations should be taken with a grain of salt given a murky outlook for corporate earnings. Earnings declined modestly in 2022, but many companies are now revising their guidance for 2023 downward. With several economic indicators flashing recessionary signals and more rate increases to come, stocks may have more downside in the short run. Given this, we are currently in favor of a slightly more defensive stance within equities and like large, quality US companies with a slight bias for value-oriented businesses. Small and mid-sized companies may be more vulnerable to the risks associated with higher wages and input costs and could struggle more in a weakening economy. Overall, we feel the US is positioned better than most of the world to weather a global recession and recommend overweighting US versus international.

INTERNATIONAL EQUITY:

Inflation and rising interest rates also proved problematic for foreign stocks, causing declines in line with US markets. In addition, foreign markets face ongoing challenges and uncertainties including those stemming from the war in Ukraine and China exiting its zero Covid strategy. As of the end of 2022, Europe had largely avoided a major energy catastrophe, prompting stocks to rally from earlier lows. Emerging markets cheered the change in China's Covid policy, however optimism faded quickly as it became obvious that the road will remain bumpy. The global economy is slowing and recession risk is growing. While foreign equities likely carry opportunities in the long run, the near-term risks appear potentially greater, and we feel less optimistic about their prospects for now. As a result, we are recommending another reduction in foreign stock allocation, along with a bias for quality.



Source: J.P. Morgan, Guide to Markets, Dec 31, 2022

Better Days Ahead....

No one knows when markets or the economy will bottom, however, historically markets have bottomed before the economy does. **"On average historically, the S&P 500 has bottomed two to six months prior to recession end, while earnings bottom eight to nine months after recession end."** *(Raymond James Investment Strategy Quarterly, Jan 2023).*

Regardless of how close we are to the end, there is already attractive long-term return potential in markets at current levels. This chart shows the annualized returns, over various time periods, the S&P 500 would generate to return to its previous high. We don't know when to expect a turnaround, however patient investors should be rewarded.

> *"The stock market is a device to transfer money from the impatient to the patient."*
> *-Warren Buffett*

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