QUARTERLY MARKET COMMENTARY: 2022-Q4

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U.S. equity markets closed out 2022 at the lower end of our Dow Jones Industrial Average (DJIA) target range of 33,000 to 34,500 resulting in a return of -7% for the tumultuous year. Given the 2022 close and the expectation of revisiting 2022 highs in the latter part of 2023, our current projected 2023 total return for the DJIA is 10%+. We must realize this upside potential is a recovery from current levels, while noting that existing fundamental projection trends remain slightly negative to flat with continuing uncertainty. We will get a better indication soon once 2022 earnings are closed out and we can preview 2023 to 2024 projections.

While we believe a DJIA support level of 33,000 has been comfortably established based on existing fundamentals, how the economy unfolds in 2023 will provide a better idea as to its upside potential. The recently reported December Consumer Price Index figure of 6.5%, was in line with estimates and continues to support our perspective of limited downside risk, barring any surprises. As we continue to observe additional favorable data with relatively softer inflation readings, we are content with the possibility of a pause in rate increases sometime during 2023. While the street may be looking for a downturn in interest rates, we believe holding rates steady is an important start in forming a convincing turnaround in market sentiment.

Our outlook for this year continues to favor dividend paying “value” stocks. Should equity markets trade within a narrow range, dividends often associated with value stocks can positively contribute to a greater portion of total return. In addition to dividends, we believe upside potential based on fundamentals remains attractive within these types of equities. On the flipside, we saw significant price declines last year for “growth” stocks, which brought down some stratospheric valuations to reasonable levels relative to earnings. Even though current prices for growth stocks are comfortably grounded, upside potential may be elusive due to lack of improving fundamentals and positive market sentiment in the existing economic environment.

As we determine recovery expectations within client portfolios based on formulated strategies, we know that a rebound in bond prices is necessary for any measurable success. We believe that holding the Fed Fund rate steady should provide a psychological spark for the beginning of a sustainable bond market rally. We believe this rally would occur in two phases. The first phase would be driven by sentiment when rates appear to have peaked, and the second phase would ensue should rates actually come down. We do not expect interest rates to drop back to historical lows, and therefore a full recovery in bond prices relative to all-time highs is not anticipated. This shortfall can be partially covered over time by the benefit of reinvesting dividends & interest at higher yields.

As we evaluate the impact that inflation has on consumers and the economy, a couple of thoughts come to mind. First, the consumer’s ability to change their demand habits for certain goods and services due to higher prices will help negate the full brunt of higher prices. Also, job destruction is not a requirement to bring down inflation. We hope to cover these topics and others at our next Round Table Discussion event to be scheduled for this spring at a location to be determined. If you are interested in attending this event or wish to discuss your financial plan & portfolio in greater detail, please do not hesitate to reach out to your advisor.

This report was written by David Y. Sun, CFA. It is a recap of the market conditions from the previous quarter and is for information purposes only