

February 13, 2023

Market Monitor

Fourth Quarter 2022



Market Commentary

- The fourth quarter was a welcome respite from the downdraft of 2022. Additional data that supported the moderating inflation mantra, a softening Federal Reserve (Fed) and the unwind of COVID-Zero policies in China led many asset prices higher.
- A notable bright spot came from across the Atlantic as developed international markets posted a 17.34%¹ rally in the final quarter of the year. The combination of a weakening U.S. dollar, diminishing concerns of an energy crisis fueled by the hopes of a warmer winter and a new U.K. Prime Minister helped Europe lead the way.

Market Commentary continued

- Even further east, China's abrupt unwind of COVID-Zero policies was welcome news for investors. Prices rallied materially through November and December as speculation rose that pent-up demand in China could produce similar "revenge" spending seen from other countries after exiting lockdowns.
- Over the quarter the Fed continued to raise rates, but at a slower pace. A 0.5% move in December was a downshift from the 0.75% moves made previously. The "Fed pause" narrative coupled with additional data on moderating inflation gave investors confidence to buy longer duration segments of fixed income markets that outperformed for the quarter. These narratives also helped add to the U.S. dollar decline over the fourth quarter.
- In spite of good news in the final quarter of the year, 2022 was a difficult year for markets. For the first time in market history the S&P 500 and Bloomberg Aggregate Bond Index fell in the same calendar year¹. This has led many investors asking what may be in store for 2023. Our Annual Outlook outlines key factors that may move the market this year.

Fixed Income

- The Bloomberg Aggregate closed 2022 down -13%¹, the worst calendar year on record. A combination of extraordinarily low interest rates to start the year and the Fed raising rates at a pace not seen since the 1970's created a downdraft few fixed income indexes could escape.
- An oversimplified, but accurate narrative of 2022 is the year of interest rate risk. A decline of -27.09% for the Bloomberg US Gov/Credit Long Index (aka, more interest rate risk) serves as one bookend while the decline of -3.69% of the Bloomberg US Gov/Credit 1-3 Year Index (aka, less interest rate risk) serves as the other. This overwhelming factor describes much of the success or lack thereof for indexes and active managers alike for the year.
- While the pain was material and acute, it does come with a silver lining. Long-term fixed income returns are predominantly influenced by yields. As interest rates increased in 2022 they pushed prices down. However, as prices fall, yields rise. Just as the price decline of fixed income in 2022 was unprecedented, so was the increase in yields. That leaves investors with a materially better outlook for fixed income returns today than we have seen in a number of years.

Equity

- Over the quarter many broad equity indexes posted positive returns as confirming data supported a moderating inflation narrative. The key inference from lower inflation is the opportunity for the Fed to pause or slow rate hikes. Higher interest rates have been a key determinant to price movement in the fourth quarter and for 2022 overall. Ten of eleven U.S. sectors posted positive returns over the quarter with energy stocks capping off 2022 with a commanding lead, up 22.8% in the fourth quarter alone. Consumer discretionary was the laggard down -10.2% as Amazon and Telsa falling -20% and -50% respectively weighed on the sector¹.
- In spite of an active ground war in Europe for the first time since World War II, much of the EU was at the top of the leaderboard. The MSCI EAFE was up 17.3%¹ and notably Germany, Italy, France, Netherlands, and Belgium all returned 20%² or more in the final quarter of the year. A combination of a weaker U.S. dollar and a relief rally on prospects for a warmer winter with moderate energy prices helped rally investors.
- Emerging market allocations also outperformed with the MSCI Emerging Markets Index up 9.7%¹ for the quarter. China, the largest country in the emerging markets index, rallied on the sharp unwind of COVID restrictions. Millions of Chinese citizens have been under restrictive measures hampering domestic spending and industrial output as one of the world's largest exporters. Investors are hopeful that the pent-up spending patterns seen in other countries following lockdowns will spur economic activity in the country.

Real Assets

- Commodities capped the fourth quarter with a positive return (up 2.2%¹) and remain the standout winner for the year. While energy pulled back over the quarter after moderating from the post-Russia invasion highs seen earlier in the year, industrial and precious metals held the index's positive return. Gold bounced back in the fourth quarter after a disappointing year. Many gold enthusiasts tout its inflation protecting principles which were not on display in 2022.
- Higher interest rates have had a profound impact on the real estate sector over the course of 2022. In particular, higher mortgage rates have sapped up retail investor demand and put home prices under pressure. Additionally, real estate continues to reinvent itself with office properties below pre-COVID occupied levels. However, higher levels of inflation mean construction and replacement costs are going up for real estate making current supply more valuable. The combination of a moderating Fed and lower supply helped bid up REITs in December offering some relief after a difficult 2022.



Jordan L. Kahn, CFA
Chief Investment Officer

¹ Fiducient Advisors Quarterly Considerations December 31, 2022

² Fiducient Advisors Market Insights December 31, 2022

*This report is intended for the exclusive use of clients or prospective clients of HCR Wealth Advisors. The information contained herein is intended for the recipient, is confidential and may not be disseminated or distributed to any other person without the prior approval of HCR Wealth Advisors. Any dissemination or distribution is strictly prohibited. Information has been obtained from a variety of sources believed to be reliable though not independently verified. Any forecasts represent future expectations and actual returns; volatilities and correlations will differ from forecasts. This report does not represent a specific investment recommendation. The opinions and analysis expressed herein are based on HCR Wealth Advisors' research and professional experience, and are expressed as of the date of this report. Please consult with your advisor, attorney and accountant, as appropriate, regarding specific advice. Past performance does not indicate future performance and there is a possibility of a loss.

Comparisons to any indices referenced herein are for illustrative purposes only and are not meant to imply that actual returns or volatility will be similar to the indices. Indices cannot be invested in directly. Unmanaged index returns assume reinvestment of any and all distributions and do not reflect our fees or expenses.