FEBRUARY 2023

MARKET UPDATE

Despite missing the Santa Claus rally last year, markets had a significant bounce in January with the S&P 500 gaining 6.28% and developed and emerging market equities gaining 8.10% and 7.90%, respectively. The gains happened across the month and were helped by a better-than-expected fourth quarter GDP report and hopes that the probabilities of the Fed pulling of a "soft landing" may be a bit higher than previously thought. The fourth quarter's earnings seasons is kicking off and will be in focus as investors assess how well companies are able to operate in this environment and if there are any tea leaves to be gleaned from their results.

Bonds also faired well on the back of a yield curve that slightly shifted downward, pushing up bond prices. The Bloomberg US Aggregate gained 3.08% in January in a welcome move, though bonds still have a ways to go before making up from last years drawdown. December's inflation report, which was released in mid-January showed that prices declined by 0.1% on a monthly basis and yearly price increases slowed to 6.5%. December's report marks the third consecutive month of both year-over-year headline and core prices slowing.

On the economic front, the US economy grew at a 2.9% rate during the fourth quarter, which surpassed many economists' expectations. In a survey of economists conducted by Bloomberg, the median forecast for GDP growth during the fourth quarter was 2.6%. While the report showed that growth in consumer demand slowed a bit in the fourth quarter, rising 2.1% vs. 2.3% in the third quarter, disposable income, even after adjusting for inflation, rose 3.3%, which was a notable acceleration compared to the 1.0% rise in the third quarter.

ADVISORS' PERSPECTIVE

Equities markets started the year off strong, with the Russell 2000 outperforming its peers, by rising 9.75% in January. However, focus remains on the Fed, the pace of rate hikes, and how long their hawkish stance will need to continue as they navigate inflation and a potential recession. During February's FOMC meeting, the Fed raised its benchmark interest rate by another 25 basis points. Many market participants believe the Fed is nearing the end of it rate hikes and may even reduce rates in the coming months to help heal the economy and move rates to their desired long-run levels. If inflation continues to fall and jobs data remains positive, we could see a sustained, lower volatility period fueled by improving economic data and lower rates.

Whether or not a recession was going to happen was a big topic in 2022. The first and second quarter GDP declined, however, the key components the National Bureau of Economic Research (NBER) evaluates show more resiliency. The US economy grew at a 2.9% annualized pace in the fourth quarter. While the economy slowed from the third quarter's 3.2%, it beat economists' expectations, which were for a 2.6% growth rate. Under the hood, consumer demand rose 2.1% though that was less than expected as the momentum behind the consumer weakened.

The NBER evaluates several components when assessing for a recession, such as nonfarm payrolls, employment survey, real personal income, and others. Employment continues to be the bright spot in high-level economic data, though the trend of a slow cooling continues. The employment survey popped in December, though this data tends to be noisier than nonfarm

payrolls. Both retail sales and industrial production have had two consecutive months of notable down months. Real personal income has been resilient in the face of rising prices and economic cooling, with six months of consecutive gains.

A positive trend in inflation data has continued with both yearly headline and core prices slowing to 6.5% and 5.7% respectively. However, monthly core prices rose 0.3%, up from a 0.2% monthly increase in November, on the back of price increases among services. Those gains were partially offset by monthly goods disinflation, which continued for the third month in a row. Headline inflation has slowed each month since July, and core inflation has slowed each month since October.

While positive movements in equity markets reduced equity implied volatility, credit spreads remain elevated, indicating potential risk in corporate balance sheets. Markets continue to try to digest mixed economic news with persistent inflation, as well as trying to anticipate what the Fed may do for the rest of the year, which can lead to sudden shifts in anticipated market risks.