Cambridge ADVISORS inc.
INVESTMENT MANAGERS

INVESTMENT PERSPECTIVE | DECEMBER 2022

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## MARKET COMMENTARY

Stocks moved higher in the quarter but it wasn't a smooth run and stocks finished the year down from their highs for the quarter. Large cap stocks in the S&P 500 rose 7.56% during the quarter but lost -18.11% for the year. Small cap stocks in the Russell 2000 Index were up 6.23% in the quarter and were down -20.44% for 2022. International stocks in developed markets performed much better and were up 11.11% for the quarter bringing their calendar year loss to -16.67%. Emerging market stocks were up 9.79% for the quarter and down -19.74% for the year. The Barclays U.S. Aggregate Bond Index had its first positive quarter for the year and was up 1.87% bringing its year-to-date return to -13.01%.

Growth stocks struggled in 2022; the communication services, consumer discretionary and technology sectors posted losses of -39.9%, -37.0% and -28.2% for the year. Unfortunately, these sectors have some of the higher weightings in the S&P 500 (about 43% combined). Energy is one of the smallest sectors at 5.2% so its 65.7% gain was amazing but not enough to make a significant impact on the index return. The utilities sector was the only other sector with positive performance at 1.6% but it also has a very small weighting of 3.2% in the S&P 500 Index.

Growth stocks have been under pressure partially due to rising interest rates. Growth stocks are valued based on their future earnings streams more so than their current earnings. When interest rates are higher, the discount rate used to determine the present value of those future earnings is also higher which results in lower present values. Value stocks may outperform again in 2023 as short-term interest rates are projected to continue to climb and pressure growth stocks. However, since value focused sector weightings in the index are lower, the S&P 500 index returns may still struggle.

Corporate earnings estimates have been coming down. Fourth quarter earnings are expected to be down -5.5%; this is the first quarter this cycle that earnings growth will be negative. For the full year, earnings growth is estimated to still be positive at 4.8%. Next year's earnings growth is projected at 2.8% according to Zacks Research.

It appears that the National Bureau of Economic Research (NBER) is not going to declare that the US was in a recession in 2022 even though first and second quarter showed contractions in GDP growth of -1.6% and -0.6% respectively. The labor market remained strong so wages and spending have held up. Many analysts are anticipating a recession to begin in 2023 as the consequences of higher interest rates and fiscal drag from the reversal of the influx to the money supply during the pandemic take effect. These indicators are lagging so are just beginning to be felt in the economy. The coming recession maybe short and shallow - most analysts are not expecting it to be long and drawn out. David Kelly of JPMorgan says we might not even have a recession but believes growth will be very low this year and next.

Inflation has peaked but may not recede as quickly as desired. The Fed is forecasting inflation to fall to 3.1% in 2023. However, Brian Wesbury with First Trust thinks inflation will still be 4% because of a miscalculation in measuring the money supply. Analysts also point to the run-up in home valuations which is reflected in the "owner's equivalent rent" and real rent factors of inflation; this part of inflation is more sticky which could cause inflation to stay higher for longer even as other areas fall.

The Federal Reserve has been fighting higher

### 2023 BENCHMARK RATES OF RETURN

| INDEX | FOURTH QUARTER | YTD |
|---|---|---|
| S&P 500 | 7.56% | -18.11% |
| Russell 2000 | 6.23% | -20.44% |
| International | 14.11% | -16.67% |
| Fixed Income | 1.87% | -13.01% |
| JPMorgan Diversified* | 6.54% | -14.60% |

*25% S&P 500 large cap stocks,10% Russell 2000 small cap stocks, 15% MSCI EAFE international stocks, 5% MSCI EME emerging market stocks, 5% REITs, 25% Barclays US aggregate bonds, and 5% each in short term Treasuries, high yield global bonds, and commodities.

***We value our relationship with you, and we are always available to meet with you in person or by phone. Please do not hesitate to call or email us with any questions that you may have. Also, if your situation has changed, please contact your advisor so we can determine if any changes are needed in your account.***



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inflation by aggressively raising short-term interest rates. A year ago, the Fed was forecasting that they would raise interest rates three times in 2022 by a total of 75 basis points. Instead, they raised rates by a total of 425 basis points and anticipate increases totaling another 75 basis points in 2023. Strategas Research and others have said that the Fed Funds rate needs to be above the inflation rate before rates would have an effect on quelling inflation. The Fed Funds rate is now 4.25% to 4.5% and the Core PCE that the Federal Reserve watches was 4.7% in November so it appears we are close; the Fed's projection for 2023 may be more accurate than it was for 2022 in terms of needed interest rate hikes.

The 10-year Treasury bond yield started the year at 1.5% and ended December at 3.9%. This resulted in double digit negative returns for the Aggregate Bond Index as declines in bond prices greatly outweighed the interest earned on bonds. This was a very abnormal occurrence. In fact, it was the worst year for the aggregate bond index since its creation in 1973. A report by Morningstar in November of 2022 reflected that the prior 12 month period was the worst period for bonds since 1926. Investors are not used to bonds having this much of a negative impact on their portfolios. The traditional 60% stock/40% bond portfolio was down -16%. Even the JPMorgan Diversified Portfolio had a negative return of almost -15%.

Looking forward, even if the Fed raises short-term rates, longer-term yields may not follow—especially if the market believes a recession is coming. An inverted yield curve often is a precursor to a recession in anticipation of the slower growth. Bond returns have been miserable as yields have increased but if the long end of the yield curve is mostly done rising, these higher yields should be more appealing to investors. David Lebovitz of JPMorgan notes that yields are near 10 year highs and fixed income valuations are much more attractive than they have been. Multiple analysts are recommending that investors start buying longer-term bonds again.

Stocks are likely to remain volatile as recession fears, inflation concerns, rising interest rates and the Russia/Ukraine conflict continue. Brian Wesbury and other analysts have targets for the S&P 500 to end 2023 near where it is now. Longer term, though, forecasts for returns are increasing. If it takes 3 years before the S&P 500 reaches a new high again, that is still a 12%+ return per year including dividends. Even if it takes 5 years, that would be an almost 8% annualized return. These forecasts are better than the low single digit returns that had been prevalent at the start of the year. With bond yields higher, a diversified portfolio should also be more beneficial than it has been the past few years.

We continue to add "target outcome" or "buffer" ETFs to portfolios. These ETFs allow investors to take part in stock market appreciation but also provide some protection if stock prices fall. Dividend income is also attractive as value stocks are currently favored over growth stocks.

We continue to encourage investors not to try to time the market or chase returns but to align your investment portfolio with your risk tolerance. We use Riskalyze software to help us measure your risk tolerance and make sure you have the appropriate risk in your accounts. With the market down, we have taken advantage of tax loss harvesting where appropriate in taxable accounts. The realized losses can offset either current year realized gains or they can be carried forward to offset future year realized gains. Securities with losses are sold to realize the tax benefit and then the proceeds are reinvested so that you still have exposure to participate in a recovery. It is also a good time to make Roth IRA contributions or to consider converting traditional IRAs to Roth IRAs. If you have any questions about your account, please do not hesitate to contact your advisor.

### CAMBRIDGE ADVISORS NEWS

In our industry, consolidation is a continuing trend but we believe it is in our best interests and our clients' best interests to remain independent. We believe the way we do things is best in class with the systems we use, the people we have and the services we provide, and we want to continue moving forward and remain in control of our future. We continue to make investments in technology and people to position our company for future growth. Thank you for the trust you place in Cambridge Advisors.

### 2023 Retirement Contribution Limits

| Retirement Plans | 2022 | 2023 |
|---|---|---|
| 401k and 403b Plans | $20,500 | $22,500 |
| Catch up contributions* | $ 6,500 | $ 7,500 |
| **IRAs** | | |
| Traditional or Roth IRA | $ 6,000 | $ 6,500 |
| Catch up contributions* | $ 1,000 | $ 1,000 |
| SIMPLE IRA | $14,000 | $15,500 |
| Catch up contributions* | $ 3,000 | $ 3,500 |

*If you are age 50 or older, you can make additional catch up contributions