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MARKET MINUTE

JANUARY REVIEW 2023

This month's Market Minute reflects the views of our Investment Office and was composed by
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OVERVIEW

2023 has started with a bang as financial markets had a robust start to the year. Although the economic data could send conflicting signals – declining inflation versus a strong jobs market – the mood amongst many investors is that slowing growth and an improving inflation outlook will allow the Federal Reserve to cease its aggressive monetary policy that drove interest rates significantly higher in 2022. Such a positive outlook not only brightened prospects for the market in general, but also enticed investors to the higher risk/greater rewards areas of the financial markets (i.e., small cap stocks and high yield bonds were leaders in their respective asset classes).

There are obstacles that could interfere with such investor confidence – weaker corporate earnings and a hawkish Federal Reserve – but investors appear to want to put the awful results of 2022 behind them and are willing to favorably view the road before them.

U.S. EQUITY MARKETS As of January 31, 2023

U.S. EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	2.9%	2.9%	2.9%	-0.9%
S&P 500	6.3%	6.3%	6.3%	-8.2%
Russell 2000	9.7%	9.7%	9.7%	-3.4%
Russell 1000 Growth	8.3%	8.3%	8.3%	-16.0%
Russell 1000 Value	5.2%	5.2%	5.2%	-0.5%

US equities traded higher in January led by US small caps stocks. The S&P 500 Index rose by +6.3%, while US small caps (Russell 2000 Index) gained +9.7%. Among small cap stocks there was little difference between growth and value-oriented firms—it was a broad-based rally. Among large cap stocks, growth-oriented names (Russell 1000 Growth Index +8.3%) far outgained value-oriented stocks (Russel 1000 Value Index +5.2%). Much of this difference may be attributable to investors re-balancing back into large-cap, growth companies after these stocks significantly lagged last year.

INTERNATIONAL EQUITY As of January 31, 2023

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quater-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	8.1%	8.1%	8.1%	-5.7%
MSCI EAFE	8.1%	8.1%	8.1%	-2.8%
MSCI Emerging Markets	7.9%	7.9%	7.9%	-12.1%
MSCI EAFE Small Cap	7.5%	7.5%	7.5%	-8.9%

International equities continued to perform well in the face of a weakening US dollar and China's pivot towards abandoning its zero-Covid policy. China's move late last year to relax Covid restrictions and provide additional support to the housing and consumer sectors began to lift investor sentiment in the final months of 2022 and it continued to buoy Chinese equities in January. As a result, China (MSCI China Index +11.8%) led most major market equity indices for January, and Chinese equity strength boosted emerging markets (MSCI EM Index +7.9%) overall as well for the month. International developed markets also performed strongly in January, with the MSCI EAFE Index ending January up +8.1%. However, much of this outperformance over US markets was due to the weaker US dollar and in local currency terms gained a similar amount as US equities.

FIXED INCOME As of January 31, 2023

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	3.1%	3.1%	3.1%	-8.4%
BarCap Global Aggregate	3.3%	3.3%	3.3%	-11.7%
BarCap US High Yield	3.8%	3.8%	3.8%	-5.2%
JPM Emerging Market Bond	3.1%	3.1%	3.1%	-11.3%
BarCap Muni	2.9%	2.9%	2.9%	-3.2%

Mainly driven by the sharp decline in interest rates, across the board the bond market delivered strong returns in January. U.S. Treasury 2-year interest rates dropped 23 basis points (4.43% to 4.20%)[1] while longer term 10-year rates declined 37 basis points (3.88% to 3.51%)[1] resulting in a 2.5% (Bloomberg U.S. Treasury Index) monthly gain for Treasury investors. Municipal bond investors tagged along for the ride posting a strong start to the year of 2.9% (Bloomberg Municipal Bond Index). Those willing to take on more risk were rewarded with 3.8% returns via the Bloomberg U.S. Corporate High Yield Index as high yield spreads significantly declined from 469 to 420 basis points.[1] In the short run, such a strong start to the year may prove difficult to maintain, but after two consecutive down years posted by the Bloomberg Aggregate Index, the first time since the index's inception, investors are optimistic a third consecutive year will not prevail.

CONCLUSION & OUTLOOK

As much as we would like to join in the market's enthusiasm, there are serious issues that investors face that could derail the joy ride. A rebound in corporate profit margins in 2023 is unlikely.[2] Reported corporate earnings, so far, have been weak, but only 30% of the S&P firms have reported. Of the firms that have reported through January 27th, 69% have had a positive earnings surprise, below the 5-year (76%) and 10-year (73%) averages[3]. Despite headline announcements of layoff notices in the tech and finance sectors, the job market shows little signs of weakening and average hourly wages are rising over 4% year-over-year. As such, we believe Fed policy will be to continue to raise short-term interest rates over the first half of 2023 and then pause for the remainder of 2023 to ensure inflationary pressures retreat to achieve the Fed's goal of a 2% inflation level.

Historically, financial markets often start to improve before the economic fundamentals portray positive economic growth; but we believe the markets may have risen too much, too early, and we are at risk of experiencing a bear market rally and not the beginning of the next bull market.

SOURCES

1 Bloomberg, LP
2 Factet Earning insight, 1/20/2023
3 https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_012723A.pdf

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