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December 2022 Recap

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PRELUDE

Many years from now, the year 2022 is likely to be remembered as a pivot point for the world economy and financial markets. The supply chain lessons from the pandemic, the Russian/Ukrainian war, forty-year-high inflation and the corresponding monetary policy — these events demarcate the end of the low interest rate era and a beginning of a new financial environment. The sudden onset of such an environment means that it will take time for people, institutions, and the markets to assimilate. For 2023, assimilation may begin with a recession. No one knows how deep or shallow the downturn may turn out to be, although there are many guesses out there. What we do know from the past is that recessions tend to be shorter than the recovery and growth phase of the economic cycle. So while we may be staring at a challenging year ahead, history tells us that we tend to persevere and emerge stronger on the other side.

GLOBAL EQUITY

U.S. equity markets staged a selloff in December, reversing the gains in the prior month. For calendar year 2022, the S&P 500 Index lost 18% while smaller stocks as represented by the Russell 2000 Index posted -21% in total return. Growth underperformed Value for the year in a hard U-turn to prior trends, reflecting the massive repricing of the more speculative areas of the markets. Driving these patterns were wide dispersion in sector returns, where the Energy sector returned an eye-popping +65% for 2022 while

TABLE 1: **Global Equity**

	DEC	QTD	YTD	1 YR
Dow Jones Industrial Average	-4.09	16.01	-6.86	-6.86
S&P 500 Index	-5.76	7.56	-18.11	-18.11
Russell 2000	-6.49	6.20	-20.46	-20.46
Russell 1000 Growth	-7.66	2.20	-29.14	-29.14
Russell 1000 Value	-4.03	12.42	-7.54	-7.54
MSCI ACWI USD	-3.94	9.76	-18.36	-18.36
MSCI EAFE USD	0.08	17.34	-14.45	-14.45
MSCI EM USD	-1.41	9.70	-20.09	-20.09
MSCI ACWI ex US USD	-0.75	14.29	-16.00	-16.00

Source: Bloomberg, as of 12/31/2022. Past performance does not guarantee future returns.

Communication Services returned -40% for the same time frame. At the center of these movements were the European war and the Federal Reserve, with the former introducing a seismic disruption to commodity prices and the latter raising rates at a pace and magnitude not seen in decades. These events reflect a shift in paradigm for the financial markets, and the repercussions have not yet been felt on Main Street to the full extent. At this time, we are expecting a negative year-over-year Q4 earnings growth for the S&P 500 Index, and it is difficult to imagine that the rest of 2023 would exhibit a sudden rebound in earnings growth under the current conditions.

International equity markets outperformed the U.S. markets for December. The developed markets outside the U.S. borders were flat for the month, benefiting from a few factors: the falling value of the U.S. dollar, an unseasonably warm winter in Europe, and a surprise pivot in the Bank of Japan's monetary policy. In particular, Europe is enjoying a spring-like winter that is friendly to the current energy situation, and the governments have subsidized the skyrocketing cost of energy to the tune of 700 billion euros in 2022. While we are thankful to see our friends across the Atlantic avoid a freeze so far, their energy issues remain, and the subsidies in the form of government debt are not a lasting solution. On the emerging market front, Chinese stocks held the MSCI EM Index from falling further than -1.4% for the month. The surprise end of zero-COVID policy meant reopening excitement in China's equity markets. However, without the adoption of western vaccines that have

helped the United States and Europe reopen in the last two years, China is experiencing a COVID outbreak the world has not seen in some time. The expectation that the Chinese reopening would be similar to those experienced in the western countries may be met with the sober reality of confusion, self-quarantining, and further disruption to the Chinese economy in 2023.

FIXED INCOME

TABLE 2: **Fixed Income**	DEC	QTD	YTD	1 YR
Bloomberg US Aggregate	-0.45	1.87	-13.01	-13.01
Bloomberg 1-3 Yr Gov/Credit	0.19	0.89	-3.69	-3.69
Bloomberg Treasury 5-7 Yr	-0.66	1.30	-11.23	-11.23
Bloomberg Investment Grade Corp	-0.44	3.63	-15.76	-15.76
Bloomberg High Yield Corp	-0.62	4.17	-11.19	-11.19
JPMorgan EMBI Global Diversified	0.33	8.11	-17.78	-17.78

Source: Bloomberg, as of 12/31/2022. Past performance does not guarantee future returns.

With a more hawkish tone from the Fed, the U.S. Treasury yield curve shifted upward, continuing a trend that we saw throughout 2022. The 10-year yield started the year at 1.5% and ended at 3.9%, repricing much of the bond market as the Fed ended the zero-rate policy. While rising rates were a major headwind for the bond market, they had a silver lining in improved yield profile of fixed income securities. After a tumultuous year for bonds, the fixed income markets have developed an appeal for investors seeking income. As we start the new year, the unknown is whether or not these yield profiles will change considerably. The answer to that question rests heavily on the Fed's policy in 2023 and how the central bank navigates through the recession.

And the course of action to be taken by the Fed in 2023 is hotly debated. Fed Chairman Powell's December message was "higher for longer" in rate policy, which means more rate hikes throughout the new year. The markets, however, beg to differ. The fed funds futures market is pricing in rate cuts starting in mid-2023, which reflects a view that a recession is nigh and that the Fed would be forced to cut rates by the middle of the year. While we agree that a recession is likely to commence in 2023, there is a possibility that the Fed may not respond to a recession in the same way they have in recent decades. A greater risk may be stagflation, a scenario in which the Fed's usual levers of liquidity become less powerful, and in fact, self-defeating. To avoid stagflation, the Fed may be willing to continue tackling inflation while accepting a recession as collateral damage. The diverging views about rates between the Fed and the markets are a point worth highlighting as we begin the new year, and we will learn of the ultimate rate policy as the months unfold.

POSTLUDE

History tells us that a negative calendar year for the S&P 500 Index is often followed by a positive one. And 2023 may well end up in the green; we should not, however, expect it to be so. And even if the year turns out to be positive, it does not mean that it will not be a volatile ride. The Fed hikes from 2022 have not yet been felt in full force on Main Street because it takes about 6 months to a year for rate policy to work through the economy. And when they do, we may see a challenging environment on corporate earnings that may not yet be priced in. However, financial markets also have an excellent historical record of being decoupled from the fundamentals, which is why it is important to stay diversified and stick to the long-term allocation that is right for your institution and your life. We may be in for a challenging year, but as I indicated in the Prelude, recessions tend to be much shorter than periods of growth, and each time we emerge stronger on the other side. So, Happy New Year to you and yours, and let's face 2023 together with a healthy long-term view on our investing goals and our portfolios.

Anna Rathbun serves as the Chief Investment Officer for CBIZ Investment Advisory Services. Her tenure with the firm has spanned economic and market research, portfolio construction, and creating insights in investment themes to share with the investment community. Anna began her career in investments at Wellington Management, and subsequently, Harvard. She has served as a Managing Director for a registered investment advisory firm where she specialized in alternative investments. She is a graduate of Harvard University with a B.A. in Economics. Her early passion for the arts led her to classical music, for which she obtained a Master of Music and Doctor of Musical Arts from the Cleveland Institute of Music. Anna's career in music spanned a wide spectrum of performances to a faculty position at her alma mater. With a unique background that embraces both finance and the arts, Anna is dedicated to the issue of financial sustainability for organizations serving a mission.