

THE SIA REPORT

2023

2023 – CHANGING LANDSCAPE YET AGAIN



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We said it earlier this year. “Inflation changes everything.” Why? Well, to put it succinctly, the 40-year high in inflation we experienced in 2022 forced a major change in the investment landscape. How? The

Federal Reserve’s congressional mandate is to maintain price stability; so when prices get out of hand (i.e. inflation) they must act. But because they were late to the game in addressing runaway inflation – believe it or not, the Fed was still stimulating the economy with both a Quantitative Easing program as well as maintaining a zero-interest rate policy as late as March – the Fed needed to play catch up. In monetary policy parlance, catching up translated into the fastest rate hiking cycle in forty years; moving rates from 0% to 4% in a mere nine months.

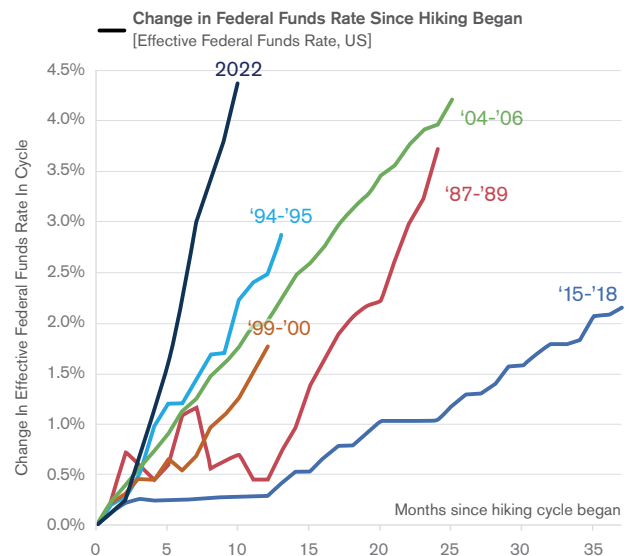
The shrapnel of this monumental change in interest rates resulted in major ‘Pain on Wall Street’ with two hurricane selloffs – one in the bond market and the other in the stock market. Now as we head towards the New Year, higher interest rates are starting to dampen economic growth. While at first higher rates dampened activity in industries dependent on loans (housing, etc.), it now appears that the weakness is spreading to the larger economy. Should investors brace for another hurricane—this time in the U.S. Economy?

Perhaps. But it's not what you think.

Cross Correlation And Lead-Lag Effects

In contrast to the pain on Wall Street this year, a weaker economy next year could be characterized as ‘Pain on Main Street’ in the form of lower home prices and higher

THE FED IS HIKING FURTHER & FASTER THAN ANY TIME IN MODERN HISTORY



Source: Federal Reserve; chart

unemployment. But for investors, this is not necessarily a bad thing.

How can this be true? Just think back to the last prolonged bear market and recession during the Great Financial Crisis. We all remember the major events, but few of us recall their precise sequence:

- 2008 served as the epicenter of ‘Pain on Wall Street’; with the collapse of Bear Stearns, Washington Mutual, Countrywide, Lehman Brothers and most of AIG.
- Stocks cratered, and ultimately bottomed in March of 2009.
- Meanwhile the malls and restaurants (Main Street) were still humming along.

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LIFE AFTER A PANDEMIC



As we reflect back on what can only be described as a tumultuous year, we're reminded of the old saying (often purported to be an ancient curse) *'May you live in interesting times.'* While we began this year still somewhat in the grip of the pandemic (with roughly 700,000 new COVID cases weekly), we end the year with COVID finally in our rearview mirror.

Most of us are now physically back in classrooms or offices (although in many businesses, the 'tethered' employee has forever given way to a much more distributed workforce). With few exceptions, life has pretty much returned to normal. Yet the economic effects of the previous two years will continue to reverberate through the global economy for some time to come.

In fact, as one plague was exiting stage left, another plague (inflation) was entering stage right. Brought on in large part by the Fed's loose monetary policy and multiple injections of financial stimulus during the pandemic – along with

lingering post-pandemic supply chain issues that have been exacerbated by the ongoing conflict in Ukraine – runaway inflation became the year's sole focus of market attention. Soaring volatility and major daily market swings have been commonplace occurrences throughout 2022. Inflation has remained stubbornly persistent, and strong employment continues unabated. Yet despite all these economic headwinds, at the time of this article's writing, the S&P 500® has recovered significantly to be down just -16% year-to-date and nearly three-quarters (72%) of S&P 500 companies reported Q3 earnings that exceeded consensus estimates.¹

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Assuming the Fed's drastic efforts gradually rein-in and tamp down inflation over the coming months, there seems much to be optimistic about as we begin looking towards the year ahead. We look forward to a brighter and hopefully far less turbulent 2023.

¹ FactSet, "S&P 500 Earnings Season Update," October 21, 2022



I believe successful wealth management is the result of an ongoing collaboration between investor and advisor, built upon trust and maintained according to the highest standards of integrity and expertise.

Brian D. Holmes,
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2023 TAX BRACKETS

The tax items for tax year 2023 of greatest interest to most taxpayers include the following dollar amounts:

Married – Filing Jointly

The standard deduction for married couples filing jointly for tax year 2023 rises to \$27,700 up \$1800 from the prior year.

Married – Filing Separately / Single

For single taxpayers and married individuals filing separately, the standard deduction rises to \$13,850 for 2023, up \$900.

Head of Household

For heads of households, the standard deduction will be \$20,800 for tax year 2023, up \$1,400.

Marginal Rates

For tax year 2023, the top tax rate remains 37% for individual single taxpayers with incomes greater than \$578,125 (\$693,750 for married couples filing jointly).

The other rates are:

35% for incomes over \$231,250
(\$462,500 for married couples filing jointly)

32% for incomes over \$182,100
(\$364,200 for married couples filing jointly)

24% for incomes over \$95,375
(\$190,750 for married couples filing jointly)

22% for incomes over \$44,725
(\$89,450 for married couples filing jointly)

12% for incomes over \$11,000
(\$22,000 for married couples filing jointly)

The lowest rate is 10% for incomes of single individuals with incomes of \$11,000 or less
(\$22,000 for married couples filing jointly)

Source: Internal Revenue Service

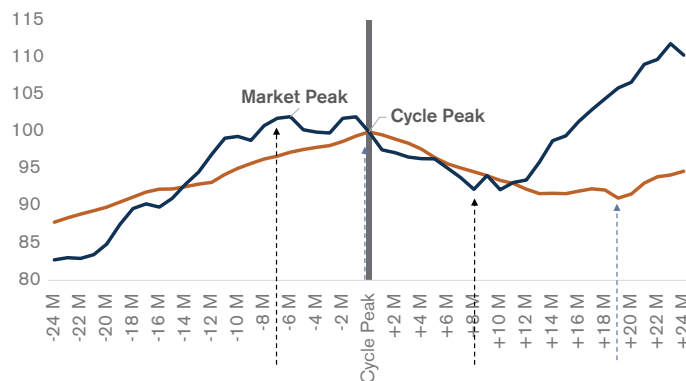


- It took some time for Main Street to finally feel the impact in the form of empty malls, lower home prices and higher unemployment.
- By the time Main Street eventually stabilized, stocks (Wall Street) were already up triple digits!

Astute investors will notice that while the two cycles were related and correlated, one led while the other significantly lagged. In other words, stocks predicted the recession—not the other way around. We may very well see the same setup occur in this current cycle.

S&P 500 VS. INDUSTRIAL PRODUCTION

(Price Performance Indexed to 100, Months)



Source: Strategas Research Partners

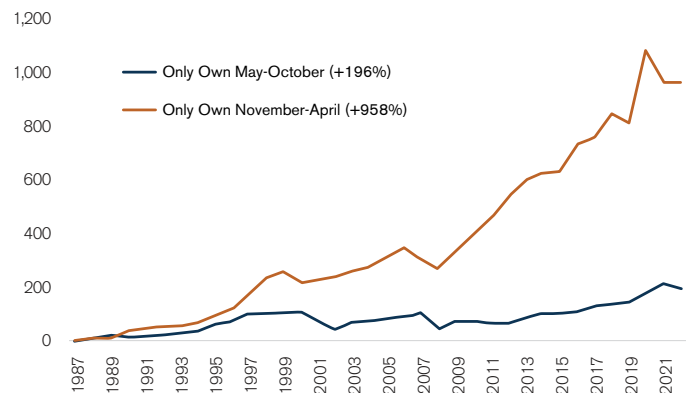
Another Change In The Investment Landscape

In short, if history holds and the patterns of prior cycles again repeat, a potentially weaker economy next year does not necessarily translate to another weak year in capital markets. Furthermore, investors can take solace in the fact that the investment landscape for 2023 is also changing. Changing already? Yes! And this time it's for the better.

Seasonals

Historically, the bulk of annual investment gains tend to occur over the coming six months.

S&P 500 TOTAL RETURN - CUMULATIVE % CHANGE: SINCE 1988



Source: Bespoke Investment Group

Presidential Cycle

In every single year following mid-term elections, stocks have not only posted gains, but the outsized returns during this period have dwarfed all others.

S&P 500 FOUR-YEAR PRESIDENTIAL CYCLE: 1928-2021



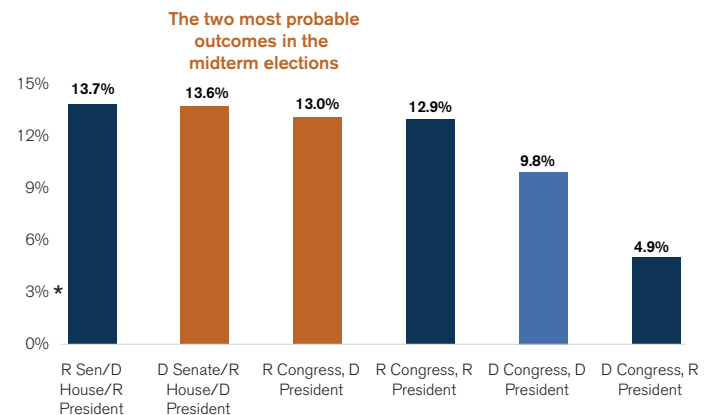
Source: Bespoke Investment Group

Political Makeup

Speaking of mid-term elections, the new division of power in Washington (Democrat President, Democrat Senate, and Republican House) historically has not only favored investors but posted the largest returns of any other combination.

PARTISAN CONTROL, AVG. ANNUAL S&P PERFORMANCE

(1933-2021, Excl. 2001-02)



*Data excludes 2001-2002 due to Sen Jeffords changing party mid-2001
Source: Strategas Research Partners

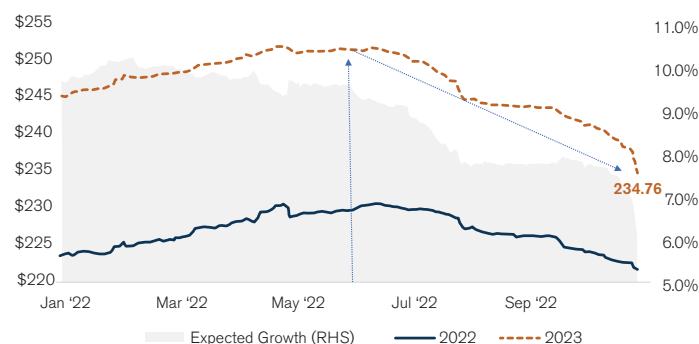
Corporate Earnings

True, not everything can be bullish. In fact, the projections for 2023 corporate earnings (EPS) have been revised almost 10% lower since last June. It makes sense, considering the projected economic slowdown. But because stocks trade on expectations, this might actually prove to be good news. With the bar now set materially lower, it should be far easier for U.S. companies to meet or exceed expectations. Normally, a move lower in EPS projections (bearish news) should have a

corresponding move lower in stock prices. *But stocks have hung in there since June*—perhaps that's a sign!

2022 & 2023 S&P 500 EPS PROGRESSION & GROWTH RATE

(Source: FactSet)



Source: Strategas Research Partners

Interest Rates

The expectation for interest rates have also moved higher since June – with Jerome Powell now saying that rates will need to be hiked above 5% (that number was in the 3's back in June). Higher interest rates are bad for stocks, right? Normally yes but once again, *stocks have managed to hang in there*.

Inflation

Coming full circle, let's revisit inflation. In mid-November a more benign inflation number came out; suggesting that the tighter monetary policy is finally starting to have an impact. Is the 7.70% October CPI print (released in November) still too high? Yes. But it's the month-over-month figure (0.3%) that's most important. Why? Because inflation is just math—an annual year-over-year tally of prices. When we post a lower number next month, a higher number from 2021 falls off. If we can just keep a 0.3% month-over-month figure through April, the math will automatically bring inflation down to under 5%. With expectations for future rate hikes stalling out around 5%, we may finally be at a point of positive real rates by mid-Spring. The landscape is changing—there's no need for the Fed to raise rates another 4% next year – let alone increase rates beyond current expectations. There's light at the end of the tunnel!

Time To Change?

Last year, we cautioned that a changing landscape would require corresponding changes to your portfolio—at least at the margin. If we do get a permanent break in inflation, we can expect stable interest rates. If material weakness in the economy ensues, we might even see lower interest rates. Both potential outcomes suggest that Fixed Income won't suffer the same fate next year as it did throughout 2022. And now, with sizeable yields, longer duration bonds might be attractive – something we haven't been able to say in years.

What else? If we get a break in rates, we may see a break in the strength (and a possible reversal) of the U.S. Dollar. What does that mean? Foreign currencies would appreciate (*perhaps take your European trip sooner than later*). But as the Pound, Euro, and the Yen strengthen, any assets denominated in those currencies would appreciate as well – providing a tailwind to international stocks. International stock valuations are also currently quite cheap compared to their U.S. counterparts. And if we get a hoped for cease-fire in Ukraine, then perhaps economies and corporate earnings would explode in a post-war boom. Higher earnings, higher valuations, and domiciled in an appreciating currency? A trifecta of tailwinds for overseas stocks – something else we haven't been able to say for quite some time.

We will be on high alert throughout the coming year to try and gauge the severity of any potential slowdown. While current data suggests a 2023 recession, perhaps the stock market has already sniffed it out. And besides, there's never been a recession in the third year of a president's term – so why should 2023 be any different? It's not like the last few years have been historic or anything?!

Make sure you have a sound financial plan. Don't over-react and let the landscape of the last few years dictate your plan for the rest of the decade. We still have 7 years left in the decade. Perhaps the Roaring 2020s are still to come.

Thank You And Happy New Year

Thank you for the tremendous trust you've placed in SIA during this tumultuous last year. We've been calling it hurricane season with two named storms (Hurricane Stocks and Hurricane Bonds) behind us, but with one potential storm (Hurricane Economy) still on the horizon. But as with all weather patterns, this too shall pass. Why? Because investment landscapes change. Rewind 100+ years ago to a time where a pandemic gripped the country, only to be followed by high inflation, a depression and a stock market rout. Sound familiar? Yet history *remembers the 'Roaring 20s' for what happened next*. Make sure you have a sound financial plan. Don't over-react and let the landscape of the last few years dictate your plan for the rest of the decade. We still have 7 years left in the decade. Perhaps the Roaring 2020s are still to come.

SIA

2023 Greetings to You and Yours

As the world gradually returns to normal, we look forward to considerably less uncertainty this year. We thank you for being a valued member of the SIA family.

*Our Best Wishes to You and Yours for a
Happy and Healthy 2023.*

SIA

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