Retirement Market RECAP Q4 2022

HANYS Benefit Services

Investors happy to leave 2022 in rearview, but may face speedbumps in 2023

After a very strong 2021, in which the S&P 500 gained over 28%, investors were cautiously optimistic heading into 2022. However, after an exceptionally painful first quarter driven by record Omicron infections, elevated Consumer Price Index readings and geopolitical tension, it appeared 2022 would be quite different. When all was said and done, equity markets experienced their worst year since 2008 as the S&P 500 fell more than 18% and, in a rare occurrence, fixed income failed to provide any downside protection, with an over 13% decline for the Bloomberg US Aggregate Bond Index. With the exception of the energy sector (+59%), there were few hiding spots from the damage in traditional financial assets.

While 2022 was difficult in nearly all areas of financial markets, the technology sector, a perennial favorite over the previous decade, was hit disproportionately hard. The NASDAQ Composite, an index comprised of technology-heavy growth stocks, experienced a painful 33% decline in 2022, considerably underperforming the S&P 500.

Aggressive growth stocks had been some of the highest performers in recent years due to the combination of loose monetary policy and an exceptionally lengthy bull market. As Akane Otani of *The Wall Street Journal* explains, "When interest rates were ultralow, as they were for more than a decade after the 2008 financial crisis, it costs investors less to bet on shares of often-unprofitable companies promising to deliver big growth years down the line".[1] However, in a period of restrictive monetary policy, it doesn't appear that the environment that allowed tech growth stocks to flourish will return anytime soon.

While 2022 was a tough year for equity investors, Q4 provided some hope for the future. The S&P 500 gained 7.56%, with optimism centered on inflation trending downward, and as a result, the rate and magnitude of rate hikes decreased. Within equity markets, international markets outperformed their U.S. counterparts with the MSCI EAFE Index, comprised of developed international stocks, gaining 17.34% during the quarter and the MSCI Emerging Markets Index gaining 9.7%. International equities have long been considered to have more attractive valuations than the U.S. based on price-to-earnings estimates, with the MSCI EAFE and MSCI EM Index displayed P/Es of 13.0 and 10.9, respectively, compared to the S&P 500's P/E of 20.2 through Dec. 31, 2022.[2]

Fixed income struggled alongside equities in 2022, failing to exhibit the negative correlation that many investors rely on in the classic 60/40 (equities/fixed income) portfolio. With the Federal Reserve (the Fed) implementing larger-than-expected rate hikes throughout 2022, bonds sold off at a historic rate. But they also saw a positive Q4. The Bloomberg U.S. Aggregate Index gained 1.87% for the quarter.

With the attractiveness in yields (the first meaningful increase in years), many investors may begin to enter fixed income again with the hope that the worst of the sell-off is over. Fixed-income investors will continue to look to the Fed, concerned over rate hikes but also the length of the tightened policy. Given the heightened recessionary fears brought on by the harbinger of an inverted yield curve, "Bond traders are betting on the Fed pivoting from raising rates to cutting them as early as next year." This potential pivot will be one of the most debated policy moves in 2023.

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[1] Otani, Akane. "Stocks Log Worst Year Since 2008". *The Wall Street Journal*. Dec 30, 2022.

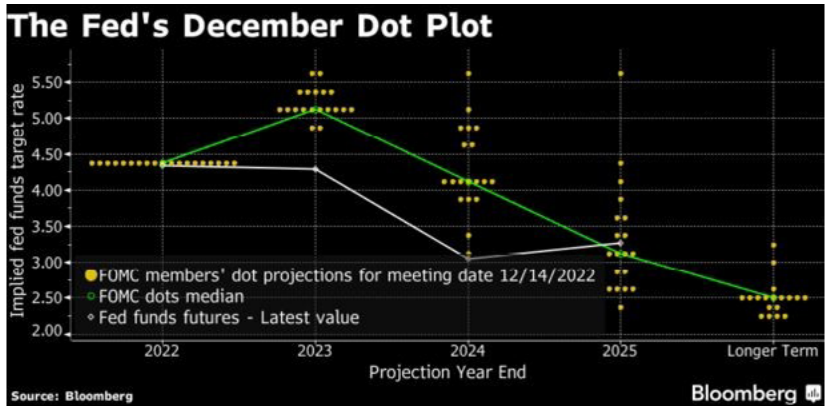
[2] Morningstar Advisor. Prospectuses MSCI EAFE, MSCI EM, S&P 500

For more information about HANYS Benefit Services, please contact
JORDAN ANDRÉ, CFP®
Investment Research Analyst, Retirement and Investment Services
800.388.1963 | jandre@hanys.org | hanysbenefits.com

Where do we go from here?

The key speedbumps facing capital markets in 2023 will not be new to those who remained invested in 2022. Top of mind for institutional and retail investors alike is a policy-induced recession. To combat inflation, the Fed raised rates on Dec. 14, 2022, by another 50 basis points, to a target range of 4.25%-4.5% (Figure 1).[3] During his press conference, Powell explained, "We still have some ways to go." The labor market and the trend of declining CPI readings will be crucial indicators for the Fed to determine how far "some ways" is. If the Fed faces the hurdle of elevated inflation readings, markets may continue to face the selling pressure felt in 2022. Geopolitics will continue to be a concern in 2023 as the war between Russia and Ukraine has no resolution in sight. Any escalations in Asia over the "One China Policy" will create uneasiness in the investment landscape and open a door of unpredictability in the region.

Fig. 1



While fear of a recession is not unwarranted, it is important for investors to consider the full business cycle picture. Recessions are undoubtedly painful, but they tend to be short-lived. The benefits of diligently investing with a longer time horizon, regardless of market sentiment, can help take emotion out of the process and avoid the illusory prospect of market timing.

[3] Matthews, Steve. "Powell Says Fed Still Has a Ways to Go After Half-Point Hike". *Bloomberg*. Dec 14, 2022. Web. https://www.bloomberg.com/news/articles/2022-12-14/fed-downshifts-to-half-point-hike-sees-5-1-rate-next-year

EQUITY INDICES	3 MO	1 YR	3 YR	5 YR	10 YR
S&P 500 TR USD	7.56%	-18.11%	7.66%	9.42%	12.56%
Russell 3000 TR USD (Broad Market)	7.18%	-19.21%	7.07%	8.79%	12.13%
Russell 1000 TR USD (Large Cap)	7.24%	-19.13%	7.35%	9.13%	12.37%
Russell Midcap TR USD	9.19%	-17.32%	5.88%	7.10%	10.96%
Russell 2000 TR USD (Small Cap)	6.23%	-20.44%	3.10%	4.13%	9.01%
MSCI EAFE NR USD (Int'l Equity)	17.34%	-14.45%	0.87%	1.54%	4.67%
MSCI Emerging Markets NR USD (E.M. Equity)	9.70%	-20.09%	-2.69%	-1.40%	1.44%
S&P United States REIT TR USD (Real Estate)	5.27%	-24.36%	0.02%	3.68%	6.37%
Morningstar Lifetime Mod. TR 2020	6.31%	-16.77%	0.94%	3.02%	5.16%
Morningstar Lifetime Mod. TR 2040	9.50%	-17.37%	2.54%	4.36%	7.55%

FIXED INCOME AND RETIREMENT INDICES	3 MO	1 YR	3 YR	5 YR	10 YR
ICE BofA 3M US Trsy Note TR USD	0.91%	1.49%	0.77%	1.31%	0.79%
ICE BofA 1-3YR US Trsy TR USD	0.74%	-3.65%	-0.41%	0.77%	0.67%
BBgBarclays Long Term US Trsy TR USD	-0.59%	-29.26%	-7.40%	-2.20%	0.60%
BBgBarclays US Aggregate Bond TR USD	1.87%	-13.01%	-2.71%	0.02%	1.06%
BBgBarclays US Treasury US TIPS TR USD	1.29%	-2.74%	2.49%	2.57%	1.37%
BBgBarclays High Yield Corp TR USD	4.17%	-11.19%	0.05%	2.31%	4.03%
BBgBarclays Global Aggregate TR USD (Global Bond)	4.55%	-16.25%	-4.48%	-1.66%	-0.44%

ICE BofAML – Intercontinental Exchange Bank of America Merrill Lynch; BBgBarc – Bloomberg Barclays; S&P 500 – Standard & Poors; MSCI – Morgan Stanley Capital International
Sources: Morningstar as of Dec. 31, 2022