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summaries

SIGMA INVESTMENT COUNSELORS

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MARKET COMMENTARY

Investors faced a challenging market environment in 2022. After three consecutive years of strong gains, culminating in the S&P 500 reaching an all-time high on January 3, stock markets around the world experienced heavy losses during the year. In addition, bonds, which generally provide ballast to investor portfolios during stock market declines, had their worst year ever due to the Federal Reserve's (Fed) aggressive rate hiking campaign to combat the highest U.S. inflation in 40 years.

The S&P 500 was down 18.1%, its worst year since 2008, while mid cap and small cap U.S. stocks were down 13.1% and 16.1%, respectively. The story was similar overseas, as developed markets were down 14.5%, and emerging markets lost 20.1%. The Bloomberg U.S. Aggregate Bond Index was down 13.0% for the year, and bonds with longer maturities suffered even steeper losses.

Despite the general market declines, the story was far worse in the more speculative areas of the market. Many special purpose acquisition companies (SPACs), cryptocurrencies and exchanges, non-fungible tokens (NFTs), and early-stage growth stocks lost 65% or more of their value, with some trading at pennies on the dollar or currently going through bankruptcy. By sticking with our "thoughtful investing" approach at Sigma, we were able to maintain discipline in client portfolios and avoid these areas of the market. The phrase "you are boring" is generally meant as an insult. If boring means protecting client assets by missing out on the calamities at FTX and Celsius, we will take it as a compliment.

There were numerous geopolitical events that drove headlines in 2022. Russia invaded Ukraine in February, which started a war that is still ongoing. This not only caused devastation to Ukraine and its people, it also contributed to a spike in food and energy prices, exacerbating an inflation surge that began in 2021. After the highly contagious Omicron variant caused a spike in cases and hospitalizations in the first few months of the year, most countries and economies began to move on to a post-pandemic world. One notable exception was China, which maintained its "zero-Covid" policy for the majority of the year, until protests in late November led to the government largely ending the policy that had been in place for nearly three years. While the impact on global markets over the short-term is uncertain, as the abrupt ending of the policy has led to a surge in cases and hospitalizations across the country, a China reopening should have a positive impact on both global demand and supply chains.

By far the most significant driver of markets in 2022 was the Fed's crusade against high inflation, and the market's hope for a pause in rate hikes and an eventual "pivot" to lowering rates. The markets reacted strongly each time Chairman Jerome Powell spoke, and investors were constantly trying to interpret what his words would mean for future interest rate policy. In December 2021, when the federal funds rate stood at a historically low range of 0.00% - 0.25%, the majority of Fed officials expected to raise rates a total of 0.75% in 2022. After abandoning the word "transitory" and realizing inflation was more entrenched in the economy than previously thought, the central bank ended up raising the

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fed funds rate a total of 4.25% throughout the year to a range of 4.25% - 4.50%, the highest level in 15 years.

While the pace of interest rate increases has caused turmoil in the stock and bond markets, the Fed appears to be nearing the end of its rate hiking campaign. Inflation readings, while still well above the Fed's target of 2.0%, started declining in the second half of the year. Gas and oil prices, which peaked in the summer, are now back to levels seen prior to Russia invading Ukraine. There has been a significant cooling of the housing market, as rising mortgage rates discourage new buyers. Supply shortages for many items in 2021 turned into surpluses and excess inventory for retailers in 2022, and shipping prices are back to pre-Covid levels. While a tight labor market continues to put upward pressure on wages and has contributed to a stickier "core" inflation, the December jobs report, which was just becoming available at the time of this writing, indicates wage gains may be starting to moderate as well.

In addition to cooling inflation, there are other reasons to be optimistic as we look forward to 2023. The Wall Street Journal reported that the stock market has moved higher in every one-year period following a midterm election since 1942, with an average return of 15%. Markets also tend to like divided government, and Republicans won control of the House of Representatives, while Democrats maintained control of the Senate and White House. In addition, consecutive down years for the S&P 500 are exceedingly rare, with the severe recession of 1973/1974 and the tech bubble of 2000-2002 being the only occurrences since World War II.

The market declines of 2022 also provide an attractive entry point for long-term investors who maintain a disciplined strategy. Bonds now provide meaningful income, with short-term Treasuries yielding 4-5%. And with stock multiples now at lower levels, future expected returns have increased significantly compared to a year ago. J.P. Morgan released their long-term capital market assumptions in November, and they see the current investing climate as the best opportunity in a decade for long-term investors.

As always, there are potential risks to the downside. The Fed's commitment to fight inflation may lead the economy into a recession, although most economists are calling for a potential 2023 recession to be mild. Markets also tend to be forward looking and may already be pricing in a recession, and they generally rebound well before the economy improves. There are also "risks" to the upside, as the Fed pulling off a "soft-landing" or the war in Ukraine ending would be positive surprises for financial markets. While the future remains unknown, staying the course and sticking to the plan are key to long-term financial success.

We appreciate the opportunity to serve as your investment advisors, and we wish you and your families a happy and healthy 2023!

David Drogheo, CFA
Director of Research

Please remember to contact Sigma Investment Counselors if there are any changes in your financial situation or investment objectives