A View from the Bevy – 4Q22

Market Review

While stocks rallied at the start of the 4th quarter, hopes of an end of year "Santa Claus rally" were extinguished by fears that prolonged interest rate hikes by the U.S. Federal Reserve (Fed) would send the economy into a recession. Though the December interest rate increase of 0.50% was less than the previous four increases of 0.75%, the Fed surprised the markets by indicating that it will increase rates for longer than expected. The market was hoping for a softer stance in the Fed's statement and a quicker end to the tightening cycle.

Although the S&P500 and DJIA managed to finish in positive territory for the quarter, the NASDAQ finished negative and had its first four-quarter losing streak since 2001. The three major U.S. stock indices all had their worst years since 2008. Other global equity markets had a good final quarter but ended the year down in line with the U.S. markets for the year.

Stock Market Indices	4th Quarter 2022	Year-to-Date
S&P 500	7.56%	-18.11%
S&P 500 (Equal-Weight)	11.64%	-11.45%
Dow Jones Industrial Average (DJIA)	16.01%	-6.86%
NASDAQ Composite	-1.03%	-33.1%
Bloomberg US Aggregate Bond	1.87%	-13.01%
Russell 2000	6.23%	-20.44%
MSCI World	9.77%	-18.14%
MSCI World ex U.S.	16.18%	-14.29%
MSCI Emerging Markets	9.7%	-20.09%

Source: AJO. Data supplied by FactSet Research Systems.

There was no place for investors to hide as 2022 was a tough year across asset classes. Bond investors were hit particularly hard as fixed income adjusted to the aggressive path of Fed interest rate increases. The US Aggregate Bond index experienced the worst return in the index's 46-year history, and the first double digit decline since 1994. Additionally, many technology and consumer-facing companies fell as fears of an economic slowdown and potential recession dimmed prospects for 2023 sales and earnings. Communications services was the worst performing sector for the year, and the only sector to gain was energy.

On the positive side, the Fed's tightening has slowed inflation and global supply chains have shown signs of recovering, aided by the late-December decision by China to end its Zero Covid Policy and reopen its economy. While the market did end the year in a disappointing manner, it is important to remember that it was on very low trading volume as many investors were on vacation the last few weeks of December. While this doesn't make the performance any easier to stomach, the end-of-the-year downturn is not necessarily a sign that negative sentiment will rule the day in 2023.

Market Outlook

Markets are on edge as we enter the new year, and we expect the expect the first quarter to be volatile. A new Congress, led by a Republican House of Representatives, will be sworn in at the start of the year. The markets typically like split government in Washington, as this limits potentially expensive legislation from passing, but investors are still focused on the Fed and their monetary policy decisions. The next Fed meeting is not until the last week of the month, so the we will have to wait before getting more insight into their next actions.

The Fed, much to the markets chagrin, has not wavered in its commitment to bring inflation down, and we expect them to hike rates at least two times early in 2023. But we also think that the Fed's tone will become more bullish as inflation does continue to abate, which will provide the market with some much-needed good news.

The flip side of the good inflation news is that the economy has been slowed by higher interest rates, increasing the odds of a recession. We believe that there will be a recession in the U.S., but it will be shallow and mild, and the U.S. is better positioned than our European friends.

As mentioned above, 2022 was a tough year for all asset classes. We saw the temporary unraveling of the historical negative or low correlation between stocks and bonds. With the bulk of rate hikes behind us and the Fed's "slower but longer" approach becoming clearer, we think it makes sense to modestly increase durations by bolstering core bond allocations, especially in investment grade credits.

While we have been overweight stocks, we will be getting client bond portfolios back to a neutral weighting as we think bonds will be back in favor. There are also some opportunities at the short end of the yield curve and money markets, paying around 3.5%, finally look attractive. We will be moving stocks back to "target" weights from over-weights. We will as always focus on quality names in our stock portfolios, and we especially like the outlook for the health care sector.

These subtle changes to portfolios reflect our cautious view of the markets in 2023 as we prepare for a potential recession. Our goal as long-term investors is to on one hand prepare for the current challenges facing us, in this case the economic fallout from the Fed's interest rate policies, while at the same time positioning our clients for the positives we see on the other side of whatever happens this year as well.

2022 was a challenging year, and nobody likes to see losses on paper. While it may seem repetitive, as we have said it so often recently, the best investment strategy is one that is geared toward meeting long-term goals and objectives, and one that while adaptable to short-term events, but does not overreact to them.

We wish you all a Happy New Year and a healthy and prosperous 2023.

Of Interest: The Danger of trading Meme Stocks

As the pandemic dragged on, many people started new hobbies, including day trading meme stocks - stocks that gains popularity among retail investors through social media. Many retail investors opened brokerage accounts and downloaded trading apps. For example, new Robinhood accounts more than tripled from the start of the pandemic through March 2022.

Some of these new investors dove into the market for entertainment purposes and potential riches, but many dropped out after experiencing of the roller coaster of short-term trading. The potentially smoother journey that diversification offers may be less entertaining, but it makes for a better experience.

The infamous meme stock AMC Entertainment Holdings serves as an example of how investors' experiences with the same security can be dramatically different. Let's talk about hypothetical investors who bought AMC on January 27, 2021, when the stock hit a record trading volume of 1.2 million shares and closed at $19.90 per share. Investors who sold on June 2, 2021, on the second highest trading volume day, at the all-time high closing price of $62.55, had a gain of 214%.

On the other end of the spectrum are those investors who held onto AMC through many wild swings. But after a tumultuous year, they finally gave up and sold AMC on January 31, 2022, at a 19% loss. Meanwhile, over the same one-year period, the Russell 3000 Index gained 18% with far less volatility.

	Peak Price	Peak Price Date	Maximum Drawdown	Maximum Drawdown Date	Close as of May 31, 2022
AMC Entertainment Holdings	$62.55	6/2/21	83%	5/11/22	$14.34
Eastman Kodak Company	$33.20	7/29/20	70%	1/28/22	$4.62
GameStop	$347.51	1/27/21	88%	2/19/21	$124.74
Workhorse Group Inc.	$41.34	2/4/21	94%	5/11/22	$3.09

Source: Bloomberg

Our example of AMC uses the benefit of hindsight to show that riches are not guaranteed and deciding when to sell is easier in theory than in practice. To have the chance of striking it rich in a single stock, you must pick the right one before it goes up. Of the names in the Russell 3000 Index, less than 2% (46 names) gained 200% or more over the course of any two-week period from March

2020 through May 2022. As shown in the table above, some of these names were notable meme stocks like AMC, Eastman Kodak, GameStop, and Workhorse Group, each of which is down substantially from its high.

In fact, approximately 30% of the 46 names ended up underperforming the Russell 3000 Index through May 2022. And only about 25% of the 46 names went on to subsequently outperform the Russell 3000 Index through May 2022. A diversified portfolio decreases the probability of a permanent loss and increases the likelihood of owning stocks that drive market performance.

Even within our retrospective sample of stocks with very high short-term returns, market outperformance is not guaranteed. And, of course, without the benefit of hindsight, the odds are heavily stacked against the meme stock investor. Chasing individual names in hopes of catching a meme stock phenomenon may be tempting, but market data indicates that you are taking a big risk.

It is better to invest for the long term in a diversified portfolio specifically designed to meet your individual wealth management goals. And always keep these three investment principles in mind:

- Diversification has been called the only free lunch in investing
- Uncertainty is part of investing
- Investments should be aligned with goals

Investing involves risk and you may incur a profit or loss regardless of strategy selected, including diversification and asset allocation. Holding stock for the long-term does not insure a profitable outcome. Investing in stocks always involves risk, including the possibility of losing one's entire investment.

Bond prices and yields are subject to change based upon market conditions and availability. If bonds are sold prior to maturity, you may receive more or less than your initial investment. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise.