Economic Summary

2022 was the year the bill came due for multiple years of highly stimulative monetary and fiscal policy. The cost has been high inflation, rapidly rising interest rates, declining asset prices, and an economy in recession. Inflation entered everyone's lexicon, as it went from transitory to sticky after posting high single-digit readings, well above the Federal Reserve (THE FED) 2% target.

Out of necessity, the Fed rapidly increased short-term interest rates from roughly zero to 4.5% during the year, the largest move since 1973. The Fed also ended the era of Quantitative Easing (Q.E.) and started Quantitative Tightening (Q.T.) to raise interest rates and decrease the nearly $9 trillion dollar balance sheet it has amassed since 2008. To the Fed's credit, inflation looks to be loosening its grip as the main drivers, Energy and Core Goods, were less consequential in the latter half of the year (CHART 1). Additionally, inflation expectations have steadily decreased throughout the year as confidence in the Fed's ability to break inflation increased.

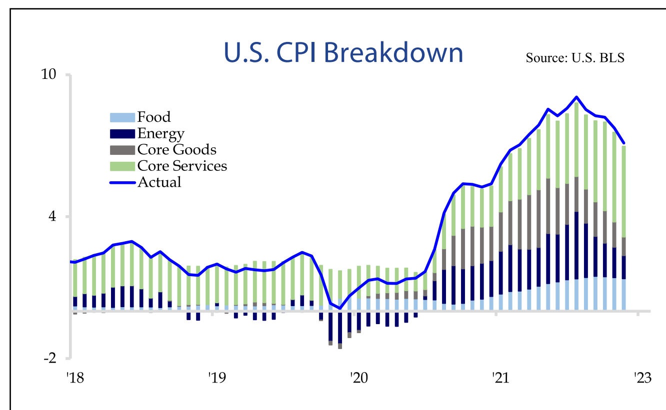

Chart 1

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS" — JANUARY 3, 2023

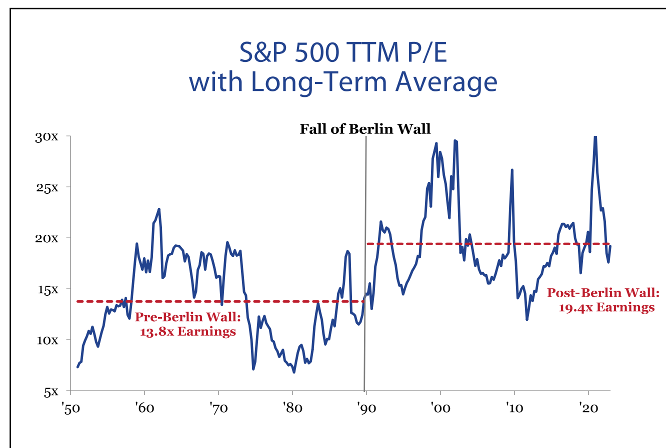

Chart 2

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS" — JANUARY 3, 2023

Russia's invasion of Ukraine and escalating tension between China and Taiwan has governments prioritizing national security over economic growth. Policies incentivizing onshoring and limiting exports have been witnessed in critical technologies, such as semiconductors. These policies have historically led to higher inflation, higher interest rates, and lower P/E ratios for stocks (CHART 2).

Past performance does not guarantee future results.

The year also saw a contentious mid-term election as both parties fought for seats in the House and Senate, along with battles at the State level. The S&P 500 has been up every 12-month period following a mid-term election going back to 1942 (CHART 3). This is attributed to stocks underperforming during mid-term election years and clarity of the political environment for the next two years.

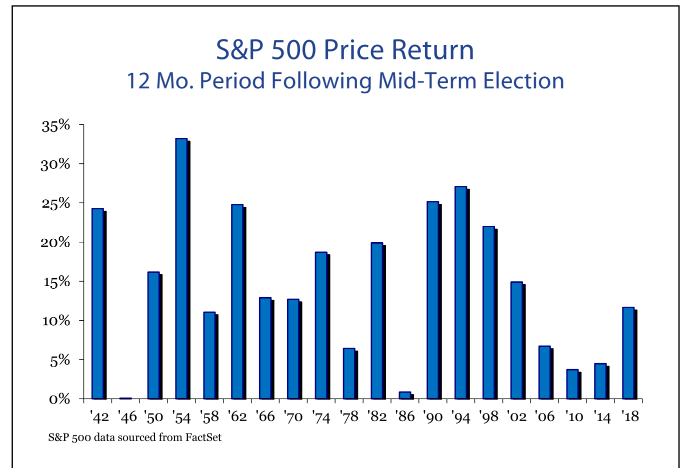

Chart 3

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS" — JANUARY 3, 2023

Corporate earnings estimates throughout the year were adjusted downward and according to FactSet estimates, the fourth quarter of 2022 will see corporate earnings down -4.1%, year-over-year. Looking forward to 2023, our estimate is that corporate earnings will be down roughly -10%. This does not necessarily mean the stock market will be down in 2023, since the bad news may have been already priced into stocks. The companies in our portfolios are well-suited to a contracting economy, as they have outstanding business characteristics, strong management teams, and exceptional balance sheets.

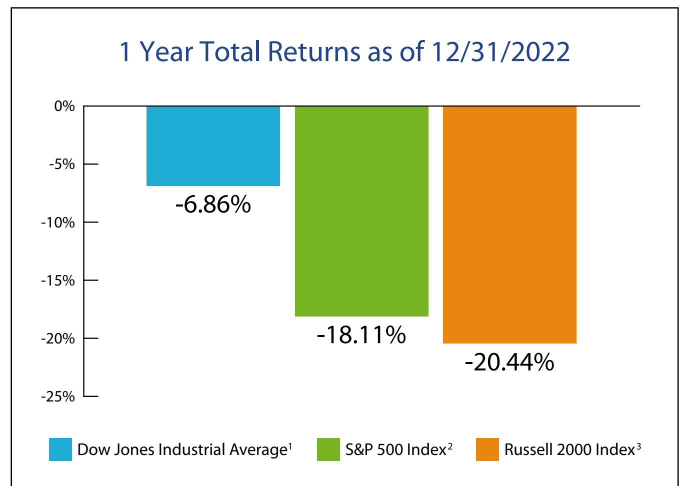

Chart 4

SOURCE: MORNINGSTAR DIRECT

The Stock Market

Equity returns were negative across all major indices in 2022, as the S&P 500 finished down over -18% (CHART 4). Small-capitalization stocks fared slightly worse, with the Russell 2000 down over -20%, and the technology-heavy Nasdaq had the roughest year

Past performance does not guarantee future results. You cannot invest directly in an index.

[1] The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.

[2] The S&P 500® Index is a capitalization weighted unmanaged index of 500 widely traded stocks, created by Standard & Poor's. The index is considered to represent the performance of the stock market in general.

[3] The Russell 2000® Index is an unmanaged index of the smallest 2,000 stocks in the Russell 3000® Index.

of all, down nearly -33%. Value stocks vastly outperformed growth, as the Russell 1000 Value (CHART 5) was down -7.5% vs. -29.1% for the Russell 1000 Growth. The outperformance of the Value Index vs. Growth Index was due to the relative overweight holdings in Energy and Utilities, which were up 66% and 2%, respectively. Additionally, being underweight in Communication Services and Information Technology was also beneficial, as they were down -48% and -30%, respectively.

The Energy sector outperformed all others, with a total return of 66%, while the underlying index, the S&P 500, was down -18%. After the banner year, the sector's P/E ratio is still the lowest in the Index and still has one of the smallest representations in the S&P 500 Index (CHART 6). One of the great misconceptions is that a barrel of oil is solely refined into gasoline and used in automobiles. In reality, only about 25% of a barrel becomes gasoline. While the other 75% becomes heating oil or other distillates used in airplanes, ships, agriculture, mining, petrochemicals, and other uses. The demand on outputs from these other industries continues to increase as the population, global economy, and the middle class grows. The energy sector has performed exceptionally well over the last year, but it remains unloved and under-owned by most investors, so there could still be a lot of upside.

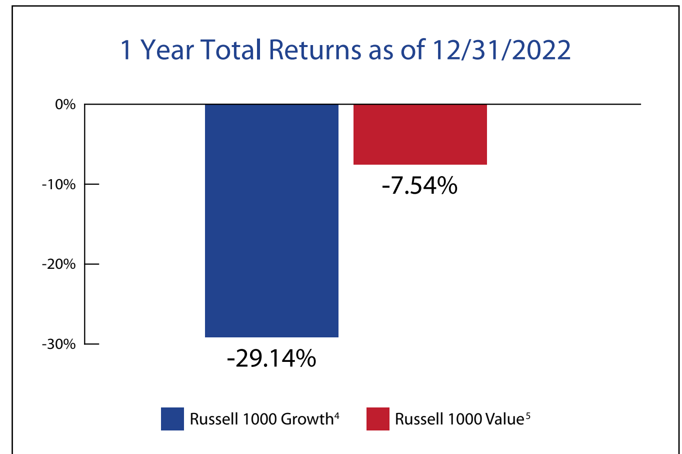

Chart 5

SOURCE: MORNINGSTAR DIRECT

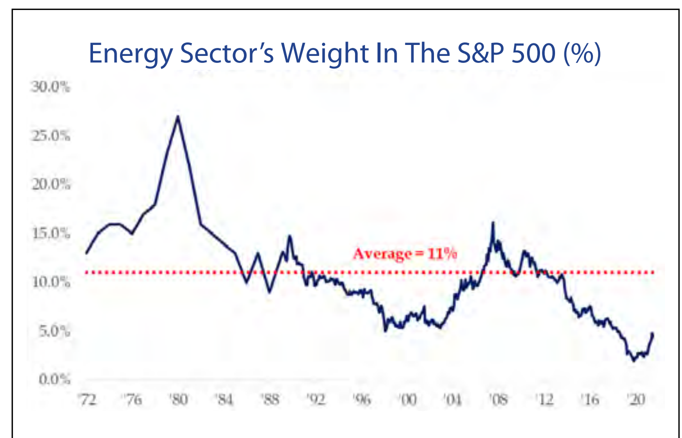

Chart 6

SOURCE: STRATEGAS RESEARCH PARTNERS "QUARTERLY REVIEW IN CHARTS" — JANUARY 3, 2023

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[4] The Russell 1000® Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values.

[5] The Russell 1000® Value Index Measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values.

The Bond Market

The yield curve for U.S. Treasuries increased across maturities with most of the movement happening on the short end of the curve due to the Fed increasing short-term interest rates. The yield curve remains steeply inverted as shorter-maturity interest rates are higher than longer-maturity interest rates. This pattern often precedes recessions. Typically, higher short-term rates reduce loan demand for capital expenditures and corporate expansion.

Corporate credit spreads hit peak levels in early October when the stock market put in its lows for the year. At year-end, spreads were still higher than historical averages, and corporate bonds remained attractive on a risk/reward basis. With interest rates up and corporate credit spreads wide, it seems an excellent time to selectively add modestly to duration and credit risk in fixed-income portfolios.

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