Palacios' Perspectives

Preview for 2023

From Wall Street to Main Street

In this newsletter, I'll do a recap of 2022 but more importantly look forward to the expectations for the upcoming year.

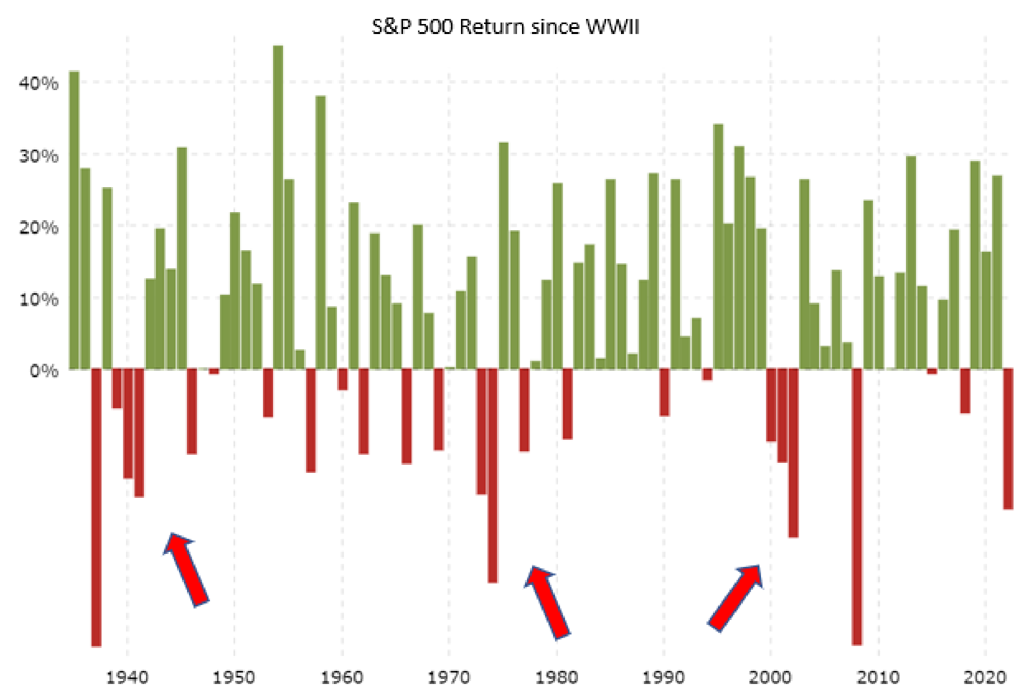
2022 In Review

This year will go down as one of the few years in the market's history where there were hardly any places to hide. Not only was each stock index in the U.S. down, so were bonds, international stocks, and most commodities with the exception of oil. The Dow Jones Industrial average was down 9%, the tech-heavy Nasdaq was down 33%, the S&P 500 was down 19%, bonds suffered a 12% loss as well as international stocks declining 17%. Oil was the lone commodity that ended up 7%, as it started the year in the $70's per barrel of West Texas Intermediate, got to as high as $120's and settled at year's end close near mid $70's once again.

The main issue for the markets in 2022 can be isolated towards one single word, inflation. The Federal Reserve had used the word "transitory" in 2021 when it observed inflation measures going higher…..but in 2022, it realized it was not quite so transitory and needed to take action immediately. March saw the first of what would end up being <u>seven</u> rate hikes, as inflation started the year around 7% and hit a high in June of 9.1%. Currently, inflation sits back at 7% and is declining pretty quickly. As I mentioned in prior communications, a rising rate environment affects stocks and bonds negatively and this year was no exception.

<u>**2023 Outlook**</u>

As we turn the calendar, I'd like for you to carefully review the following chart.



Source

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What I derive from that chart is that since the 1930's, out of 25 years when the market's returns were negative, only five times or 20% of the time do the markets follow that with another negative return year. Aside from history being on our side, I'm going to outline the general thought going into this year and where my expectations land.

General/Consensus thinking for 2023

A Goldman Sachs survey of investors finds that the most common trade for the 1st half of the year is Shorting the SPX. To start, the SPX is a fund that mirrors the return of the S&P 500 (the largest 500 US publicly traded stocks). Secondly, shorting is an investment strategy whereby one tries to profit when stocks decline. This is a risky maneuver because in the event investors are wrong, they could lose a lot (as stocks can increase indefinitely). Part of the thinking that investors have for this thinking is that Federal Reserve will continue its rate hikes and will keep markets choppy. This same consensus though, believes the markets will return positive returns for the full year.

Factors that will impact 2023 returns:

1) Inflation (currently at 7% and declining, but how quickly will it get back to 3%-4%?
2) US Dollar weakening…will it continue? Its already declined 10% versus other currencies.
3) Fed stopping rate hikes…how quickly will the Fed pause? Will they have to lower rates if a recession does indeed hit?
4) Potential Recession…. if we get one, how deep/shallow will it be? How quickly will it end?

My thoughts about 2023

I am more of a believer that the consensus thinking will be right but for a shorter period of time. I don't think it takes 6 months of negative returns and we finish the year higher. I feel like once the first three months of the year are past, the markets will begin to price in higher returns. Why do I think this?? To start, I think the last Fed hike will be in February and will serve as a positive catalyst for stocks. I also don't think that earnings are going to decline as much as most believe. With the US Dollar weakening, this makes for better revenues that multi-national firms like Apple, Google, Nike, etc will benefit from…they will see a bump in earnings due to exchange rates being more favorable. Lastly, I am in the camp that inflation will drop pretty quickly, and this will ease the Fed's necessity to hold a hard line towards more rate hikes. I do believe the 80% of the time that the markets rebound after a negative year will indeed be the case and I think we see the start of a new bull market.

Parting Thoughts

I thank you for your time to read this newsletter, your trust in us to manage your assets and guide you towards retirement! I welcome an opportunity to discuss the above detail and wish us all a prosperous and blessed 2023!

Regards,

E. Palacios

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