

## 2022 Fourth Quarter Update and 2023 Outlook

**Review:** Returns for most asset classes were positive in the quarter, though not enough to offset the negative returns of the first three quarters. Markets reacted positively to signs that inflation has peaked, speculating that the current rate hike cycle is nearing an end. This also led to a weakening in the US dollar, which helped international equities outperform the S&P 500 in the quarter. Fixed income also rallied but finished the year with the worst returns in decades. The -13.0% return of the Bloomberg US Aggregate Bond Index was the worst return in the index's history, which goes back to 1976.

| Period                                   | 4Q22  | 3Q22   | 2Q22   | 1Q22  | 2022   |
|--|-------|--------|--------|-------|--------|
| <b>S&amp;P 500</b>                       | 7.5%  | -4.9%  | -16.1% | -4.6% | -18.1% |
| <b>MSCI EAFE<sup>1,2</sup></b>           | 17.4% | -9.3%  | -14.3% | -5.8% | -14.0% |
| <b>MSCI Emerging Markets<sup>2</sup></b> | 9.8%  | -11.4% | -11.3% | -6.9% | -19.7% |
| <b>Bloomberg U.S. Aggregate Bond</b>     | 1.9%  | -4.8%  | -4.7%  | -5.9% | -13.0% |
| <b>Bloomberg Municipal Bond</b>          | 4.1%  | -3.5%  | -2.9%  | -6.2% | -8.5%  |

<sup>1</sup>Europe, Australasia, Far East

<sup>2</sup>MSCI returns are in U.S. Dollars

## 2022: A Uniquely Challenging Year

As the table above indicates, 2022 was an incredibly challenging year for investors, as almost all asset classes delivered negative returns for the full year—cash and commodities (not shown) were the two major positive outliers. Most notable was the double-digit negative return delivered by a 60/40 mix of the S&P 500 and Bloomberg US Aggregate Bond Index. Even though that bond index only has data back to 1976, one can use a mix of other bond returns to estimate comparable returns further back in time. The chart on the next page shows yearly returns for the S&P 500 and fixed income going back to 1926. Although there have been a few years where major stock market selloffs led to worse combined returns, 2022 stands out as the only year with negative double-digit returns in both equities and fixed income.

As we highlighted in last quarter's update, the 2022 selloffs were driven by faster than expected interest rate hikes due to higher than expected inflation. Near term returns will likely continue to be driven by the paths of inflation and interest rates. However, the starting conditions in 2023 are significantly different than 2022—lower equity valuations, higher bond yields, slowing inflation—which could lead to earnings growth ultimately being the dominant factor driving investment returns this year.

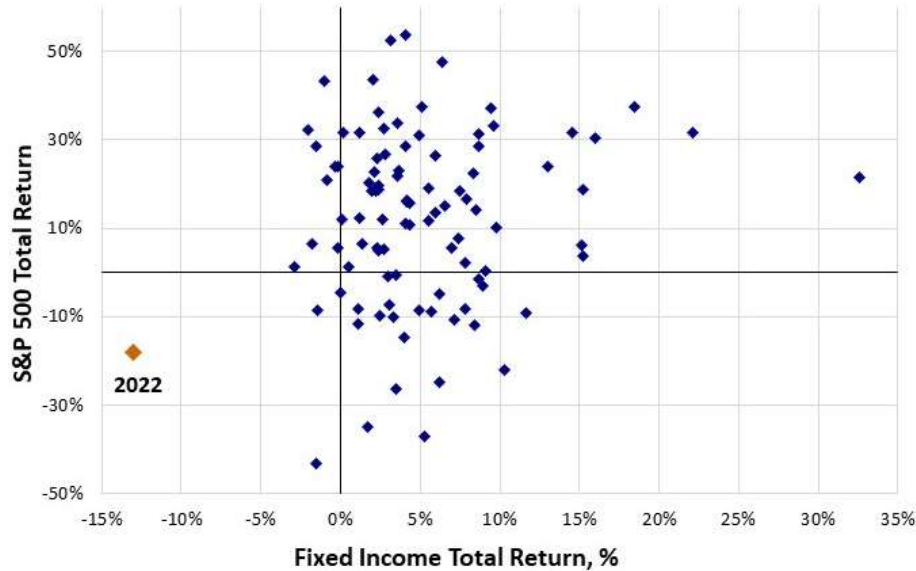
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### &P 500 and Fixed Income Total Returns, 1926-2022



Sources: Bloomberg, Ibbotson (Bloomberg Aggregate Bond Index used for 1977-2022 Fixed Income returns; Ibbotson data used to estimate comparable 1926-1976 values)

**Outlook:** It is currently estimated that US GDP growth was 1.9% in 2022, modestly lower than the 2010-19 average of 2.3%. However, growth is expected to slow to 0.3% in 2023. Unemployment is still very low, supporting consumer spending, but there are signs of increasing headwinds (e.g. weaker trends in freight volumes and credit delinquencies) that bear watching. The market expects the Federal Reserve to raise rates in February and March before pausing, and the key questions are:

- Will inflation continue to decrease sufficiently so that the Federal Reserve does not need to raise rates more than its 5.1% median estimate for the year?
- What will be the impact of the current and future rate hikes on economic growth?

We expect international growth to be mixed. China's recent relaxation of COVID restrictions may boost economic growth, if the easing of restrictions is maintained. Growth in Europe continues to be challenging, and the current estimate for 2023 GDP growth is slightly negative. The strong rally in the US Dollar last year is not likely to repeat this year assuming a pause in Fed rate hikes, which may ease some pressure on emerging economies.

**Strategy:** Given the questions around economic growth, we continue to prefer quality stocks at reasonable valuations, particularly those exposed to trends less dependent on the economic cycle. Volatility will likely remain elevated in the near term as companies begin to report Q4 earnings and their outlooks for 2023. Additionally, economic data releases could also contribute to volatility due to their impact on the outlook for inflation and interest rates. Clearly, fixed income has not been immune to the volatility seen in the past year, but the selloff has increased the relative attractiveness of a number of areas within fixed income, which should help it regain its usefulness as a defensive tool in balanced portfolios. We will continue to use any volatility as opportunities to upgrade portfolios, which could include changes to holdings of individual securities in equities or fixed income.