<u>2022 was unique, 2023 will be a better year + the Value of Advice</u>

2022 was unique in that both the stock market and the fixed income market went down in the same calendar year. As Stephen Weiss of Short Hills Capital Partners pointed out on CNBC on November 22nd, 2022 was only the fifth time in 50 years that the fixed income market (meaning U.S. Treasuries) and equities went down in the same year. We also know that real estate had a bad year in 2022. And the huge meltdown in bitcoin/crypto currencies made matters considerably worse for some investors.

The markets did poorly in 2022 due to a nearly vertical increase in interest rates. This had a direct negative impact on bond prices. And it negatively impacted the stock market by increasing the discount rate used to value the present value of the future earnings of stocks. Or to put it in easier-to-relate terms, higher rates made stocks less attractive relative to safer investments such as GICs. The stocks that got impacted the most were the ones that were extremely overvalued and those that did not have earnings. Even large and well-known companies such as META Platforms (formerly Facebook), Netflix, Amazon, and Disney experienced declines of over 50%.

2023 should be a much better year, in my opinion. I believe that the worst is behind us – recognizing that I can be wrong. Going somewhat against what was the current consensus view at the beginning of the year, <u>I am actually optimistic about 2023. Among the multitude of reasons I am optimistic, let me point out the following three</u>:

- Inflation numbers have been coming down over the past few months. Markets will fluctuate on days that inflation numbers are announced, and are then compared to expectations. But I do believe inflation is coming down at a quicker pace than the U.S. Federal Reserve believes it is. Lower inflation should eventually result in a pause in central bank rate increases, and eventually to declines in those rates.
- Since 1928, the U.S. S&P 500 index was down 26 times on a calendar basis - so about a quarter of the time. In the year after a negative return, the S&P 500 has advanced 12.6% on average, with median return being 20.4%. Source: RBC DS, Portfolio Advisory Group, January 5, 2023
- Historically, the first quarter of a U.S. Presidential pre-election year is up more than 90% of the time, with a 7% average. This is the best quarter of a 16 quarter presidential cycle. P.S. The second quarter is the third best quarter of a U.S. presidential cycle. Source: CNBC, Ryan Detrick, chief market strategist, Carson Group, Dec 22, 2022

The above being said, I do not expect the future to be filled with rainbows and unicorns. Here is what is at the top of my list of things that keep me up at night:

- At the very top of the list, the possibility that China invades Taiwan.
- Putin loses power in Russia and is replaced by an even more belligerent leader. Bad as that would be, that might not be a net negative for the markets. But it worries me as a human being.

Here's to a better2023.

THE VALUE OF ADVICE

2022 was a somewhat painful reminder that markets can have negative years. Despite COVID, the last negative calendar year we experienced for the stock market was back in 2018. Markets went down in 2018 due to an increase in interest rates - the bottom being reached on December 31st. Overall, I would forecast that on average, one calendar year out of four will be negative. And over a five year period, one is likely to experience at least one bear market (a decline of 20% in the index), and sometimes two.

One of the many benefits of dealing with an Investment Advisor is in getting help setting realistic long-term expectations for the type of portfolio that fits an investor's risk profile. For example, the markets did extremely well from mid- 2020 to mid-2021, mainly due to the decrease of interest rates and partly due to the distribution of stimulus cheques. This in turn might have contributed to unrealistic future return expectations for new investors who did not seek expert advice.

Another benefit of dealing with an Investment Advisor is the ability of getting a second opinion. This is even more important in these days with exposure to 'influencers in social media' and others making irresponsible claims who might then encourage investors to invest heavily in aggressive sectors such as crypto currencies and pot stocks. Unlike decades ago when information was more difficult to obtain, I would say these days, there might actually be too much information (and promotion) available through the internet, making it harder to decipher what is really important and legitimate. A second opinion from an experienced advisor who is backed by a large reputable research department becomes especially helpful….and much more helpful than ads featuring movie stars and athletes, I would say! Getting a second opinion is especially handy in bad years such as 2022 when one might be tempted to sell after a significant market decline.

Here are a few other benefits in dealing with an Investment Advisor for your consideration: retirement planning, estate planning, guidance in setting financial priorities , ongoing communication, newsletters, tax optimization, education, requests for financial plans and/or financial projections, discussion of risk management, access to a variety of investment tools/products, etc.

Studies have also shown that people who work with advisors tend to have a greater net worth over time, are more successful at saving, and for the most part have confidence and a positive sense of well-being with respect to their finances. Source: RBC Global Asset Management, the Value of Working with a Financial Advisor, August 31, 2020

Should you have any questions or concerns, please feel free to reach out. And as always, we encourage you to contact us if there has been an important change in your financial situation.

Wade Brown Wealth Management
January 17, 2023

Insights/Opinions from Experts

In this section, as I often do, I would now like to offer recent quotes/insights/observations from respected market experts that hopefully provide useful perspective during these very uncertain times. Admittedly, I have favored positive outlooks, partly because they were harder to find at the beginning of the year and partly because they reflect my own views at the present time.

"…I get negative core inflation (Prof. Siegel's take on CPI numbers announced January 12th)...the Fed will at some time be forced to realize that we have really solved the inflation problem …they will not stay as near as tight as they claim…If the earnings per share go (down) to 200 for the S&P 500, my studies have shown that the right P/E ratio for a recession level of earnings is actually 22 or even 24…not 16 or 17 or 18…A severe recession (typically) lasts a year and a half. I don't see that…the Fed will have to lower the discount rate to a two handle by the end of this year because they are going to see the economy slipping, and inflation way down. When stocks see a two handle on the Fed funds, even a big dip in earnings will not look so bad in terms of what value will actually be… If you look at the bear market we have had this year, it was caused by the sharpest increase in real interest rates that we experienced since Volker (1980) … I think we are on the cusp of a new bull market because everyone says the first half will be bad and the second half may be better. What does history show? When everyone is on one side, they are usually wrong."
Source: CNBC, Dr. Jeremy Siegel, Wharton Finance Professor, January 13

"2023 S&P 500 Target, Base Case 4,300 (current level is 3990)…a lot of the weakness that we even thought would happen in the first half of the year (2023) got pulled forward into December...don't stocks lead earnings which lead the economy? (A question Brian directed to another panelist)"
Source: CNBC, Brian Belski, Chief Investment Strategist, BMO Capital Markets, January 13

"Our model for earnings is that they will go down 5%...It can be better than that. Stocks lead earnings which lead the economy. The stock market has already discounted a recession at some point."
Source: BNN, Brian Belski, Chief Investment Strategist, BMO Capital Markets, January 16

"I am very pleased with this morning's CPI news…Inflation has clearly peaked on a year-over-year basis…. When you look at the three month annualized for the headline CPI inflation, you get 0.0 per cent as the annual increase over the past three months…And if you take out food and energy and look at core inflation, you get 2.2 percent, which is a wonderful number…I think October 12th was the bear market low...As far as I know I am one of the only strategist that thinks earnings will go up this year."
Source: CNBC, Dr. Ed Yardeni, president of Yardeni Research, January 12

"(Regarding future U.S. Federal Reserve pause in interest rate increases then a change/pivot to lower rates) I think they will not be too far apart. I think the Pause will be the catalyst for renewed risk appetite. And the PIVOT will be the turbo charger"
Source: CNBC, Paul McCulley, former PIMCO chief Economist / Georgetown Professor, January 3

"2023 S&P 500 Target: 4,750...The possibility of double digit gain in 2023 is much higher than people expect….Inflation has already fallen by half…Earnings can do better than expected…Rare for stocks to have back-to-back declines…In the 21 years where stocks had declines in a single calendar year, the following year was positive in 18 instances, seven of those had negative earnings growth…."
Source: CNBC, Tom Lee, Fundstrat, Head of Research, December 14

It is not hard to find pessimistic forecasts for 2023. Leading the pack for the bears/pessimists is Mike Wilson, from Morgan Stanley.
"Morgan Stanley's Mike Wilson warns U.S. stocks could slump another 22% if recession arrives in 2023….The chief strategist , who correctly predicted the 2022 stock market sell off suggested that the S&P 500 could find a bottom of around 3,000 points by the end of 2023… corporate earnings forecasts for 2023 are materially too high….Wilson is not alone in his view…..Michael Kantrowitz at Piper Sandler &Co said in a CNBC interview last week that he expects the benchmark index to fall to about 3,225 by the end of this year, or about a 16% slump from current levels."
Source: CBS MarketWatch, article by Isabel Wang, January 9

And to provide some perspective to those who might believe only the stock and fixed income markets declined in 2022:
"The home price index fell to $736,600 last month, a 1.6 per cent drop from November and 13 per cent lower than the February peak. That marks the largest downward swing since the financial crisis of 2008 and 2009…the Canadian Real Estate Association (CREA) is predicting the downward trend will continue this year….The association predicts the annual average price nationally will fall 5.9 per cent from last year…."
Source: The Globe and Mail, January 17, 2023