THE FINANCE COUPLE™
TWO PERSPECTIVES WITH ONE FOCUS... YOU

A Review of 2022 and Preview of 2023

January 2023

"The pessimist sees difficulty in every opportunity; the optimist sees the opportunity in every difficulty."
– Sir Winston Churchill

Happy New Year! Or, maybe more appropriately, Good Riddance to 2022! Seriously, 2022 was one for the record books, and not in a good way. Not only did the stock market do poorly, but bonds had one of its worst years since 1976, real estate got clobbered, and cash paid little to nothing for most of the year – not to mention all the geopolitical and domestic issues plus an ugly war to boot.

But there is some upside, or at least some lemonade that was made from the financial lemons. First, valuations have come down across the board, which is much more rational than the bubble conditions we wrote about twelve months ago. Second, expectations have come down; market participants seem to have moved solidly from greed to fear - a good contrarian indicator, if nothing else. Third, although interest rates have gone up, the flip side of that coin is that fixed income yields have gone up as well. Fourth, the drop in security values may have allowed you to take some realized losses (tax-loss swaps?) that may lower your taxes. Fifth, and finally, some of the silly (for lack of a better word) investing strategies, in our minds, have shown their expensive uselessness by helping a lot of people lose a lot of money.

As to what happened more specifically, LPL Research reminded us that the S&P 500 entered a bear market in June of this year, and despite a valiant effort in August, it was unable to dig its way out, ending 2022 with a 19.4% loss. Part of the reason was due to the fact that with inflation reaching levels not seen in 40 years, the Federal Reserve instituted the most aggressive series of interest rate hikes in decades such that the 3-month Treasury Bill now yields approximately 4.6%. Thus, the negative correlation between stocks and bonds that investors had become accustomed to, did not hold in 2022; in fact, 2022 was the worst year on record for bonds, based on Bloomberg U.S. Aggregate Bond Index data back to 1976.

Based on these occurrences in 2022 and the supporting data, we seem to be either in a recession or preparing for one. In fact, few historical indicators have been as good at signaling recession as inversions in the U.S. Treasury yield curve (when short-term interest rates, like the 3-month Treasury Bill, are higher than long-term rates, like the 10-year Treasury Bond yield – as is the case currently). So what is a person to do?

Well, without sounding smug (hopefully), another upside to the 2022 downside is that our belief in actual planning has been reaffirmed again. For twenty-six years we have been preaching to always get ready for good times and bad in good times and bad, and a terrible year reminds us all that the only constant in life is change, and fun run-ups will always be followed by painful pullbacks. So the answer to the question is two-fold: one, do not panic as we are on a course that is not unexpected, and two, keep planning for the inevitable to happen one day. In today's case, that means plan and expect for things to get worse (and maybe much worse) before things get better, and two, plan and expect for things to get better eventually.

We also believe there may be a number of head-fakes in 2023, whereby today's news might make you think the tables have turned. Case in point is last Friday's job report (on January 6th). It was essentially a "Goldilocks" report that showed a growing-but-slowing labor market, a tick-up in employment participation, and a down-shift in the pace of wage gains. In response, the S&P 500 went up more than two percent in less than just seven hours, and the 10-year Treasury Bond yield went down almost 5%. But one day does not a long term trend make. And though the Fed has, in our eyes, been doing a terrible job over the last few years, it's still worth remembering the quote "don't fight the Fed", especially when they continue to advocate for still higher rates (to fight what they called "transitory" and then "peaking" inflation just a short while ago!).

All kidding aside, the Fed is fighting for their credibility, which is why we believe they will stick to their rate-rise guns, and is also one of the reasons why we believe things will remain more uncertain in the short-term. This, in addition to the fact that we continue to have politicians from both sides of the aisle spending like drunken sailors to gain social-media notoriety as well as re-election makes us think that things may get worse before they get better (personally, I would love term limits!). But inevitable recessionary pain (remember, natural business cycles almost always have recessions) could be postponed further due to persistent strength created by artificial and temporary stimulus – namely, unspent fiscal stimulus sitting in deposit accounts. But eventually that cache will be tapped out and the lagging effects of Fed tightening will catch up, possibly resulting in a slump later in the year. All this could also explain why, coming full circle, the bond market seems to be fighting the Fed; though central bank policy makers have forcefully projected further increases in the key federal-funds target rate, to a median 5.1% by the end of 2023, according to CME Fed Watch the fed-funds futures market, a bond market proxy for some, only sees increases to the 4.5% range.

Again, our advice remains the same: plan for the best of times as well as for the worst of times, knowing both may come to fruition. Only by doing some actual financial planning may you be able to weather the storm until brighter days shine, as well as hopefully temper your emotional state of being. And though we are relatively pessimistic for the short-term, we remain confident in democracy and capitalism and American ingenuity – and thus optimistic for the long term, remembering well Sir Winston Churchill's other words, when he declared, "I am an optimist; it does not seem too much use being anything else."

Have a wonderful start to 2023, and as always, thank you for your friendship and trust!

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