

QUARTERLY MARKET GUIDE: Q1 2023

Our View of What's Most Relevant Now

January 20, 2023



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Please see important disclosures at the end of this report.

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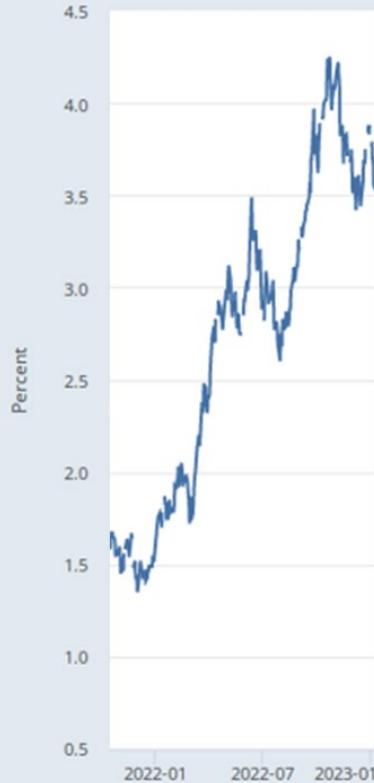
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Data in Focus: Market Rates

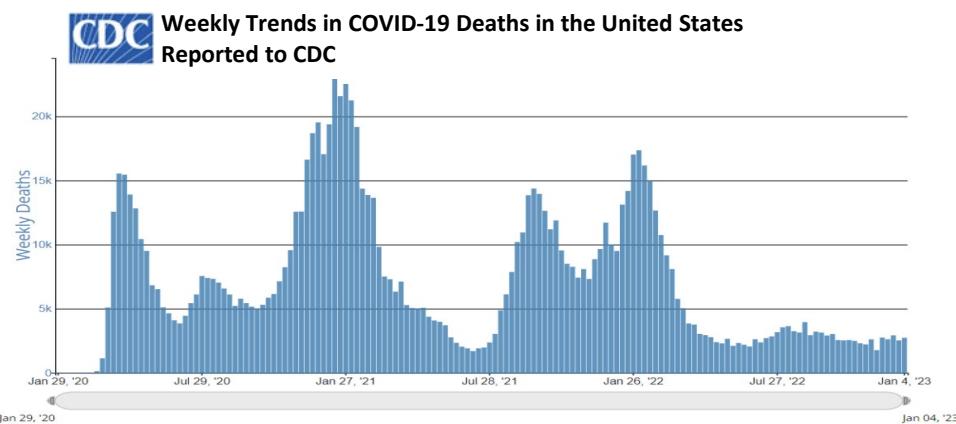
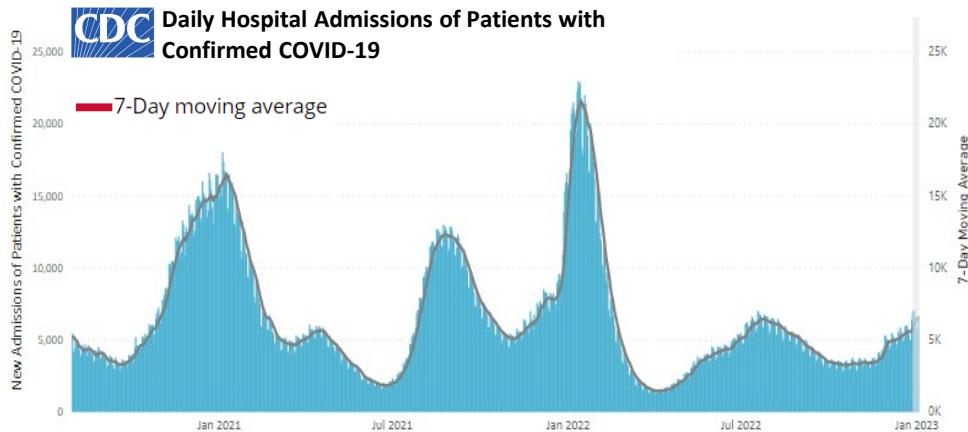
FRED Market Yield on 10-Yr U.S. Treasuries



After peaking at 4.25% last October 10-year Treasury yields have declined to about 3.4%. This is curious as the Fed continues to indicate that rate increases will continue in 2023. Is this normal ebb and flow, or does the bond market doubt the Fed? (See pgs. 4, 13, 14 & 15.)

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COVID-19



Source: Centers for Disease Control and Prevention

We're switching to show the chart for reports to CDC of 'Hospital Admissions' data from previously showing 'COVID-19 Cases Reported.' This is because the unreported self-test results were undermining the latter. Having said that, we do hope that all COVID-19 data may soon affirm that we're moving beyond this pandemic, at which time we'll cease reporting on it within this publication.

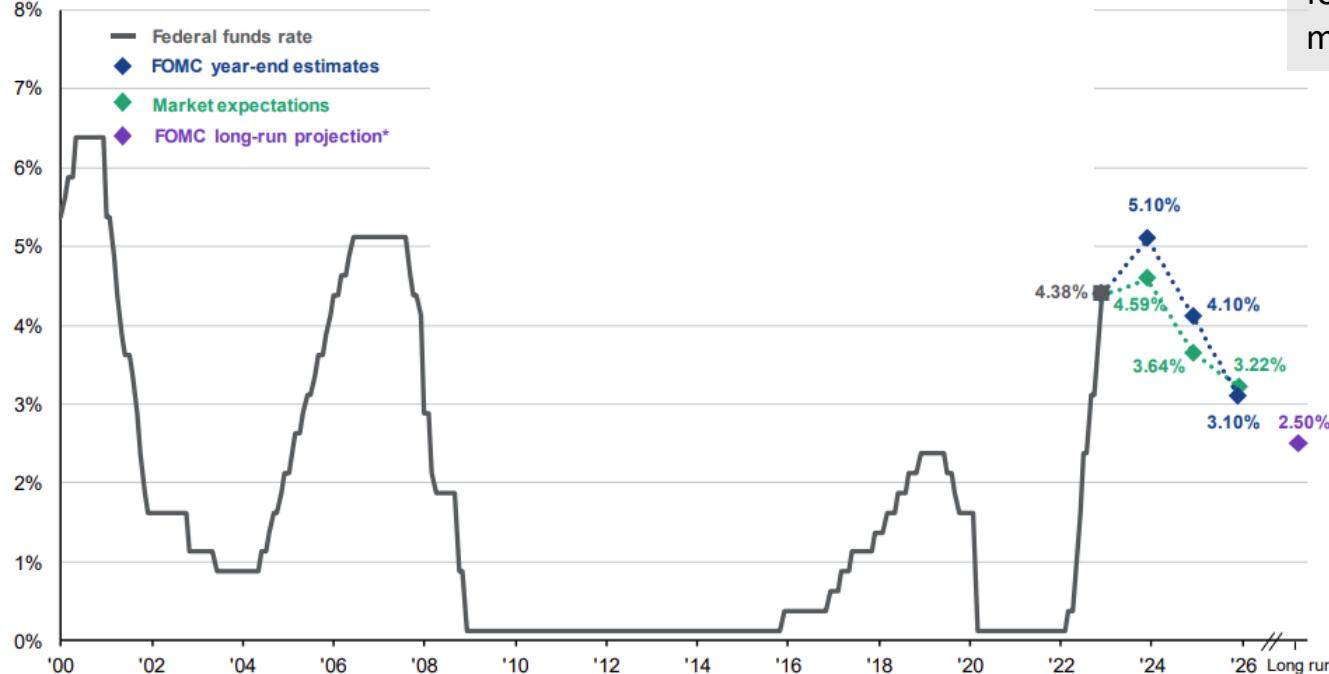
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Economy

Federal Funds Rate

Federal funds rate expectations

FOMC and market expectations for the federal funds rate



Inflation data will remain prominent for both FOMC and market expectations.

Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.

Market expectations are based off of the respective Federal Funds Futures contracts for December expiry. *Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.

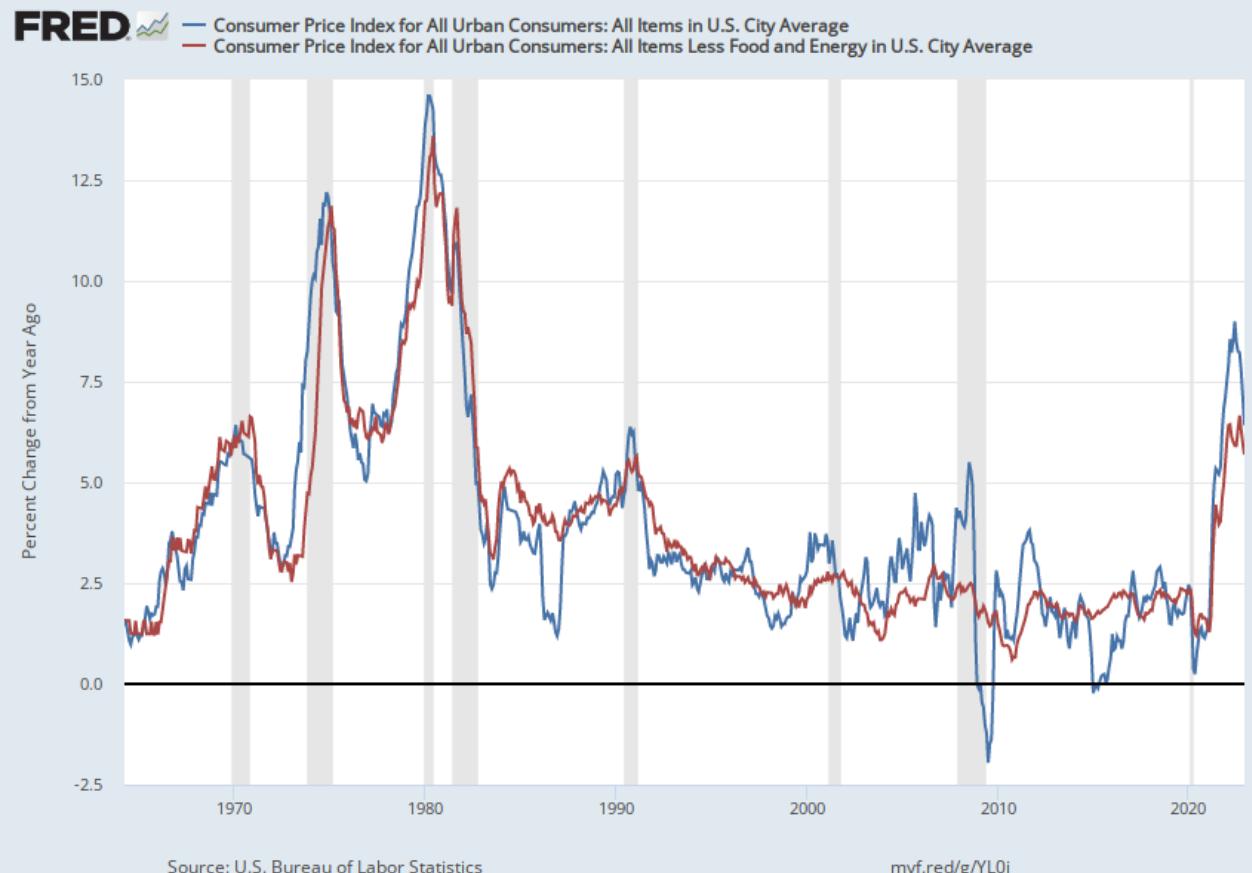
Guide to the Markets - U.S. Data as of December 31, 2022.

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Economy

Inflation

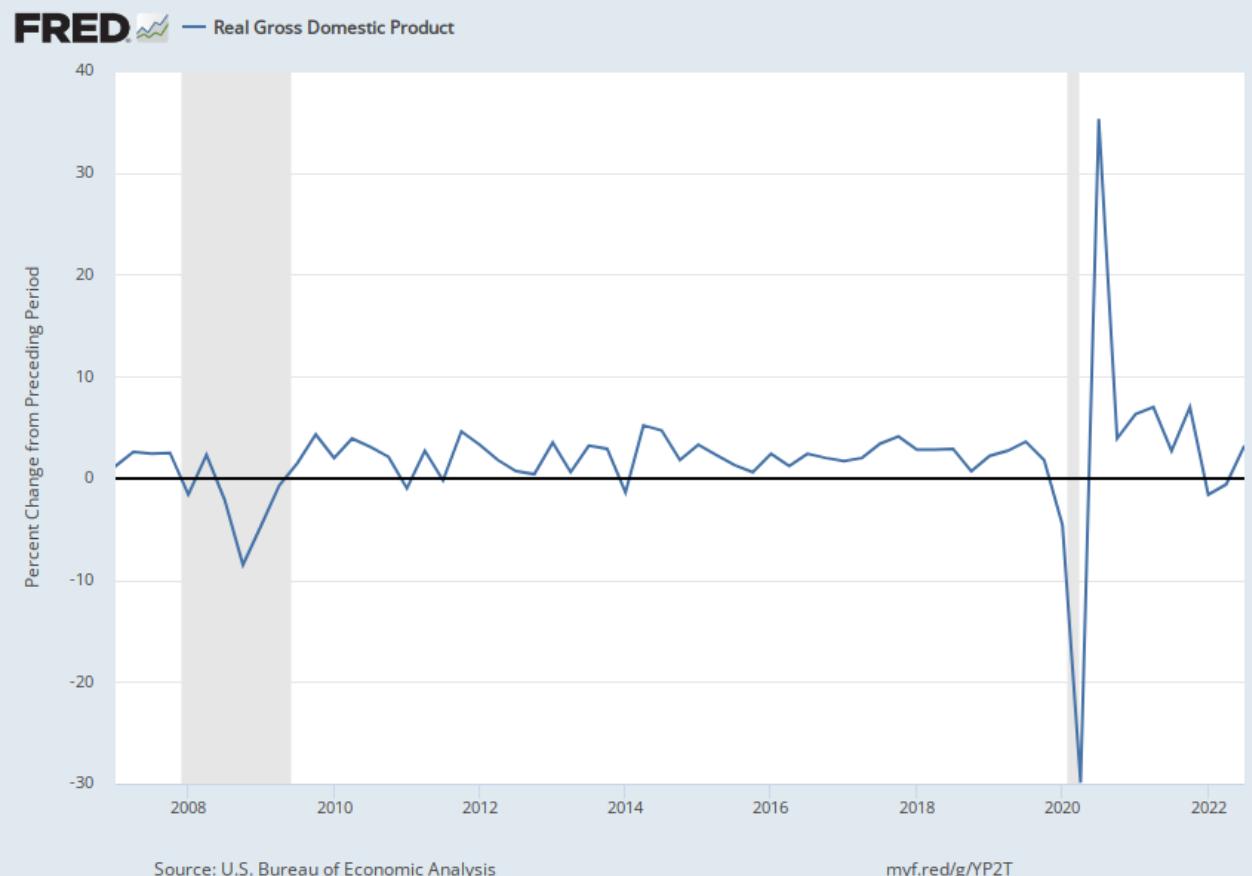


December's reported inflation of 6.42% exhibited a notable improvement (i.e., deceleration) from the high of 9.0% in June 2022. However, December's number, in and of itself, remains intolerably high in the Fed's view.

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Economy

Real GDP

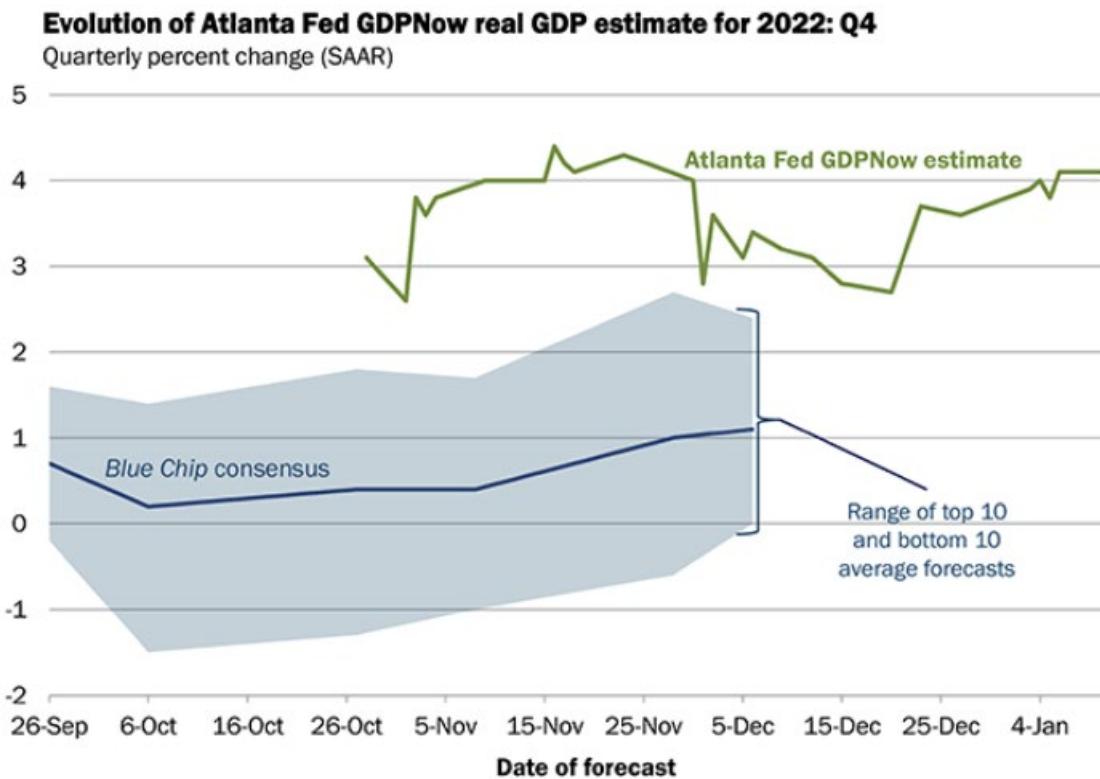


Q3 GDP was reported at +3.2% (quarter over quarter). That was a meaningful improvement from negative prints in both Q1 and Q2 of 2022 (-1.6% and -0.6%, respectively). Preliminary Q4 GDP is scheduled to be released on January 26, 2023.

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Economy

Real GDP Estimate – Atlanta Fed GDPNow



Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

While the Atlanta Fed's model can yield erratic estimates, this model was more accurate than the "Blue Chip" consensus for Q3. As of now, this model is calling for a further improvement in Q4 vs. the +3.6% reported for Q3. Such strong growth would appear to provide headroom for additional Fed rate hikes.

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Economy

Unemployment Rate

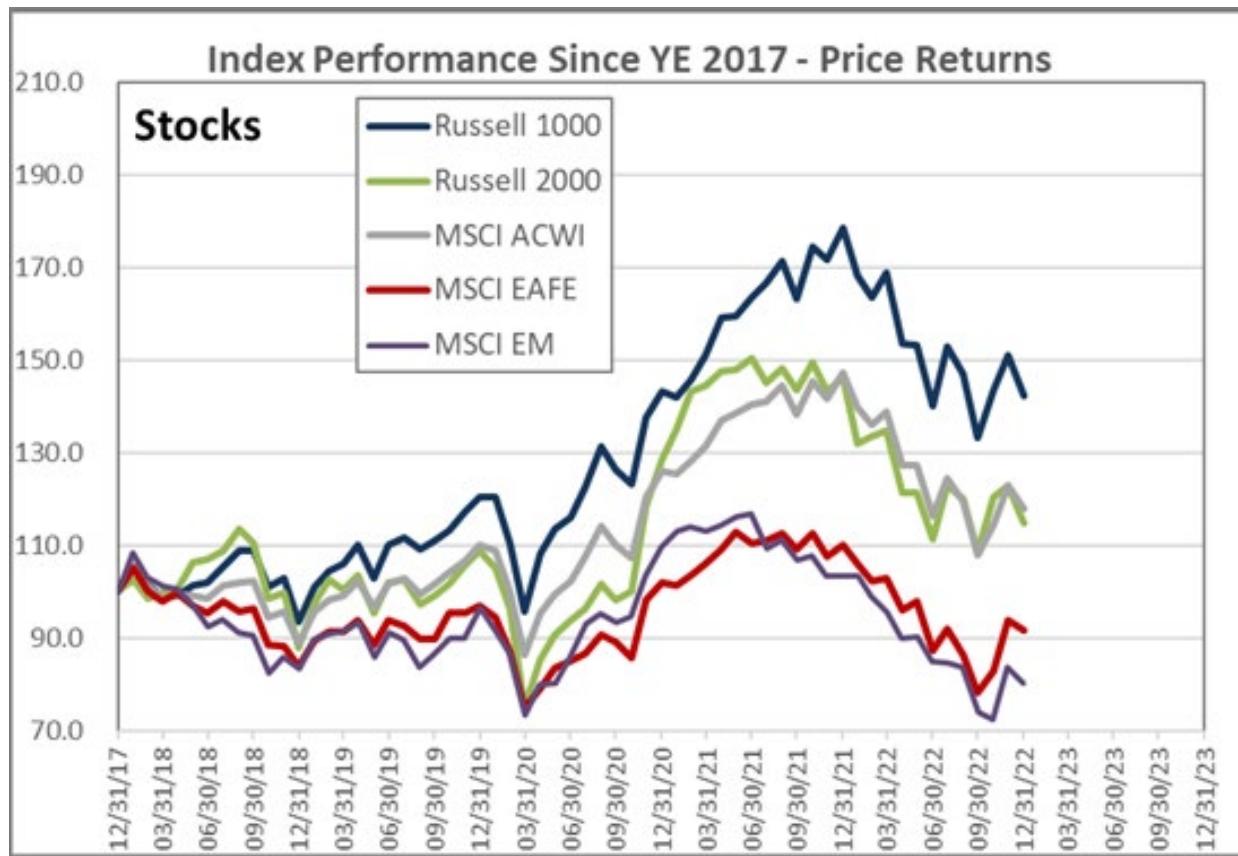


The unemployment rate for December held at 3.5%, a low “full employment”-type number that has prevailed for 9 months - since March 2022.

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Equities

Sub-Asset Class Relative Performance



Source: Bloomberg and Yahoo Finance monthly index data, with analysis by Villagran Investments LLC

Equity indexes have recovered some from their September lows. We'll see whether this recovery is merely a bear market rally or something more sustainable. It is interesting that International Developed stocks have outperformed since the lows. (See page 11.)

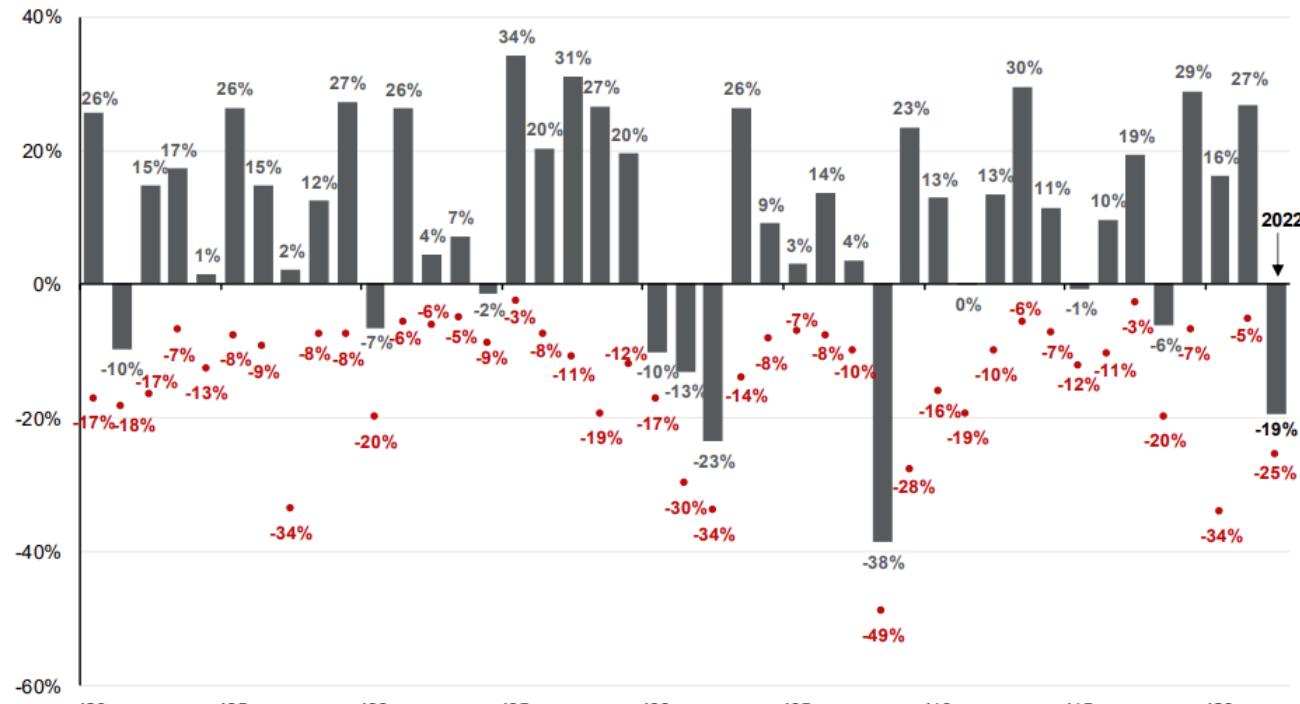
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Equities

S&P 500 Annual Returns & Intra-Year Declines

S&P intra-year declines vs. calendar year returns

Despite average intra-year drops of 14.3%, annual returns were positive in 32 of 43 years



Within the context of the last 42 years, 2022's downdraft for the S&P 500 measured as the 7th worst intra-year decline and 3rd worst full year decline.

Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2022, over which time period the average annual return was 8.7%.

Guide to the Markets – U.S. Data are as of December 31, 2022.

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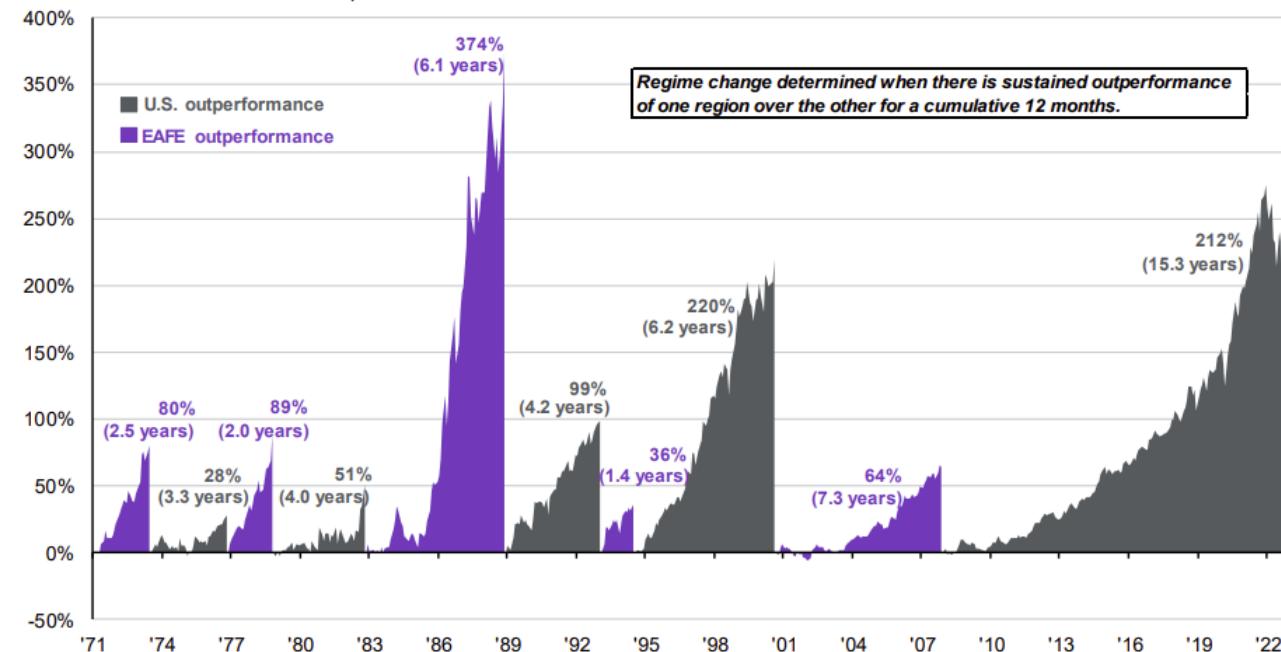
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Equities

Global Equities Relative Performance Cycles

MSCI EAFE and MSCI USA relative performance

U.S. dollar, total return, cumulative outperformance*



While the outperformance of U.S. equities vs. International may continue, the cycle is certainly 'long in the tooth.' May be a good time to review portfolio allocations to international equities.

Equities chart on this page will rotate thru the year based on perceived relevance.

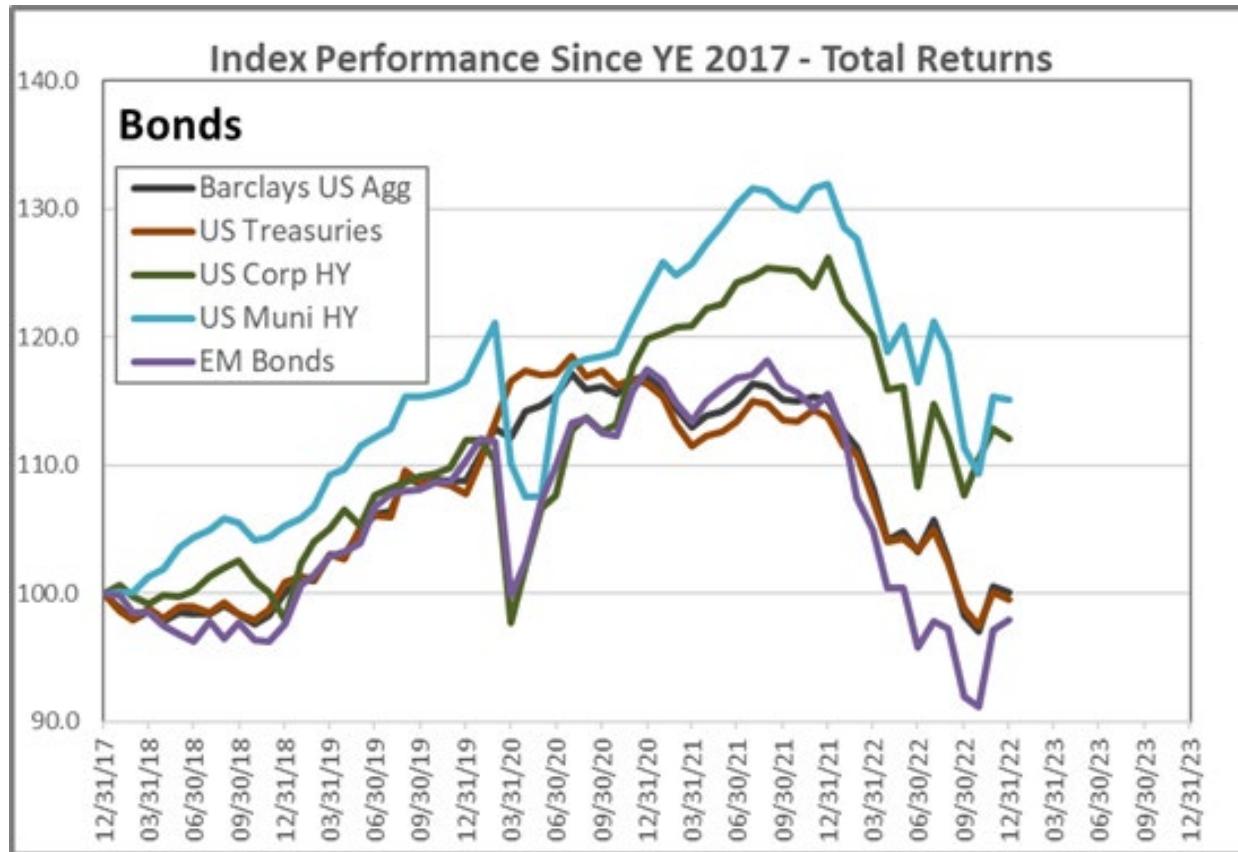
Source: FactSet, MSCI, J.P. Morgan Asset Management. *Cycles of outperformance include a qualitative component to determine turning points in leadership.
Guide to the Markets - U.S. Data are as of December 31, 2022.

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Fixed Income

Sub-Asset Class Relative Performance



The downdraft for bond indexes in 2022 was sharp – and the worst on record for investment grade bonds. Nevertheless, a bad year for bonds is still comparatively minor compared to what a major downdraft for stocks can look like.

Source: Bloomberg monthly index data, with analysis by Villagran Investments LLC

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Fixed Income

Market Yield - U.S. Treasury 10-Year Bond

FRED  — Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis



We expect the dichotomy between the recent pull-back in 10-year Treasury market rates vs. the Fed guidance of further rate hikes to be reconciled by about mid-year – one way or another.

Source: Board of Governors of the Federal Reserve System (US)

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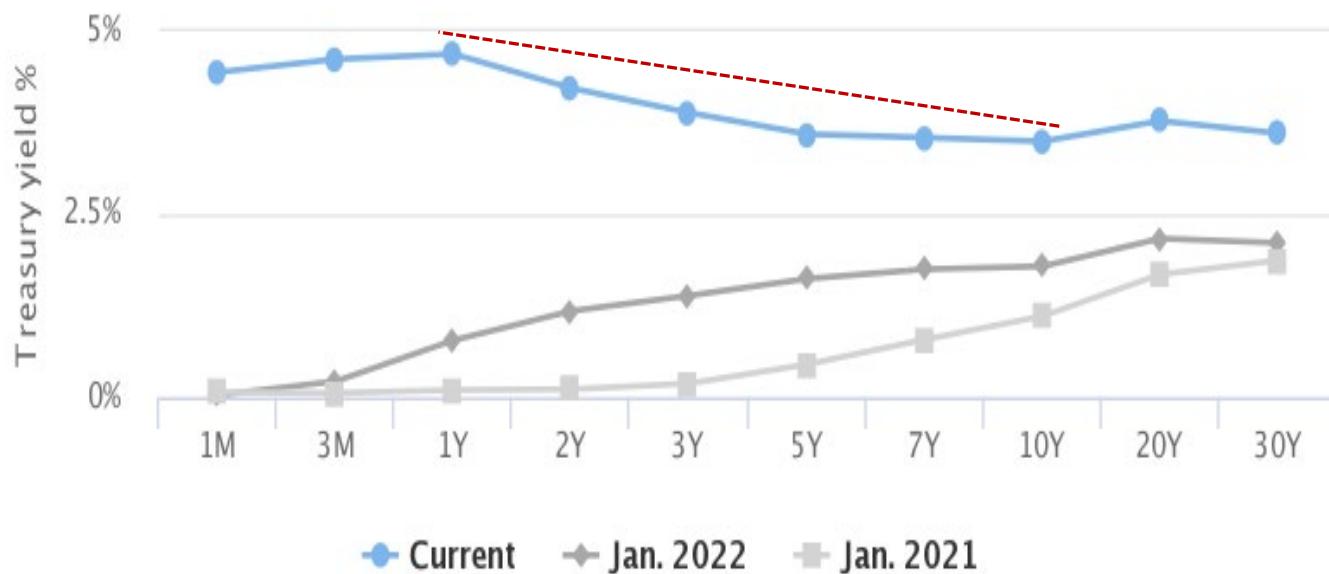
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Economy

Treasury Yield Curve

As of January 13, 2023

The Treasury yield curve inversion has now lasted 6 month.
(See page 15)

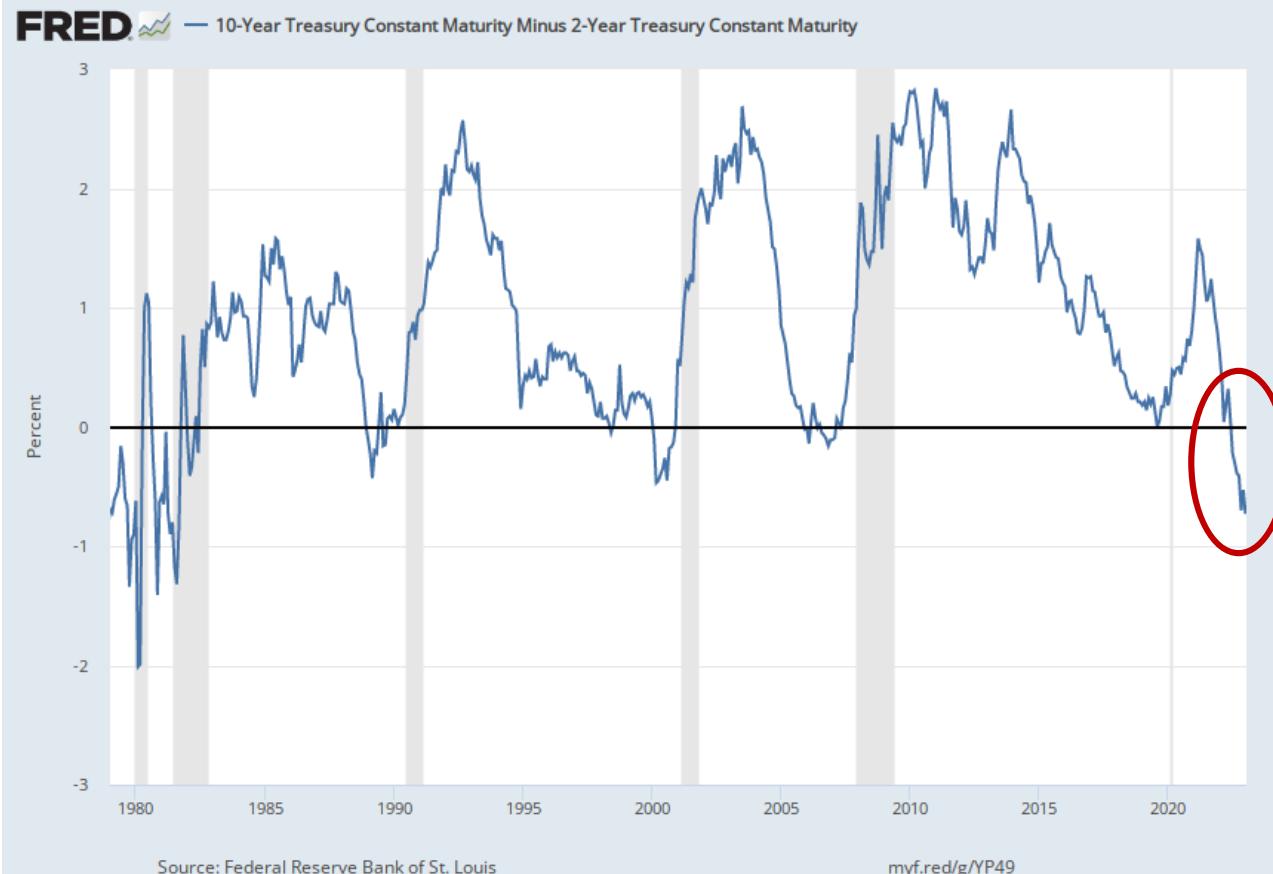


Source: GuruFocus.com

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Economy

Treasury Yield Spreads – 10-Year vs. 2-Year



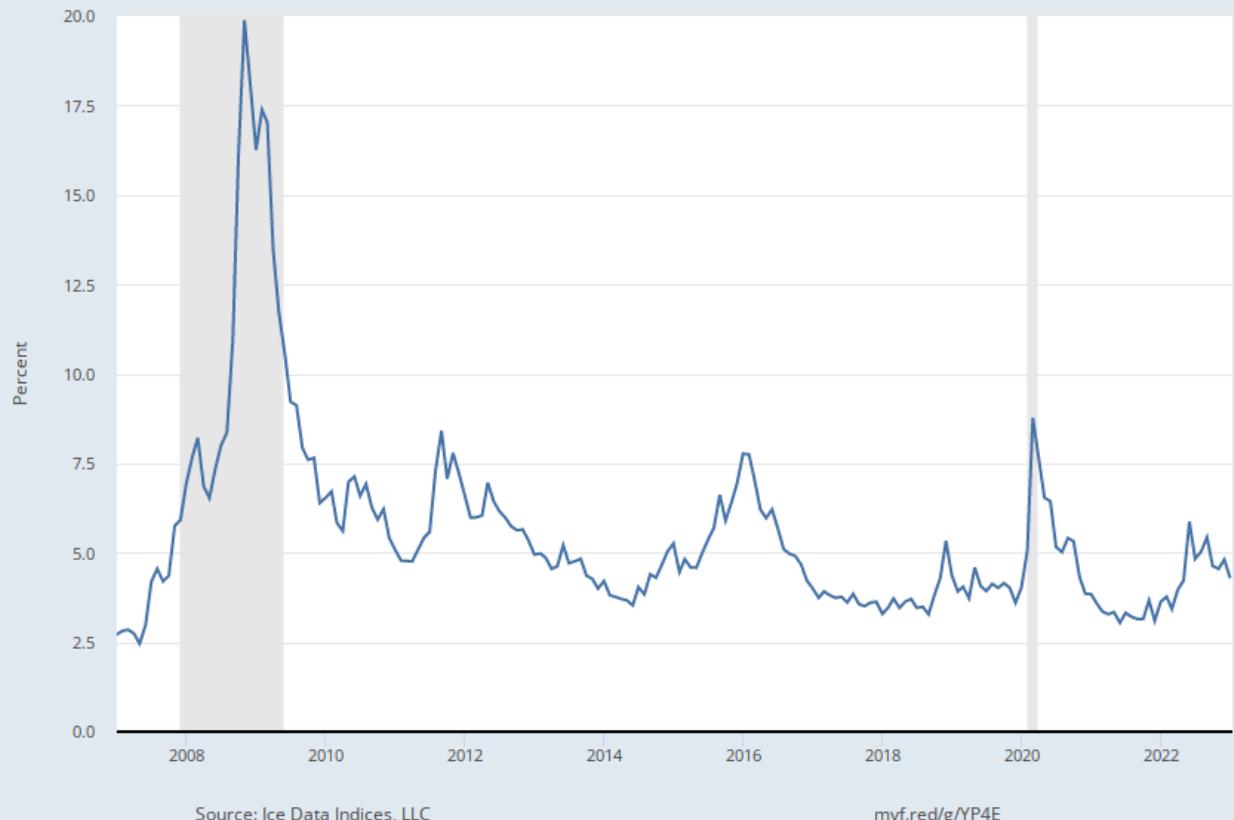
This chart clearly shows the consistency by which yield curve inversions have been followed by recessions. The prevailing inversion has now lasted 6 months.

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Economy

Credit Spreads – U.S. Corp High Yield vs U.S. Treasuries

FRED  — ICE BofA US High Yield Index Option-Adjusted Spread



High yield spreads remain within non-recessionary parameters, in our view. Were a recession to become evident, along with a decline in corporate profits, bond rating downgrades, and a couple news-worthy bond defaults, a spike in credit spreads would result.

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Rafael A. Villagran, the author of this report, is a Portfolio Manager, Head of the Asset Management Department, and investment advisor representative of NWAM, LLC dba Northwest Asset Management and RIA Innovations, an SEC registered investment advisor. This publication is in no way a solicitation or offer to sell securities or investment advisory services. Statistical information, quotes, charts, references to articles or quoted statement or statements regarding market or other financial information is obtained from sources which we believe reliable, but we do not warrant or guarantee the timeliness or accuracy of this information.

Sources Include:

Centers for Disease Control and Prevention – COVID-19 Data Tracker <https://www.cdc.gov/coronavirus/2019-ncov/covid-data/covidview/index.html>

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IMPORTANT DISCLOSURES

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Reference to market index information is included for illustrative purposes only, as it is not possible to directly invest in an index. Indexes are unmanaged, hypothetical vehicles that serve as market indicators. Index total return performance data reflects the assumptions of the reinvestment of interest and dividends but does not include the deduction of fees or transaction costs which otherwise reduce performance of an actual portfolio. Any blended indexes are shown for informational purposes only and are not representative of any particular investment or plan.

Definitions of Indexes Referenced

Russell 3000 – Index comprised of 3,000 largest U.S. stocks by market capitalization.

Russell 1000 – Index comprised of 1,000 largest U.S. stocks by market capitalization.

Russell 2000 – Index comprised of 2,000 smaller U.S. stocks by market capitalization within the Russell 3000.

S&P 500 – Compilation of 500 major U.S. stocks meeting certain criteria; market capitalization and float-weighted.

MSCI All Country World (ACWI) – Global equity index across market capitalizations with about 2,800 constituents, representing about 85% of the free float-adjusted market capitalization across 23 developed and 27 emerging markets.

MSCI All Country World ex USA – Global equity index across market capitalizations, which excludes the U.S., with about 2,300 constituents which represents free float-adjusted market capitalization across 22 developed and 27 emerging markets.

MSCI Europe, Asia & Far East (EAFE) – International equity index across market capitalizations, which excludes North America, with about 840 constituents which represents free float-adjusted market capitalization across 21 developed markets.

MSCI Emerging Markets (EM) – International equity index across market capitalizations with about 1,400 constituents which represents free float-adjusted market capitalization across 27 emerging markets.

Bloomberg Barclays U.S. Aggregate Bond – Widely followed bond benchmark comprised of investment grade, U.S. dollar denominated, fixed rate taxable bonds including Treasuries, government-related, corporate, mortgage-backed, and agency.

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IMPORTANT DISCLOSURES (Continued)

Definitions of Indexes Referenced (Continued)

Bloomberg Barclays U.S. Treasuries – U.S. bond index comprised of U.S. dollar denominated, fixed rate nominal bonds issued by the U.S. Treasury, and excludes T-Bills and STRIPS.

Bloomberg Barclays U.S. Corporate High Yield Bond – Fixed rate U.S. dollar denominated index of corporate bonds rated BB+ or below by Fitch and S&P.

S&P Municipal High Yield Bond – U.S. index of municipal bonds that are either not rated or rated below investment grade.

Bloomberg Barclays Emerging Market Bond – International bond index comprised of U.S. dollar denominated bonds hard currency debt from sovereign, quasi-sovereign and corporate issuers in Emerging Markets.

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