Q1 2023 NEWSLETTER

IMPACT

FINANCIAL STRATEGIES

January 3, 2023

Thinking Again

"… the purpose of learning Isn't to affirm our beliefs; it's to evolve our beliefs." – Adam Grant, Think again

2022. One year ago, we were all looking towards a more historically "normal" year. We had just come off of 2 back to back years defined by pandemics, global shutdowns, social awakening, fires, floods, impeachments, and market volatility; each of which had been of historical proportions. 2022 didn't play out that way (didn't feel that way.) The world and markets didn't behave the way we *thought* they would, or *thought* they should.

Two times in two weeks, two of my personal mentors suggested that I should pick up Adam Grant's book, Think Again. I cannot imagine a more appropriate setting against which to reevaluate some very long-held beliefs, expectations, and assumptions. Starting with the speed by which the Federal Reserve began raising rates, followed very quickly by a hostile European land invasion, and a spring and summer that gave us price increases of the like many of us have never experienced as an adult. The markets *should not* have behaved the way they did. I promise you; I have been deeply evaluating what I/we can learn from this year. I am "thinking again" about how I can integrate what I've learned to strengthen your financial position and give your more confidence and peace of mind. This will be a major focus of our meeting and reviews as we navigate 2023. You will hear more about this.

Professionally, (and humbly) I also achieved a major Milestone. In Sept, after thousands of hours of studying, I completed a weeklong intensive Capstone Class at University of Chicago Booth School of Business and then successfully passed my exam to become a Certified Private Wealth Advisor. Here is more info if you are interested. But with this education, you can rest assured that we as a team are committed to always being on the cutting edge of strategies, trends, and solutions that will make the most IMPACT on your future. I could not have committed time and mental energy without the support of my Amazing Team. And each of them is constantly striving to become more and become better; our culture is one that is fully designed to add more value to you, our client Tribe.

I anticipate that 2023 will be another volatile year, and it will have two distinct economies and markets. I also believe the future is brighter than it was when we started 2022. We need to manage downside risk, we need to evaluate our emotions, we need to revisit your plans to make sure you are still on track, and we need to believe. We also need to be flexible, be realistic, and be open to new ideas based on what we've learned and what the markets have taught us.

Happy New Year!!! See you in 2023. Have fun, love a lot, remember what really matters, and turn off your phone at the table. :)

I hope you enjoy this newsletter, please reach out if you have any questions or comments,

Justin

Quarterly Insights – January 2023

Surging Interest Rates and High Inflation Result in the Worst Year for Stocks and Bonds in Decades

Easing inflation pressures and a resolution of the fiscal turmoil in the United Kingdom fueled a strong rally in stocks and bonds early in the fourth quarter, but hawkish Fed guidance, disappointing economic data, and rising global bond yields weighed on markets in December and the S&P 500 finished the fourth quarter with only modest gains that capped the worst year for the index since 2008.

The end of the third quarter was volatile as global bond yields spiked in response to the spending and tax cut package proposed by former U.K. Prime Minister Liz Truss, and that volatility continued as the fourth quarter began with the S&P 500 hitting a new low for the year on October 13th. However, that market turmoil ultimately resulted in political change in the U.K. as PM Truss resigned on October 20th and was replaced by former Chancellor of the Exchequer Rishi Sunak, who immediately took steps to disavow Truss' plan and restore market confidence in U.K. finances. In part due to a very short-term oversold condition and following a no-worse-than-feared third-quarter earnings season, stocks and bonds staged large rallies in mid and late October and the S&P 500 finished the month with a substantial gain, rising 8.1%.

The positive momentum for stocks and bonds continued in early November thanks to a growing number of price indicators that implied inflation pressures had finally peaked. The October CPI report (released November 10th) showed the first solid decline in consumer price data for the year and that was echoed by price indices contained in national and regional manufacturing reports, as well as other official inflation statistics. Both stocks and bonds enjoyed solid gains in response to the data because while inflation remained far too high on an absolute level, markets hoped these declines would result in the Federal Reserve not raising interest rates as high as previously feared. Those hopes were boosted after the Thanksgiving holiday when Fed Chair Powell stated that interest rates would only need to rise "somewhat" higher than previous projections. Investors took that "somewhat" remark as a sign that previous estimates for rate hikes were too aggressive and that extended the rally into early December. The S&P 500 ended November at multi-month highs with another solid monthly gain of 5.6%.

However, investor optimism faded in December as global central banks signaled that they were still committed to aggressively hiking rates, economic data showed clear signs of slowing growth, and several negative earnings announcements raised concerns of an earnings recession in 2023. First, at the December meeting, the Fed revealed that they expected rate hikes to take the fed funds rate above 5% (from the current 4.375%), which was higher than market expectations. Then, economic data released in mid-December, including regional manufacturing indices and the November retail sales report, showed economic activity was slowing. Finally, both the European Central Bank and the Bank of Japan surprised markets with hawkish policy decisions, providing yet another reminder to investors that rates will continue to rise in 2023 despite clearly slowing global economic growth and the increasing threat of recession. Stocks dropped from mid-December on, and the S&P 500 ended the month of December with a loss of 5.90%.

In sum, 2022 was the most difficult year for investors from a return and volatility standpoint since the Global Financial Crisis. Multi-decade highs in inflation combined with historically aggressive Fed rate hikes and growing concerns about economic and earnings recessions to pressure both stocks and bonds. The S&P 500 posted its worst performance since 2008 while major benchmarks for both stocks and bonds declined together for the first time since the 1960s, punctuating just how disappointing the year was for investors.

Q4 and Full Year 2022 Performance Review

Unlike the first three quarters of 2022, when all four major indices saw quarterly declines, performance was mixed during the fourth quarter as the Dow Jones Industrial Average rose sharply, while the S&P 500 and Russell 2000 were solidly higher. Like most of 2022, however, the Nasdaq lagged and fell slightly in the fourth quarter. Expectations for higher rates, slowing economic growth and underwhelming earnings weighed on the tech sector in the fourth quarter, which was the case for much of 2022. Conversely, less economically sensitive companies that trade at lower valuations than tech stocks outperformed again as investors continued to shift towards defensive sectors amid growing recession fears. On a full-year basis, all four major indices posted negative returns, with the Dow Jones Industrial Average relatively outperforming while the Nasdaq badly lagged the other major indices.

By market capitalization, large-caps slightly outperformed small-caps in the fourth quarter, but modestly outperformed throughout 2022. Concerns about future economic growth and higher interest rates (which can impact small-caps disproportionately due to funding needs) were the main drivers of large-cap outperformance and small-cap underperformance throughout 2022. Small-cap stocks did show some resilience in the fourth quarter with the Russell 2000 index registering a solid gain as investors' hopes for a peak in inflation and ultimately interest rates, led to some dip buying in the segment.

From an investment style standpoint, value massively outperformed growth all year and that trend continued in the fourth quarter. Underwhelming earnings weighed on tech stocks in the final three months of the year, while concerns about slowing economic growth combined with rising bond yields hit richly valued tech stocks throughout 2022. Value stocks, meanwhile, were viewed as more attractive in the market environment of 2022 due to lower valuations and exposure to business sectors that are considered more resilient than high-growth parts of the market.

On a sector level, 10 of the 11 S&P 500 sectors finished the fourth quarter with a positive return, although only two of the 11 ended 2022 with gains. Energy outperformed other sectors not just in the fourth quarter but for all of 2022. In the fourth quarter, energy stocks were helped by progress on the post-Covid economic reopening in China which increased energy demand expectations, while a falling dollar was an added tailwind for commodities including oil and gas. More to that point, the other strong sector performers in the fourth quarter were industrials and materials, which also benefitted from an improving Chinese demand outlook and a weaker U.S. dollar. For the full year, energy was, by far, the best-performing sector in the market as an early-year surge in oil and natural gas prices in response to increased geopolitical risks and reduced Russian supply helped push energy stocks sharply higher. Defensive sectors, specifically utilities and consumer staples, were the next best-performing sectors finishing the year with small gains and losses, respectively, again as investors rotated towards less economically sensitive corners of the market amid rising recession risks.

The tech sector and those sectors with overweight exposure to high-growth companies badly lagged in the fourth quarter and over the course of 2022. In the fourth quarter, communication services were only fractionally positive while the consumer discretionary sector posted a negative return on weakness in high-growth internet and consumer stocks. For the full year, those same two sectors posted the worst returns in the S&P 500, as investors shunned richly valued, growth-oriented tech companies.

S&P 500 Total Returns by Month in 2022											
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
-5.17%	-2.99%	3.71%	-8.72%	0.18%	-8.25%	9.22%	-4.08%	-9.21%	8.10%	5.59%	-5.90%

Source: Morningstar

US Equity Indexes	Q4 Return	2022 Return
S&P 500	7.56%	-18.11%
DJ Industrial Average	16.01%	-6.86%
NASDAQ 100	-0.04%	-32.38%
S&P MidCap 400	10.78%	-13.06%
Russell 2000	6.23%	-20.44%

Source: YCharts

Internationally, foreign markets handily outperformed the S&P 500 in the fourth quarter thanks to a large bounce in Chinese stocks as Beijing ended its “Zero-Covid” policy and commenced an economic reopening, while a falling dollar boosted global economic sentiment. Foreign developed markets outperformed emerging markets in the fourth quarter thanks in part to a large bounce in U.K. shares following the resignation of PM Truss and the abandonment of her fiscal spending and tax cut plan. For the full-year 2022, foreign developed markets registered solidly negative returns, but thanks to the fourth-quarter rally, relatively outperformed the S&P 500.

International Equity Indexes	Q4 Return	2022 Return
MSCI EAFE TR USD (Foreign Developed)	17.40%	-14.01%
MSCI EM TR USD (Emerging Markets)	9.79%	-19.74%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	14.37%	-15.57%

Source: YCharts

Commodities saw gains in the fourth quarter as both oil and gold logged positive returns. A falling dollar paired with an improving outlook for Chinese demand as the government moved towards reopening their economy pushed oil higher throughout the quarter. Gold, meanwhile, saw steady gains in the final three months of the year thanks primarily to the decline in the U.S. dollar. For 2022, commodities posted a large, positive return due to the significant gains in oil futures and other energy commodities that came in response to geopolitically driven supply concerns following Russia’s invasion of Ukraine. Gold, however, saw only a slightly positive return for 2022 as sharp rises in the U.S. dollar and Treasury yields midyear weighed on the yellow metal, limiting gains.

Commodity Indexes	Q4 Return	2022 Return
S&P GSCI (Broad-Based Commodities)	3.44%	25.99%
S&P GSCI Crude Oil	1.20%	5.06%
GLD Gold Price	9.85%	0.42%

Source: YCharts/Koyfin.com

Switching to fixed income markets, the leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) realized a positive return for the fourth quarter but declined sharply for the full year of 2022, as more-aggressive-than-expected Fed rate hikes combined with decades-high inflation pressured most bond classes.

Looking deeper into the fixed income markets, longer-duration bonds outperformed those with shorter durations in the fourth quarter, as bond investors reacted to more-resilient-than-expected economic data. For the full year, shorter-term bonds handily outperformed longer-duration bonds as they were less impacted by Fed rate hikes and spiking inflation.

Turning to the corporate bond market, both higher-yielding, lower-quality corporate bonds and investment grade bonds posted similarly positive returns for the fourth quarter, as investors reacted to the possible peak in inflation. Lower-yielding and safer investment-grade corporate debt underperformed for the full year, however, as investors shunned those bonds for shorter-duration debt and corporate debt with higher yields.

US Bond Indexes	Q4 Return	2022 Return
BBgBarc US Agg Bond	1.87%	-13.01%
BBgBarc US T-Bill 1-3 Mon	0.89%	1.52%
ICE US T-Bond 7-10 Year	0.98%	-14.90%
BBgBarc US MBS (Mortgage-backed)	2.14%	-11.81%
BBgBarc Municipal	4.10%	-8.53%
BBgBarc US Corporate Invest Grade	3.63%	-15.76%
BBgBarc US Corporate High Yield	4.17%	-11.19%

Source: YCharts

<u>Q1 and 2023 Market Outlook</u>

Markets ended 2022 on a decidedly negative note and the December losses helped to ensure that 2022 was the worst year for stocks since 2008 and the worst year for bonds in multiple decades, as both asset classes posted annual declines for the first time since the 1960s.

The losses in stocks and bonds were driven by decades-high inflation, a historic Fed rate hike campaign and geopolitical unrest. But while those factors were clear negatives for asset prices in 2022, it's important to note that as we enter 2023, the market is approaching a potentially important transition period that could see each of these headwinds ease in the months ahead.

First, inflation has shown definitive signs of peaking and declining. The Consumer Price Index has fallen from a high of 9.1% in June to 7.1% in November, while other metrics of inflation have registered similar declines. Now, to be clear, inflation remains much too high in an absolute sense, but if price pressures ease faster than expected, that will present a positive surprise for markets in the first several months of 2023.

Second, after a historically aggressive rate hiking campaign in 2022, the current Fed hiking cycle is likely nearly complete. In December, the Federal Reserve signaled that it expected the peak interest rate to be just 75 basis points higher than the current rate. That level could easily be reached within the first few months of 2023 and the Fed ending its rate hike campaign will remove a significant headwind from asset prices.

Finally, while both economic growth and corporate earnings are expected to decline in 2023, those negative expectations have been at least partially priced into stocks and bonds at current levels. As such, if the economy or corporate America proves to be more resilient than forecasts, it could provide a positive spark for asset markets in early 2023.

As we start the new year, we should expect financial media commentary to be focused on the 2022 losses and current market risks, including earnings concerns and recession fears. But the market is a forward-looking instrument, and while there are undoubtedly economic and corporate challenges ahead in 2023, some of those best-known risks are partially priced into markets already, and the truth is that there are potential positive catalysts lurking as we start a new year.

More broadly, market history is clear: Declines of the magnitude we saw in 2022 are usually followed by strong recoveries, not further weakness. The S&P 500 hasn't registered two consecutive negative years since 2002, while bonds, represented by the Bloomberg U.S. Aggregate Bond Index, have never experienced two negative consecutive years. And that reality underscores an important point, that market declines such as we witnessed in 2022 have ultimately yielded substantial long-term opportunities in both stocks and bonds.

The stagflation of the 1970s and sky-high interest rates of the early 1980s eventually gave way to the strong economic growth and market rally of the 1980s. The dot-com bubble burst of the early 2000s was followed by substantial market gains into the mid-2000s. The financial crisis, which remains the most dire economic situation we've experienced in modern market history, was followed by strong rallies in the years that followed, and not even the worst global pandemic in over 100 years could result in sustainably lower asset prices.

As such, while we are prepared for continued volatility and are focused on managing both risks and return potential, we understand that a well-planned, long-term-focused, and diversified financial plan can withstand virtually any market surprise and related bout of volatility, including multi-decade highs in inflation, historic Fed rate hikes, geopolitical unrest, and rising recession risks.

At Impact Financial Strategies, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. Successful investing is a marathon, not a sprint, and even temporary bouts of volatility like we experienced over the past three months are unlikely to alter a diversified approach set up to meet your long-term investment goals.

Therefore, it's critical for you to stay invested, remain patient, and stick to the plan, as we've worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.

Rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

Justin

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The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market.

The Dow Jones Industrial Average (DJIA), commonly known as "The Dow" is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal.

The NASDAQ Composite Index is an unmanaged index of securities traded on the NASDAQ system.

The S&P MidCap 400® provides investors with a benchmark for mid-sized companies. The index, which is distinct from the large-cap S&P 500, measures the performance of mid-sized companies, reflecting the distinctive risk and return characteristics of this market segment..
Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index.

The S&P GSCI is a composite index of commodities that measures the performance of the commodity market. S&P GSCI Gold is an index tracking changes in the spot price for gold bullion. S&P GSCI Crude Oil is an index tracking changes in the spot price for crude oil. GLD is a gold index fund based on gold and holds gold and/or cash as its only assets, but shareholders are not guaranteed to receive physical gold in exchange for their shares.

The MSCI EAFE (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 22 developed nations.

The MSCI Emerging Markets is designed to measure equity market performance in 25 emerging market indices. The index's three largest industries are materials, energy, and banks.

The MSCI ACWI (All Country World Index) is a free floating-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets.

The Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixedrate taxable bond market.

The Barclays US T-Bill index measures the performance of public obligations of the U.S. Treasury that have a remaining maturity of greater than or equal to 1 month and less than 3 months.

The ICE U.S. Treasury 7-10 Year Bond Index is market value weighted and is designed to include U.S. dollar denominated, fixed rate securities with minimum term to maturity greater than or equal to seven years and less than ten years.
Barclays Capital U.S. MBS Index measures the performance of investment grade fixed-rate mortgage-backed pass-through securities of GNMA, FNMA, and FHLMC.

The Barclays Capital Municipal Bond is an unmanaged index of all investment grade municipal securities with at least 1 year to maturity.
The Bloomberg Barclays US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USDdenominated securities publicly issued by US and non-US industrial, utility and financial issuers.

The Bloomberg Barclays U.S. Corporate High Yield Bond Index is composed of fixed-rate, publicly issued, non-investment grade debt, is unmanaged, with dividends reinvested, and is not available for purchase. The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility and Finance, which include both U.S. and non-U.S. corporations.

Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Diversification and asset allocation do not ensure profit or protect against loss. Holding investments for the long term does not insure a profitable outcome. Investing involves risk and you may incur a profit or loss regardless of the strategy selected. Links are being provided for information purposes only. Raymond James is not affiliated with and does not endorse, authorize or sponsor any of the listed websites or their respective sponsors. Raymond James is not responsible for the content of any website or the collection or use of information regarding any website's users and/or members.
Investing in ommodities is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

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