

WINTER 2023

One year ago, as 2022 began, the stock market, as measured by the Standard & Poor's 500 (S&P 500), hit an all-time high of 4,796.56, after a gain of 28.7% in 2021. Investors will recall, however, that the mood at that time was hardly celebratory, as concerns were mounting about the possibility of trouble ahead. The threat of inflation, higher interest rates and stretched valuations in the stock market were major worries for investors. Those fears were well founded in 2022 as the S&P 500 suffered its worst year since 2008.

The S&P 500 had a negative total return of 18.1% (including dividends) in 2022 and the NASDAQ, home to many technology and "new economy" giants, declined by 33.1%. The Dow Jones Industrial Average, by comparison, declined by only 8.8%, helped, in part, by a broader mix of industrial, health care and consumer products companies. Value stocks significantly outperformed growth stocks in 2022. The Ishares Russell 1000 Value Fund declined by 8.2% while the Ishares Russell 1000 Growth Fund lost 29.5%. Large value holdings include Berkshire Hathaway, Johnson & Johnson, ExxonMobil, and J.P. Morgan while the growth fund's largest holdings are Apple and Microsoft.

The long-time leader in the U.S. stock market, Apple, declined by 26.4% in 2022 after a gain of 34.6% in 2021. Many other technology-oriented giants such as Microsoft, Alphabet (Google), Meta (Facebook) and Amazon suffered similar fates in 2022. The price that investors were willing to pay for growth declined sharply as interest rates rose and the threat of recession loomed. Indeed, many of these companies have addressed a possible earnings growth slow down and, after years of rapid hiring, layoffs and other expense reduction efforts have been announced.

While the gain in the S&P 500 in 2021 was achieved amid much volatility, so was the loss in 2022. According to CNBC, one third of the trading days in 2022 saw moves in the market of over 1%. In a more startling finding, Nicolas Colas of

Datatrek¹, reported that 95% of the decline in the S&P 500 in 2022 occurred over just 5 trading days. In years past, we have looked at where the annual returns, both good and bad, have come in any given year, and it is usually compressed into very few trading days. We have learned that while it would be nice to avoid the worst of the down days in a bad market, this compression of returns into a few days speaks to the folly of market timing over the long term.

Many Wall Street strategists expect continued volatility in 2023 and even some of the more optimistic ones allow that things might get worse for stocks before recovering in the second half of the year. There are concerns that the Federal Reserve will continue raising rates to the point that the economy will slide into a meaningful recession. The combination of higher interest rates and lower earnings could impact valuations in the stock market as price/earnings ratios may decline as investors are less willing to pay for a slowing earnings growth rate. The less optimistic strategists see earnings declining in a recession and reason that stocks still don't reflect this possibility. Higher interest rates, in addition to slowing capital investment and purchases of homes and cars for example, also offer a more attractive alternative to stocks than in years past with short term treasury notes yielding above 4.0%

Argus Research², in a recent Market Digest, lists the range of estimates for the S&P 500 and the earnings per share for the S&P 500 for 2023. The forecasts range from a year-end target of 3500 (down roughly 9%) to 4500 (up about 17%). The earnings per share for the S&P 500 are projected to be between \$230 and \$250, which results in a P/E ratio of between 14-18X. Again, according to Argus, the current P/E ratio is about 16X, which doesn't seem too extreme despite all the potential obstacles.

Only the most optimistic strategists see a return to levels in the S&P 500 where we began 2022. Long experience has taught us the folly of predicting short term and even annual moves for the stock market. The one thing we can say with confidence is that the all-time high for the S&P 500 set on January 3, 2022, will not stand forever as the record holder. It may take time, but that record will be reset many

¹ Nicolas Colas, Datatrek, December 28, 2022

² Argus Market Watch January 3, 2023

times at higher and higher levels. Patience may be required however, as the high point for the S&P 500 set in 2007 was not bested until 2013. The high mark in 2007 occurred almost 7 years after the zenith in 2000. While we don't know of course, we have a feeling the wait won't be as long this time around. We continue to believe that a diversified portfolio of top-quality stocks will provide solid returns over the long term. We wish you all the best for a happy and healthy New Year.

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