Market Commentary

As of December 31, 2022

Economy & Market Review

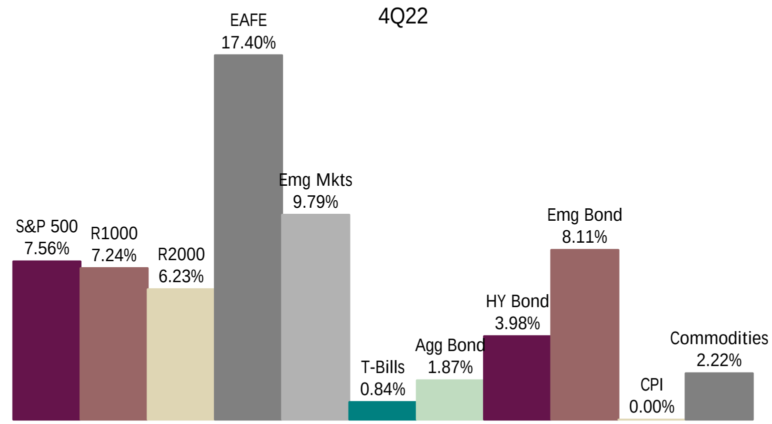
Fourth Quarter 2022

The fourth quarter provided a glimmer of positive light in an otherwise abysmal year in the markets. Let us hope the light at the end of the tunnel is not an oncoming train. Inflation appears to be moderating somewhat, but the inflation level is still elevated compared to the Federal Reserve's (Fed) goal of 2%. December inflation was up 6.5% year-over-year. Hence, the Fed's persistent hard-core inflation-busting stance. The increase in the federal funds rate has created historic bond market losses in 2022. After three negative quarters plunging 13% for the year, bonds found some stability increasing 1.9% in the fourth quarter. Equity markets also produced positive quarterly results as the S&P 500 large cap stock index rebounded with a 7.6% increase, but finished the year down 18.1%. US small caps increased 6.2% for the quarter, but lost 20.4% for the year. Internationally, developed non-US stocks jumped 17.4% for the quarter, but were down 14% in 2022, and emerging market equities were up 9.8% during the quarter, but fell 19.7% for the year.

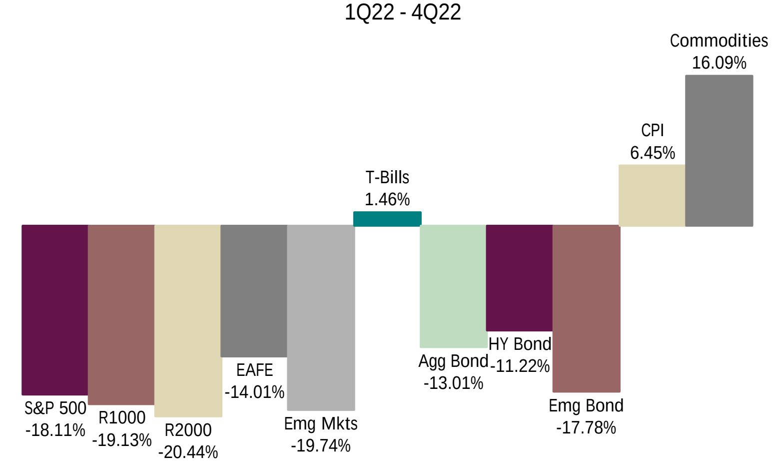
Even with the increase in interest rates, the domestic economic activity continues to endure. The seemingly strong US labor market has been a thorn in the Fed's side, but supportive for people that want a job. December payrolls added 223,000 jobs which was above consensus estimates. That brought the unemployment rate back down to 3.5% matching a 53 year low. Employment is a coincident indicator, not a leading indicator, so employment usually coincides with the peaks and troughs of the economic cycle. By definition, coincident indicators do not lead and don't decline ahead of recessions. Even with low unemployment, some economic cracks are starting to develop. Leading economic indicators are at levels historically indicating recession. Consumer sentiment although off the recent lows is still in recessionary territory. Consumers appear more financially stretched as the savings rate (US Personal Saving as a percentage of Disposable Personal Income) is near lows set in 2005, credit card debt is increasing and housing affordability is challenged. On the bright side for the Fed, but not for employees, wage growth cooled in December. Over longer periods, labor costs and price growth (inflation) are closely linked. Since the Bernanke Fed, the central bank has attempted to mute each recession, but now we will see if their actions create the next recession.

Global Market Performance

Quarter Performance

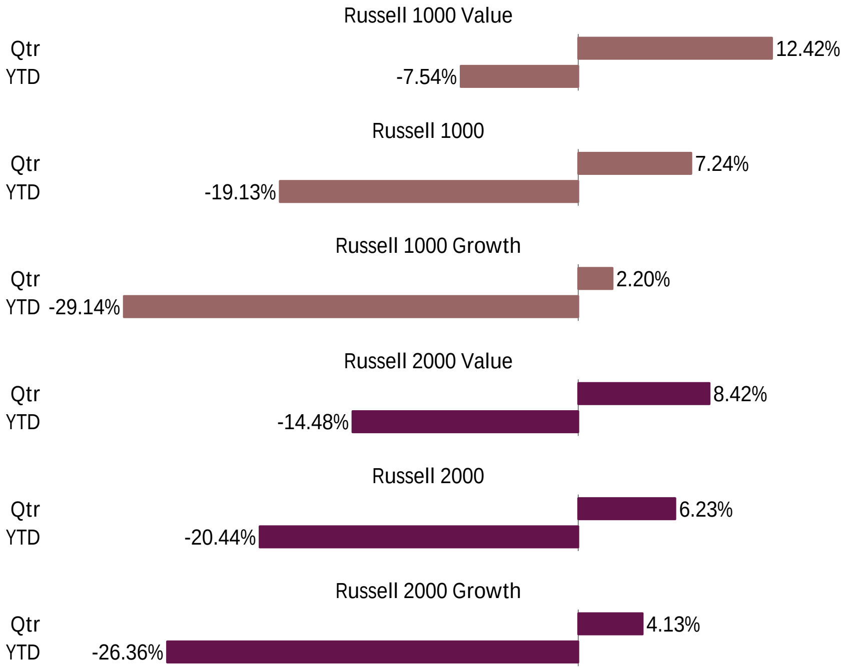


Year To Date Performance



U.S. Equity Markets

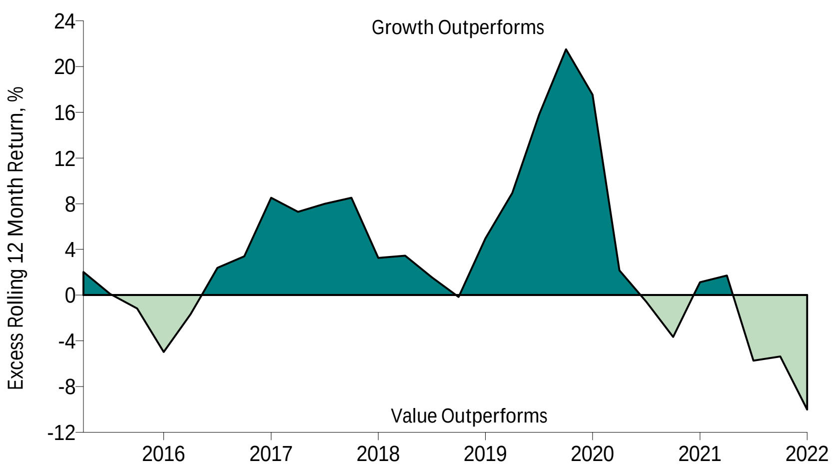
U.S. Equity Style Performance



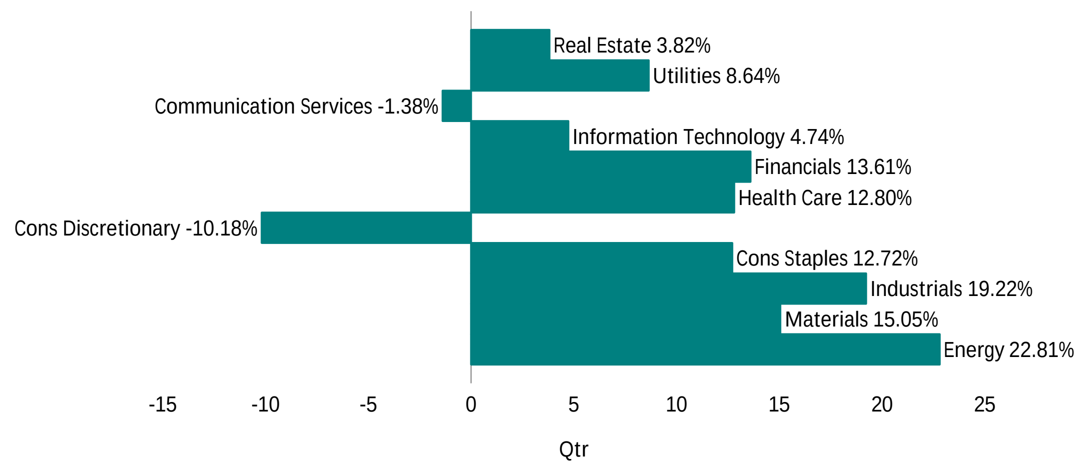
Value stocks actually found a moment in the sun with positive relative returns compared to growth stocks for both the quarter and the year. From an absolute return perspective, value stocks were still down on the year. The Russell 1000 Value Index was down 7.5% and the Russell 1000 Growth Index was down 29.1% for 2022. Small cap value (Russell 2000 Value Index) was down 14.5% and small cap growth was down 26.4% during the year. From a valuation perspective, based upon a comparison of current P/E (Price-to-Earnings ratio) to 20-year average P/E ratio, all large cap valuations by style still trade at premiums and only small cap growth is meaningfully discounted. The S&P 500's current Price-to-Earnings ratio (P/E) of 16.7x is only slightly lower than the 25 year average of 16.8x, and many other valuation metrics still register above their respective 25 year averages.

Although nine of the eleven sectors had positive performance for the fourth quarter, Energy and Utilities were the only two sectors with positive results in 2022. Energy was up a massive 65% as supply and demand imbalances along with global strife impacted commodity prices. Utilities as a defensive sector were up 1.6%. During 2022, Communication Services (-39.9%), Consumer Discretionary (-37%) and Technology (-28.2%) sectors provided heavy losses as these economic areas repriced with higher rates and were also impacted by their more extreme initial valuations.

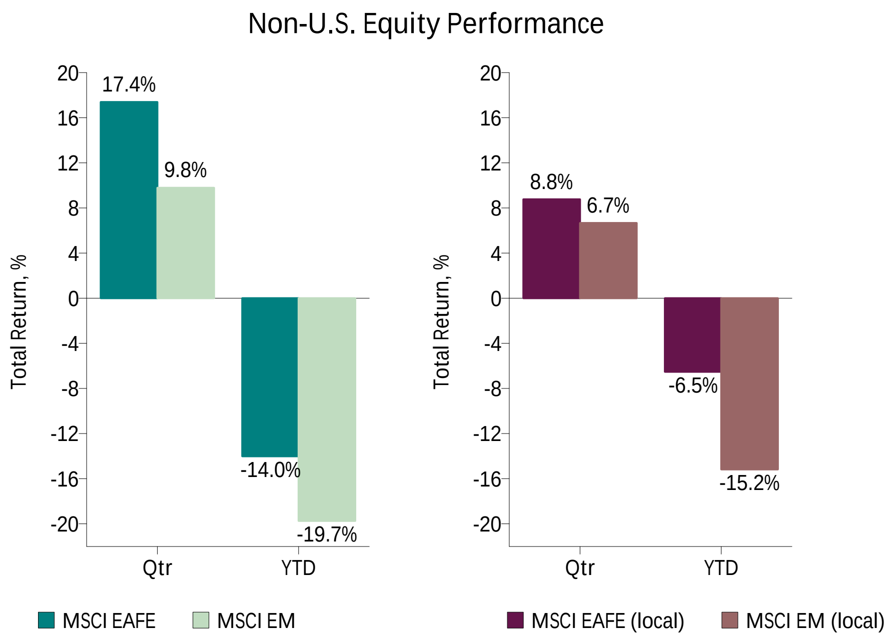
Growth Relative to Value (Russell 1000)



U.S. Equity Sector Performance (S&P 500)

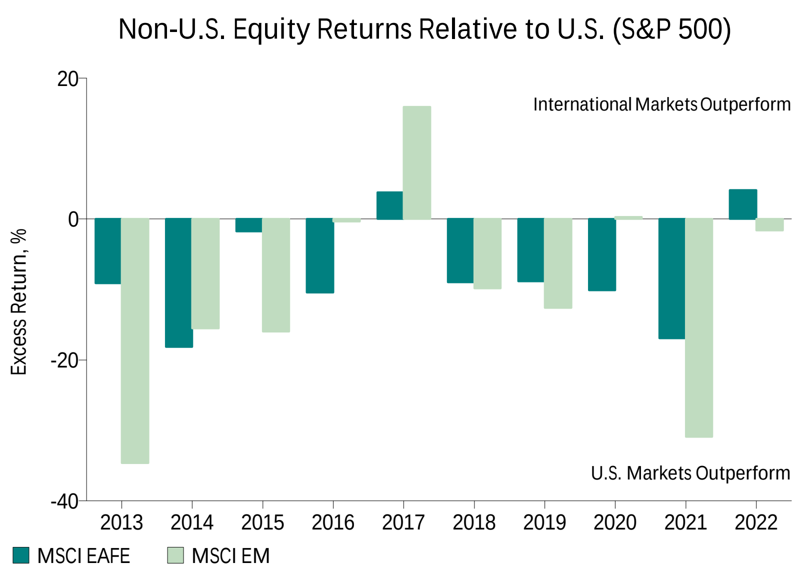


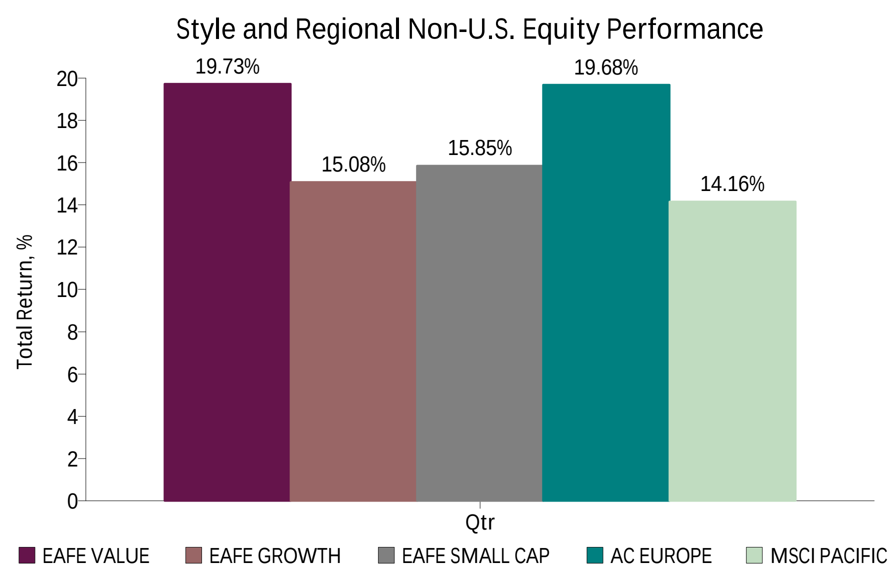
International Equity Markets



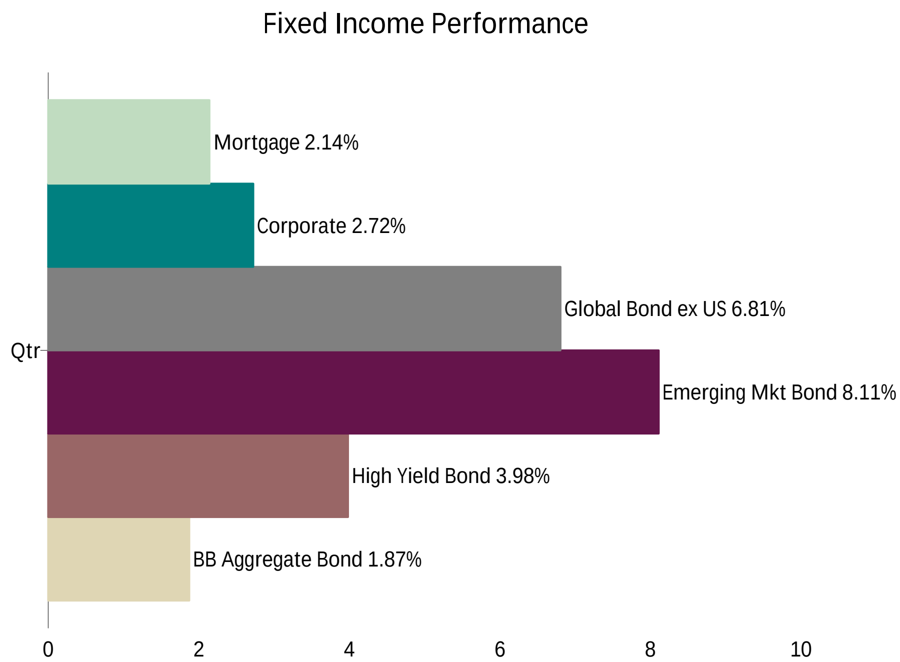
Historically, the US has been a difficult market to beat from an investment perspective, but not always. The decade of the 2000's saw international stocks (especially Emerging Markets) outperform US stocks. During 2022, international developed markets outperformed the US for the first time since 2017. In 2017, international's outperformance only lasted one year, but with recent global trade and interest rate changes, this reversal may have some durability. The MSCI EAFE Index, a proxy for large international developed equity markets, was up 17.4% during the quarter finally getting some support from a weaker dollar. This strong fourth quarter return relative to the US propelled the yearly outperformance. International valuations based on P/E (Price-to-Earnings ratio) have been lower than the US for the last 20 years, but current valuations are much less than the US.

Emerging markets (EM) relative returns were worse than the US, down 20% in 2022. Some of EM underperformance can be attributed to Chinese equity market's poor performance as China is about one-third of the index. China's recent reopening will likely support EM returns going forward. Both international developed and EM may get a boost from a less powerful US dollar.



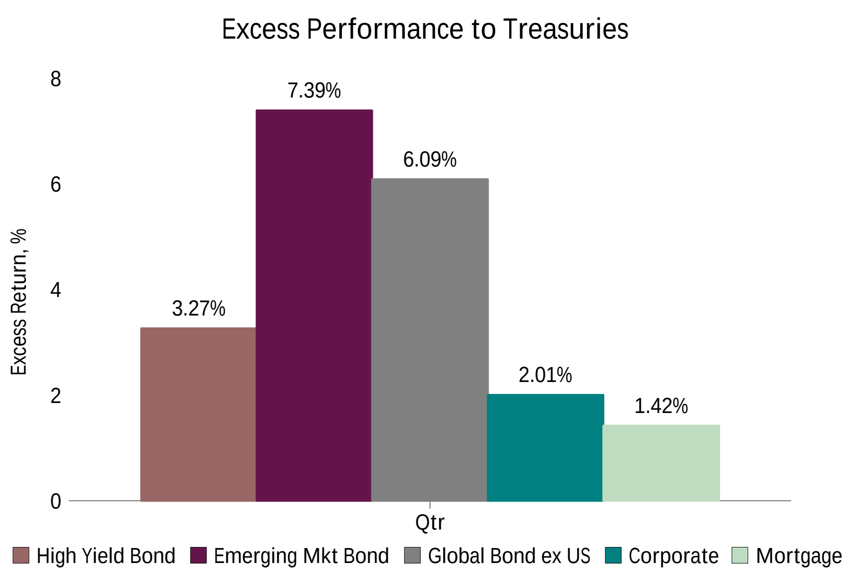


Fixed-Income Markets



While the change has been agonizing (severely negative bond market returns), the course of yield adjustment has returned some value to fixed income investments. For a long time, depressed spreads (the yield difference between two different bonds or two classes of bonds generally with similar maturities) and historically low rates kept future return expectations restrained. Currently, rates are much higher and the risk premium compensation is closer to long-term averages. This may set the stage for more favorable return expectations going forward.

Cash-like stable value and money market variable investment rates have continued higher. The yield is still less than inflation, but improving nonetheless. As the treasury yield curve continues to be inverted, the longer end of the curve still doesn't believe that higher rates are sustainable. An inverted yield curve means investors are getting paid a higher yield on shorter term bonds than longer ones. This is historically abnormal and not sustainable. The resulting inverted yield curve has the 10 Year – 2 Year spread as -0.67%, only surpassed by early December's -0.84%. The US 10 year yield started the quarter at 3.67% increasing to 3.88% at the year end.



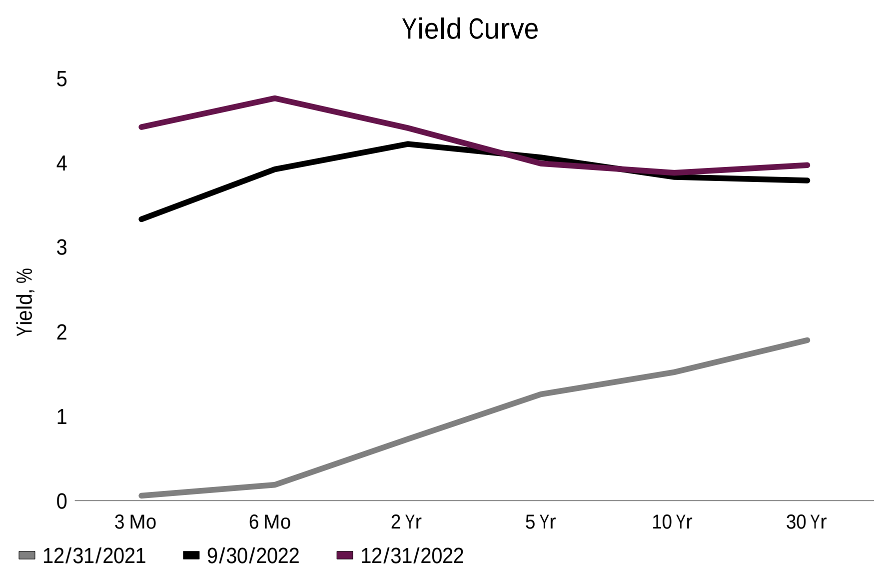
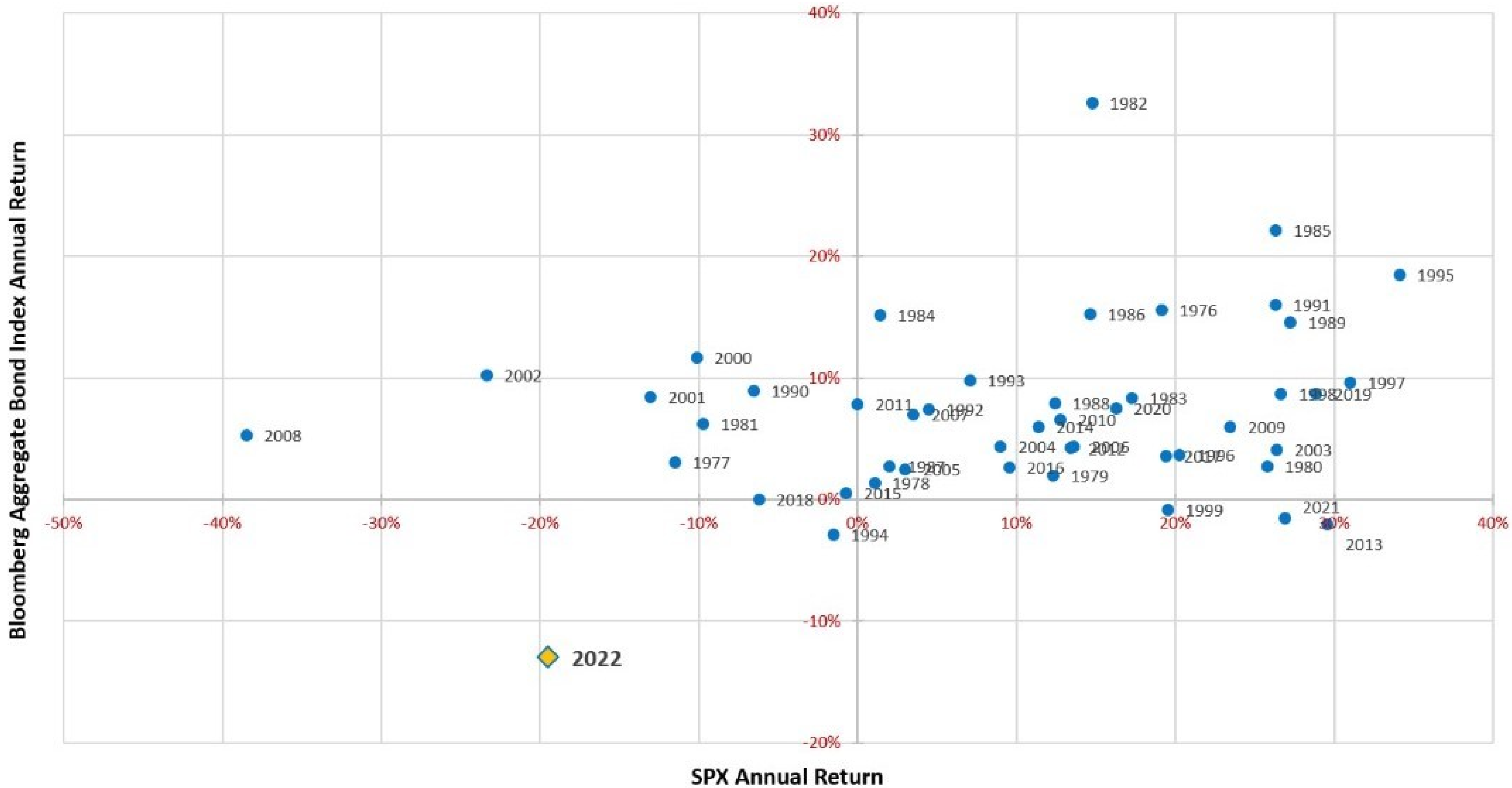


Chart of the Quarter

2022 has been a wakeup call for investors... in both stocks and bonds

S&P 500 vs. Bloomberg US Aggregate Bond Index Return by Year (1976-2022)



As discussed in our third quarter commentary, historically, equity markets have experienced three negative quarters in a row and likewise the bond market has been down three quarters in a row. However, not until 2022 have both the stock and bond markets fallen together for three consecutive quarters. The US investor has certainly experienced worse stock market drawdowns, but the graph really highlights how awful the bond market performance was in 2022 in which there hasn't even been a comparable dating back to 1976.

Source: Bloomberg, DoubleLine

				Small Cap Stocks 21.31%	Emerging Mkt Stocks 37.75%		Large Cap Stocks 31.43%				
Emerging Mkt Stocks 18.63%				High Yield 17.49%	International Stocks 27.77%		Small Cap Stocks 25.52%	Gold 24.61%			
International Stocks 17.39%				Large Cap Stocks 12.05%	Large Cap Stocks 21.69%		International Stocks 22.13%	Large Cap Stocks 20.96%			
Large Cap Stocks 16.42%		Large Cap Stocks 13.24%		Commodities 11.77%	Small Cap Stocks 14.65%		Emerging Mkt Stocks 18.90%	Small Cap Stocks 19.96%			
Small Cap Stocks 16.35%		Real Estate 12.49%		Emerging Mkt Stocks 11.60%	Gold 12.66%		Gold 18.43%	Emerging Mkt Stocks 18.69%	Commodities 27.11%		
High Yield 15.58%	Small Cap Stocks 38.82%	US Bonds 5.97%		Real Estate 8.76%	60/40 Blended Index 12.07%		60/40 Blended Index 16.50%	60/40 Blended Index 12.24%	Large Cap Stocks 26.45%		
60/40 Blended Index 11.09%	Large Cap Stocks 33.11%	60/40 Blended Index 5.51%		Gold 8.10%	Intl/EM Bonds 10.41%		High Yield 14.41%	International Stocks 11.13%	Real Estate 22.18%		
Real Estate 10.94%	International Stocks 15.78%	Small Cap Stocks 4.89%	Real Estate 15.01%	60/40 Blended Index 7.85%	Real Estate 7.62%		Intl/EM Bonds 9.98%	Intl/EM Bonds 7.90%	Small Cap Stocks 14.82%		Annualized Return
Intl/EM Bonds 10.60%	60/40 Blended Index 14.85%	High Yield 2.50%	Large Cap Stocks 0.92%	Intl/EM Bonds 5.77%	High Yield 7.48%		US Bonds 8.72%	US Bonds 7.51%	60/40 Blended Index 10.05%	Commodities 16.09%	-1.26
Gold 8.26%	Real Estate 13.94%	Intl/EM Bonds 2.08%	US Bonds 0.55%	International Stocks 5.01%	US Bonds 3.54%	Real Estate 8.35%	Commodities 7.69%	High Yield 6.17%	International Stocks 8.29%	Real Estate 7.46%	10.17
US Bonds 4.22%	High Yield 7.42%	Gold 0.12%	60/40 Blended Index 0.11%	US Bonds 2.65%	Commodities 1.70%	3-month T-Bills 1.87%	Real Estate 5.35%	Real Estate 1.17%	High Yield 5.36%	3-month T-Bills 1.46%	0.70
3-month T-Bills 0.11%	3-month T-Bills 0.07%	3-month T-Bills 0.03%	3-month T-Bills 0.05%	3-month T-Bills 0.33%	3-month T-Bills 0.86%	US Bonds 0.01%	3-month T-Bills 2.28%	3-month T-Bills 0.67%	3-month T-Bills 0.05%	Gold 0.44%	1.55
2012	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	
Commodities (1.06)%	US Bonds (2.02)%	Emerging Mkt Stocks (1.82)%	Intl/EM Bonds (2.42)%			Gold (0.93)%		Commodities (3.12)%	US Bonds (1.54)%	High Yield (11.22)%	4.95
	Emerging Mkt Stocks (2.27)%	International Stocks (3.44)%	Small Cap Stocks (4.41)%			High Yield (2.26)%			Emerging Mkt Stocks (2.22)%	60/40 Blended Index (11.35)%	6.50
	Intl/EM Bonds (4.13)%	Commodities (17.01)%	High Yield (4.64)%			Intl/EM Bonds (3.17)%			Gold (4.33)%	US Bonds (13.01)%	1.34
	Commodities (9.52)%		International Stocks (5.25)%			60/40 Blended Index (3.71)%			Intl/EM Bonds (4.44)%	International Stocks (15.57)%	5.41
	Gold (27.33)%		Gold (12.11)%			Large Cap Stocks (4.78)%				Intl/EM Bonds (18.17)%	0.94
			Emerging Mkt Stocks (14.60)%			Small Cap Stocks (11.01)%				Large Cap Stocks (19.13)%	12.74
			Commodities (24.66)%			Commodities (11.25)%				Emerging Mkt Stocks (19.74)%	3.23
						International Stocks (13.78)%				Small Cap Stocks (20.44)%	9.66
						Emerging Mkt Stocks (14.25)%					