Capital Market Review / *Fourth Quarter 2022*

The Big Picture

Does the Fed have any real power?

Wall Street strategists are far more bearish than Wall Street analysts. The strategist community sees the current situation as driven by the actions of the Federal Reserve; the theory goes that the Fed raising rates will cause economic activity to slow down, the economy to go into a recession, and the market to crash. This argument seems logical, but it ignores a significant factor and makes some assumptions that might not hold true.

First, it ignores the fact that the market has already dropped well into bear market territory. Secondly, it assumes that Fed actions have a significant impact in the real economy.

How does the increase in interest rates impact companies? There are two possible ways. First: If they sell a product that requires most customers to use financing, but most businesses do not sell products that are so expensive that their customers must finance them. Second: If a company must borrow a great deal of money to run its operation, the interest expense on that debt would cause earnings to go down. In the manufacturing days of the 1970s and 80s this was true, but is it today?

Analysts, on the other hand, see the world from the bottom-up, and it simply does not look so bad from that view.

> *How much do higher interest rates impact your daily life?*

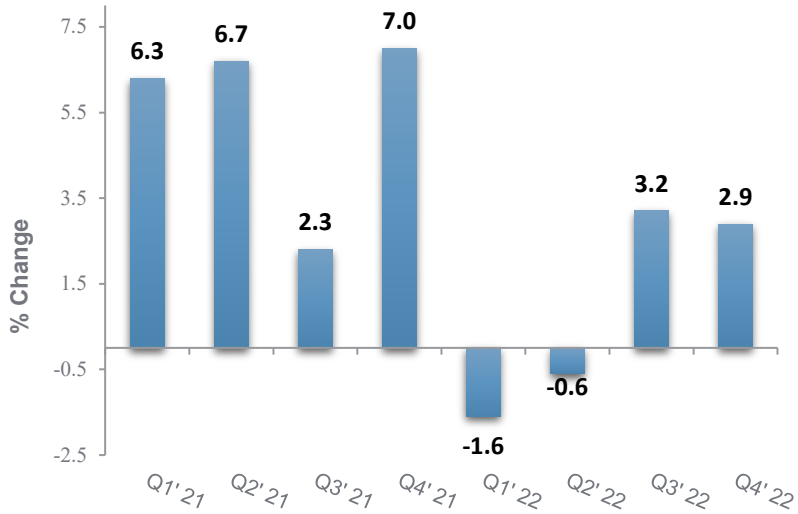
The Economy

The 3rd quarter 2022 GDP growth came in up 3.2 percent, which was a slight recovery from two negative quarters previously. The initial reading on 4th quarter came in at 2.9 percent which was better than expected.

The official unemployment rate dropped to 3.5 percent through December. The labor market remains tight, and participation is growing. This is occurring while inflation is coming down, so it will be interesting to see when this good news is treated as good news by the market.

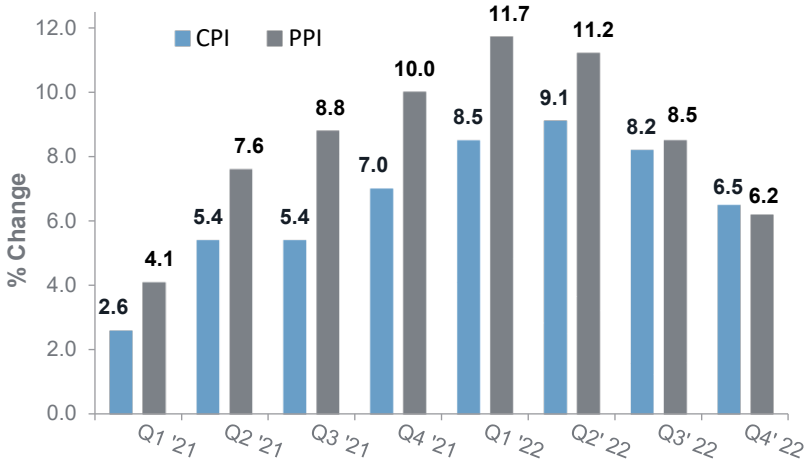
Inflation is 6.5 percent based on the latest consumer price index report. While still high the level has been consistently dropping for several months. The producer price index, which tracks wholesale prices, is up 6.2 percent over the last 12 months.

Domestic GDP



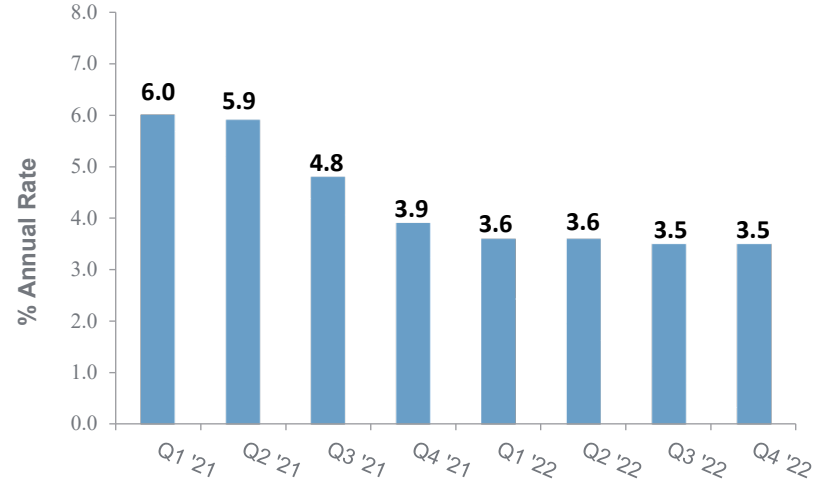
Source: Factset

Inflation Indicator
12 month unadjusted



Source: Factset

Unemployment Rate

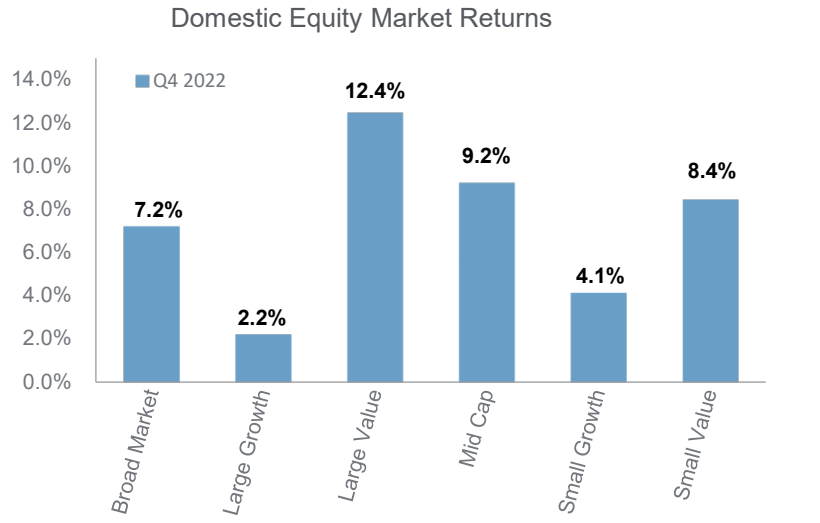


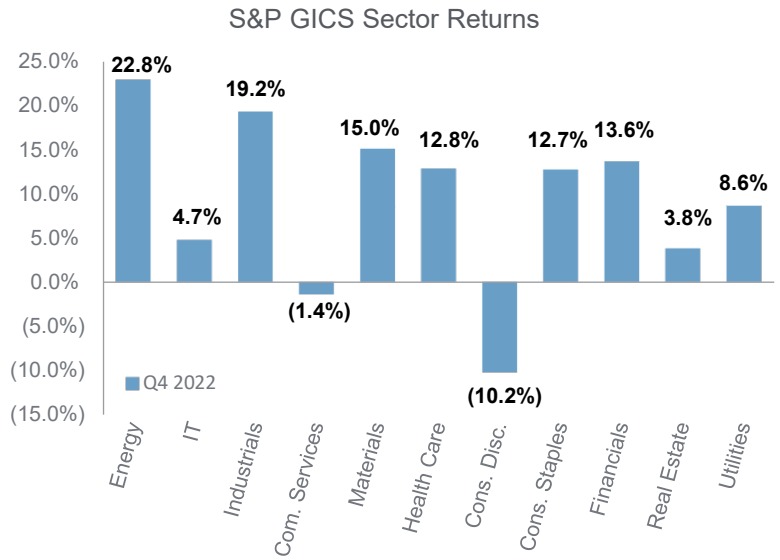
Source: Factset

Domestic Equity Markets

The market finally rallied. For the quarter, the S&P 500 finished up 7.56 percent, and small company stocks represented by the Russell 2000 index were up 6.23 percent. Value outperformed with the Russell 1000 Value index up 12.42 percent while the Growth index was up 2.20 percent. For small companies, the value index was up 8.42 percent, and the growth index was up 4.13 percent.

Energy was the best place to be by far, followed by industrials. Communication services and consumer discretionary stocks were negative. This represents a big change from the last few years which were dominated by our reaction to the pandemic.

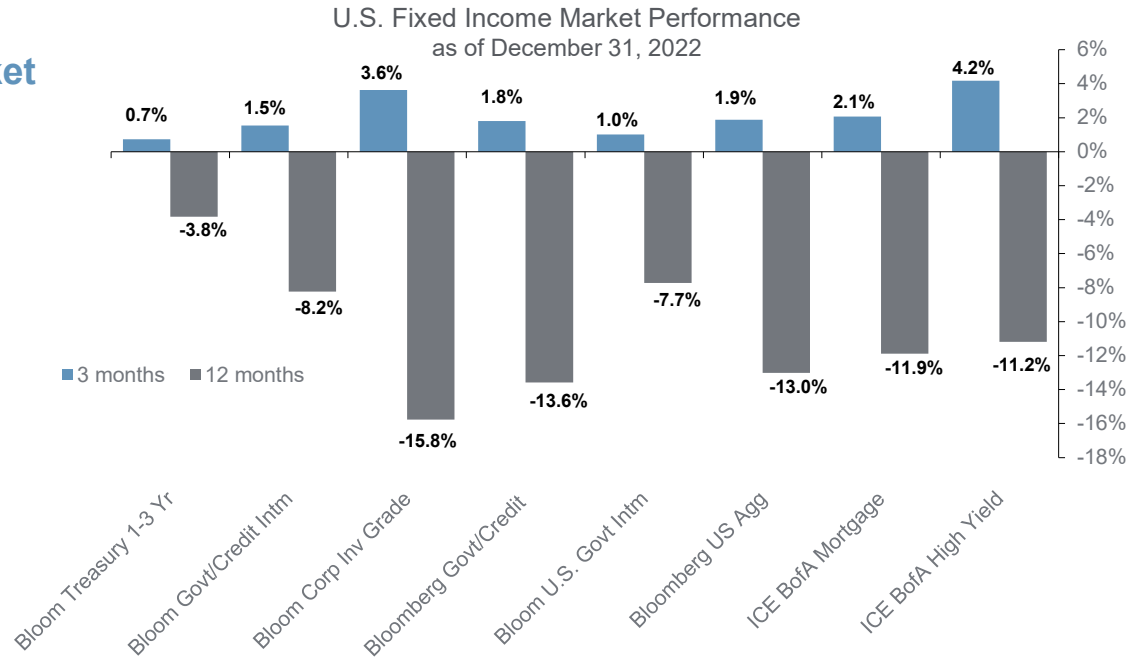




Domestic Fixed Income Market

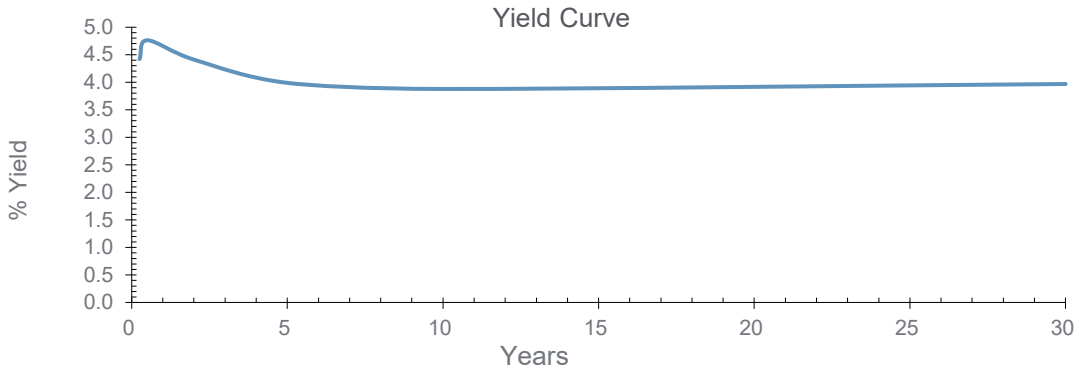
Bonds provided positive results. The Barclays US Aggregate Bond index ended up 1.87 percent. High yield bonds rose 3.8 percent. Bond yields remain attractive.

The ten-year Treasury ended the quarter with a 3.88 percent yield. The yield curve remains negative from 2 to 5 years, and extremely flat. The market is signaling a Fed induced recession.



Yield Curve as of Dec. 31, 2022

Time to Maturity	Interest Rate
3 Month	4.42
6 Month	4.76
2 Year	4.41
5 Year	3.99
10 Year	3.88
30 Year	3.97



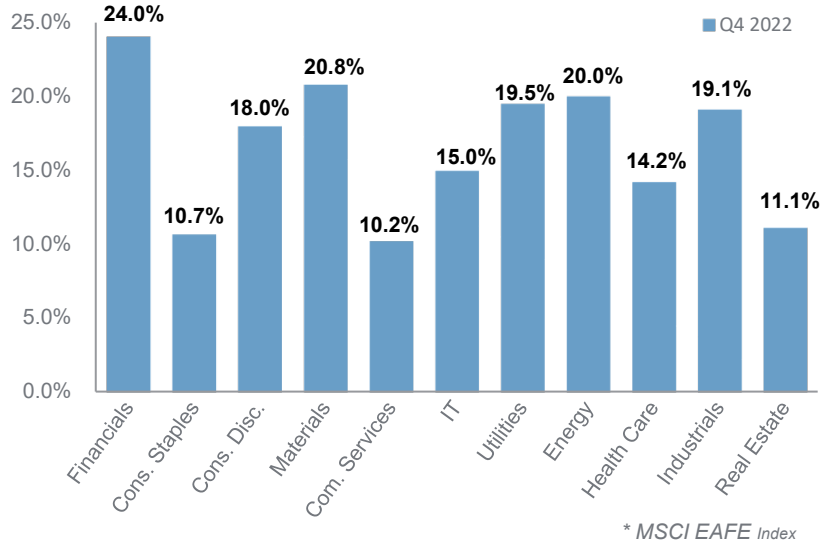
International Markets

International stocks were the best place to be. The EAFE index finished up 17.40 percent and the MSCI Emerging Markets index ended the quarter up 9.79 percent.

Financials were the best place to be. This was followed by energy, utilities and industrials. The pivot from stay-at-home industries to the real economy is a global phenomenon.

The dollar remained the major driver of returns. The UK, as an example, experienced a return of 8.56 percent in local terms, but for the American investor the return was 16.98 percent. This was a reversal of the earlier strength of the dollar. Currencies are volatile but do tend to revert to the mean over time.

Developed International Sector Returns*



* MSCI EAFE Index

Source: T. Rowe Price

MSCI Country Returns
Three Months Ending December 31, 2022

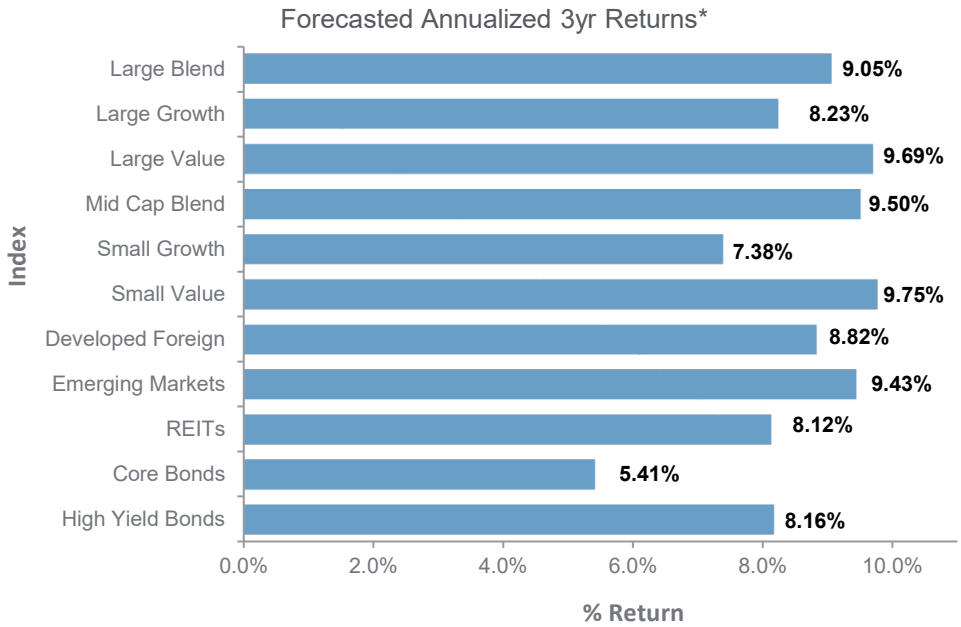
	Return US$ (%)	Return Local Currency (%)	Currency Effect (%)
Austria	31.07%	20.31%	10.76%
Belgium	22.69%	12.62%	10.07%
Denmark	31.64%	20.85%	10.79%
Finland	16.37%	6.82%	9.55%
France	22.30%	12.26%	10.04%
Germany	24.69%	14.46%	10.23%
Ireland	21.49%	11.52%	9.97%
Italy	26.62%	16.22%	10.39%
Netherlands	21.04%	11.39%	9.64%
Norway	17.29%	6.04%	11.25%
Portugal	17.23%	7.61%	9.62%
Spain	23.14%	13.04%	10.11%
Sweden	18.28%	11.06%	7.23%
Switzerland	10.42%	3.79%	6.63%
UK	16.98%	8.56%	8.42%
Europe Total	**19.42%**	**10.46%**	**8.96%**
Australia	15.73%	9.72%	6.01%
Hong Kong	18.22%	17.57%	0.65%
Japan	13.26%	3.25%	10.02%
New Zealand	24.56%	11.41%	13.16%
Singapore	10.46%	4.01%	6.45%
Pacific Total	**14.16%**	**5.89%**	**8.27%**
Brazil	2.51%	0.07%	2.45%
Canada	7.65%	6.15%	1.50%
China	13.53%	12.50%	1.03%
Greece	29.18%	18.58%	10.60%
Hungary	36.33%	18.45%	17.88%
India	2.06%	3.79%	-1.73%
Indonesia	-3.51%	-1.36%	-2.15%
Korea	18.47%	4.71%	13.76%
Mexico	12.65%	9.17%	3.48%
Poland	47.75%	31.21%	16.54%
Thailand	16.12%	6.62%	9.50%
Emerging Markets	**9.79%**	**6.66%**	**3.13%**

Market Forecast

Pessimism remains very high, and results are likely to be better than expected. This should bode well for the market in 2023. Having said that we would not be surprised if markets get worse before getting better. Caution is still in order.

In the longer-term, value stocks and small company stocks still look more attractive. International stocks look more attractive than domestic, and the currency situation seems to be normalizing. This bodes well.

Bonds are looking worthwhile and behaving like bonds should. This allows investors to be patient with the stock market as bonds are now a reasonable alternative to stocks in the short run.



Changes in Return Expectations

as of December 31, 2022

Asset Class	Change Over Quarter	Change Over Year
Large Blend	0.09%	1.71%
Large Growth	0.21%	1.63%
Large Value	-0.13%	1.63%
Mid Cap Blend	0.01%	1.71%
Small Growth	0.03%	1.67%
Small Value	-0.14%	1.20%
Developed Foreign	-0.03%	2.21%
Emerging Markets	-0.17%	1.48%
REITs	0.43%	1.81%
Core Bonds	0.32%	2.25%
High Yield Bonds	0.08%	2.67%

*Forecasted 3-year annualized returns represent Iron Capital's investment return expectations for various asset classes over the next 3 years. They are calculated using a weighted average of historic returns and forward return assumptions. They are meant to be a tool to judge relative attractiveness of asset classes and not a guarantee of future investment returns.

SELECTED INDEX RETURNS - PERIODS ENDING December 31, 2022

	Quarter	Year-to-Date	One Year	Three Years	Five Years	Ten Years
US EQUITIES						
Broad Stock Market - Russell 3000	7.18%	-19.21%	-19.21%	7.07%	8.79%	12.13%
Large Stocks - S&P 500	7.56%	-18.11%	-18.11%	7.66%	9.42%	12.56%
Dow Jones Industrial Average	16.01%	-6.86%	-6.86%	7.32%	8.38%	12.30%
Medium-Size Stocks - Russell Mid-Cap	9.18%	-17.32%	-17.32%	5.88%	7.10%	10.96%
Small Stocks - Russell 2000	6.23%	-20.44%	-20.44%	3.10%	4.13%	9.01%
Small Value Stocks- Russell 2000 Value	8.42%	-14.48%	-14.48%	4.70%	4.13%	8.48%
Small Growth Stocks- Russell 2000 Growth	4.13%	-26.36%	-26.36%	0.65%	3.51%	9.20%
Large Value Stocks - Russell 1000 Value	12.42%	-7.54%	-7.54%	5.96%	6.67%	10.29%
Large Growth Stocks - Russell 1000 Growth	2.20%	-29.14%	-29.14%	7.79%	10.96%	14.10%
US FIXED INCOME						
1-3 Yr Treasury (Gov't) Bonds - Bloomberg	0.73%	-3.82%	-3.82%	-0.46%	0.74%	0.65%
US Government Bonds Int - Bloomberg	1.01%	-7.73%	-7.73%	-1.38%	0.46%	0.69%
US Corporate Inv Grade Bonds - Bloomberg	3.63%	-15.76%	-15.76%	-2.88%	0.45%	1.96%
Government/Credit (Corp) Bonds - Bloomberg	1.80%	-13.58%	-13.58%	-2.57%	0.21%	1.16%
Int Govt/Credit (Corp) Bond - Bloomberg	1.54%	-8.24%	-8.24%	-1.26%	0.73%	1.12%
US Aggregate Bond Market - Bloomberg	1.87%	-13.01%	-13.01%	-2.71%	0.02%	1.06%
Mortgage Backed Securities - ICE BofA	2.07%	-11.88%	-11.88%	-3.23%	-0.51%	0.75%
US High Yield Bonds - ICE BofA	4.17%	-11.19%	-11.19%	0.05%	2.31%	4.03%
INTERNATIONAL (Measured in US Dollars)						
Non-US Stocks - MSCI EAFE	17.40%	-14.01%	-14.01%	1.34%	2.03%	5.16%
World Stocks (includes US) - MSCI World	9.89%	-17.73%	-17.73%	5.45%	6.69%	9.44%
European Stocks - MSCI Europe	19.42%	-14.53%	-14.53%	1.93%	2.48%	5.19%
Japanese Stocks - MSCI Japan	13.26%	-16.31%	-16.31%	-0.63%	0.60%	5.90%
Asian Stocks (Ex-Japan) - MSCI Pacific ex-Japan	15.75%	-5.86%	-5.86%	1.71%	2.29%	3.93%
Chinese Stocks - MSCI China	13.53%	-21.80%	-21.80%	-7.38%	-4.40%	2.62%
Indian Stocks - MSCI India	2.06%	-7.49%	-7.49%	10.74%	6.25%	7.55%
Emerging Markets - MSCI EM	9.79%	-19.74%	-19.74%	-2.34%	-1.03%	1.81%
Int'l Gov't Bonds -FTSE Non-USD World Gov't Bond	6.51%	-22.07%	-22.07%	-7.96%	-4.21%	-2.27%
REAL ESTATE						
FTSE NAREIT Equity-Reits Index	5.24%	-24.37%	-24.37%	-0.11%	3.58%	6.48%
SHORT TERM INTEREST RATES						
T-Bills	0.87%	1.50%	1.50%	0.71%	1.25%	0.74%

Note: Returns for periods longer than 12 months are annualized.