**Email 1/6/23**

**The Outlook For 2023**

Welcome to 2023 and we hope you had a happy New Year celebration.  Usually, New Year’s resolutions are routinely made early in January and just as routinely, broken down by February.  Maintaining discipline is the key to achieving your objectives and this applies not only to your resolutions, but to your financial goals as well.

To state it plainly, last year was a significant disappointment.  The Standard & Poor’s 500 Index (e.g. broad measure of large-cap U.S. stocks) was down over 19.5%.  The technology heavy NASDAQ 100 Index was down almost 33%.  Small company stocks as tracked by the Russell 2000 index were down 21%.  International stocks as measured by Morgan Stanley’s all-cap world index (ex-U.S. stocks) was down over 16%.  Finally, bonds as tracked by Bloomberg’s Global Aggregate bond index was down more than 16%.  There was literally no place to hide in 2022 unless you went to cash and earned near 0%.  Frankly, going to cash is not an option for successful investing over the longer term and protecting yourself from the effects of inflation.

The good news is that one down year does not make a trend.  Ultimately, the financial markets reflect economic realities.  In the U.S. that means the stock and bond markets tend to trend up over time as a reflection of growth in GDP.  For perspective consider the following; (1) over the last forty-two (42) years the U.S. stock market as measured by the S&P 500 index finished positive in thirty-two (32) years; (2) since the beginning of 2009 (i.e. after the great recession) the stock market finished positive in eleven (11) of those fourteen (14) years.  Total return over the 14 years was almost 325% or 10.9% per year and; (3) only one (1) (i.e., 2022) of the last four (4) calendar years was down.  Total return over the 4 years was 53.9% or 11.4%, annually, including 2022’s decline.

In times of uncertainty (i.e., which we are most certainly in) volatility will reign supreme until the uncertainty begins to clear.  Right now we have lots of issues to be concerned about starting with will the Federal Reserve continue raising interest rates and by how much. Will the economy go into a recession in 2023, has inflation peaked, will unemployment rise, is the U.S. government going to be in gridlock for the next couple of years and what is happening in Ukraine and how does that affect global commodities (i.e. oil, grain, etc.).  No one really knows the answers to any of these questions.  What I do know is that these issues will ultimately be resolved and undoubtedly replaced by new ones (e.g. hopefully less mind-numbing) and the economy will continue to grow and the financial markets with it, as it has since time immemorial.

The financial markets are reacting to economic data as it drops in the news cycle depending on how it views the Federal Reserve will react.  What we would normally consider to be good news (i.e., unemployment dropped to 3.5% this week) is bad news given the perception that this statistic will prompt continued rate increases.  Bad news such as worker average hourly earnings declining year-over-year which should help reduce inflation in the services sector is good news, prompting the Federal Reserve to ease off the accelerator.  No one ever said the stock market is rational.

Currently, my opinion is that we are on the verge of a mild recession.  The ISM Manufacturing index has been in contraction territory for two months.  The ISM Services index finally dropped into contraction territory for the first time in 30 months.  Wages are rising less than inflation and corporate margins declined in 2022 more than revenues rose (i.e. declining earnings).  Employment looks better than it actually is because I believe we have a structural problem (i.e., not enough workers) rather than a booming economy.  I also believe the markets have priced in most of this, meaning downside risk is likely lower than many anticipate.  Stock valuations are at or below their 25-year averages.  The question is, what is the Federal Reserve going to do this year and when.  Eventually, they will stop raising interest rates and the markets will likely react positively.  Will they do it in the next couple of months as most analysts and economists are hoping, or will they persist further into the year and over-correct.  Time will tell and volatility will be the order of the day until the Federal Reserve announces that it sees light at the end of the tunnel.

I continue to recommend for long-term oriented investments, that you maintain your current allocation strategies if your risk profiles and time horizons remain long-term (i.e., 4-5 years or more).

Make sure that funds you know you will need in the short-term are safe to relatively safe from volatility and that your long-term oriented investments are well diversified and subject to risk and volatility levels you are able to be comfortable with. If you have any questions or concerns about these things, please call me to discuss them further.

I have included below a link to a year-end review and market outlook commentary by Brad McMillan, Commonwealth’s Chief Financial Officer.  In it he discusses his view of what happened last year and his economic outlook going forward into the new year.  I encourage you to view it to get another perspective.

See <https://player.vimeo.com/video/786094519?h=ea6c8004c0>.

I am always available to you via phone, zoom conference or in person. I look forward to talking with you over the next few weeks. If you have any questions or if we can be of any help, please do not hesitate to contact Linda or me.

*Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results.*

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