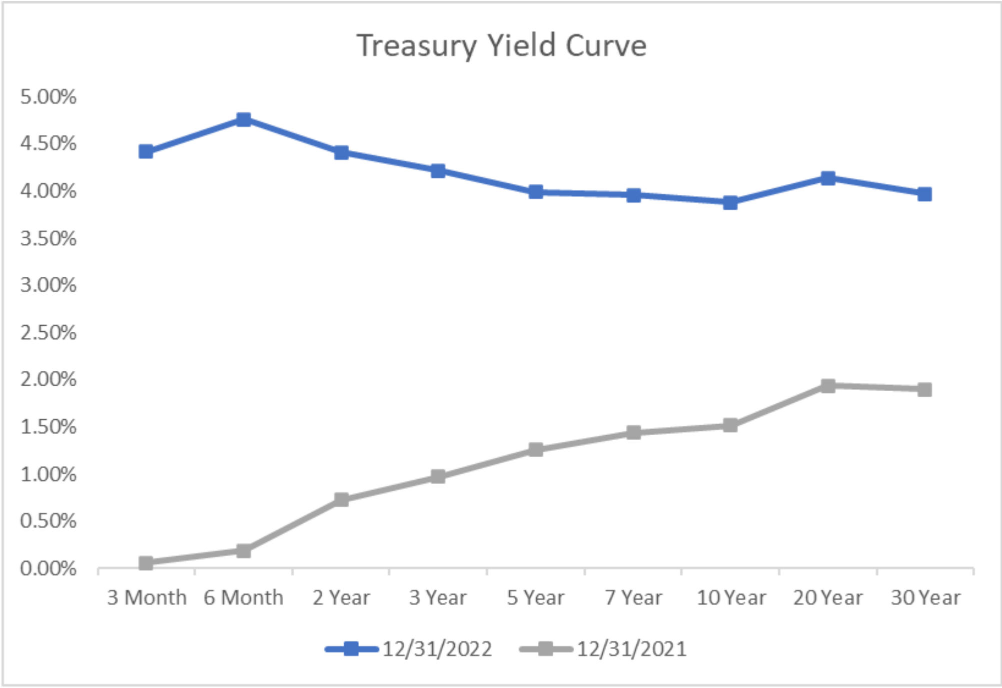
DECEMBER 2022 MARKET REVIEW

There is no sugarcoating the fact that 2022 was a miserable year for the vast majority of diversified investors. Stocks, bonds, gold, real estate, and crypto all decreased in value while the only major safe havens were commodities and cash. By now, we know the story of 2022 is characterized by stubbornly persistent inflation, aggressive monetary policy, slowing growth, and the reappearance of tail-risk events (Russia/Ukraine). The fiscal and monetary policy measures enacted during the pandemic massively subsidized risk taking throughout 2020 and 2021. Policy makers acted as if Covid was more akin to an economic depression rather than an equivalent natural disaster event, and abruptly unwound their easing in 2022, at the expense of multi-asset portfolios. In this 2022 annual review, we will highlight several storylines, and discuss the lessons that markets taught us, or better yet, reinforced, throughout the year. It is also important to spotlight three reasons to be hopeful for a better 2023, despite widespread expectations of an imminent recession:

1. The equity market selloff has been frontloaded by aggressive central banks
2. Monetary policy tightening is less likely to cause financial stress as banks are in a solid position following the Global Financial Crisis
3. Many speculative assets have already been hit hard

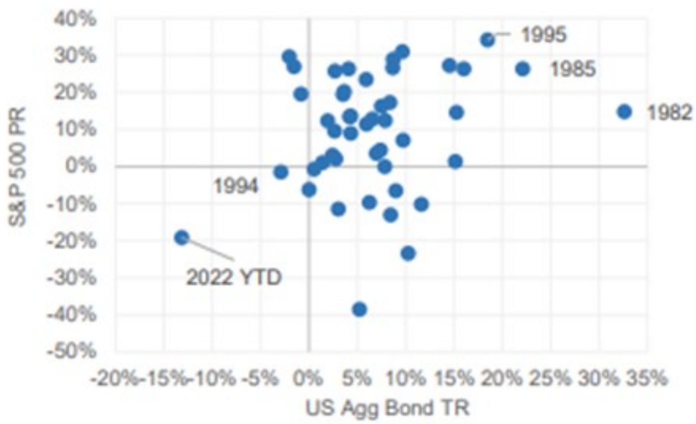
	12/31/2022 Level	QTD Change	1 Year Change
S&P 500	$3,829	7.6%	-18.1%
MSCI ACWI Ex USA	$251	14.3%	-16.0%
MSCI Emerging Markets	$486	9.7%	-20.1%
Bloomberg US Aggregate	$2,048	1.9%	-13.0%
10 Year Treasury Rate	3.88%	+5 BP	+237 BP
Bloomberg Commodity Index	$113	1.2%	13.8%
Bitcoin	$16,604	-15.1%	-64.8%

The topic that markets have obsessed over most this past year has been the high level of inflation globally, and the interconnected nature of inflation, monetary policy, and higher interest rates. As we have discussed ad nauseam in previous reviews, central banks have attempted to use their imperfect tools to bring down inflation. The Fed, and most other central banks have raised base rates which increases the borrowing cost for corporations, and for consumers through credit card debt and higher mortgage rates. The Fed has raised the base rate to over 4%, while the US yield curve has shifted dramatically higher such that investors can now earn 4.75% with a 1-year US treasury, compared with 0.4% at the end of 2021. These higher yields are a boon for fixed income investors moving forward, however, those that owned bonds over the past year have seen falling principal values on what many consider to be low-risk investments. Bond investors who have owned funds investing in short term treasuries have seen losses greater than 5%, while funds owning more risky forms of bonds have fallen over 10%. While it appears as though volatility has been centered on equities given the lower returns vis-à-vis bonds, relative to historical experience, bonds had one of the worst years on record.



Data Source: Y Charts

Figure 12: Could 2022's Record Pain Become 2023's Solid Gain? It Worked for Volcker and Greenspan.



Source: Bloomberg, Evercore ISI Research

The bull market in equities ended in early 2022 as concerns over war, an energy crisis, and slowing global growth were too much to overcome. Global equities fell over 18%, while value-oriented companies vastly outperformed growth companies; a trend our client portfolios were well positioned for. The rationale for overweighting value was that growth companies had been propped up for a number of years by low interest rates and excess liquidity, where the marginal dollar of investment was allocated to pockets of the market including speculative technology, crypto, and electric vehicles. The problem was that investors did not do their homework on many of these companies that are running nowhere near profit but have been portrayed as innovating world changing technologies. It is quite clear that many investors have been duped by high-cost marketing campaigns and expectations of large financial returns and will unfortunately experience permanent capital destruction. This is not to say that all growth is bad, and all value is good – there are certainly examples of incredibly well-run businesses that are experiencing a high-growth phase that should be owned by investors just as there are companies that are inexpensively valued that should be ignored. While our clients have largely avoided major losses across the portfolio, the impact of such tremendous decreases in value in a subset of financial assets is widespread and affects sentiment and consumer confidence. Given the fall in both equities and bonds, a generic balanced portfolio has performed quite poorly this year, as seen in the above graph. The expensive nature of both stocks and bonds has pushed us towards including diversifying strategies alongside traditional assets, which has ultimately improved risk-adjusted returns.

Finally, now is a perfect time to step back and note the lessons that financial markets taught us, or reinforced, in 2022. This is certainly not an exhaustive list, but these are items that we feel are important – several of these being applicable outside of finance as well.

1. Do not fight the Fed – in tightening cycles, be wary of owning risky assets as the Fed is not worried about negatively impacting the equity market in order to achieve their mandate.
2. Good times teach bad lessons – many investors have been lulled into a mindset that stocks can only go up due to the long bull market after the Global Financial Crisis, and therefore, have not been discerning in their investment decisions.
3. If it seems too good to be true, it most likely is – one of the major red flags of crypto firm FTX, prior to its blowup, was offering investors "high returns with no risk".
4. Markets and individual companies do not trend higher or lower solely on metrics or ratios, rather, they move based on psychology and a story that investors either agree or disagree with.
5. If someone speaks with a high degree of certainty about the future, especially relating to financial markets, stay away! Even top Wall Street strategists get their predictions completely wrong. At the end of 2021, the median 2022 S&P 500 forecast was 25% higher than the actual end of year closing value. Humility is important.
6. Sometimes it is the rate of change of economic factors that matter most, rather than the absolute level. February and October had very similar year-over-year inflation figures in the US, however, the market reaction was much more favorable post the October reading as it showed evidence that peak inflation had finally occurred.
7. It is widely believed throughout the industry that ETFs have democratized investing and that the majority of individuals should allocate to these funds (*this is not entirely our opinion*). However, not all ETFs are created equally, as the launch of new thematic ETFs focuses on assets that are currently en vogue. Quite often the introduction of a new ETF, or large inflow of investor dollars, coincides with a market top rather than a continuation of momentum. For example, the flagship fund from ARK Invest (the ARK Innovation ETF) managed $28B at its peak in February 2021. Since then, the fund has fallen 80%, and is now only $5.8B, despite adding $15B of investor contributions over the past 3 years.