Eideard Group
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Market Commentary

4Q 2022

Market Movement Highlights

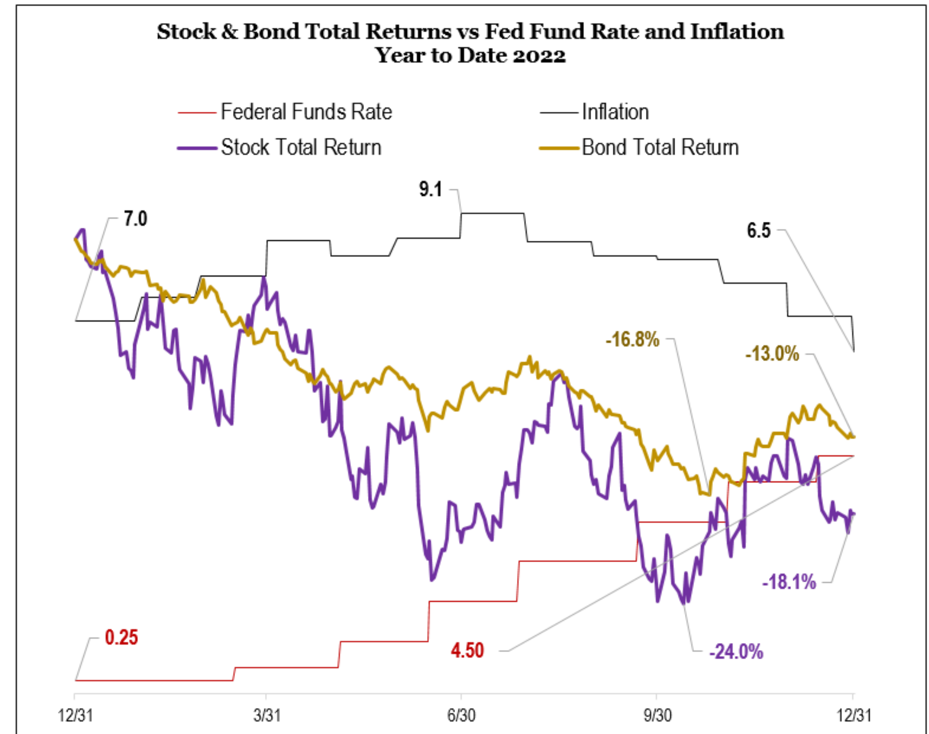
After several years of worry-free cruising financial markets when the only concern was how high can high prices go for equities (especially for technology stocks) 2022 delivered a brutal reminder of just how quickly the markets can turn. To make matters worse, the bond market, typically considered "the" safe haven in times of stock market volatility, offered no solace for even the most conservative of investors. There was simply no place to hide for long-standing typically reliable diversified investment portfolios. By mid-year, financial pundits in unison, began opining on what they believed to be "the death" of portfolios anchored in the most traditional of asset allocations; the 60/40 stock to bond split. Unfortunately for most of the year they were right!

By year's end, the S&P 500 stock index retreated (18%) its 3rd worst performance in the last 40 years. But even that was modest relative to the tech heavy Nasdaq index which relinquished (33%) or small cap core stocks which gave up (20%) on the year. The international markets, both developed and emerging, fared only modestly better but still posted dismal returns of (14%) and (20%) respectively.

On the flip side, bonds of all types, were whipsawed by the pain of precipitous price declines. The US Aggregate Bond index contracted by (13%) its worst showing since 1980 while US Investment Grade Corporates fell by nearly (16%). Neither were high quality municipal bonds spared as prices fell on average by (8.5%). Even the safest of the safe, US Treasury bonds, registered negative returns climbing back to a (12%) loss by year's end.

About the only bright spot worth mentioning in 2022 was the energy sector though it too was saddled with elevated volatility. West Texas Intermediate (WTI) crude oil prices rose +62% from January to June, only to fall (42%) to a bottom by December, before closing out the year up +7%. Over the same period, US natural gas prices increased by +160% to peak in August, before dropping (54%) to end the year up +20%. Just imagine having sold your stocks and bonds on the notion of re-investing in oil and gas at the mid-year point! Your portfolio return would have been much more gratifying but only if your heart had not failed you during the wild ride.

To put it as succinctly as possible, an historically reliable 60/40 portfolio allocation invested simply in two indices; the S&P 500 and the US Aggregate Bond index delivered a miserable (16%) negative return on the year.



So what was different this time around relative to prior market disruptions? As the above chart illustrates, the ignition to last year's

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wholesale negative returns was almost completely attributable to an unprecedented and enormously rapid shift in Federal Reserve monetary policy (easy to tight money) in an attempt to wage war against an extraordinarily rapid rise in inflation. But lest we forget, the stage on which inflation was launched was the product of federally sponsored relief during Covid, the post-contagion's re-opening trade, a couple of post-pandemic congressionally sponsored spending sprees, and Russia's surprise invasion of the Ukraine.

With this as a backdrop, in a span of just nine months, the Fed had jacked its benchmark overnight rate from 0.25% to 4.50%; a 17 fold increase in its benchmark lending rate. Naturally, bond market yield curves precipitously followed suit across all maturities leading to havoc in every corner of the global financial markets.

60/40 Portfolios for the Long Run

So how should we think about the traditional 60/40 portfolio in the aftermath of 2022?

The best answers simply lie in researching how the allocation has historically performed especially after such a miserable year. Our brief examination (see Table next page) offers the following observations:

1. A year in which both stocks and bonds registered negative returns is extremely rare. Since 1980 it has only happened once, 2022!
2. The (16%) loss in 2022 was very similar to the (14%) loss incurred during the 2000-20002 dot-com bubble and the (20%) loss during the 2008 global financial crisis. Most salient is the fact that a 60/40 portfolio has historically performed exceedingly well in the immediate five years following these periods of significant disruption and loss.
3. It is also a rarity for a 60/40 portfolio to experience negative returns in two successive calendar years. It happened only twice during the dot.com bust. Also, when returns were negative, the 60/40 portfolio rarely lost more than 5%. That happened three times (2002, 2008 and 2022). Following the first two disruptions in 2003 and 2009 the portfolio posted returns in excess of +18%.

Another sidebar worthy of note is that stock valuations were significantly higher at the peak of the dot.com period in 2000 than they were just prior to the 2022 bear market. At year-end 2000, the S&P 500's price /earnings ratio peaked at 30.5x vs 2021's year-end 24.0x. Currently, the index PE is hovering around 19.2x vs its 40 year average of 21.9x and while there are no guarantees it could soften further its does present a much more attractive entry point than any time in recent memory.

Looking Forward

Notwithstanding the seismic shift in monetary policy over the last eleven months, the consumer and the US economy continue to show resilience in the face of higher costs while the stock and bond markets have materially re-set and become better balanced. Despite that some companies, including most noticeably those in the technology sector, have begun announcing major layoffs (perhaps overdue anyway), the underlying labor market also remains strong while upward inflationary pressure appears to have been capped if not beginning to recede. Does this portend a softer than expected landing? We think so! That said, we know for certain that the only macroeconomic keys that presently matter (inflation, Fed policy and economic growth) and the dynamics between them will define how the economy and financial market performance plays out in 2023. On that note let us offer a few time-tested investment postulates for your consideration as we embark on the New Year. As always, we are prepared to guide you through this re-evaluation process.

1. First, it's a good time to re-examine your risk tolerance and portfolio allocation to ensure alignment and reinforce your comfort level as we

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enter 2023. But dare not be hesitant to consider or re-consider the 60/40 split!

2. Stay meaningfully invested with a bias toward high quality US stocks proportionately anchored between large and small caps.
3. Remain cognizant of investment style (growth and value), Strike a tactical balance between them but do not abandon one for the other!
4. Consider or continue holding nominal energy investments despite ESG headwinds. In particular consider the oil majors and larger market cap midstream infrastructure MLP's where risk is nominal and yields remain compelling.
5. And as always, keep sufficient cash (or) equivalents on hand to meet near term liquidity needs so as to avoid the untimely tapping of longer-term portfolio investments irrespective of market conditions.

As we enter another year, we here at the Eideard Group wish to thank you for your continued trust, confidence and support in our professionals, our staff and its work on your behalf! We wish all of you, our client families, and the best of good heath, wellness and re-accelerating prosperity in 2023.

Eideard Group

January 25th, 2023

60/40 Core Portfolio Still Works in the Long Run [1]

Years	Stocks (S&P 500)	Bonds (US Aggregate)	60/40 Stocks & Bonds	60/40 Negative Returns	60/40 Portfolio after Negative Years
1980	31.7%	2.7%	**20.1%**		
1981	-4.7%	6.3%	**-0.3%**	**-0.3%**	
1982	20.4%	32.6%	**25.3%**		Five year Total Return 140%, annualized 19.1%
1983	22.3%	8.4%	**16.7%**		
1984	6.2%	15.2%	**9.8%**		
1985	31.2%	22.1%	**27.6%**		
1986	18.5%	15.3%	**17.2%**		
1987	5.8%	2.8%	**4.6%**		
1988	16.5%	7.9%	**13.1%**		
1989	31.5%	14.5%	**24.7%**		
1990	-3.1%	9.0%	**1.7%**		
1991	30.2%	16.0%	**24.5%**		
1992	7.5%	7.4%	**7.5%**		
1993	10.0%	9.8%	**9.9%**		
1994	1.3%	-2.9%	**-0.4%**	**-0.4%**	
1995	37.2%	18.5%	**29.7%**		Five year Total Return 152%, annualized 20.3%
1996	22.7%	3.6%	**15.1%**		
1997	33.1%	9.6%	**23.7%**		
1998	28.3%	8.7%	**20.5%**		
1999	22.9%	-0.8%	**13.4%**		
2000	-9.0%	11.6%	**-0.8%**	**2000 to 2002 combined:**	
2001	-11.9%	8.4%	**-3.7%**		
2002	-23.0%	10.2%	**-9.7%**	**-14%**	
2003	28.4%	3.6%	**18.5%**		Five year Total Return 56%, annualized 9.4%
2004	10.7%	4.1%	**8.1%**		
2005	4.8%	2.1%	**3.7%**		
2006	15.6%	4.1%	**11.0%**		
2007	5.5%	7.0%	**6.1%**		
2008	-36.6%	5.2%	**-19.8%**	**-20%**	
2009	26.9%	5.9%	**18.5%**		Five year Total Return 82%, annualized 12.7%
2010	14.8%	6.5%	**11.5%**		
2011	2.1%	7.8%	**4.4%**		
2012	15.9%	4.2%	**11.2%**		
2013	32.2%	-2.0%	**18.5%**		
2014	13.5%	6.0%	**10.5%**		
2015	1.4%	1.1%	**1.3%**		
2016	11.8%	2.7%	**8.1%**		
2017	21.6%	3.5%	**14.4%**		
2018	-4.2%	0.0%	**-2.5%**	**-3%**	
2019	31.2%	8.7%	**22.2%**		Five year expected Total Return 50%, annualized 8.5%
2020	18.0%	7.5%	**13.8%**		
2021	28.5%	-1.5%	**16.5%**		
2022	-18.1%	-13.0%	**-16.1%**	**-16%**	
2023 [2]	13.0%	7.0%	**10.6%**		

(1): Eideard Group Research. Similar pattern can be observed with 70/30 or 50/50 Portfolios.

(2): Goldman Sachs projection.

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