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Market Musings

A newsletter brought to you by Victoria Capital Management, Inc.

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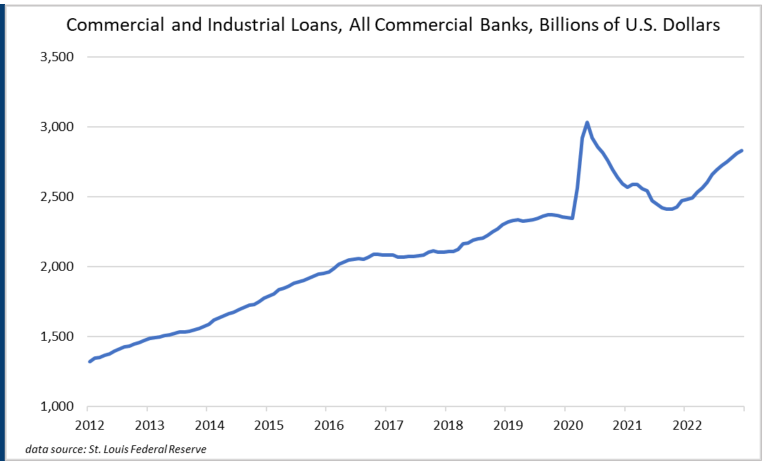
Federal Reserve monetary policy is designed to slow economic activity to reduce inflation. As interest rates rise, economic activity is expected to slow. However, since the Fed began to accelerate their interest rate increases, business loan demand has been rising, contradicting the Fed's strategy.



"The goal isn't more money. The goal is living your life on your terms."

— Will Rogers

Slowdown or Recession?

Preliminary gross domestic product (GDP) for the fourth quarter 2022 clocked in at 2.9%, slightly above the consensus estimate of 2.5%. At the same time that the economy was stronger than anticipated, inflation was weaker than expected. For December, the consumer price index (CPI) came in -0.1% in line with expectations. For the 12 months ended December 2022, CPI was up by 6.5%. Playing an important role was the surge in oil prices during the year to over $125 per barrel. By year end, the price had dropped below $80 a barrel. Unless there is some unexpected rebound in oil prices, the 12-month average of inflation is likely to decline well into 2023 giving some hope that the Federal Reserve will slow or stop increases in the fed funds rate.

The current GDP estimate for the 1st quarter of 2023 is 0.7%, a lot slower than the 4th quarter and dangerously close to becoming a negative quarter. Even though a bevy of recent economic statistics (e.g., LEI, ISM indices, retail sales, etc.) point to a recession early in '23, there remains the stubborn strength in employment, the near record low unemployment rate as well as record job openings; suggesting the economy is not ready for a recession. Even though housing has been impacted negatively by the rise in interest rates, that same increase in interest rates, when affecting the yield on money market funds, has boosted savers' income from these investments by over $200 billion. Given the holders of money market funds, we are likely to see that savings pool grow as the yield on such funds exceeds 4%. Other sources of demand include a buildup in defense spending that is funding the war in Ukraine as well as producing armaments for other NATO nations in the name of upgrading defense capabilities. We also expect increased spending from state and local governments which have benefited from federal government spending on the Covid pandemic. On balance, 2023 looks like the economy will be slow as the year begins but should move back toward a typical year of moderate growth and low inflation.

Market Commentary

Global equity markets have gotten off to a great start in 2023 after posting losses last year like those incurred in 2000. The adage "what goes up, must come down" applied to losses across the board in 2022 after three years of stellar returns in 2019, 2020 and 2021. Welcoming in this new year were gains in domestic equity markets with the S&P 500 up 6.3%, the DJIA up 2.9% and the NASDAQ up 10.7%!

Most foreign equity markets have done even better with developed foreign markets at 8.1%, slightly outpacing emerging markets which gained 7.9%. Ever since the low point in mid-October, most global equity markets have been strong despite fears of a global recession, continued war in Ukraine and uncertainty surrounding future interest rate increases by central banks.

Since 1980, it is just the sixth time (through 1-19-23) that the U.S. Dollar Index has declined 10% or more from a 5-year high. Following the five previous 10%+ declines in the value of the dollar, the S&P 500's median performance over the next year was a gain of 19.1% with positive returns all 5 times. (*source: Bespoke Investment Group*)