

Weekly Market Insights

January 3, 2023

Happy New Year!

Financial Markets

We wish a very happy New Year to all of our readers. We realize the past year has not been a particularly happy one in the financial markets. The last week of the year was relatively flat with no particularly dramatic moves. Investors appeared fatigued from the prior 51 weeks. The S&P 500 closed down 0.14%, the Dow down 0.17%, and the NASDAQ down 0.30%. The leading sectors were Financials and Energy, while Consumer Staples and Materials brought up the rear. Performance for the year 2022 was far more dramatic given high inflation and rising interest rates. The total return (including dividend reinvestment) for the S&P 500 was -18.1%, the Dow -6.9%, and the NASDAQ -32.5%. Both the S&P 500 and the NASDAQ reflect larger exposure to the weak Technology sector, where rising rates had the most impact on stock valuations. It appeared as if traders and portfolio managers were just happy to get the year over with.

Economics

We have often written that the fascinating thing about financial markets is they reflect not just financial matters such as earnings, but the hopes and fears of the population. This has clearly been the case in 2022.

An excellent way to begin this portion is to quote the opening line of Martin Wolf's most recent column in the *Financial Times*: "Few will regret the passing of 2022. It has seen a brutal onslaught on a peaceful neighbor by a vile despot." Russia's act of aggression dramatically increased the cost of energy, adding to the already rising inflation rate. Central banks around the globe had been fueling national economies with low interest rates to combat serious downturns caused by the pandemic. As consumer demand and economic growth began to return, inflation became a serious problem, forcing central banks to reverse course and raise interest rates. This, of course, led a downturn in global equity markets. Where does that leave the economy and financial markets now? Statistical analysis of markets is both interesting and useful but far from perfect, so we urge caution. What analysts at the Fed are looking for are

imbalances within the economy. For example, a shortage in the labor pool driving up wages and causing inflation. Another, which we mentioned earlier, is too much money in the system chasing a stable amount of goods.

There are signs that tighter monetary policy is slowing the economy, which is what the Federal Reserve wants. Alas, there are inflationary sources outside the realm of normal economics. The pandemic disrupting supply chains and the war in Ukraine driving up energy prices are just two examples.

Financial markets are anticipatory creatures, so it is interesting to look ahead at some possible future events and consider what they may mean.

The war in Ukraine ends. Most likely, it is an unsatisfactory ending. It would relieve pressure on energy prices and would provide some relief from global inflation. Russia would come out poorer and with their reputation tarnished. Tensions would remain high.

China is likely to continue having economic difficulties. Most readers are well aware of China's problems caused by its poor handling of COVID. With the immediacy of their COVID challenges, some have forgotten that China has a series of other substantial headwinds. These include a very difficult real estate problem, an ambitious Silk Road program that is not paying off, a repudiation of Deng and reversion to Mao, and, for the first time since Tiananmen Square, public demonstrations against the government. As China stumbles, look for India to make economic inroads at China's expense. One of the major problems holding back India's economic progress has been the enormously large and complex bureaucracy. About five years ago, India took the first step to reduce it. The first step was to eliminate a very odd tax. India allowed each of its states to tax products from each of its other states as if from a foreign country. Interestingly, the *Financial Times* recently ran a front page story about India making inroads by taking manufacturing business from China.

Weekly Market Insights (cont'd)

There are two interesting possibilities for the U.S. in attempting to avoid a reoccurrence of supply chain interruptions, help relieve employment shortages, increase productivity, and assuage the feelings of those who are concerned about immigration. The first is a large U.S. investment in its own productive resources such as infrastructure and education. This adds to production and holds down inflation while allowing for an increase in wages. Second is to redirect some of our supply chains to Central and South America. It redistributes production and makes for better relations in the Americas. The great majority of immigrants from the south come looking for employment. Increasing opportunities there would reduce the large flow from the south and would also make the effort more politically acceptable for some.

Conclusion

The above is an interesting 2023 wish list. Some may actually come true. What are the likely events facing the global economy in 2023? Although a recession in the United States seems probable, we continue to believe the most advantageous country to invest in remains the U.S. It is far ahead in fighting inflation and already has programs in place to spark investment. The European Union lags the U.S. in monetary policy adjustments in general, and adjusting the Euro to accommodate the industrial north and the agricultural south will be difficult indeed. At the moment, the U.K. has too much to deal with to be an investment target.

We wrote a lot about possibilities for 2023, but we remind readers that some are more likely and some are quite unlikely.

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