Graves Light Lenhart
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Graves Light Lenhart January '23 Market Commentary

A Good Start Following a Bleak 2022

Market Overview:

After experiencing a turbulent 2022, January provided a strong start to the new year. This occurred despite mixed earnings results, as the markets digested several positive countervailing trends, including better-than-expected GDP growth, a slowing pace of inflation as well as expectations for reduced rate hikes by the Federal Reserve (Fed). The latter has had a significant impact on the US dollar, as central banks around the globe largely continue to maintain an aggressive pace of rate hikes. With the dollar weakening from its September 2022 peaks, international markets (namely international stocks) largely benefitted as they experienced a significant currency tailwind.

On the earnings front, 4th quarter results for S&P 500 constituents has initially been subpar, with positive earnings surprises recording below their 5-year and 10-year averages. As a result, the index is reporting lower year-over-year earnings for the 4th quarter through January 27th (according to Factset). This is mostly a result of lower profitability, or margins, as aggregate revenues have actually been increasing on a year-over-year basis.

Asset Performance:

In a sharp reversal from last year, most of the investment universe experienced a very strong month of returns. The S&P 500 increased 6.2%, its best January performance since 2019. Away from Large-cap stocks, performance was relatively better, with the S&P MidCap 400 +9.2% and the S&P SmallCap 600 +9.5%. International equities outperformed the US, boosted by a weakening US dollar, China's reopening and a warm weather reprieve in Europe which has lowered the probability of a severe recession on the continent. The MSCI EAFE index – representing developed markets outside of the US and Canada – rose 8.1% during the month and has bounced nearly 27% since the end of September(!), a stark reminder of the sharp recoveries often experienced coming out of *or* during a bear market.

Key US Index Returns	2022	January '23
S&P 500	-18.1%	+6.3%
Nasdaq	-32.5%	+10.7%
Dow Jones Industrial Average	-6.9%	+2.9%

Relevant Fixed Income Yields	YE 2022	January '23
US 10-Year Treasury Note	3.88%	3.53%
Investment Grade Corp. (C0A0)	5.5%	5.1%
High Yield Corp. (H0A0)	9.0%	8.2%

Source: Factset as of 02/02/23

With interest rates down across the board to start the year, fixed income securities commensurately benefitted. The Bloomberg Aggregate – coming off of its worst annual performance on record – returned 3.1% for the month. Remarkably, this is the second highest monthly return recorded in the last decade for this index of high-quality fixed income securities, which underscores the upside potential in many parts of the bond market that is now trading at a discount to its issued par value. In short, as it becomes plausible for interest-rates to normalize, fixed income investors can benefit as the prospective return profile has markedly improved for most bond assets. Lastly, we highlight that the bond markets are pricing-in an optimistic path to lower inflation levels, as reflected in the TIPS market (Treasury Inflation-Protected Securities). The more optimism priced in, the smaller the margin of error for inflation "misses" were they to occur.

Summary Thoughts:

We recently circulated our quarterly newsletter which provided a "deeper dive" into our views on asset allocation for client portfolios (GLLLW 1Q23 Newsletter). We reiterate these recommendations, while also adding that an increasing level of optimism has become priced into many parts of the market, including profitless companies which have experienced the sharpest rally. As such, we remain focused on long-term portfolio positioning, leaning into assets where attractive valuations provide a guidepost to maximizing our clients' long-term financial success. While we cannot dictate future returns, we believe that a disciplined and methodical approach to portfolio construction is the best means to navigate an ever-evolving market landscape.

Financial Planning Corner / Why Use Exchange-Traded Funds?:

At GLLW, we commonly use Exchange-Traded Funds (ETFs) to construct client portfolios. While ETFs have been around for nearly 30 years, their usage for investment portfolios has become increasingly proliferate. While coming in different shapes and sizes, ETFs are essentially a basket of securities and trade like a stock, being bought and sold on an exchange to provide investors access to markets throughout the trading day. We have found the client experience to be more favorable overall when utilizing ETFs versus their mutual fund counterparts, in that clients can often achieve greater tax efficiency, lower fund costs and improved market liquidity through the ETF structure. We emphasize that as we structure client portfolios, we place great rigor into *both* the asset classes we are purchasing along with the best available investment vehicle to provide access to the underlying assets in terms of underlying cost as well as tax-efficiency. This is where ETFs have become increasingly useful across our clients' portfolios. For a primer on ETFs and how they work, this link from Charles Schwab provides a helpful overview (Schwab: Understanding ETFs).

As we meet with you to discuss your financial planning goals, we are happy to answer any questions you may have on ETFs and how they fit within your portfolio.

Warm regards,

Ash Heatwole, CFA
Director of Wealth Management & Portfolio Manager

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The value of fixed income securities will fluctuate with changes in interest rates, prepayment payment rates, exercise of call provisions, changes in the issuer's credit ratings, market conditions, and other variables such that they may be worth more or less than original cost if sold prior to maturity. There is also a risk that the issuer will be unable to make principal and/or interest payments. Although treasuries are considered free from credit risk they are subject to other types or risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate, and deflation risk, which may cause the principal to decline and treasury securities to underperform traditional securities.

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