Morgan Stanley
Private Wealth Management

January 2023

The Novelli Group
At Morgan Stanley
Private Wealth Management

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Rocky Roads

2022 will go down as one of the worst years ever for financial markets. Sure, most readers will remember the distressing results from 2008 and even a few can recall the mid 1970's, but last year was a real doozie.

According to my research involving Thompson One, Reuters and Trading Economics, consider these facts:

- The S&P 500 lost over 18%, suffering its seventh worst calendar year since 1931.
- The Bloomberg Aggregate Bond Market Index, which started in 1976, had its worst performance ever and was off -13%! The worst year prior was 1994 at -2.9%.
- A traditional 60/40 portfolio of US stocks and bonds was off more -16%, the third worse year since 1931.

It was a year where there were few places one could hide, but it was also a year where a few adjustments helped improve returns. For example, investors that heeded calls to pivot from growth and tech dominated portfolio allocations to value stocks, were served well by that decision. The Russell 1000 Growth Index was off -29% while the value index performed better off -7.5%.

No matter how you slice it, diversified, conservative investors struggled throughout the year as capital markets digested steeply rising rates, high inflation and bouts of severe volatility throughout the year. So, where do we go from here?

More Potholes Possible

As we shared in our September 2022 Perspectives, which you can read on our website or here, we expect 2023 to be a year punctuated by a range bound equity market as the full effect of rising short term rates and tighter monetary policy increasingly create drag on the economy, slowing growth and output, while also tampering inflation. There are many economists suggesting these impediments will tip the US economy into recession, creating more potholes in this year. However, we believe that if the Fed pivots in the coming months, as we expect, they will have done enough to restrain inflation but navigate a soft landing, avoiding recession and slowing demand enough to bring rising prices back into check. If our belief proves true, we might have left the rocky roads behind and be able to avoid troubling potholes ahead.

Silver Lining

There is a silver lining from 2022! Finally, after nearly 15 years of extremely low interest rates creating challenges for retirees, the improvement in interest rates may be a sign that normal market conditions might finally emerge. For over a decade, investors who held conservative investments like cash, money market funds and certificates of deposits were penalized for avoiding greater risks and more volatility with anemic paltry returns. But as we enter 2023, we see conditions finally emerging were a sense of normal can be expected. If inflation does temper in the coming weeks, there will be a better broad landscape for balanced investors to enjoy reasonable returns from their more conservative investments such as bonds.

To further accentuate this, Morningstar, the reputable mutual fund research firm, reported on their website in December 2022 that, in their opinion, investors can safely afford to withdraw more from their nest eggs in retirement than before. Morningstar said, "Because equity valuations have declined and cash and bond yields have increased, the forward-looking prospects for portfolios—and in turn the amounts that new retirees can safely withdraw from those portfolios over a 30-year horizon—have enjoyed a nice lift since we explored the topic last year. Whereas last year's research suggested that a 3.3% withdrawal rate was a safe starting point for new retirees with balanced portfolios over a 30-year horizon, this year's research points to 3.8% as a safe starting withdrawal percentage, with annual inflation adjustments to those withdrawals thereafter."[1]

As a team, we remain particularly focused on 4th quarter earnings, which will reported throughout January and February. How company performance stacks up will tell a lot about the risks of recession and whether the market has indeed reached the end of the bear market cycle last September, as we've suggested. Patiently, we will be keeping our eyes on those results to find more certainty in the coming weeks!

Happy New Year!

[1] Morningstar, *What's a Safe Withdrawal Rate Today?*, December 13, 2022, Christine Benz, John Rekenthaler