ROBERTSON STEPHENS®

December 12, 2022 – Investment Commentary

Macro Monday Market Performance

Stocks gave back much of the previous two weeks' gains as some surprisingly strong economic data weakened hopes that the Federal Reserve might soon be able to shift its program of raising interest rates to tackle inflation. The S&P 500 Index recorded its worst return in five weeks, while the small-cap Russell 2000 Index suffered its worst week since late September.

Within the S&P 500, the typically defensive healthcare, consumer staples and utilities sectors fared best. Energy shares fell sharply as international oil prices tumbled to their lowest level since January. Financials also performed poorly as several bank executives offered negative near-term outlooks. Goldman Sachs' CEO David Solomon warned about "some bumpy times ahead," while JPMorgan Chase CEO Jamie Dimon told CNBC that a "mild to hard recession" may hit next year.

It still feels as if markets remain in something of a holding pattern ahead of a packed calendar of events in the week ahead. This includes the latest interest rate decisions from the Fed, European Central Bank (ECB) and Bank of England (BoE). Expectations of the Fed's terminal rate continue to hover around the 5% mark, where they've been for around a couple of months now. Sovereign bond yields have ended the week higher. Despite hitting its lowest level in more than two months, the 10yr US Treasury has ended the week 5bps higher at 3.54%. Similarly, the 10yr German Bund closed ended the week at 1.93%, a rise of 8bps. The big question is whether the Fed and ECB will provide a dovish signal this week.

Elsewhere, the downward trajectory in oil prices is also flowing through to the real economy, with US gasoline prices now down by just over a third from their peak in mid-June, currently at $3.329/gallon. Furthermore, the energy price declines were seen in European natural gas futures as well, which fell -6.9% on the week. The latest US services numbers provide yet another data confirmation that the inflation process is still well-embedded in the economic system. Its drivers have moved from an isolated set of factors (energy and food) to goods inflation and, now, services and wage inflation. We believe, while the headline rate will continue to fall, inflation is likely to prove more sticky than the Federal Reserve seems to expect. With that, the 2s-10s yield curve inversion deepened to levels last seen 41 years ago.

2023 Outlook and Equity Considerations

2023 has three summary pillars. *First*, we believe the Fed will raise short-term rates to ~5% and subsequently hold steady through 2023. Market consensus, as reflected in fed funds futures, shows confidence that the Fed will peak at 5% in early 2023, and by the second half of the year, will be cutting rates amid economic uncertainty. We disagree and focus on three vectors for considering rates, including 1. level of rates, 2. the speed to achieve the terminal rate and 3. increasingly more relevant the duration ("pause period") in which rates are maintained. The *second* pillar is that we believe the yield curve will remain inverted and the *third* pillar is that adverse earnings revisions due to margin compression will dominate in first half of 2023 guidance. While we think about forward earnings valuations top-down and bottom-up, a top-down macro view will likely limit multiple expansion for many sectors. A Fed pivot would represent a tailwind to price-earnings (P/E) multiples but seems unlikely unless growth expectations decline materially.

Maybe, the US consumer and households appear healthy based on what we see in the rearview mirror. The limit is, cash on hand, continuing necessary monthly expenses, credit balances, cost of said credit, and savings. At some point, consumers will demonstrate at different times a behavioral change and become reactive to the sticky inflation and higher interest rates. The "excess savings" is highly concentrated among the upper middle class and wealthy consumers drive a material percentage of consumer spending, so other consumer segments will initially struggle.

The macroeconomic backdrop is quickly transitioning from very low to higher rates. The low-rate environment significantly benefited large-cap and speculative companies in the last decade. Post the tech crash in the early 2000s, small/mid-cap outperformed the S&P 500 in changing macro environments, including higher and lower rates and GDP. This is because of the low valuation base and improving earnings catalyst. Can this take place again as we have seen after other recessions? Currently, small and mid-cap indexes are trading near historic P/E lows relative to their large-cap peers. However, valuation without a catalyst could be a setup for a “value trap”.

Pivoting to consider a global approach. For context, as of November 1, 2022, the broad-based emerging market index was down almost 30% for the year, and the S&P 500 was -17%. Today, that same emerging market benchmark is down ~20% and the S&P is down ~17% — a performance gap of approximately 13% to only approximately 3%. The benefits of a global portfolio are not clear all the time but help during certain moments in time.

So far, 2022 is the second-best calendar year since 2000 for value stocks (as represented by the Russell 1000 Value Index) relative to growth stocks (as represented by the Russell 1000 Growth Index). Value has outperformed growth by roughly 20% year-to-date as of 11/30. The Investment Office believes a more resilient portfolio entering 2023 would benefit from an emphasis on value stocks.

Disclosures
Investment Commentary Sources: Bloomberg and Morningstar
Investment advisory services offered through Robertson Stephens Wealth Management, LLC (“Robertson Stephens”), an SEC-registered investment advisor. Registration does not imply any specific level of skill or training and does not constitute an endorsement of the firm by the Commission. This material is for general informational purposes only and should not be construed as investment, tax or legal advice. It does not constitute a recommendation or offer to buy or sell any security, has not been tailored to the needs of any specific investor, and should not provide the basis for any investment decision. Please consult with your Advisor prior to making any Investment decisions. The information contained herein was carefully compiled from sources believed to be reliable, but Robertson Stephens cannot guarantee its accuracy or completeness. Information, views and opinions are current as of the date of this presentation, are based on the information available at the time, and are subject to change based on market and other conditions. Robertson Stephens assumes no duty to update this information. Unless otherwise noted, any individual opinions presented are those of the author and not necessarily those of Robertson Stephens. Indices are unmanaged and reflect the reinvestment of all income or dividends but do not reflect the deduction of any fees or expenses which would reduce returns. Past performance does not guarantee future results. Forward-looking performance targets or estimates are not guaranteed and may not be achieved. Investing entails risks, including possible loss of principal. Alternative investments are only available to qualified investors and are not suitable for all investors. Alternative investments include risks such as illiquidity, long time horizons, reduced transparency, and significant loss of principal. This material is an investment advisory publication intended for investment advisory clients and prospective clients only. Robertson Stephens only transacts business in states in which it is properly registered or is excluded or exempted from registration. A copy of Robertson Stephens’ current written disclosure brochure filed with the SEC which discusses, among other things, Robertson Stephens’ business practices, services and fees, is available through the SEC's website at: www.adviserinfo.sec.gov. © 2022 Robertson Stephens Wealth Management, LLC. All rights reserved. Robertson Stephens is a registered trademark of Robertson Stephens Wealth Management, LLC in the United States and elsewhere.