ROBERTSON STEPHENS®

## Investment Q4 and 2022 Recap

### Macro Still Matters…

After only two weeks of trading, markets are delivering gains that are quickly reversing last year's losses. Year-to-date returns of 4%-8% on Equities (Europe & EM outperforming the US) and 3%-4% on Fixed Income (High Yield outperforming High Grade) are already close to what some of these markets typically generate over 6-12 months. Mean-reversion has been prevalent. The biggest winners so far have been some of 2022's biggest losers: those that lost over half their value last year (META; Bitcoin; ETFs for ARK Innovation, Blockchain & Non-Fungible Tokens) up 8% to 25% so far, and ESG thematics like Hydrogen (+17%) and Solar (+10%). The biggest -- and almost the only -- loser has been the US dollar, which entered the year overvalued in the context of interest rate and growth differentials and a decline in "safe haven" premium due to geopolitical risks.

Whether the market is correct in the near term depends on three primary dynamics (1) the magnitude of US disinflation; (2) the persistence of the late 2022/early 2023 growth upturn; and (3) the evolving corporate profits recession.

Prior to the recent print, inflation was running at 7.1% year over year. Each month, the year-on-year calculation adds a new month and drops an old month. Dropping a high-inflation month usually lowers inflation. Dropping a low-inflation month usually increases inflation. Last week's US CPI print on Thursday came in exactly in line with market expectations. As a result, the market had a strong rally, as the print cemented expectations that the Fed would slow down their rate hikes to 25bps in the next meeting. In terms of the details of the release, monthly CPI came in at -0.08% in December, which was the biggest monthly decline in prices since April 2020 at the height of the pandemic. In turn, that took year-on-year CPI down to a one-year low of +6.5%. Also worth pointing out, the decline in December was heavily influenced by falling energy prices, which came down -4.5% on the month, and the core CPI measure that strips out food and energy was up by +0.30% on the month, ticking up from its 15-month low in November.

Investors moved to price in a more dovish Fed for meetings after February as well, with the terminal rate priced in for June down by -2.9bps to 4.91%, whilst the end-2023 rate was also down -5.6bps to 4.40%.

With investors pricing in smaller rate hikes, front-end Treasury yields fell in response, and the 2yr yield reached its lowest level since early October thanks to a -6.8bps fall on the week to 4.18%. The moves at the long-end were also sizeable, with the 10yr yield falling -8.2bps to 3.48%.

For equities, the picture was also very resilient this week, with the S&P 500 (+1.9%), where most of the largest US banks released their quarterly financials with a similar tone for the Nasdaq, which rose (+3.2%) on the week.

Over in Europe, the situation remained similarly constructive with the major equity indices all continuing to advance this week, including the STOXX 600 (+1.8%), the DAX (+3.3%) and the French CAC 40 (+2.4%). In fact, that brought the German DAX's gains for 2023 so far to +8.35%. Sovereign bonds also continued to rally, with yields on German 10yr bunds (-4.9bps), French OATs (-9.6bps) and Italian BTPs (-22.4bps) all declining.

Elsewhere on the data side, there were further signs of resiliency in the US labor market, with the weekly initial jobless claims over the first week of 2023 coming in yesterday at 205k (vs. 215k expected). That adds to a positive trend recently and takes the 4-week moving average down to 212.5k, which is its lowest level since October. Separately in Europe, we heard from the ECB that inflation expectations were falling, with their Consumer Expectations Survey for November showing a decline in 12-month inflation expectations from 5.4% to 5.0%. Furthermore, the 3-year expectations measure fell from 3.0% to 2.9%.

### Portfolio Catalysts

The key takeaway is that inflation is broadly moving in the right direction, albeit it is unlikely to be a straight line and the Fed target seems far away. The questions for investors in the short-term are: How much moderation is enough for the Fed to hit the pause button on rate hikes and for how long will they pause before they cut? While the debt ceiling has been on investors' radar as a perennial risk, it has taken on greater significance ever since the Speaker of the House election. What could it mean for markets if the US government doesn't raise the debt ceiling in time and extraordinary measures become necessary? That happened back in the summer of 2011. Not surprisingly, stocks sold off very significantly. More surprisingly, US Treasuries prices rose (yield down) as investors sought a “safe haven” asset class – even though that particular safe haven was in jeopardy of not being able to service its interest payments. Within stocks, higher quality outperformed, and high yield credit fell.

Also on the radar is the start of earnings season. This is not only important in terms of what it tells us about how a specific company fared, but we also are typically provided with some guidance on expectations for the near term. In addition, we can glean broader economic insights from what is discussed on earnings calls. Bank of America CEO Brian Moynihan described the economic environment as “increasingly slowing.” The bank’s consumer balances were roughly flat, while the average outstanding credit card balance rose 14% year-on-year. JPMorgan Chase CEO Jamie Dimon warned that the ultimate effects of geopolitical tensions, Europe’s energy crisis and high inflation are still unknown.

The Investment Office is vigilant about paying attention to various earnings calls and guidance in the coming weeks. Meanwhile, the Investment Office is optimistic about the 2023 municipal market. As we enter 2023, we believe portfolios are positioned to earn more income while taking less risk and retain the capacity to add value through separately managed accounts where suitable. Income once again provides a meaningful base for portfolios along with manager selection across credit, sector, structure and curve exposures.