Westwood Wealth 2022 Market Review

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Overview

The year 2022 may best be described by one word: inflation. The economies of the United States and the world were influenced by rising inflation, its causes, and the policies aimed at curtailing it. While inflationary pressures began to mount in 2021, they were exacerbated by continuing supply shortages; the ongoing effects of the COVID-19 pandemic, both here and abroad; the Russian invasion of Ukraine; and a global energy crisis.

Early in 2022, the Federal Reserve expected inflation to reach 2.6% by the end of the year, not much above their 2.0% target. Federal officials expected supply bottlenecks to ease, economies to re-open after relaxing COVID-related restrictions, and economic activity to return to something close to normal.

Unfortunately, the Fed underestimated how rising wages, federal aid, and expanded savings would lead to increased consumer spending, which continued to outpace supply, and drive prices higher. Most importantly, Fed officials didn’t foresee the impact the Russian invasion of Ukraine would have on world trade in energy, food commodities, and resources such as natural gas and crude oil. And inflation was not just felt in the U.S. but throughout world economies as well. The

International Monetary Fund expects worldwide inflation to hit 8.8%, the highest rate since 1996. In response, the Federal Reserve began the most aggressive policy of interest-rate hikes in more than 15 years.

Consumer price indexes in the 19 countries that use the euro currency rose to 10.0% or higher in November from a year earlier, while prices for food rose at a faster pace. Inflationary pressures also impacted world economies in the Middle East, Africa, South America, Canada, and Mexico. Rising inflation made countries' imports more expensive and forced central banks to raise interest rates. The U.S. dollar surged in value against most world currencies, weakening foreign currencies and contributing to rising prices for goods and services.

While overall inflationary pressures may have peaked as we close out 2022, food and energy prices remain elevated. Energy prices led the price surge at the beginning of the year. Crude oil prices rose to more than $110.00 per barrel for the first time since 2011. Energy prices, which were already rising at the end of 2021, were sent soaring following the Russian invasion of Ukraine as Russian refining capacity diminished amidst sanctions and trade restrictions imposed by several countries.

However, energy prices have since stabilized somewhat. Helping to stem surging oil prices was a notable retreat in Chinese energy demand amidst COVID-related restrictions; the stabilization of Russian crude output; increased U.S. oil production; and a release of oil from the Strategic Petroleum Reserve.

The U.S. economy saw a slowdown in growth for much of 2022. Gross domestic product contracted in the first two quarters of the year after advancing at an annualized rate of 5.9% in 2021. But GDP rebounded in the third quarter, climbing 3.2%. Although inflation has cut into consumers' purchasing power, they have continued to spend during difficult economic times, supported by rising wages, job growth, and access to savings accumulated during the pandemic.

Industrial production lagged through the summer months, only to rebound during the latter part of 2022, ultimately exceeding its pace from a year earlier. The housing sector was hit particularly hard by rising mortgage rates and diminished inventory. Existing home sales were more than 35.0% below their pace in 2021, while sales of new single-family homes lagged by more than 15.0%.

Inflation also impacted the stock market, both at home and abroad. Several market sectors that had led the bull surge since 2008 suffered notable pullbacks. Information technology and communication services ended up as two of the worst performing sectors in 2022. Retail stocks also took a tumble as inflation drove up nondiscretionary items like food and energy, leaving less for consumers to spend on discretionary products and services. Also plaguing retailers were rising costs associated with products, services, and labor.

This past year was not only a difficult one for stocks and bonds, but also for “alternative assets” such as crypto. Rising interest rates impacted the viability of crypto. Couple this with revelations of fraud and abuse, and crypto assets have fallen precipitously.

Nevertheless, as 2022 draws to a close, there are some positives to consider entering the new year. The GDP expanded for the first time in the third quarter, and crude oil and gas prices reversed course and dipped lower. Primary inflationary indicators, such as the consumer price index and the personal consumption expenditures price index, trended lower at the end of the year. Ultimately, the economic outlook for 2023 will likely depend on the path of inflation and whether the economies of the U.S. and the world can avoid a recession as prices are driven lower.

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Snapshot 2022

The Markets

- Equities: Stocks began 2022 on a sour note, ending January and February in the red. Unfortunately, things didn’t get much better for the remainder of the year. Following a bull market that lasted more than 10 years, stocks experienced a sizeable pullback. The benchmark indexes listed here declined in each of the first three quarters of 2022. The Nasdaq lost more than 33.0% on the year, negatively impacted by the Federal Reserve’s aggressive, inflation-fighting policy, which hampered tech and growth stocks. While Wall Street showed some resilience in the fourth quarter, stocks suffered their worst year since the financial crisis of 2008.
- On the last day of the year, each of the benchmark indexes listed here ended the year lower, despite a solid fourth quarter. Among the market sectors, only energy advanced, gaining a robust 59.04%. The remaining market sectors lost value, led by communication services (-40.4%) and followed by consumer discretionary (-37.6%), information technology (-28.9%), real estate (-28.5%), materials (-14.1%), financials (-12.4%), industrials (-7.1%), health care (-3.6%), consumer staples (-3.2%), and utilities (-1.4%).

- Bonds: Historically, when stocks are down investors move to bonds. However, for most investors that paradigm did not hold true in 2022, as both stocks and bonds suffered double-digit losses. The Bloomberg (formerly, Barclays/Lehman) Aggregate Bond Index realized the worst return in its history after declining nearly 13.0%. The yield on 10-year Treasuries rose by more than 230 basis points, as bond prices sank (bond prices and yields move in opposite directions). The U.S. Treasury yield curve (the difference between short-term bond interest rates and long-term rates) has been inverted for much of the year. Currently, the difference between the 3-month bond and the 10-year bond is roughly -0.65%, indicating an inverted yield curve. Historically, an inverted yield curve has often signaled a recession. However, other economic indicators seem to indicate that a full-blown recession is unlikely.
- Oil: Crude oil prices rode a wave of volatility throughout 2022. An energy crisis, rising demand, and the Russian invasion of Ukraine sent prices soaring, hitting a high of more than $122.00 per barrel in early June. However, demand waned, particularly in China, where COVID-related lockdowns stifled requirements for crude oil. Crude oil prices were also driven lower by additional U.S. output, including the release of crude oil from the Strategic Petroleum Reserve. By the end of the year, crude oil prices rose by about 7.0%.
- Prices at the pump climbed higher to begin the year. However, as crude oil prices declined, so did retail gasoline prices. The national average retail price for regular gasoline was $3.281 per gallon to begin 2022. Gas prices steadily increased throughout the first half of the year, reaching a high of $5.006 in June. Gas prices trended lower for the remainder of 2022, closing out the year at $3.091 per gallon for the week ended December 26.
- FOMC/interest rates: The target range for the federal funds rate began the year at 0.00%-0.25% and ended 2022 at 4.25%-4.50%, an increase of 425 basis points. Inflation began to climb in 2021, as strong consumer demand collided with pandemic-related supply constraints, which drove prices up, reaching a 39-year high in November 2021. The Fed initially termed the rapid rise in prices “transitory,” expecting that the factors driving inflation upward would subside. However, inflationary pressures did just the opposite for much of 2022, particularly following the Russian invasion of Ukraine in February. In an effort to combat rising inflation, the Fed began hiking the federal funds target range. The first rate hike came in March (25 basis points), followed by four consecutive 75-basis point interest-rate increases. At its last meeting of 2022 in December, the Fed announced a 50-basis point rate hike. Following its last meeting in December, the Fed’s economic projections showed the personal consumption expenditures price to end 2022 at 5.6%, with prices not anticipated to settle at or near the Fed’s target goal of 2.0% until 2025.
- US Dollar-DXY: Since June, the value of the U.S. dollar has been increasing relative to most foreign currencies, particularly the British pound and the Euro. Despite slipping at the end of the year, the dollar remained on track for its biggest annual gain since 2015. In 2022, the dollar has gained about 8.5% against a basket of currencies. The aggressive policy adopted by the Fed to combat rising inflation sent the dollar soaring, reaching a high of about 18.0% in September. The expectation that the Fed will be less hawkish in 2023 has cut into the dollar’s value during the last quarter of 2022.

- Gold: Gold prices began the year at $1,830.30 and closed 2022 at $1,829.70, a decrease of about 0.3%. During the first quarter of 2022, gold prices spiked to $2,053.00 per ounce, following the start of the Russia/Ukraine war. However, by the end of the first quarter, gold prices settled in the $1,930.00 per ounce range. By the third quarter, weakness in the stock market coupled with a surging dollar sent gold prices down to a 30-month low of $1,691.00 per ounce. For the remainder of the year, gold prices hovered between $1,750.00 and $1,800.00 per ounce.

Eye on the Year Ahead

The battle against rising inflation will likely continue to dominate much of the economy and stock market in 2023. If and when the Federal Reserve scales back its aggressive interest-rate hikes, investors might be more inclined to return to equities, particularly tech shares. However, the war in Ukraine and new COVID cases will also have an impact. If nothing else, 2023 should be very interesting.

Data sources: Economic: Based on data from U.S. Bureau of Labor Statistics (unemployment, inflation); U.S. Department of Commerce (GDP, corporate profits, retail sales, housing); S&P/Case-Shiller 20-City Composite Index (home prices); Institute for Supply Management (manufacturing/services). Performance: Based on data reported in WSJ Market Data Center (indexes); U.S. Treasury (Treasury yields); U.S. Energy Information Administration/Bloomberg.com Market Data (oil spot price, WTI, Cushing, OK); www.goldprice.org (spot gold/silver); Oanda/FX Street (currency exchange rates). News items are based on reports from multiple commonly available international news sources (i.e., wire services) and are independently verified when necessary with secondary sources such as government agencies, corporate press releases, or trade organizations. All information is based on sources deemed reliable, but no warranty or guarantee is made as to its accuracy or completeness. Neither the information nor any opinion expressed herein constitutes a solicitation for the purchase or sale of any securities, and should not be relied on as financial advice. Forecasts are based on current conditions, subject to change, and may not come to pass. U.S. Treasury securities are guaranteed by the federal government as to the timely payment of principal and interest. The principal value of Treasury securities and other bonds fluctuates with market conditions. Bonds are subject to inflation, interest-rate, and credit risks. As interest rates rise, bond prices typically fall. A bond sold or redeemed prior to maturity may be subject to loss. Past performance is no guarantee of future results. All investing involves risk, including the potential loss of principal, and there can be no guarantee that any investing strategy will be successful.

The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The S&P 500 is a market-cap weighted index composed of the common stocks of 500 largest, publicly traded companies in leading industries of the U.S. economy. The NASDAQ Composite Index is a market-value weighted index of all common stocks listed on the NASDAQ stock exchange. The Russell 2000 is a market-cap weighted index composed of 2,000 U.S. small-cap common stocks. The Global Dow is an equally weighted index of 150 widely traded blue-chip common stocks worldwide. The U.S. Dollar Index is a geometrically weighted index of the value of the U.S. dollar relative to six foreign currencies. Market indexes listed are unmanaged and are not available for direct investment.

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