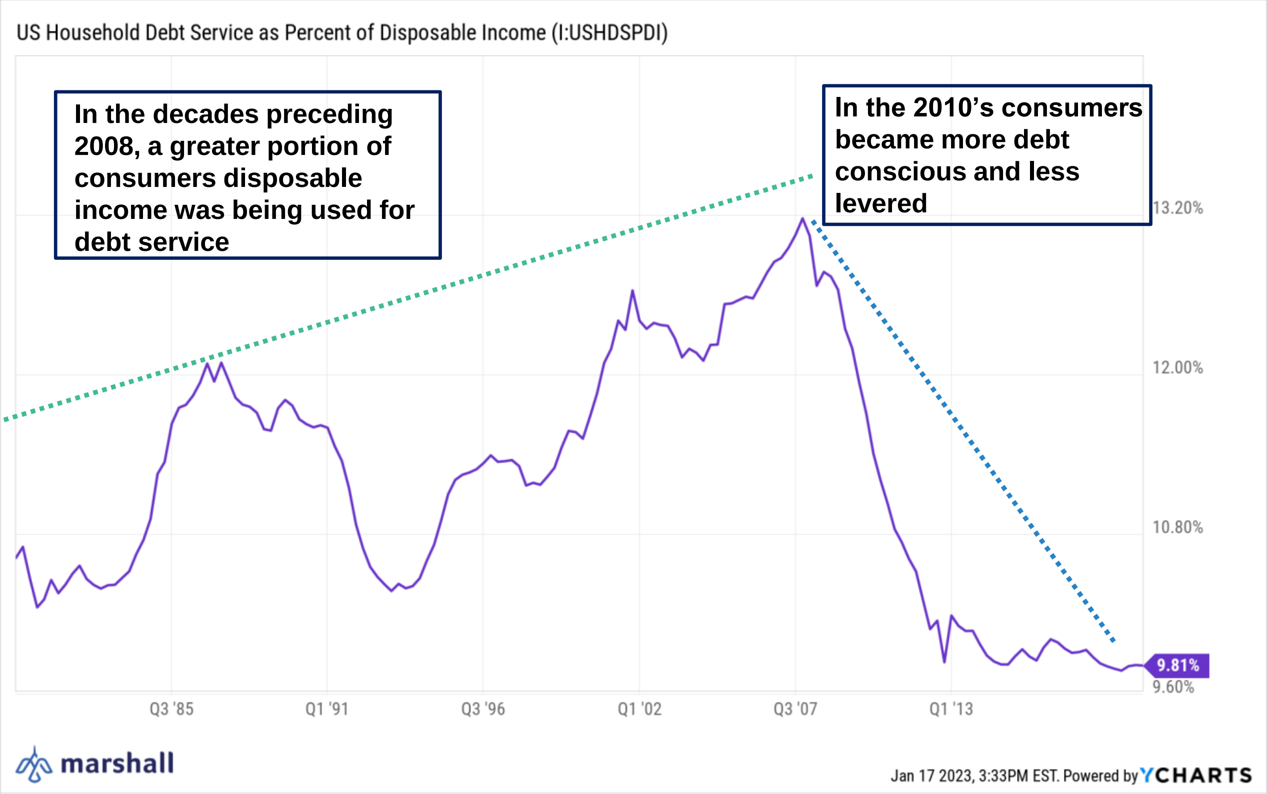
WealthIQ: January 2023

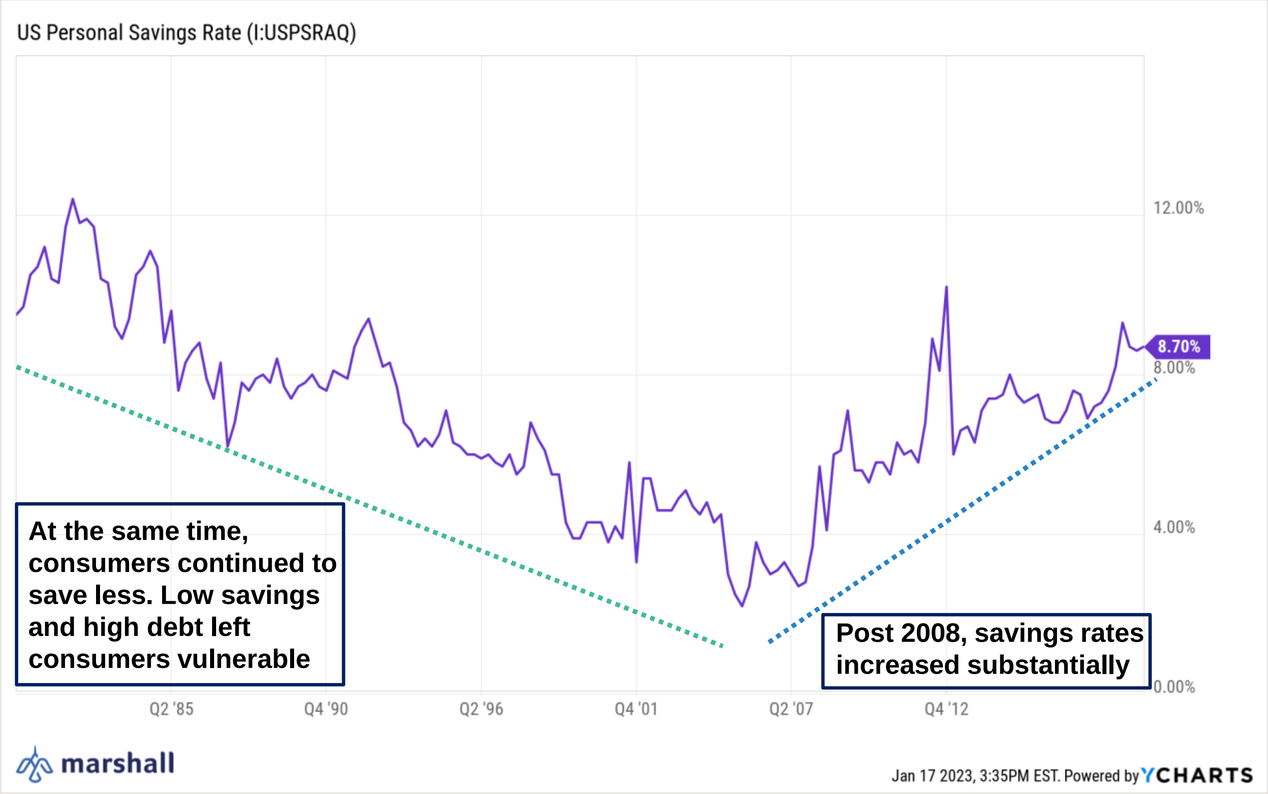
2022: Year of the Bear

Executive Summary: 2022 was a challenging environment for financial markets, making the overexuberance investors enjoyed in 2021 feel like a distant memory. We believe some of the pain investors experienced last year can be attributed to consumer behavior and monetary policy changes in the period following the 2008 Great Recession. Some of these residual effects, coupled with tight labor conditions, could continue to influence economic growth, which has recently been moderating. Current favorable inflation trends may also provide a path to lower inflation rates this year than are currently expected.

marshall

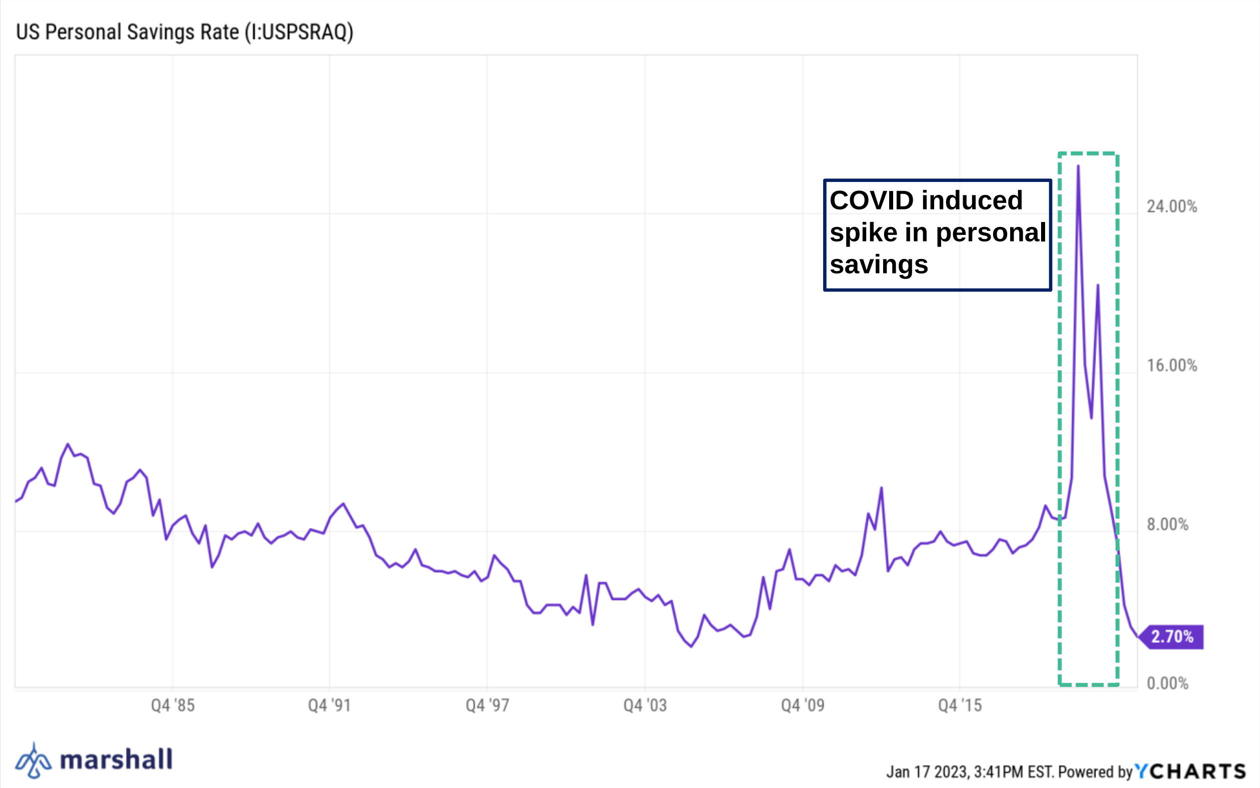
1) 2022 was the most challenging market environment since the Great Recession. In many ways, it's helpful to look back at that period to better understand what happened in markets this past year. In the years preceding 2008, U.S. consumers allocated an increasing portion of their disposable income to debt service (bottom left) and saved less than ever before (bottom right), leaving many U.S. consumers economically vulnerable when the economy slumped into recession. However, the pain and scars of the Great Recession served as a transformative event that seemed to change consumer behavior, investor risk appetite, and monetary policy in the decade that followed. Households dramatically cut their debt service costs while also increasing their savings rate as we moved through the 2010's.

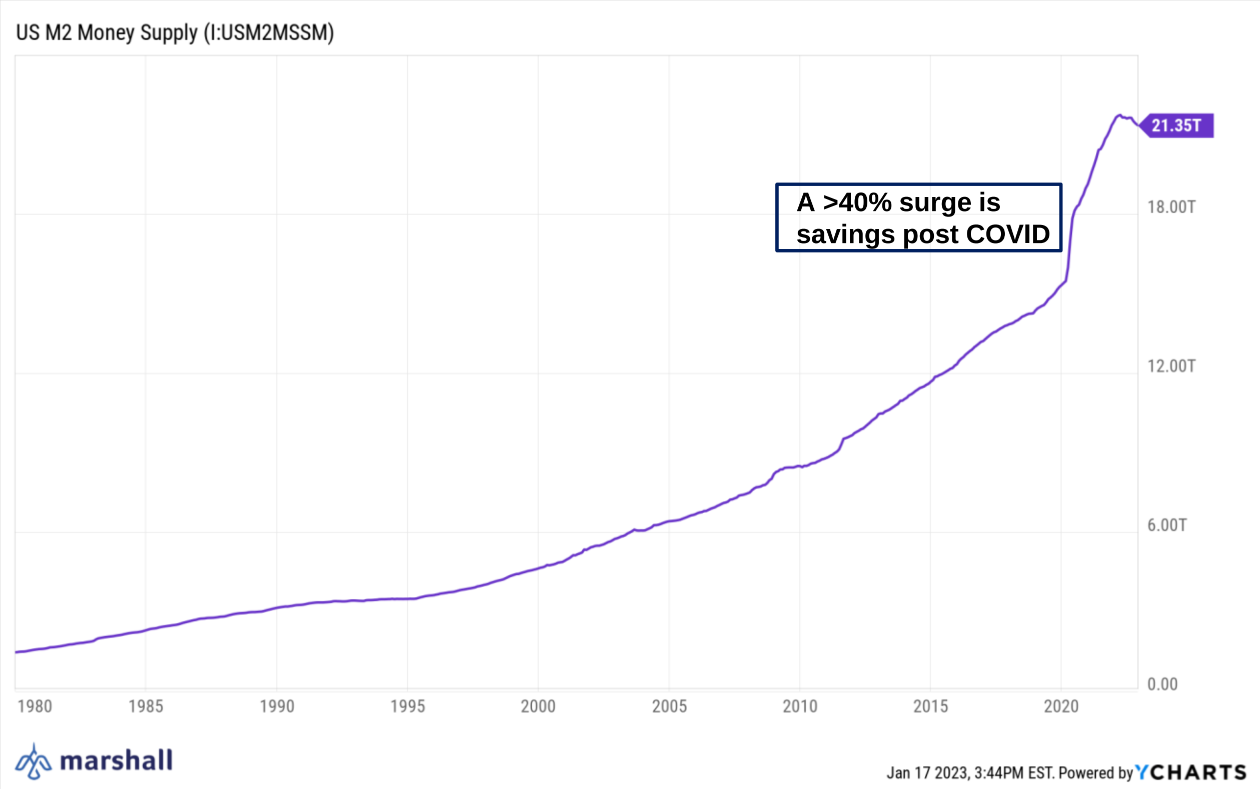




Data Source: YCharts; Federal Reserve; Bureau of Economic Analysis

2) Fortunately, when economic activity was suddenly halted in March 2020, U.S. consumers found themselves on better financial footing than prior to the 2008 economic shock. In addition, with daily life temporarily interrupted by sudden restrictions, consumers had fewer opportunities to spend. Robust fiscal stimulus and accommodative monetary policy helped pull the economy out of sharp contraction and left consumers, in aggregate, with more cash than ever before.

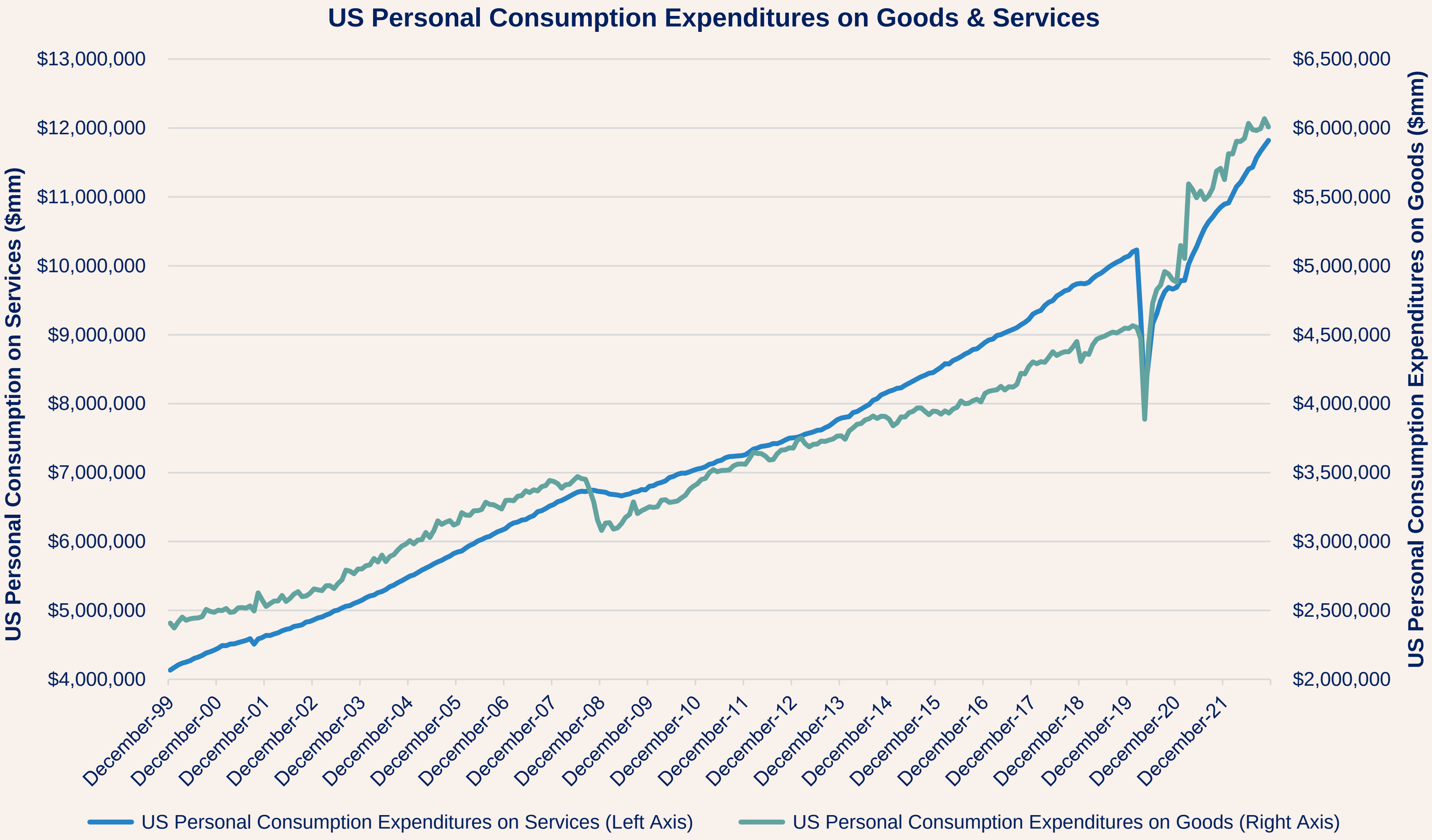




marshall

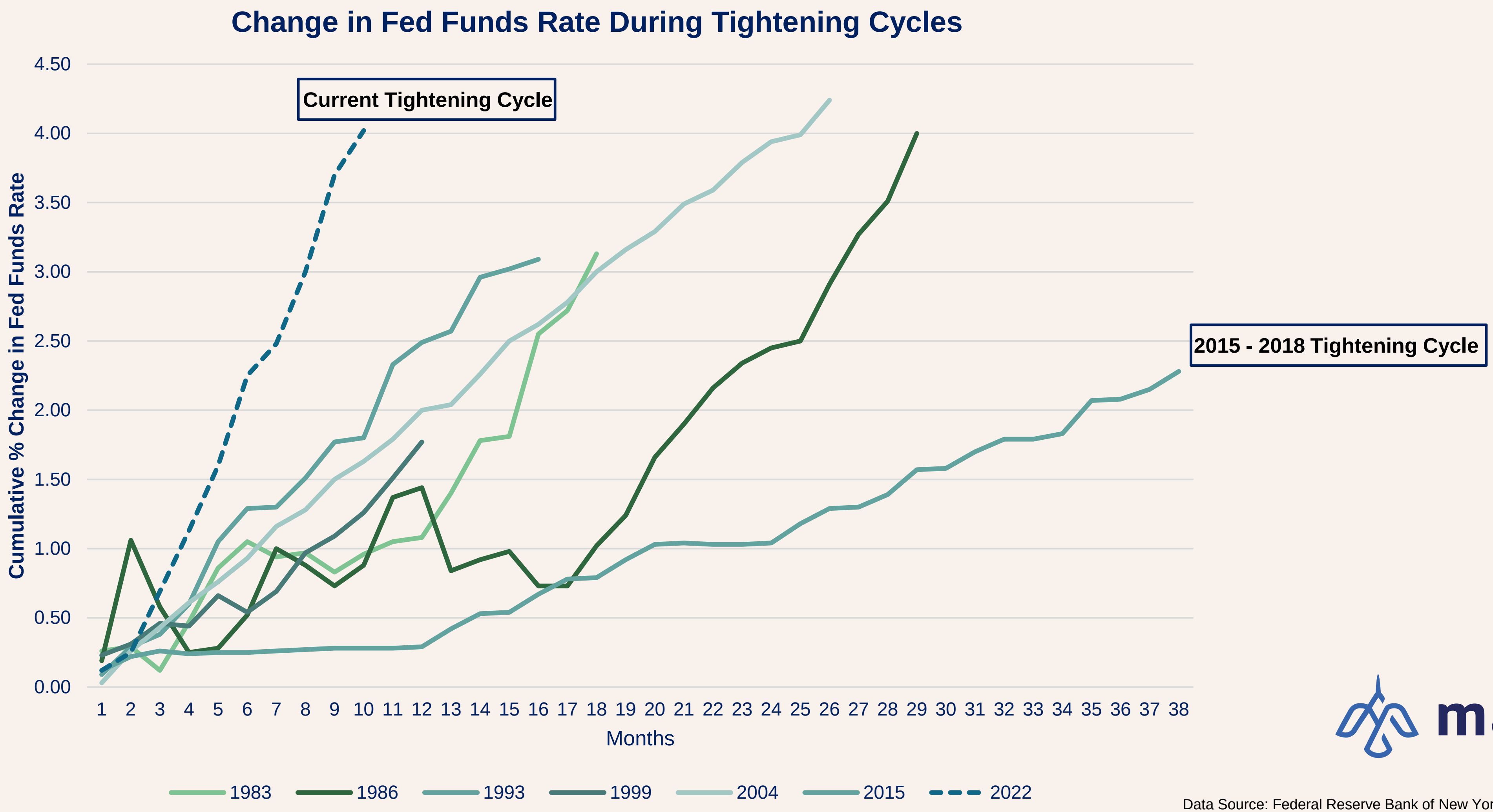
Data Source: YCharts; Federal Reserve; Bureau of Economic Analysis

3) Initially, consumers mostly sequestered to their homes began consuming a lot of physical goods (green line, right axis). We can all probably share stories about purchasing new items for our household, or know people who did, in the months following COVID. As a result, goods spending began to grow above trend. As daily life gradually returned to normal, consumers began to shift spending away from goods and back towards services (blue line, left axis).



Data Source: YCharts; Bureau of Economic Analysis

4) This created an almost perfect storm of “too much money chasing too few goods.” Suddenly, the highly accommodative monetary policy that had produced modest annual economic gains and relatively benign inflation needed to be reversed quicker than many on Wall Street anticipated. The Federal Reserve increased interest rates by 4% in a ten-month period (dashed line)- the quickest and steepest policy shift over the past 40 years. For comparison, it took the Federal Reserve 38 months to raise interest rates approximately 2.3% during the last tightening cycle that spanned from 2015 to 2018.

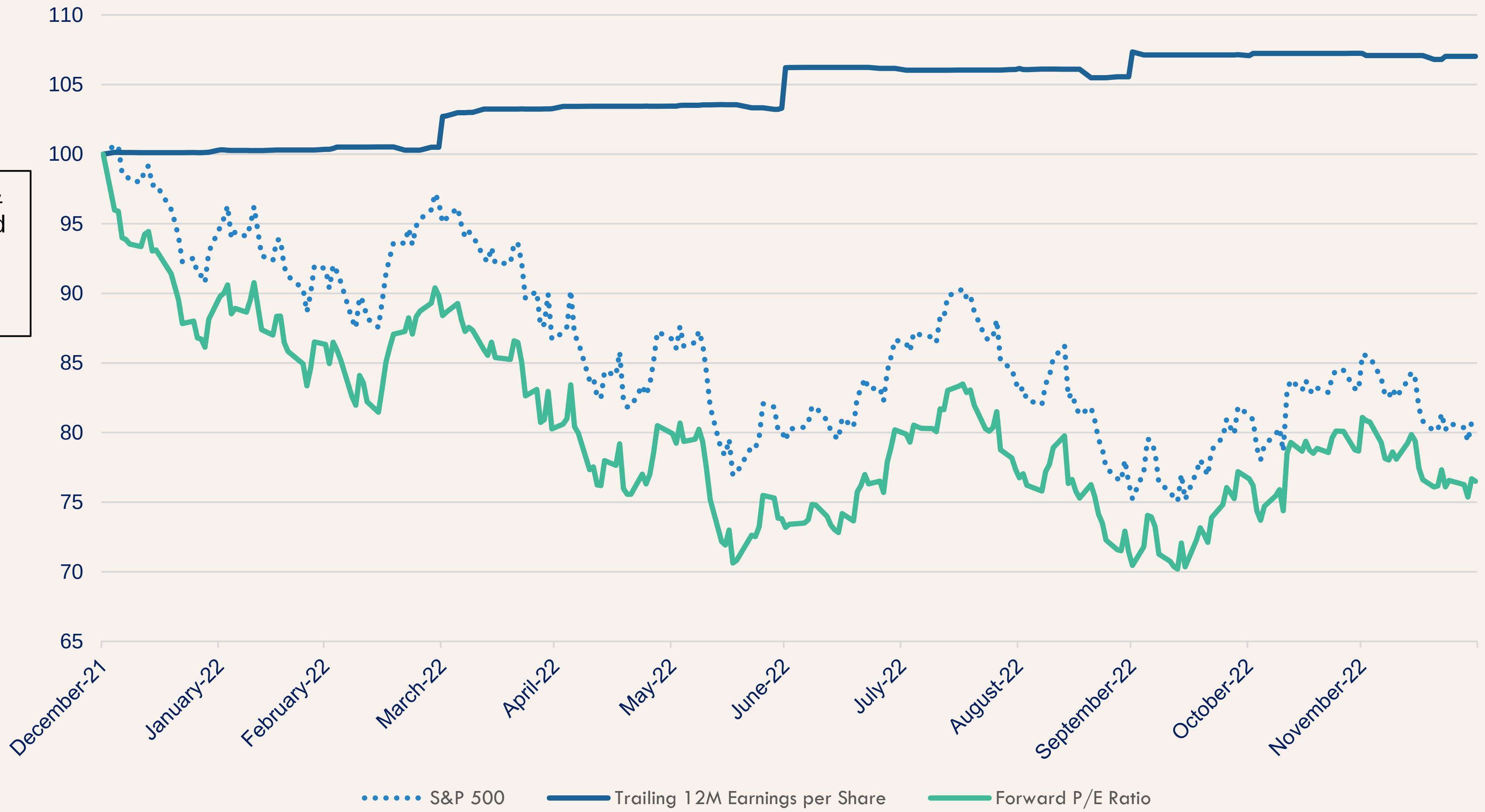


Data Source: Federal Reserve Bank of New York; Federal Reserve Bank of St. Louis

5) The rapid pace of tightening wreaked havoc on financial markets. Stocks had their worst year in over a decade as price/earnings multiples contracted in response to the sharp rise in rates. The widely followed S&P 500 and Nasdaq indices ended the year down -19.4% and -33.1%, respectively. Fixed income offered little respite as the sudden jolt in interest rates punished bonds issued during an era of low interest rates. The bellwether Barclays Aggregate Bond Index declined a staggering -13.0%, an extremely rare occurrence for an index composed primarily of investment grade bonds and U.S. Treasury securities.

Approximate Decomposition of S&P 500 Performance*

*Earnings, Multiples, & S&P 500 Price Indexed to 100; Year-to-Date through December 31, 2022



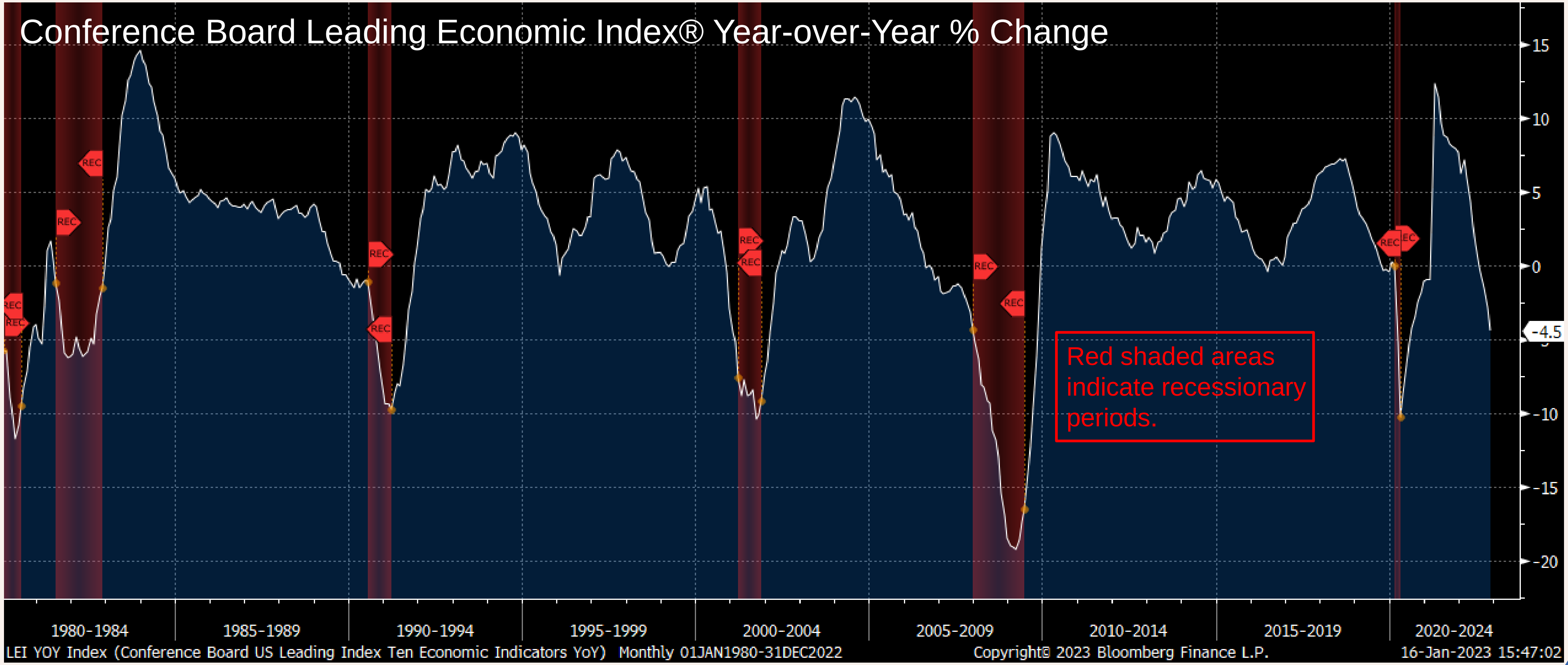
Earnings growth was a positive contributor to S&P 500 performance in 2022

Multiple contraction, or how much investors were willing to pay for $1 of earnings, was a significant detractor from S&P 500 performance.

marshall

Data Source: Bloomberg, L.P.; YCharts

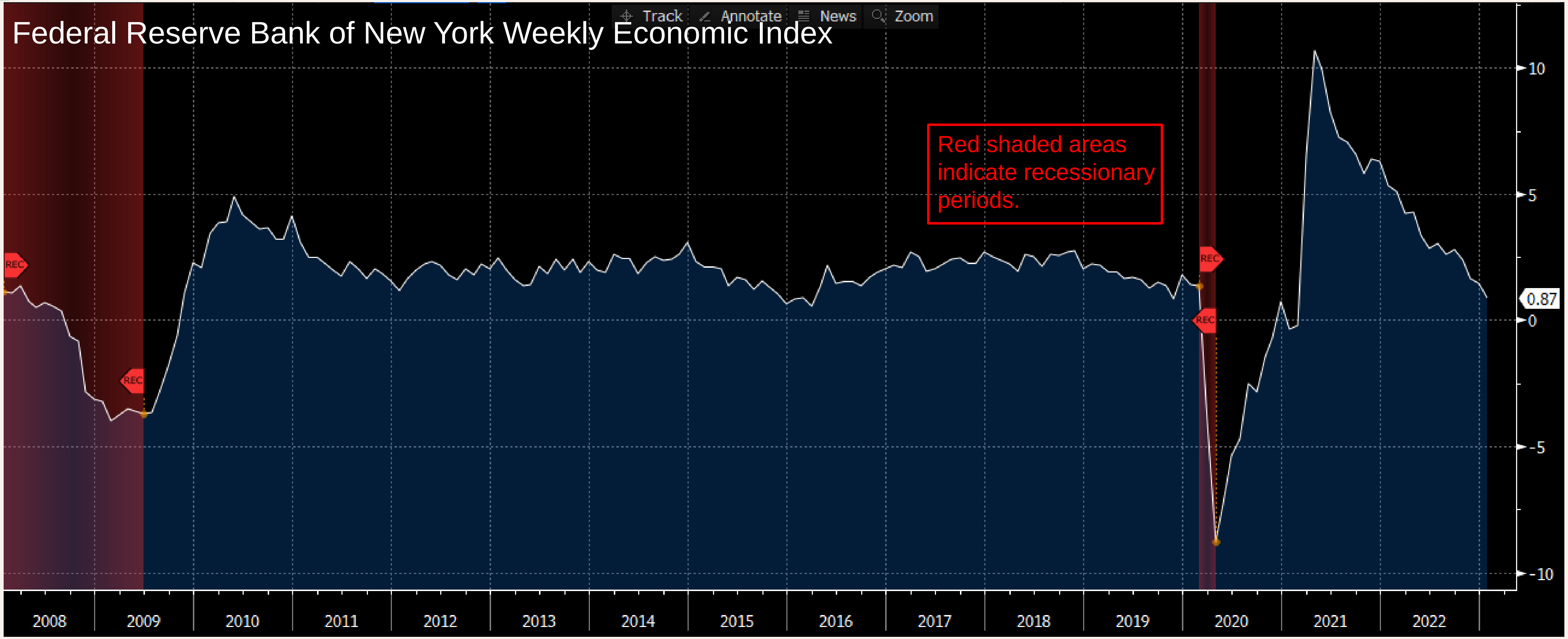
6) Entering 2023, many economic forecasters predict the U.S. economy will enter recession in the near future. The Bloomberg consensus economist recession probability for 2023 stands at 67.5%. Such expectations are not unfounded. Leading economic indicators (LEI), such as stock prices, interest rate spreads, and building permits, are all in contraction. In fact, a composite index of leading indicators called The Conference Board Leading Economic Index®, is approaching contractionary levels seen in past recessions. Nonetheless, it is worth noting the post-COVID expansion has, thus far, been unusual for economists to forecast as 'normal' behavior and relationships have not always held.



marshall

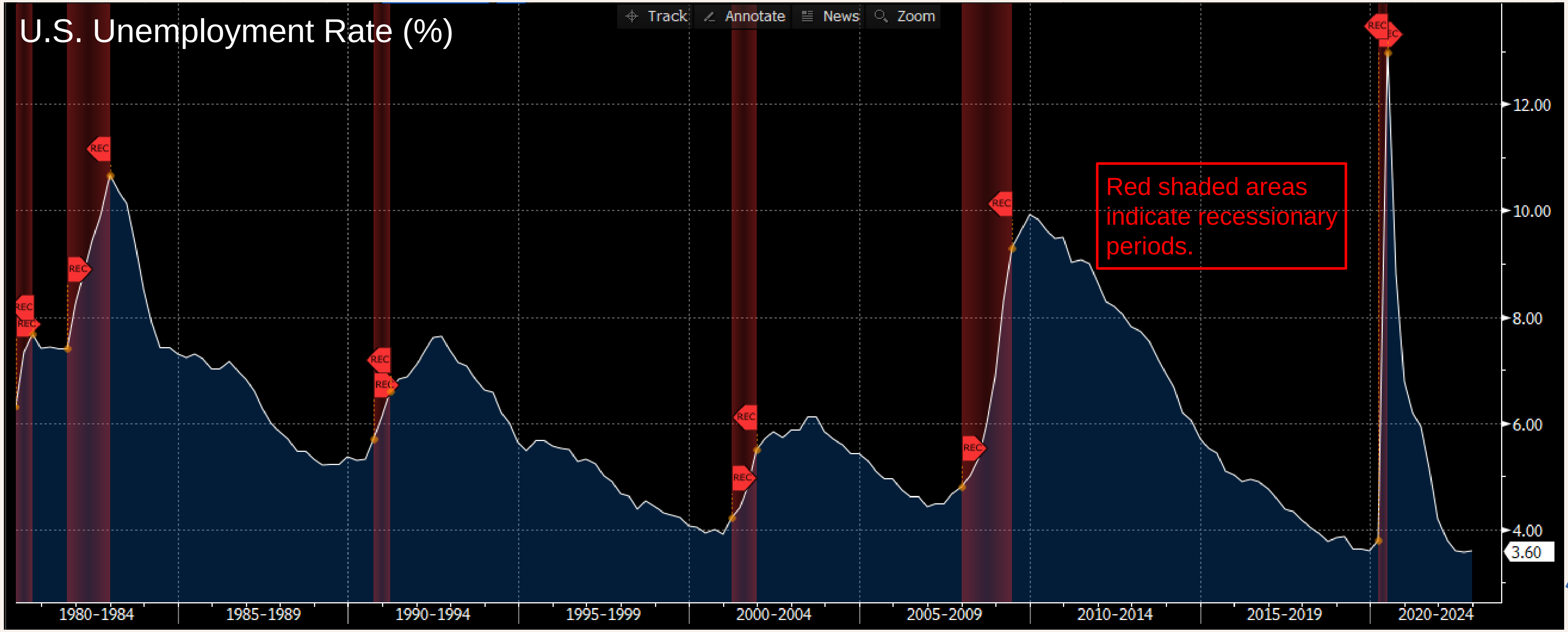
Data Source: Bloomberg, L.P.; Conference Board

7) Though at least one real-time, high-frequency measure of the economy complied by the Federal Reserve Bank of New York shows that economic growth remains positive despite moderation. The index is composed of 10 underlying series to measure consumer behavior, labor market conditions, and production. If the chart looks familiar, the U.S. Weekly Economic Index is one we referenced in 2020 to show that economic activity appeared to be recovering.



Data Source: Bloomberg, L.P.; Federal Reserve Bank of New York

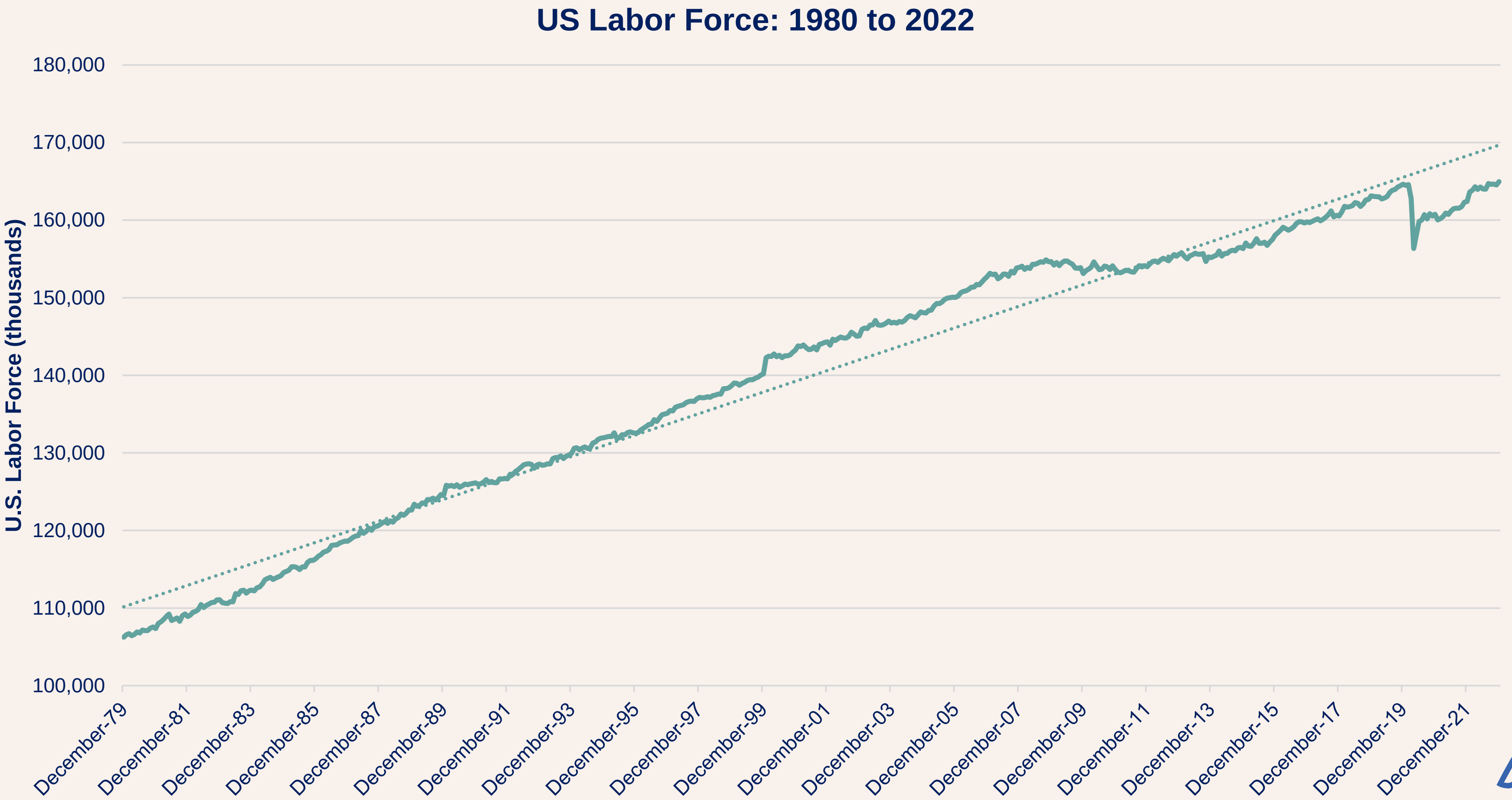
8) One important metric used to measure economic activity is labor. As the Federal Reserve explains, *"…when interest rates go down, it becomes cheaper to borrow, so households are more willing to buy goods and services… Businesses can also hire more workers, influencing employment. And the stronger demand for goods and services may push wages and other costs higher, influencing inflation."* Since the Federal Reserve has tightened rates, one would expect the opposite of the prior statement: As interest rates go up, it becomes more expensive to borrow, households should be less willing to buy goods and services. Businesses should part with workers, increasing unemployment, lowering wage pressure, and other costs. However, thus far, the unemployment rate has remained low and hasn't reacted the way the Federal Reserve may normally expect.



marshall

Data Source: Bloomberg, L.P.; Bureau of Labor Statistics

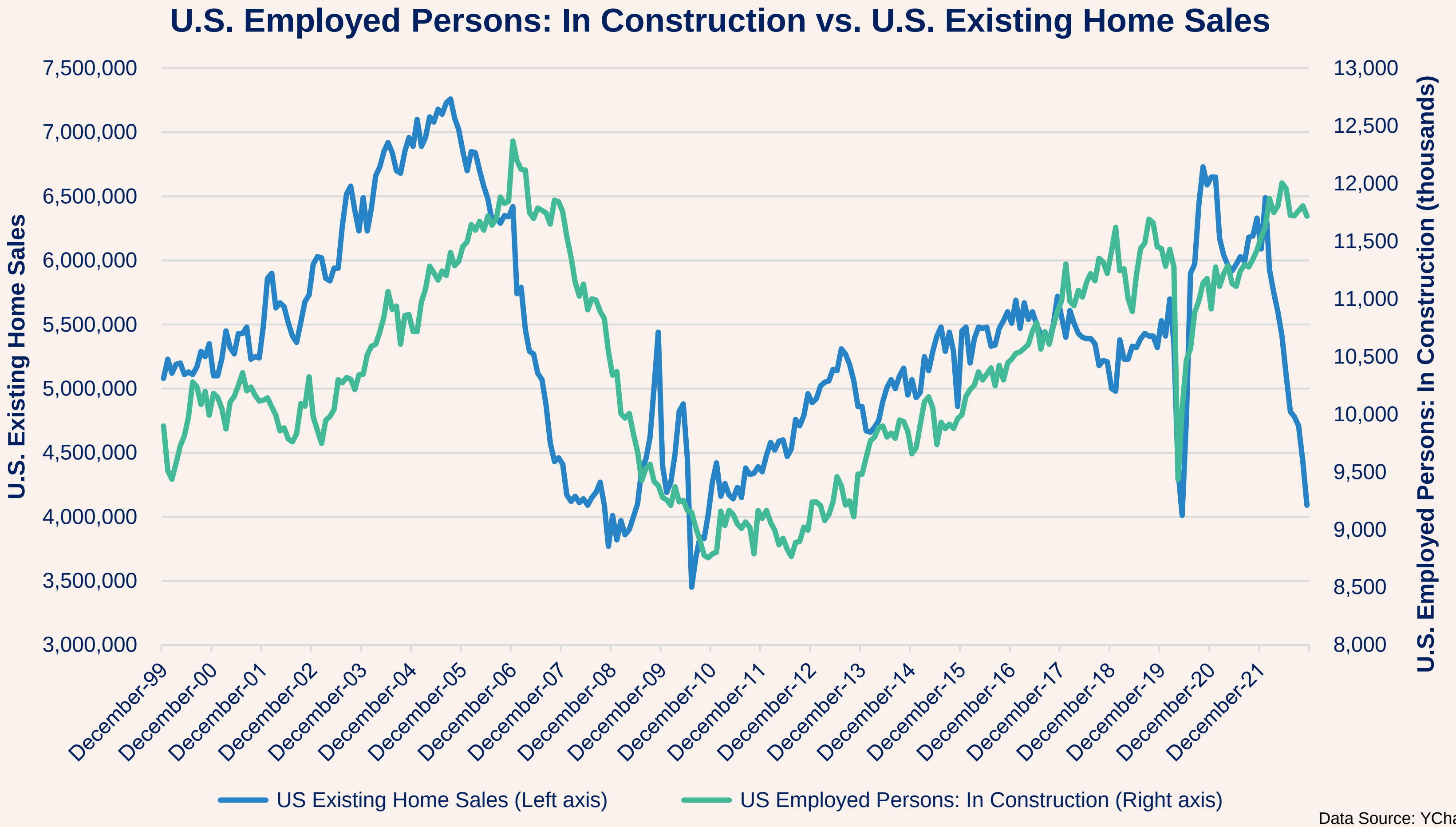
9) One reason for this could be labor force participation, or the number of individuals in the labor force, has only just reached pre-pandemic levels. Somewhat unexpectedly, labor force participation hasn't recovered amongst workers aged 65 and over and younger workers aged 20 to 24. While there could be numerous reasons for this, the lack of workers has contributed to tighter labor market conditions as the size of the labor force remains below trend. This is important as the long-term growth rate of the labor force can have a major impact on longer run potential economic growth.



marshall

Data Source: YCharts.; Bureau of Labor Statistics

10) As a result, there may not be enough ‘excess labor’ for businesses to cut, especially since so many businesses seem to have had difficulty filling open positions over the past two years. An example of this is the construction industry. Following the post-COVID housing boom, 2022 experienced a housing bust as home sales slowed sharply during the year (blue line, left axis). However, even with slowing housing demand, the number of employed persons in construction hasn’t changed significantly (green line, right axis). This is different from what was observed during the housing downturn in 2008 and is a positive sign as some economists suggest that a ‘soft landing’ of the economy is possible if workers stay employed and modestly pull back on spending rather than a complete retrenchment.

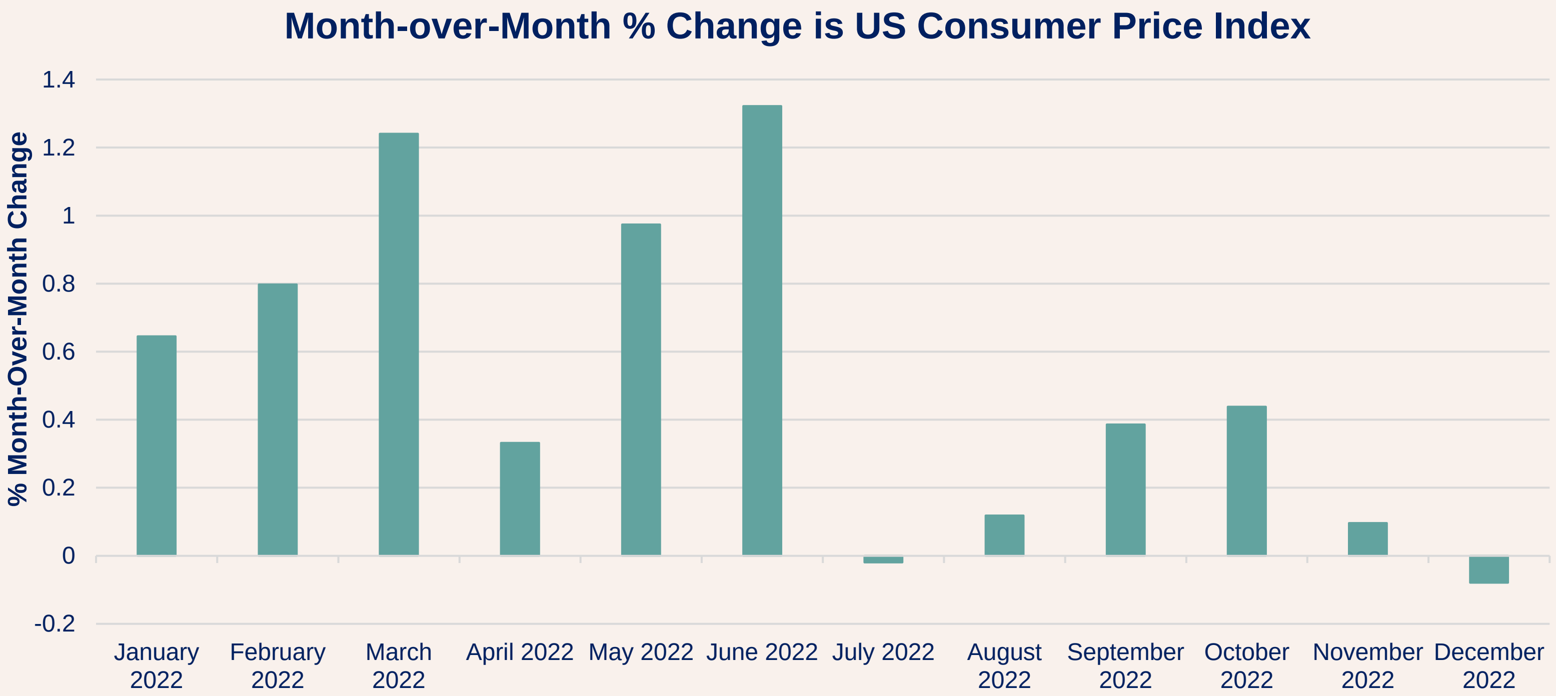


marshall

Data Source: YCharts; Bureau of Labor Statistics; National Association of Realtors

11) Another important relationship is inflation. While it may sound like wishful thinking today, we believe there is path where headline CPI could be lower than many expect come this summer. Year-over-year inflation seems to have peaked at an annual rate of 9.1% in June 2022. In the table and chart below, we summarize the month-over-month percentage change in CPI. From January 2022 to June 2022, the month-over-month increase in CPI averaged 0.9%. Since then, there has been a noticeable slowdown in the month-over-month change in inflationary pressure, with the average month-over-month percentage change in CPI coming in at 0.2%. This compares to the monthly historical average of 0.3% since 1948.

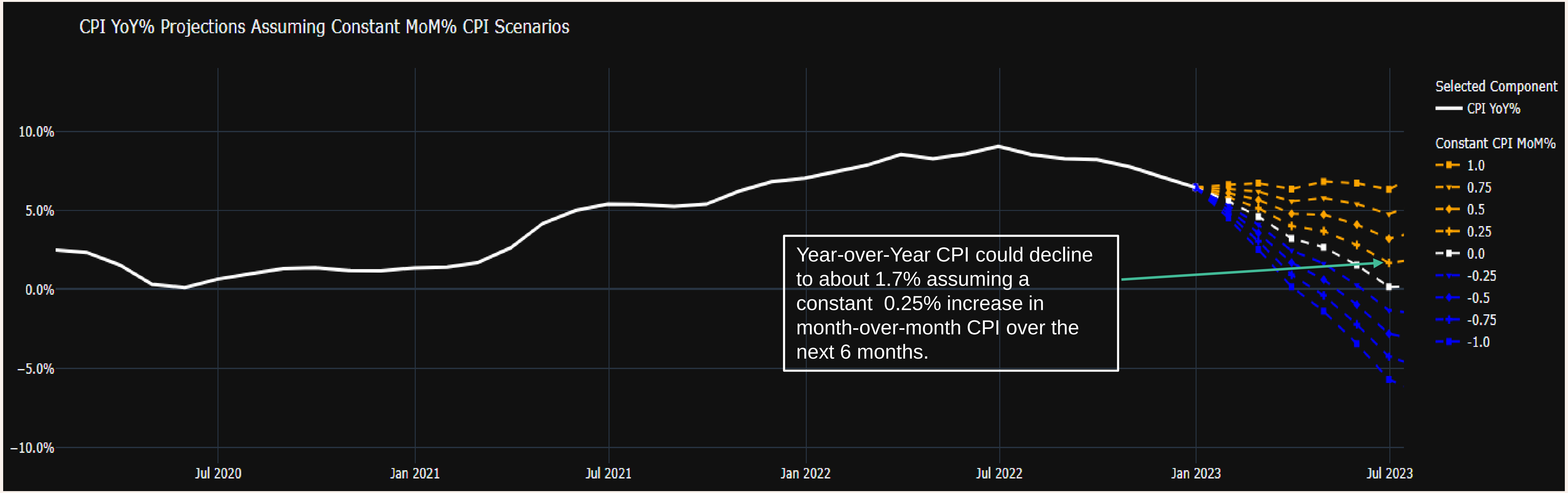
January 2022	February 2022	March 2022	April 2022	May 2022	June 2022	July 2022	August 2022	September 2022	October 2022	November 2022	December 2022
0.6%	0.8%	1.2%	0.3%	1.0%	1.3%	0.0%	0.1%	0.4%	0.4%	0.1%	-0.1%
Average Month-over-Month % Change: 0.9%						**Average Month-over-Month % Change: 0.2%**					
Historical Average Month-over-Month % Change since 1948: 0.3%											



marshall

Data Source: Bloomberg L.P.; Bureau of Labor Statistics

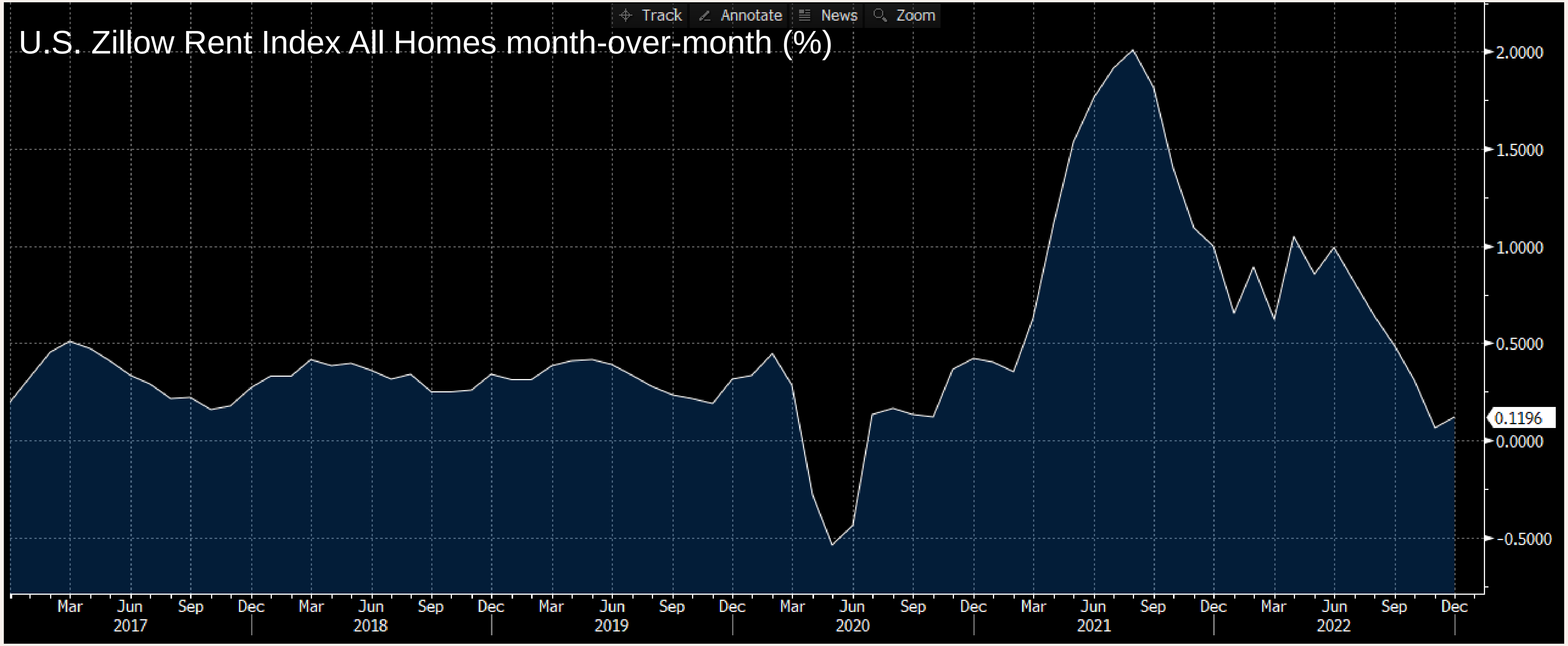
12) Projecting ahead, if inflation were to continue to expand month-over-month at 0.25%, the year-over-year inflation rate ending June 2023 would fall to less than 2%. This is below the Bloomberg consensus forecast of 4% for Q2 2023. Economic research firm, Pantheon Macroeconomics, believes inflationary change me be upon us, recently stating, “The five drivers of the U.S. inflation surge are all in retreat.” If this scenario were to play out, we believe the Federal Reserve may have to adjust their interest rate rhetoric, which could become a positive catalyst for markets. Understandably, economic outlooks today remain cautious, but we believe this is something that bears watching.



marshall

Data Source: Bloomberg L.P.; Pantheon Macroeconomics

13) Despite these broad positive developments, one large and still stubbornly high contributor to CPI over the past couple of years has been the cost of shelter, namely rent. However, recent data from the Cleveland Federal Reserve's New Tenant Repeat Rent Index shows an adjustment may be underway with year-over-year rental changes mean reverting. This corroborates more real-time data from Zillow (below) that shows month-over-month rental prices continuing to moderate. Shelter inflation accounted for more than half of all services inflation in the December CPI report; any moderation in this category would likely bring additional relief to the CPI index.



Data Source: Bloomberg L.P.; Zillow

14) Looking ahead to 2023, an easing of inflationary pressures would likely benefit last year's battered bonds. Taking a high-level view, fixed income yields are discernibly more attractive than they've been, on average, over the past twelve years. It's hard to believe only a few short years ago 10-year Treasury notes were yielding just 0.6%, compared to 3.5% today. As a result, we believe investors may once again benefit from bonds that can provide better income and relief to help dampen the impact of equity market volatility within a portfolio.

	12 Year Average (2010-2021)	Current (a/o 01/13/2023)
Money Market Yield	0.5%	4.3%
10-Year Treasury Yield	2.3%	3.5%
Investment Grade Corporate Debt Yield	3.3%	5.1%
High Yield Debt Yield	6.5%	7.9%

marshall

Data Source: YCharts; Bloomberg L.P.; Schwab Value Advantage Purchased Money Fund; Bank of America Merrill Lynch: U.S. Corporate Master, U.S High Yield Master

Interested in sending our investment team a note? Please send an email to wealthiq@marshallfinancial.com.

Adam Reinert, CFA, CFP®

Chief Investment Officer

George Evans II, MBA

Chief Investment Strategist

Sean Dann

Research Analyst

marshall

Marshall Wealth IQ is aimed at sharing insightful financial market and economic data in easy to visualize charts with brief analyses. This commentary isn’t designed as a call to investment action, but rather as a dependable source to help you feel better informed about current events in today’s market and the underlying trends impacting current wealth.

It’s impossible for anyone to know with certainty what will happen today, tomorrow, or even a minute from now. Investment involves risk and volatility; it’s why long-term investors have historically been rewarded with excess returns relative to cash. Our investment department monitors market data and works with our wealth advisory teams to right-size portfolios should something change relative to long-term trends. In the meantime, we’ll continue to share financial and economic data we believe is insightful and relevant to your wealth to help you feel informed.

Thank you for reading; please be well.

Disclosures:

Marshall Financial Group, Inc ("Marshall Financial") is an SEC-registered investment adviser with its principal place of business in Doylestown, Pennsylvania.   This newsletter is limited to the dissemination of general information pertaining to Marshall Financial Group's investment advisory services. Investing involves risk, including risk of loss. References to market indices are included for informational purposes only as it is not possible to directly invest in an index. The historical performance results of an index do not reflect the deduction of transaction, custodial, and management fees, which would decrease performance results. It should not be assumed that your account performance or the volatility of any securities held in your account will correspond directly to any comparative benchmark index.

This newsletter contains certain forward-looking statements (which may be signaled by words such as "believe," "expect" or "anticipate") which indicate future possibilities. Due to known and unknown risks, other uncertainties and factors, actual results may differ materially from the expectations portrayed in such forward-looking statements. As such, there is no guarantee that the views and opinions expressed in this letter will come to pass. Additionally, this newsletter contains information derived from third party sources. Although we believe these sources to be reliable, we make no representations as to the accuracy of any information prepared by any unaffiliated third party incorporated herein, and take no responsibility, therefore.

For additional information about Marshall Financial, please request our disclosure brochure as set forth on Form ADV using the contact information set forth herein, or refer to the Investment Adviser Public Disclosure web site (www.adviserinfo.sec.gov). Please read the disclosure statement carefully.

marshall