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Good Riddance! – Looking Forward in 2023

By Mike Skoric

Needless to say, 2022 was a disappointing year for investors with the S&P 500 finishing down over 19%. An even more negative surprise was the US bond market, where the loss was 13% as measured by the Bloomberg US Aggregate Bond Index. This was only the fifth time that this index had a negative return since its inception in 1976, the first ever second consecutive year of negative returns, and by far the worst ever yearly return. Most of this was driven by the huge spike in inflation which led to one of the most aggressive interest rate hiking campaigns in the history of the Federal Reserve. Fortunately, we continue to see numerous data points that provide ample evidence that the Fed's strategy is working. Inflation is decelerating ("disinflation"), and this allows the Fed to slow the magnitude of rate hikes by going back to quarter-point increments starting with their next meeting in February. But with slowing inflation, we also expect to see a significant slowdown in corporate earnings and an increasingly possible recession in the latter part of the year. So with this complicated backdrop, what kind of expectations are realistic for 2023?

As was discussed in our last market commentary, the huge increase in interest rates has led to a significant spike in yields across the fixed income investment universe. Consequently, we are very excited about this asset class and expect better than average returns bearing signs that a deep and long recession may be brewing. Meanwhile, on the equity side we feel good about valuations which after last year's market large drop are much more in line with long-term levels. Based on the still strong consumer confidence and labor market data, we also believe that we should be able to avoid a long and deep recession. Furthermore, if that is the case, then matching or even modestly exceeding 2022 corporate earnings levels should be achievable. This would provide another strong pillar of support to the domestic equity market. Meanwhile, equity valuation levels in most of the remainder of the world continue to be even more attractive than those in the US.

With this economic backdrop, what kind of outlook do we see from some of the better-known equity market strategists for 2023? Based on a December 2022 survey of market pundits, the average ending value for the S&P 500 index was projected to be around 4,190, representing an increase of around 9% from the 2022 closing level. If you add in dividends, the total expected return for the year would be almost 11%. The highest single estimate (Ed Yardeni of Yardeni Research) was for the S&P 500 to be at 4,800, which represents a whopping 25% return. And even the single lowest estimate (Michael Wilson of Morgan Stanley) was for the S&P 500 to close at 3,900 which would result in a small but still positive return for the year. So given the very optimistic fixed income outlook and more cautiously optimistic equity outlook, we do look forward to a much better 2023!