Marketline January 2023

Stocks:

January's action was a resumption of the upward momentum of the last quarter of 2022, with all three domestic indices showing positive returns. The flashy tech-heavy Nasdaq was strongest, with a 10.7% price return; the S&P ranked second at 6.2% and the Dow managed 2.8%. As we continue into February, the favor shown technology stocks remains apparent. Even overseas returns picked up with a very strong opener to the year: Canada's TSE rose 7.1%; Mexico stormed up 12.6%; and European stocks hung in there with 4.3%.

Last month we noted the tinge of bearishness saturating projections for the first half of this year. We are often reminded that the market is counterintuitive, and this month was a good illustration of that principle. In the face of an impending recession, softer earnings, rising costs, and a litany of other negatives, stocks still climbed. January was another reminder that trying to time markets is useless. Most pundits were calling for a trading range in the first half of this year and a good second half: perhaps it will be the exact opposite!

Meanwhile, just a reminder that while the Fed is still hiking interest rates, Congress is doing its best to counteract that by spending more than $100 billion dollars per month over and above what we take in. As one wag said many decades ago, "a billion here and a billion there, and pretty soon you are talking real money." What's the effect of the federal largess? Government money supports projects that may or may not prove economical, supplanting private money which is disciplined by needing a reasonable return. The flow of funds from the Feds is an artificial prop, and in the short term, it is making inflation worse as the government competes for workers that companies also need.

On the horizon are debt ceiling negotiations. We have received several questions about how these negotiations might affect the market. Here is the answer, and it applies to any risk we face:

1. Stock markets can cope with the degree of uncertainty that exists on a daily basis.
2. When some event causes more uncertainty than is "usual", markets become turbulent to reflect new risks.
3. When the uncertainty is resolved, markets find a new normal.

That's it – rinse and repeat. This same thing was in play after 9/11, when the pandemic hit, during the last debt ceiling negotiations, when computers went awry in 1987, and at every other point of perceived danger in history. An appropriate way to view moments of uncertainty is as a gift, supplying the opportunity to buy assets cheaper. We're hoping we have that chance.

Bonds:

Bond yields fell a bit last month, all along the curve. Of course, this was one reason stocks rallied. The all-important ten-year yield closed at 3.5%, down from 4% in October. This decline has helped push mortgage rates down, another factor that's counteracting the effects of the Fed's tightening moves.

As it has been since last summer, the yield curve remains inverted with short maturity bonds yielding more than long bonds. We examined historical inversions and found that the longest lasting inversion took over 2 ½ years to correct itself, while run of the mill inversions seem to last a year and a half. So we could be living with this for some time before a serious economic slowdown appears and flips the curve back to normal. Meanwhile, the overall decline in yields has given us "sticker shock": only a few short weeks ago, it was easy to find tax exempt bonds yielding over 4% - now, not so much. Supply will be sluggish this year in the municipal arena, too, lending support to existing portfolio pricing but making it difficult to reinvest when issues are called away or mature.

Investment grade corporates are – overall – slightly more attractive than municipals. We have also been buying Treasuries – a sector that we haven't been involved in since I started this company in 1997. Generally we bought agency paper (Federal Farm Credit, Federal Home Loan Banks) instead, but these days Treasuries offer better liquidity in what is proving to be a balky market for investors.

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