Convergence Commentary

January 2023 Market Recap

Quick Hits:

- Stocks had their best start to a year since January 2019.
- Bonds also continued to rally as rates and volatility in the bond market continued to decline.
- Inflation continued its downward trajectory in December, but the tight labor market remains an obstacle in the Fed's inflation fight.

Market-Moving Highlights

Headline CPI declined for the first time in December since the start of the current inflationary cycle, driven lower by energy and used cars. On an annual basis, CPI increased at a rate of 6.5%, down from 7.1% in November. Core CPI also continued to moderate, but at a slower pace than the headline number. Continued deceleration of CPI bodes well for the market, as it means the Fed is likely getting closer to the end of its rate-hiking cycle. In the near term, we expect the Fed to remain somewhat hawkish, as they have repeatedly said they do not plan to cut rates in 2023 until they are confident that inflation is on a trajectory back to their targeted 2% level. However, the bond market is pricing in rate cuts in the middle of 2023. Since the Fed has stated they will be data dependent, continued data showing declining inflation could lead to a change in their stance. The Fed has a dual mandate of stable prices and maximum employment. At some point, the conversation surrounding the Fed will likely shift from fighting inflation to balancing its fight against inflation with potential increases in unemployment. So long as labor markets remain tight and unemployment remains low, the Fed will likely keep rates elevated.

The International Monetary Fund increased their global growth expectations for 2023, citing strong labor markets, disinflation, and continued strong data that points to a resilient consumer. This is another positive data point for the soft-landing narrative that has started to become a more realistic possibility than it appeared even just a couple of months ago.

As of the end of January, the peak of earnings season has started with more than half of the S&P 500 still to report their 4th quarter earnings. Thus far, earnings reports have been mixed but better than some feared. Earnings per share for the S&P 500 are on track to decline by about 5%, while revenue is on pace to grow by 4%. These figures are subject to change with some of the biggest companies like Apple and Amazon yet to report.

Index Performance

Index	1 Month	1 Year	2022	5 Year
S&P 500	6.28%	(8.22%)	(18.11%)	9.54%
Nasdaq Composite	10.72%	(17.95%)	(32.54%)	10.34%
Russell 2000	9.75%	(3.38%)	(20.44%)	5.54%
MSCI ACWI ex US	8.13%	(5.22%)	(15.57%)	1.85%
Bloomberg US Aggregate Bond	3.08%	(8.36%)	(13.01%)	0.86%

Stocks across the board had an upswing in January with the S&P 500, Nasdaq, and Russell 2000 all off to their best start to a year since January 2019. It also marks the strongest month for the major indices since July. Some of the rally can be attributed to better investor sentiment with the calendar turning over, and there was substantial tax loss selling at the end of December that likely depressed prices some. However, the primary driver of performance is the growing hope of a soft landing. Whether or not this will materialize is still to be determined, but the economic data is increasingly pointing to a greater probability of this happening. Finally, international stocks continued their strong rebound off their October lows, with the international index up over 25% since October, despite the fears of a recession in Europe. A warmer winter has helped reduce fears of the energy crisis worsening and early GDP estimates for the 4th quarter in Europe show the EU was able to avoid a recession for now as a result, despite widespread forecasting of economic contraction.

S&P 500 Sector Highlights & Commentary

Best-Performing Sectors		Worst-Performing Sectors	
Consumer Discretionary	15.13%	Utilities	(2.00%)
Communication Services	14.77%	Health Care	(1.83%)
Real Estate	9.91%	Consumer Staples	(1.09%)

The best-performing S&P 500 sectors in January were closely aligned with those that were the worst performers in 2022. Consumer Discretionary and Communication Services were both driven by strong performances from their largest companies, like Tesla and Meta Platforms, which were up about 40% and 24%, respectively. The reversal of performance for 2022's worst stocks was even more evident based on the performance of the most-shorted stocks in the market. While it is encouraging to see some of these stocks rebounding substantially to start the year, this could be a sign that the investors are getting ahead of themselves with the soft landing scenario in certain parts of the market.

Meanwhile, the worst-performing sectors in January were the more defensive parts of the market, as utilities, health care, and consumer staples all posted negative returns. As we have noted repeatedly, these sectors outperform when uncertainty looms. With the market becoming more optimistic about the economic outlook, it is not surprising to see these three sectors lag the market as a result of their defensive nature. All three of these sectors had also become relatively expensive based on their historical averages, which is a symptom of the extreme defensive investor positioning at the end of 2022.

What to Watch in February

As mentioned earlier, the majority of earnings will be reported in February, so investors will get a better idea of the earnings results from the 4th quarter. Company earnings guidance for the first and second quarters of 2023 will also help investors understand the direction of the economy moving forward.
The Fed will report its rate hike decision on the first of February. The market widely expects a 25 basis point hike, but Jerome Powell's speech will be watched closely for signs of the Fed's plans moving forward.

Market Wrap

The rally in January was a sigh of relief for investors. However, there are still substantial risks in the market that could derail the rally's gains. The Fed has not declared the end of their rate hike cycle and may not do so until inflation reaches a more reasonable level, which likely can't happen unless the labor market cools off, or there are more signs of the economy contracting. At this point, the market is more focused on where the economy is at than what is happening with inflation, as it now appears that inflation did in fact peak in the middle of 2022. With all that being said, starting off the year with a strong January tends to result in a strong year, as shown in the chart below. The S&P 500 achieved a "January Trifecta" meaning the S&P 500 had a positive return during the Santa Claus rally period, a positive first five days of the year, and a positive monthly return (LPL). When this happens, the market averages an annual return of 17.4% and the annual return was positive 90% of the time. When this has happened in the past during a year in which a recession occurs, the average return is even higher at 34.8%. This reaffirms that the market is forward-looking, so if there is going to be a recession in 2023, the market will price that in ahead of time.

January Trifecta Indicator | S&P 500 Performance

Year	Santa Claus Rally	First Five Days	January Barometer	Feb-Dec Return	Annual Return	Earnings Growth (YoY)	Recession?
1950	1.3%	1.7%	1.6%	19.8%	21.7%	22.4%	No
1951	3.6%	2.8%	6.0%	9.7%	16.3%	-14.1%	No
1952	1.6%	0.2%	1.6%	10.1%	11.8%	-1.6%	No
1954	1.7%	0.5%	5.1%	38.0%	45.0%	10.4%	Yes
1958	3.5%	2.5%	4.3%	32.4%	38.1%	-14.2%	Yes
1959	3.6%	0.3%	0.4%	8.1%	8.5%	17.3%	No
1961	1.7%	1.2%	6.3%	15.8%	23.1%	-2.4%	Yes
1963	1.7%	2.6%	4.9%	13.3%	18.9%	9.5%	No
1964	2.3%	1.3%	2.7%	10.0%	13.0%	13.2%	No
1965	0.6%	0.7%	3.3%	5.6%	9.1%	14.1%	No
1966	0.1%	0.8%	0.5%	-13.5%	-13.1%	6.9%	No
1971	1.9%	0.0%	4.0%	6.5%	10.8%	11.1%	No
1972	1.3%	1.4%	1.8%	13.6%	15.6%	12.6%	No
1975	7.2%	2.2%	12.3%	17.2%	31.5%	-10.5%	Yes
1976	4.3%	4.9%	11.8%	6.5%	19.1%	24.5%	No
1979	3.3%	2.8%	4.0%	8.0%	12.3%	20.5%	No
1983	1.2%	3.2%	3.3%	13.5%	17.3%	11.0%	No
1987	2.4%	6.2%	13.2%	-9.9%	2.0%	21.8%	No
1989	0.9%	1.2%	7.1%	18.8%	27.3%	2.4%	No
1995	0.2%	0.3%	2.4%	30.9%	34.1%	18.9%	No
1996	1.8%	0.4%	3.3%	16.5%	20.3%	8.7%	No
1997	0.1%	1.0%	6.1%	23.4%	31.0%	9.8%	No
1999	1.3%	3.7%	4.1%	14.8%	19.5%	15.1%	No
2004	2.4%	1.8%	1.7%	7.1%	9.0%	20.8%	No
2006	0.4%	3.4%	2.5%	10.8%	13.6%	15.7%	No
2011	1.1%	1.1%	2.3%	-2.2%	0.0%	14.4%	No
2012	1.9%	1.8%	4.4%	8.7%	13.4%	6.1%	No
2013	2.0%	2.2%	5.0%	23.4%	29.6%	6.4%	No
2017	0.4%	1.3%	1.8%	17.3%	19.4%	11.6%	No
2018	1.1%	2.8%	5.6%	-11.2%	-6.2%	22.5%	No
2019	1.3%	2.7%	7.9%	19.5%	28.9%	1.0%	No
Average	**1.9%**	**1.9%**	**4.6%**	**12.3%**	**17.4%**	**9.9%**	-
Median	**1.7%**	**1.7%**	**4.0%**	**13.3%**	**17.3%**	**11.1%**	-
% Positive	-	-	-	**87.1%**	**90.3%**	**83.9%**	-

Source: LPL Research, Bloomberg 1/31/23

Past performance is no guarantee of future results.

All indexes are unmanaged and can't be invested in directly.

Sources

January Set to Hit the Seasonality Trifecta | Daily Market Update | January 31, 2023 (eloqua.com)

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Travis Cook, CFP®, CMFC®

CEO, Financial Advisor

Tyler Hoffmann, MBA

President,
Financial Advisor

Dr. John Stansfield, CFA

Director of
Investments

Logan Clark

Assistant Investment
Research Analyst

3919 S Providence Rd, Columbia, MO 65203
573.818.2264
www.convergence-financial.com

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