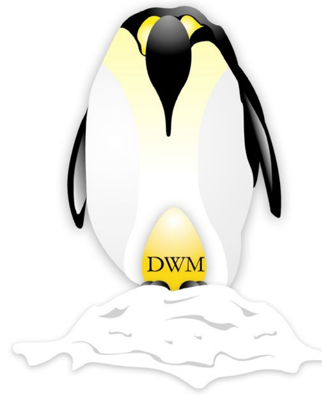


Disciplined Wealth Management

12/31/2022 Quarterly Newsletter

Discipline is the key to success

With every approach to the stock market, bear in mind that there will always be periods of over-performance and periods of under-performance. Here at Disciplined Wealth Management (DWM), our goal is to concentrate your portfolio in the leading asset classes while avoiding the performance-sapping lagging asset classes; over the long term, our approach strives to provide you with better performance compared to the overall stock market average (the S&P 500) and with less risk. In summary – stay disciplined during times of under-performance; don't become emotional and abandon a proven long-term strategy during a usually short period of under-performance, but stick with it and let the strategy work for you. If someone says they are never wrong, they have just proven themselves otherwise.

General Commentary—

Consumers are heading into yearend with less cheer than in recent months. Personal consumption expenditures (PCE), the Fed's preferred measure for inflation, ticked up 0.1% in November, the smallest gain since July, missing the consensus of a 0.2% increase. Real PCE, which adjusts for inflation, was practically unchanged, also its weakest showing in four months. Real durable goods spending dropped 1.5%, reversing most of the jump in the prior month, led by reduced spending on new vehicles. In contrast, real services spending increased 0.3%, led by food services and accommodations. This reflects the continued post-pandemic shift in consumer demand back toward more services and fewer goods. The services share of total PCE picked up to 66.3% last month, nearly 2.0 percentage points above its cycle low in March 2021, but still far short of the 69.1% share in February 2020.

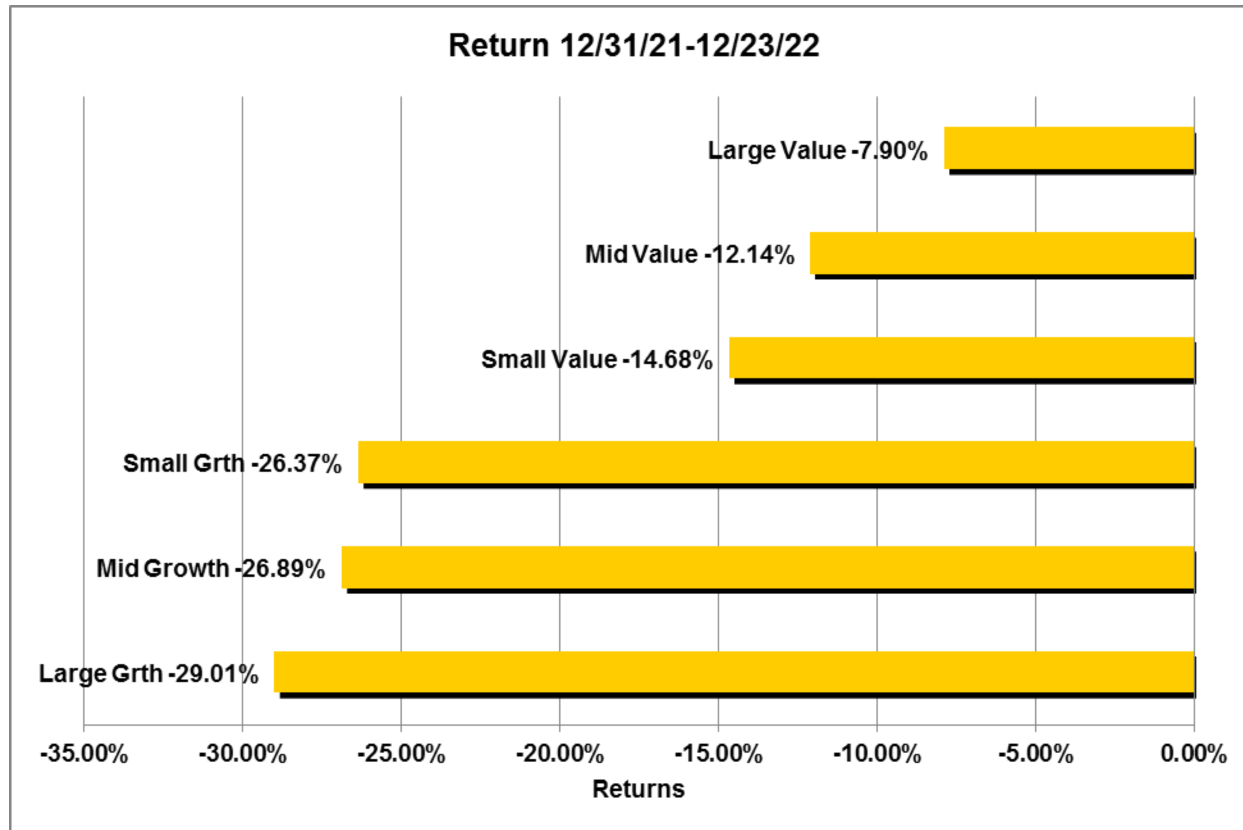
Personal income rose 0.4% in November; double the consensus of 0.2%. Disposable personal income (DPI) rose by the same amount. The increase was led by gains in employee compensation and asset returns, partly offset by declines in proprietors' income and rents. Real DPI rose 0.3%, its fifth consecutive gain. Even so, it is down 2.9% from a year ago, and its level now is lower than at the start of the pandemic, as fiscal stimulus is behind us and inflation has eroded most other gains.

The personal saving rate edged up to 2.4% from 2.2%, still close to the record low of 2.1% back in 2005. While a low saving rate gives a near-term boost to spending, it also is a sign that consumers are struggling financially, as inflation erodes their purchasing power.

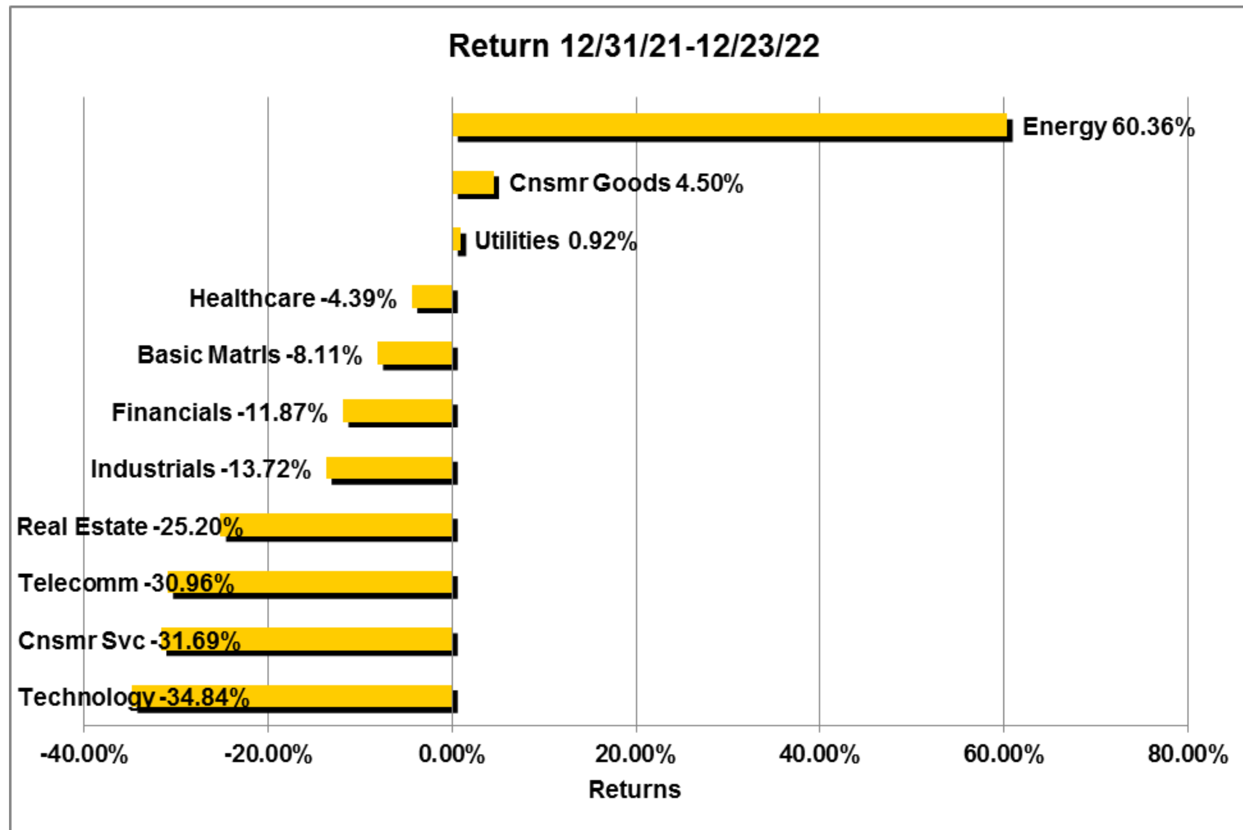
Price pressures moderated, but were still elevated. The PCE Price Index edged up 0.1%, while core prices rose 0.2%, the least in four months, and matching the consensus. On a year by year basis, the PCE Price Index eased to 5.5%, the slowest pace in over a year, and down from a peak rate of 7.0% back in June. Core inflation fell to 4.7%, matching its rate from four months ago, but down from a peak rate of 5.4% in February of this year. Most of the pullback in the year by year price growth came from the goods side. Durable goods inflation slowed to 2.7%, the least since March 2021, and a fraction of the peak rate of 10.6% in early 2022. Nondurable goods inflation eased to 8.1%, the slowest pace since January. Even services inflation came down slightly to 5.2% from 5.5% in the prior month which was the highest inflation rate since January 1985. Although still tentative, the decline in service inflation is a sign that Fed tightening is beginning to tamp down underlying price pressures. It supports the Fed's decision to downshift its rate hikes earlier this month. We expect the Fed to end the tightening cycle in the 1st quarter of 2023. But with price growth still far above its target of 2.0%, rates will likely remain elevated throughout next year.

As we go to press, the overall Market Environment Indicator (MEI) remains bearish, along with the Individual Fund Signals (IFS). We will continue to monitor these indicators and make the necessary adjustments. For an individual performance review, please call 303-471-5189. Please note that, in the following pages, the performance charts for certain asset classes showing year-to-date returns, are for illustration purposes only and do not reflect our Relative Strength Analysis (RSA) system.

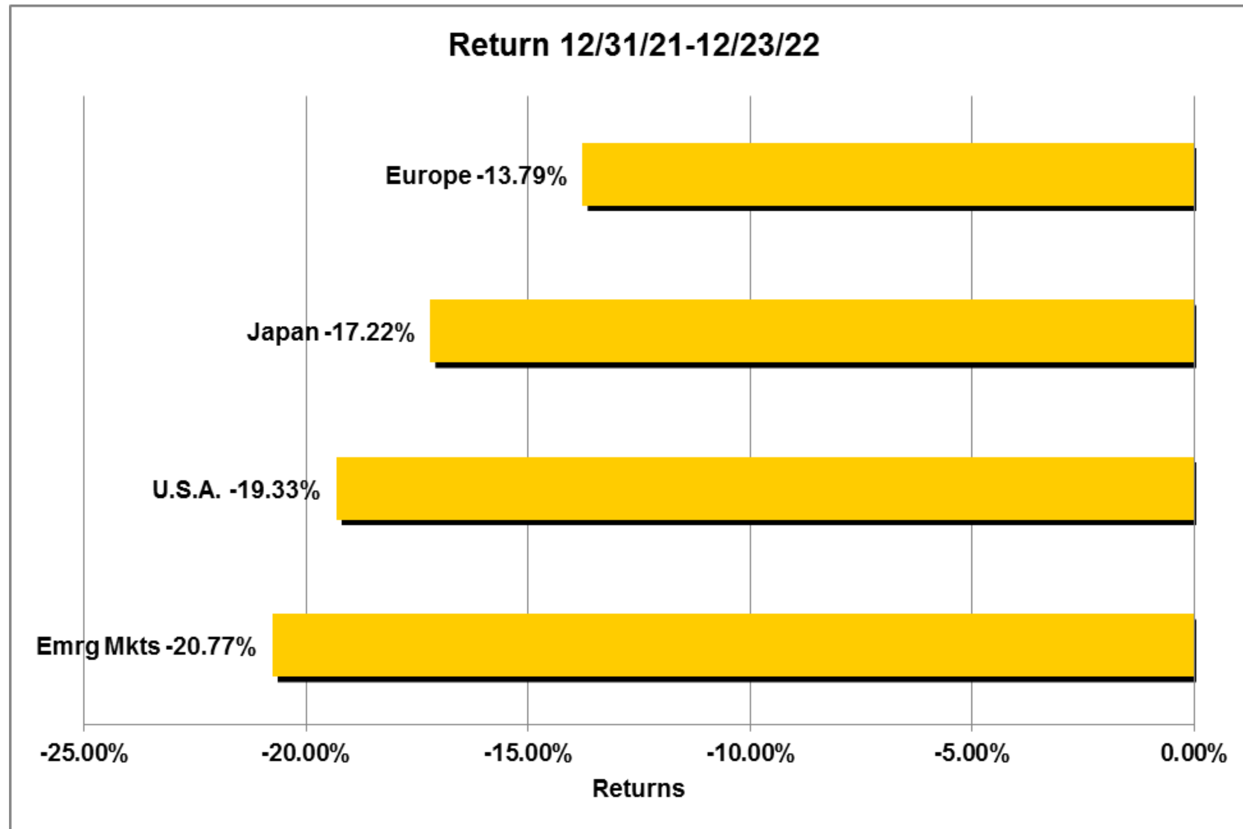
Style Boxes — As of December 23, 2022, mid growth experienced the largest move up in my Relative Strength Analysis (RSA), jumping four positions to claim the number one spot. Large value and mid value both fell one position to finish in second and third place. Small value fell the most, dropping two positions to fall out of the top four to finish in fifth place. Small growth maintained its stronghold on the fourth position. As usual, we will continue to rely upon our time-tested RSA to guide our investments in Style Boxes.



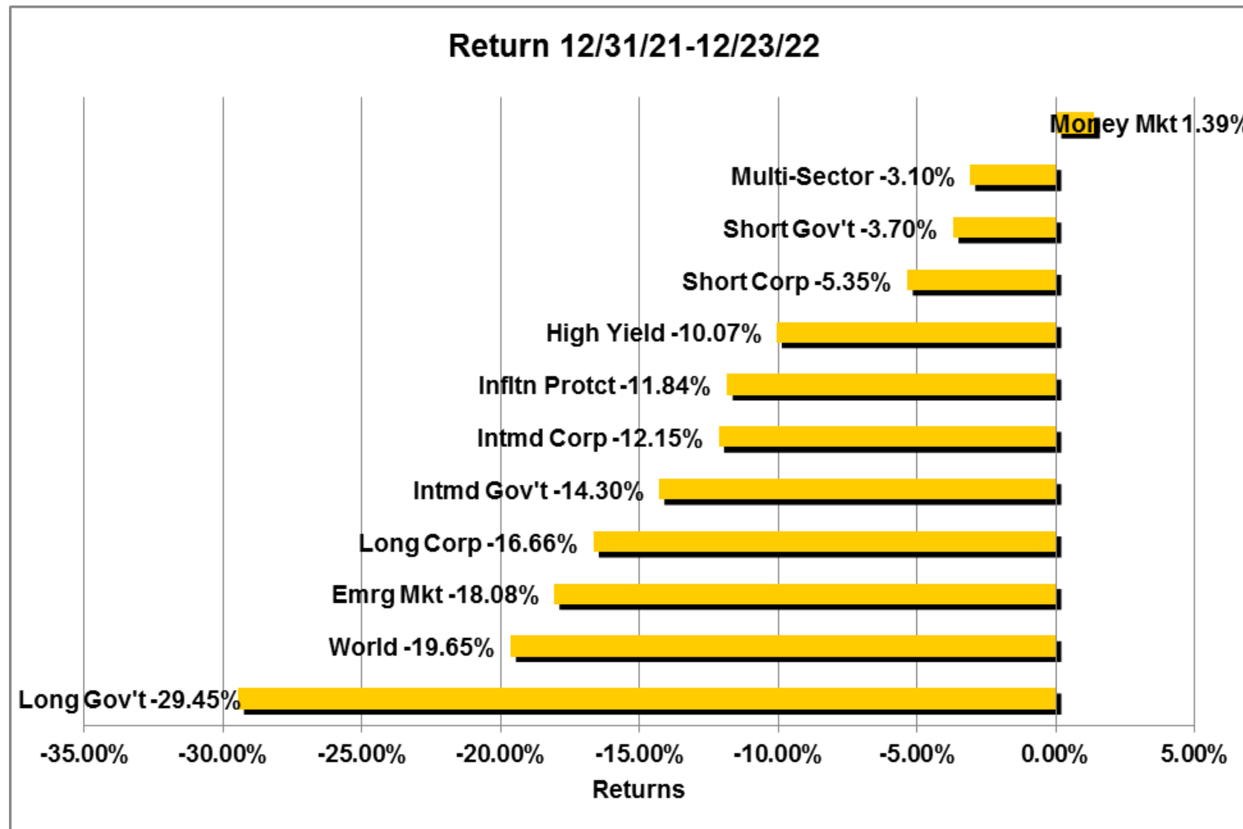
Sectors — As of December 23, 2022, basic materials experienced the largest move up in my RSA, jumping seven spots to finish in third place. Industrials had the second largest jump, moving up four positions to finish in second place. Energy moved up two spots to claim the number one position. Financial services moved up one positon to round out the top four. Utilities experienced the largest drop in my RSA, falling six positions to finish in seventh place. As usual, we will continue to rely upon our time-tested RSA to guide our investments in Sectors.



Internationals — As of December 23, 2022, Europe experienced the largest move up in my RSA, jumping three spots to claim the number one position. The USA fell the most, dropping two spots to finish in third place. Japan maintained its stronghold on second place, as Emerging Markets fell one position to finish in fourth place. As usual, we will continue to rely upon our time-tested RSA to guide our investments in Internationals.



Bonds — As of December 23, 2022, emerging market bonds experienced the largest jump in my RSA, moving up eight spots to finish in second place. High yields jumped seven spots to claim the number one position. Money markets fell two spots to finish in third place but continue to yield more than 75% of the bond universe. As usual, we will continue to rely upon our time-tested RSA to guide our investments in Bonds.



Forecast —

2023 Outlook

This year, the stock market faced a litany of macro challenges. The economic, earnings, and Fed cycles all shifted from being accommodative to restrictive, setting the stage for the most prolonged bear market since the financial crisis.

Heading into 2023, the macro headwinds are largely still in place. The key difference is that by the end of next year, many cycles should have rotated once again to being friendly to risk assets.

Less clear is the path throughout the year. A recession could mean new lows in the S&P 500 and a steeper earnings decline. A weaker economy would allow the Fed to stop hiking as early Q1. The stock market tends to bottom before the economy, so a brief and shallow recession could allow for a cyclical bull market in the second half.

If a recession is avoided, the bear market lows were likely made in the fall of 2022. Stock market gains would likely be stronger in the first half of 2023. EPS growth could be modestly positive. Less clear would be whether a March rate hike is the end of the tightening cycle or merely a pause.

Given the multiple forks in the road, we averaged recession and non-recession scenarios to arrive at our 2023 S&P 500 Signs of an improving macro environment target. Per our macro outlook, we applied a 75% probability of a recession outcome to come to a year-end 2023 S&P 500 price target of 4300, about 7.5% above current levels.

Volatile leadership Mean reversion is common around the start of bull markets. Growth could enjoy a multi-month rebound, but it should be viewed within the context of a secular bear versus Value. Small-caps tend to underperform heading into recessions but are among the most consistent outperformers in early bull markets and expansions.

Bear markets have never ended before the start of recessions, so a recession would likely mean new lows in the popular averages. The stock market tends to lead the economy out of a recession, too, by an average of four months. Absent a financial crisis, the recession should be shorter than recent cases. The average recession bear decline is 34.6%, but a milder recession could equate to a smaller-than-average drop. To date, the 2022 decline is in line with the average non-recession bear. If the Fed achieves a soft landing, 2023 could cover months 3-15 of a post non-recession bull.

Which one will be the case? No one knows for sure and only time will tell. DWM, for one, will continue to rely upon its tactical tools to stay in line with the market's fluctuations. Always remember: the key to investment success is to stay disciplined and flexible in an ever-changing market environment. The moment you start to second-guess your decisions is usually when you shouldn't.

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Sources: Style box data = i-Shares Russell Indexes. Source: Investors FastTrack.Sector data = DJ US Sector Indexes via I-Shares. Source: Investors FastTrack. International data = i-Shares for Emerging Markets, Europe, pan, S&P 500 Index for U.S.A. Source: Investors FastTrack.
Bond data = various bond exchange traded funds (ETF). Source: Investors FastTrack.