MARKETS IN FOCUS

2022 Annual Review/2023 Outlook

Expect familiar themes to persist

January 2023

Many investors are glad to have 2022 in the rearview mirror, and for good reason. It was a painful year from a return perspective across the world, with U.S. equities posting their worst year since 2008. While it was far from the worst drawdown ever, the sting of losses was particularly painful because bond performance was just as miserable. The S&P 500 Index ended the year down approximately -18% while bonds as measured by the Bloomberg U.S. Aggregate Bond Index were down -13%: one of the worst years in modern financial history. The much maligned 60/40 portfolio was down -16% in 2022, the worst return when stocks were not down more than -25% going back to 1940. Investor sentiment across a number of metrics also touched all-time lows, though depressed sentiment luckily didn't impact the consumer's willingness to spend.

Most of the negativity, both from a sentiment and return perspective, was driven by inflation. Matt Orton, CFA, Chief Market Strategist at Raymond James Investment Management, said he sees 2022 as a one-dimensional year where the persistence of inflation dominated virtually all other themes. And while it's tempting to see 2023 in a similarly one-dimensional way, with many of this year's themes simply shifting into reverse, Orton said he doesn't believe it will be that simple. First and foremost, even as inflation continues to decline in the coming year, the extent of that decline remains uncertain. After misjudging inflation so dramatically in 2021, central banks will likely treat initial signs of retreating inflation with some skepticism. Additionally, interest rates' journey from 8% to 4% will be much easier than from 4% to the U.S. Federal Reserve's 2% target, which Orton said pushes the easing narrative further out. Second, he said, don't forget that a downshift doesn't necessarily mean a lower terminal rate. The market still needs to adjust to the revised dot-plot rate forecast in the Federal Open Market Committee's December summary of economic projections, Orton said.

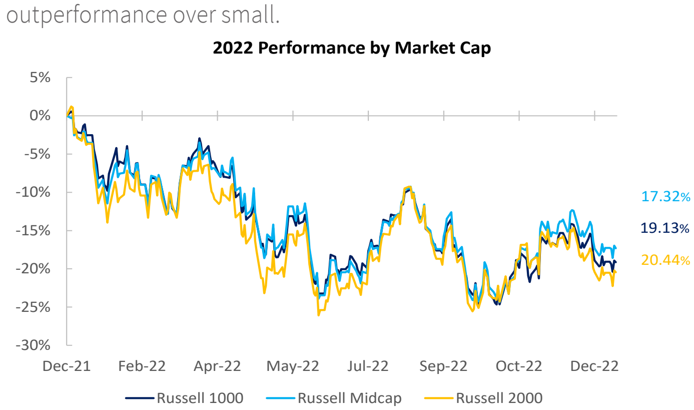
> "I certainly don't expect the gap between value and growth to be as wide as it has been over the past two years.

As a result, he said many themes that dominated the last year are likely to persist, at least in early 2023.

Large outperformed small (again) … but mid-caps were the winner

Small caps just can't catch a break. After dramatically outperforming in late 2020 and early 2021, performance down the market cap spectrum left a lot to be desired in 2022. In fact, the Russell 2000® Index had its worst first 9-month performance on record. However, the performance gap between small- and large-caps for 2022 was quite small at -1.3% (Russell 2000 -20.4% versus Russell 1000® Index -19.1%). But mid caps actually were the top performers of 2022 with the Russell Midcap® Index down "only" -17.3%. The outperformance of mid was largely driven by the underperformance of the mega-cap complex, most evident in consumer discretionary and communication services sectors. Larger weights to semiconductors and the industry's underperformance in the large-cap space also contributed to mid-cap relative results. A larger exposure to utilities in the Russell Midcap also had a positive impact.

The impact of the mega-caps likely will continue to hurt large-cap performance in the near term, at least relative to mid caps, Orton said. Small caps were challenged by the underperformance of biotechnology, which looks to have stabilized and might not be as much of a relative performance drag going forward. Utilities and consumer discretionary also positively contributed to mid outperformance over small.



Source: Bloomberg, as of 12/31/22

Value beat growth (again)

Value has been on a strong run, outperforming growth in 2021 and again in 2022. In fact, value beat growth by the largest margin since 2000 in the large-cap space. As the charts below illustrate, the relative strength of value in 2021 was concentrated down the market-cap spectrum while last year it was concentrated in large. Not surprisingly, the performance of mega-caps played a big role in this, dominating large-caps in 2021 and dragging them down in 2022. That said, the outperformance of value last year was broad, with every sector positively contributing to the relative performance (and every sector except for utilities in the Russell 1000 Value Index outperformed its counterpart in the Russell 1000 Growth Index). And it wasn't the terrible performance of information technology that was the primary contributor to value outperformance. In fact, Orton said it was encouraging to see that financials – the largest sector within value indices – was among the top-contributing sectors to outperformance across all market capitalizations. Energy was also a top contributor to value outperformance broadly, which makes sense given its larger weight.

"I believe there's scope for financials – particularly money center banks – to perform well in 2023, which could contribute to continued value outperformance," Orton said. "Further, information technology and consumer discretionary could remain under pressure earlier in the year as the market still needs to catch up with the Fed. But I certainly don't expect the gap between value and growth to be as wide as it has been over the past two years."

Two strong years for value

		Value	Core	Growth	Value Gap
2022 Returns	Large	-7.5%	-19.1%	-29.1%	21.6%
	Mid	-12.0%	-17.3%	-26.7%	14.7%
	Small	-14.5%	-20.4%	-26.4%	11.9%
2021 Returns	Large	25.1%	26.4%	27.6%	-2.5%
	Mid	28.3%	22.6%	12.7%	15.6%
	Small	28.2%	14.8%	2.4%	25.8%

Large Caps
Russell 1000 (core)
Russell 1000 Value
Russell 1000 Growth

Mid Caps
Russell Midcap (core)
Russell Midcap Value
Russell Midcap Growth

Small Caps
Russell 2000 (core)
Russell 2000 Value
Russell 2000 Growth

Source: Bloomberg, as of 12/31/22

It's also worth noting that along with value outperformance, market breadth improved in 2022. While the stock market was weighed down by challenges to mega-caps and technology more broadly, the market of stocks performed much better. In fact, Orton noted that the S&P 500® Equal Weight Index outperformed the cap-weighted index by nearly 7% (-11.47% versus -18.13%). However, absolute returns were painful no matter how you cut it, and the last time market breadth was strong at the same time as the market was down occurred in 2000.

"Take that with a grain of salt," Orton said, "but it's certainly worth highlighting. What's encouraging to me is that idiosyncratic risk matters once again; fundamentals matter again; and that paints a constructive environment for active management."

The Stock Market underperformed the Market of Stocks
Ratio of S&P 500 Index to S&P 500 Equal Weight Index 2022 performance

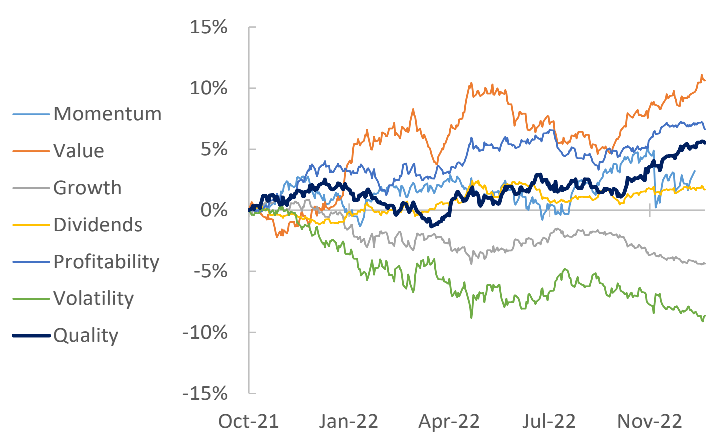
Source: Bloomberg, as of 12/30/22

High quality mattered

Even though the broad market disappointed throughout 2022, there have been specific areas that consistently added value. From a factor perspective, it's not surprising that valuation mattered. With an incredibly rapid tightening of financial conditions and increase in real rates, it's not surprising that investors were focused on price that they were paying for growth. With the death of ZIRP – zero interest-rate policy – profitability also mattered again and we saw quality perform well throughout the year. Quality to Orton includes companies with higher return on equity, higher return on assets, free cash flow, and earnings stability. Dividend growth was also a consistent winner.

"It's important to draw a distinction between dividend yield and dividend growth, with the former unlikely to outperform in a higher-rate environment and questions around the sustainability of high dividends in lower-quality companies," Orton said. He said these factors will likely continue to dominate in early 2023 as uncertainty remains high and the market fully adjusts to the reality of a "higher for longer" policy from the Fed. Additionally, defensives have become momentum (i.e., what's working continues to work), and until we see a structural change Orton said he expects this will remain the case.

Quality has worked well over the past year, along with dividends and valuation



Source: Bloomberg, as of 12/30/22

Percentage of active managers outperforming Morningstar category index

2022

	Value	Blend	Growth
Large	45%	79%	41%
Mid	85%	68%	38%
Small	82%	83%	38%

3 Years

	Value	Blend	Growth
Large	69%	24%	10%
Mid	60%	54%	50%
Small	76%	73%	80%

5 Years

	Value	Blend	Growth
Large	48%	9%	6%
Mid	52%	29%	44%
Small	62%	63%	85%

10 Years

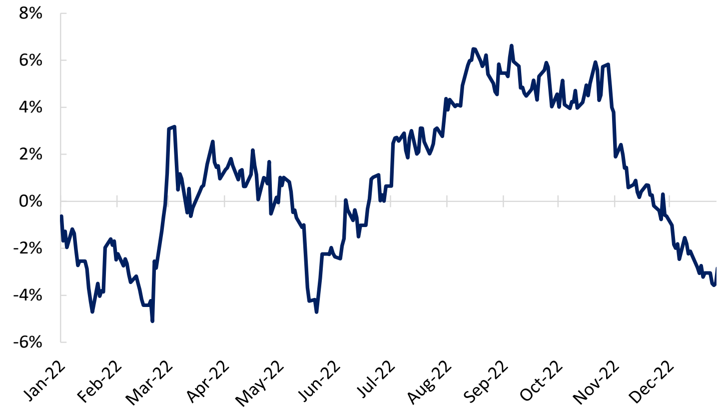
	Value	Blend	Growth
Large	39%	4%	3%
Mid	30%	13%	35%
Small	51%	51%	71%

Large caps	Mid caps	Small caps
Russell Top 200® Index (core)	Russell Midcap Index (core)	Russell 2000 Index (core)
Russell Top 200® Value Index	Russell Midcap Value Index	Russell 2000 Value Index
Russell Top 200® Growth Index	Russell Midcap Growth Index	Russell 2000 Growth Index

Source: Morningstar, as of 12/31/22

International outperformed

Ratio of S&P 500 to MSCI EAFE® (Net) Index 2022 performance



Source: Bloomberg, as of 12/30/22

International staged a comeback

Despite double-digit inflation in Europe, heightened recession concerns, and hawkish central banks, international developed equities outperformed U.S. equities for the first time since 2017. Underperformance of the mega-cap complex in the United States coupled with meaningfully better performance of international banks drove the bulk of the performance dispersion. A larger weight to the materials sectors – specifically, more exposure to miners that benefitted from rising commodity prices earlier in the year – also helped international outperform.

"The key question is, can this continue?" Orton said. Valuations for international equities remain quite attractive relative to the U.S., but he said economic headwinds, neutralized market positioning, and further price-to-earnings compressions and earnings declines overseas present headwinds. Positioning in Europe is back to pre-Ukraine war levels (up more than 40% from October lows) while U.S. positioning is now neutral. Orton said it's also worth noting that European risk premia is back to its 10-year average and U.S. risk premia is at its 10-year lows.

"I believe that P/E ratios may still be too high, particularly in Europe where earnings are likely to be revised lower," he said. "That said, performance of international developed has been strong recently and a warmer winter so far can prevent some of the worst-case energy scenarios from playing out. I would lean into value overseas given that recessionary risks are already baked into these sector valuations."

Risk Information:

Investing involves risk, including risk of loss.

Diversification does not ensure a profit or guarantee against loss.

Disclosures:

Index or benchmark performance presented in this document does not reflect the deduction of advisory fees, transaction charges, or other expenses, which would reduce performance. Indexes are unmanaged. It is not possible to invest directly in an index. Any investor who attempts to mimic the performance of an index would incur fees and expenses that would reduce return.

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Definitions

A 60/40 portfolio is based on a widespread investment strategy calling for a portfolio allocation of 60% equities and 40% bonds or other fixed-income securities.

The terminal rate is the rate at which the U.S. Federal Reserve stops raising the federal funds rate in an attempt to bring down inflation. The federal funds rate, known as the fed funds rate, is the target interest rate set by the Federal Open Market Committee of the Federal Reserve. The target is the Fed's suggested rate for commercial banks to borrow and lend their excess reserves to each other overnight.

The U.S. Federal Reserve dot plot is a chart summarizing the Federal Open Market Committee's (FOMC) outlook for the federal funds rate. Each dot represents the interest rate forecasted by one of the 12 members of the committee.

The summary of economic projections is produced following meetings of the Federal Open Market Committee and includes meeting participants' projections of the most likely outcomes for real gross domestic product growth, the unemployment rate, and inflation for a forward-looking three-year window and over the longer run.

Factor investing is an approach to investing that selects securities based on characteristics associated with higher returns. These characteristics, or factors, can be macroeconomic factors or style factors. Macroeconomic factors are focused on broad risks across asset classes and include the rate of inflation: growth in gross domestic product; and the unemployment rate. Style factors include differences in growth versus value stocks; market capitalization, and industry sector. Factor performance refers to a focus on performance of securities within a particular factor or between groups of different kinds of factors.

Growth investing is a stock-buying strategy that focuses on companies expected to grow at an above-average rate compared to their industry or the market.

Value investing is an investment strategy that involves picking stocks that appear to be trading for less than their intrinsic or book value.

A zero interest-rate policy (ZIRP) describes a central bank setting its target short-term interest rate at or close to 0% with a goal of encouraging low-cost borrowing that stimulates economic activity.

Profit factor investing considers the gross profit of an investment divided by the gross loss (including commissions) for the entire trading period. This method is used to assess the amount of profit per unit of risk, with values greater than one indicating a profitable system.

Return on equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders' equity.

Return on assets (ROA) is a financial metric focusing on how profitable a company is in relation to its total assets. It is typically expressed as a percentage using a company's net income and average assets. The higher the ROA, the better the company does at managing its balance sheet efficiently and productively to generate profits.

Defensive stocks provide consistent dividends and stable earnings regardless whether the overall stock market is rising or falling. Companies with shares considered to be defensive tend to have a constant demand for their products or services and thus their operations are more stable during different phases of the business cycle.

Momentum investing is a strategy that aims to capitalize on the continuance of an existing market trend. It is a trading strategy in which investors buy securities that are already rising and look to sell them when they look to have peaked. It entails taking long positions on financial instruments with prices trending up and short positions on instruments with prices trending down.

Dividend investing is a strategy that seeks to invest in companies that pay out dividends and considers a company's dividend yield, ability to grow and pay dividends over time, and dividend payout ratio, or the amount being paid out to shareholders in the form of dividends versus how much income the company retains.

Volatility investing is a strategy that seeks to take advantage of sudden changes in the price of assets in markets where prices are changing rapidly, erratically, or by large degrees when compared with their historical averages. Investments in securities with volatile prices can carry both high potential rewards and high risk.

Quality investing is a strategy that seeks to invest in companies with low debt, stable earnings, consistent asset growth, and strong corporate governance, as reflected in financial metrics such as ratios of return to equity and debt to equity, as well as to earnings variability.

Dividend yield, which is expressed as a percentage, is a ratio of the current rate of dividend payout divided by the current stock price.

Hawkish, dovish, and centrist are terms used to describe the monetary policy preferences of central bankers and others. Hawks prioritize controlling inflation and may favor raising interest rates to reduce it or keep it in check. Doves tend to support maintaining lower interest rates, often in support of stimulating job growth and the economy more generally. Centrists tend to occupy the middle of the continuum between tight (hawkish) and loose (dovish) monetary policy.

Price-to-earnings (P/E) ratios measure a company's current share price relative to its earnings per share. The ratio is used to help assess a company's value and is sometimes referred to as the price multiple or earnings multiple.

A multiple, sometimes referred as the price multiple or earnings multiple, is a measure of a company's value based on the ratio of its current share price to its earnings per share. This ratio is known as the price-to-earnings ratio, or P/E.

P/E compression occurs when a company's P/E multiple decreases, often as a result of lowered investor expectations.

A risk premium – or premia, in the plural – is the investment return an asset is expected to yield beyond the risk-free rate of return. It compensates investors for taking on the additional risk of the investment over that of a risk-free asset.

Indices

The S&P 500 Index measures change in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 75% of the investable U.S. equity market.

The S&P 500® Equal Weight Index is the equal-weight version of the S&P 500. It includes the same constituents as the capitalization-weighted S&P 500, but each company in the S&P 500 Equal Weight Index is allocated a fixed weight, or 0.2% of the index total at each quarterly rebalance.

The Bloomberg U.S. Aggregate Bond Index is composed of the total U.S. investment-grade bond market. The market-weighted index includes Treasuries, agencies, commercial mortgage-backed securities (CMBS), asset-backed securities (ABS) and investment-grade corporates.

The MSCI EAFE® (Net) Index measures the performance of performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. The MSCI EAFE® (Net) Index subtracts any foreign taxes applicable to US citizens but not applicable to citizens in the overseas country.

The Russell Top 200® Index measures the performance of the 200® largest companies in the Russell 3000® Index, which represents approximately 68% of the total market capitalization of the Russell 3000® Index.

The Russell Top 200® Growth Index offers measures the performance of the especially large cap segment of the U.S. equity universe represented by stocks in the largest 200 by market cap. It includes Russell Top 200® Index companies with higher growth earning potential as defined by Russell's leading style methodology.

The Russell Top 200® Value Index measures the performance of the especially large cap segment of the US equity universe represented by stocks in the largest 200 by market cap that exhibit value characteristics. It includes Russell Top 200® companies that are considered more value oriented relative to the overall market as defined by Russell's leading style methodology.

The Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000® Index, which represents approximately 93% of the total market capitalization of the Russell 3000® Index.

The Russell 1000® Growth Index measures a growth-oriented subset of the Russell 1000 Index, which tracks approximately 1,000 of the large-sized capitalization companies in the United States equities market.

The Russell 1000® Value Index measures a value-oriented subset of the Russell 1000® Index, which tracks approximately 1,000 of the large-sized capitalization companies in the U.S. equities market.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 7% of the total market capitalization of the Russell 3000® Index.

The Russell 2000® Growth Index measures the performance of the small-cap growth segment of the U.S. equity universe. It includes those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 2000® Value Index measures the performance of the small-cap value segment of the U.S. equity universe. It includes those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.

The Russell Midcap® Index measures the performance of the mid-cap segment of the U.S. equity universe. It includes approximately 800 of the smallest securities of the Russell 1000® Index based on a combination of their market capitalization and current index membership and represents approximately 27% of the total market capitalization of the Russell 1000® Index.

The Russell Midcap® Growth Index measures the performance of the midcap growth segment of the U.S. equity universe. It includes those Russell Midcap® Index companies with higher price-to-book ratios and higher forecasted growth values.

The Russell Midcap® Value Index measures the performance of the midcap value segment of the U.S. equity universe. It includes those Russell Midcap® Index companies with lower price-to-book ratios and lower forecasted growth values.

Contact us at **800.521.1195** or visit **RJInvestmentManagement.com** for more investment insights.

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