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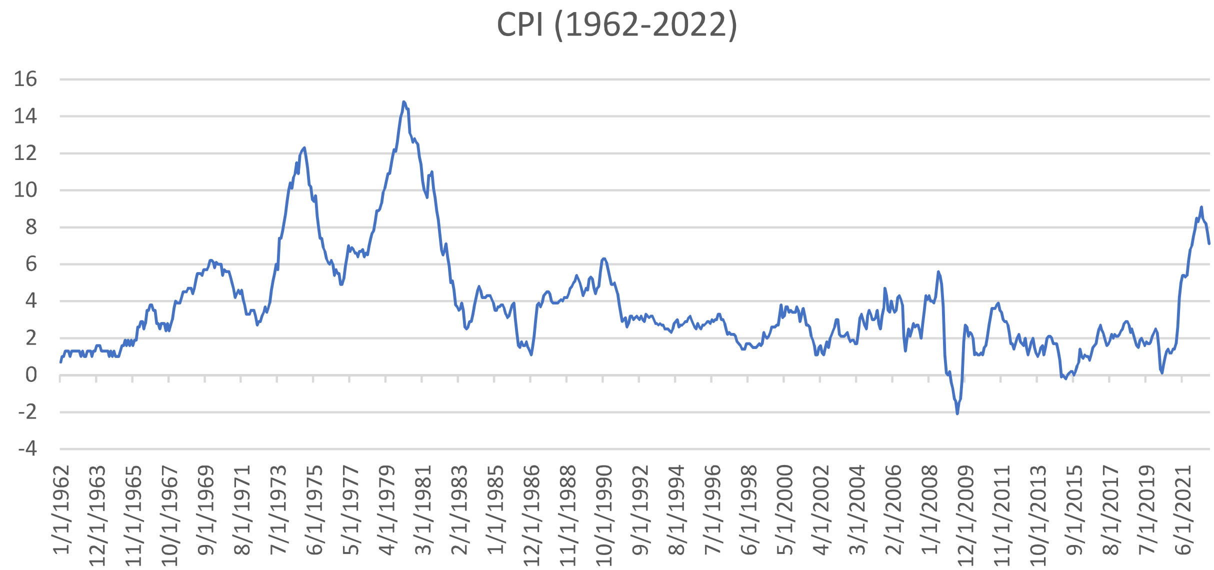
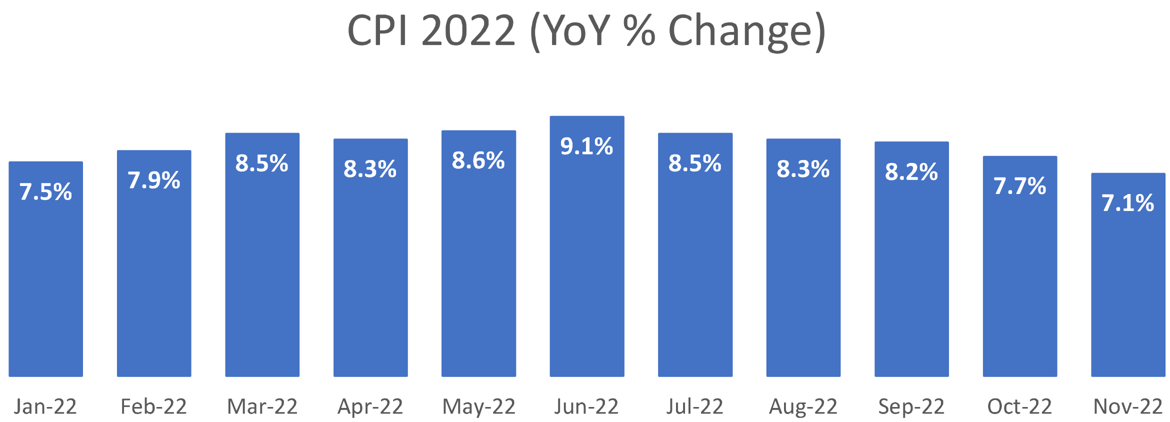
American National Bank & Trust

December Update

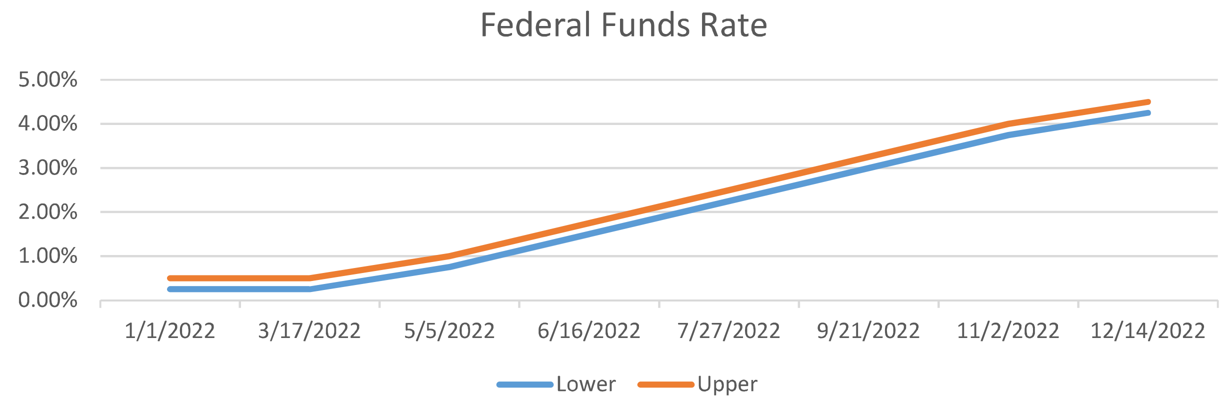
The US stock market officially entered a bear market in June 2022. We have seen seven bear markets since 1960, and they average a loss of (-38%) and have, on average, a 16-month duration. Over the last 11 months, we have been at a loss of (-25%). While we are putting 2022 behind us, the inflation headline welcomes 2023 right alongside us. While Personal Consumption Expenditures (PCE) might be a better indicator of inflation, Consumer Price Index (CPI) is the most visible and frequently reported. Currently, CPI is at a 40-year high.



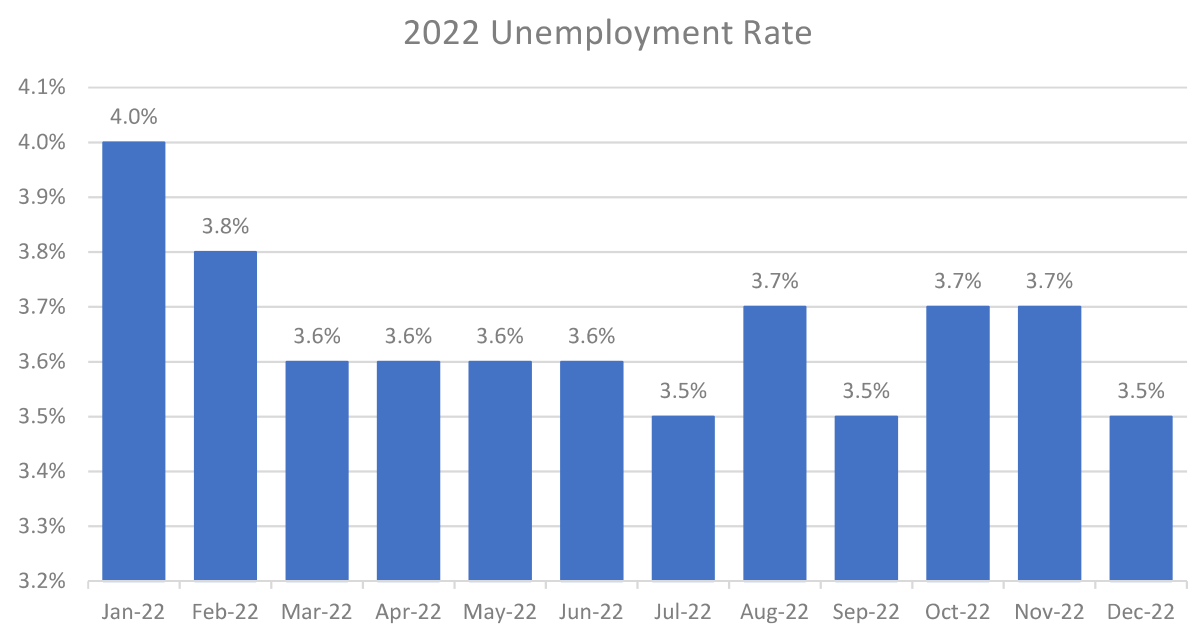
The Fed has been fighting a defensive battle against inflation, which is slowly coming down. CPI hit its inflection point in June at 9.1% annualized. In the future, we expect the inflationary environment to decline gradually over the next five years to the Fed's target rate of 2%. We expect that in 1 year, CPI will be at 6%, in 3 years, it will fall to 3%, and in 5 years, we will be back to the target of 2%.



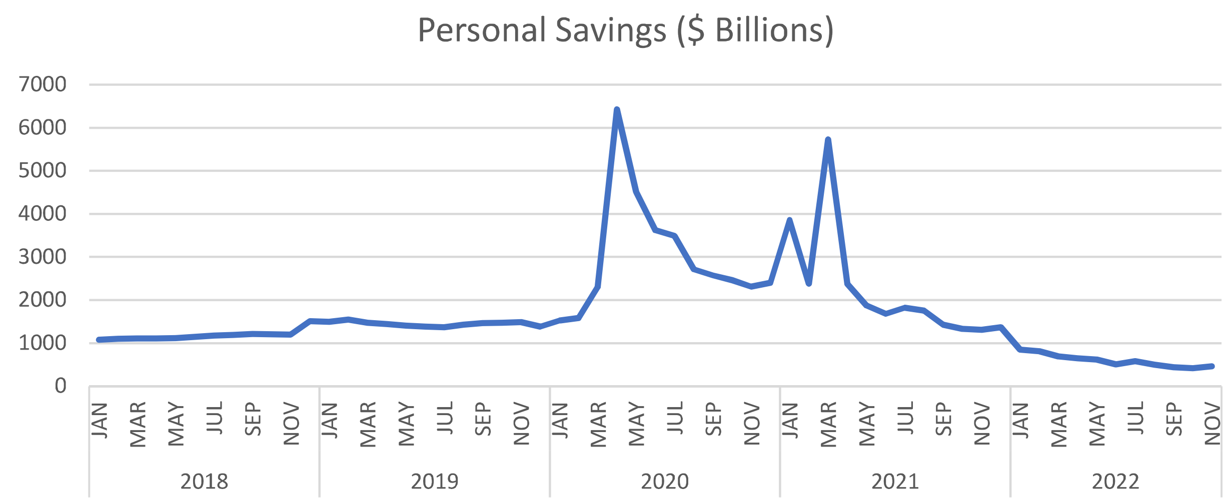
The Fed's primary tool for fighting inflation has been through raising short-term interest rates. 2022 saw some of the most aggressive interest rate hikes the United States has seen in years. We started the year at a Fed Funds interest rate of 0.25% - 0.50% and finished at a range of 4.25% - 4.50%. After four straight increases of 0.75%, the Fed slowed the rate of their raises to 0.50% in their last meeting in December. We expect interest rate increases to continue into 2023 as the Fed waits to see if they have inflation under control.



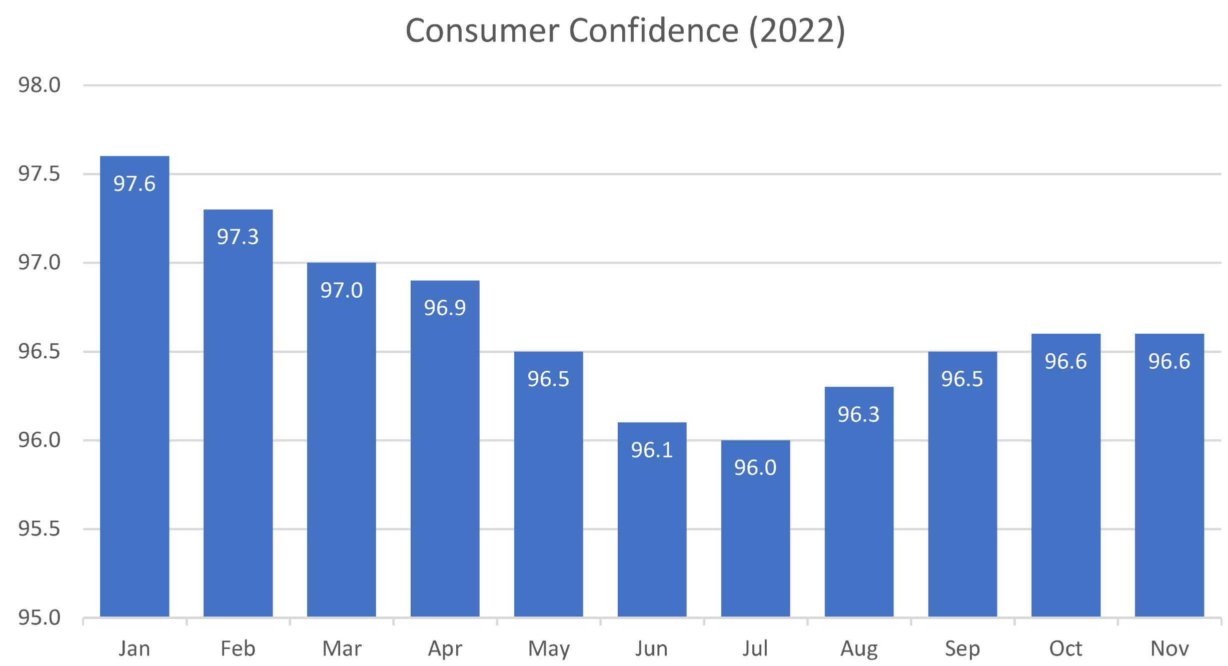
These aggressive rate hikes risk sending the economy into a recession. The Fed is trying to be cautious of this and trying to generate a "soft landing". However, these interest rate hikes reverberate through the economy. One of the hardest hit was the housing sector. Housing permits, starts, sales, and inventory were all lower in 2022. Interest rate hikes can also affect unemployment. This, however, has held firm for the moment, hinting some upside that if the US goes into recession, it will not be deep.



One indicator that could be stronger is personal savings. From 2010-2020, US personal savings were at $1 trillion. It peaked during the pandemic as people stayed home and received stimulus checks. It reached at high as $5 trillion during this time. Now that number sits at $625 billion, indicating people have been burning through their savings.

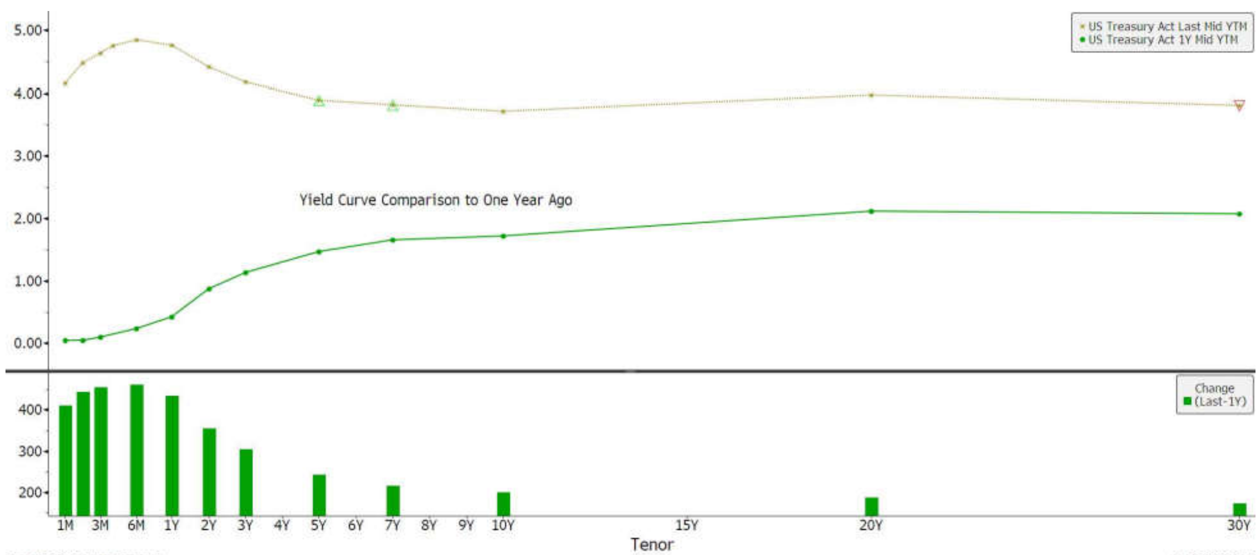


Consumer Confidence is another indicator that showed poorly in 2022. A study from the University of Michigan is relatively easy to interpret. With 100 as a baseline, anything above that shows consumer optimism, and the opposite can be said for anything below 100. The last reported number came from November and was only 96.1. That is up from the year low in July of 96, versus the January high mark at 97.6.



2022 was no doubt a rough year for stocks. The year returned a loss of near (-20%) across all sectors, with the tech-heavy NASDAQ down more than (-30%). With the current economic landscape, including a strong dollar adding to the inflationary pressure, that can't come as a surprise. There is also the impact of the presidential cycle. 2022 was the 2nd year of President Joe Biden's administration; historically, the 2nd year is also the worst for the stock market. The 3rd year, however, is one of the best years historically.

The bond market didn't escape 2022 without significant damage, either. With the Fed raising interest rates, long-term bond interest rates were pushed up. The iShares Core U.S. Aggregate Bond ETF (AGG) declined (-15%). To add insult to injury, the yield curve is inverted at 2 and 10 years. This is a sign of a possible recession looming. However, the Fed can't raise interest rates forever, and when they start cutting rates, the bond market should begin a recovery process.



Starting a new year also comes with fresh optimism. With a selloff in 2022, it has also dropped stock valuations, which should help the stock market. Value stocks outperformed growth stocks for the first time since 2016. Also, earning estimates were weakened almost across the board, leaving room for positive surprises. With the suppressed economy, IPOs and mergers had slowed and built up while companies waited for a better economic landscape. Government spending has also increased by 4.3%. This may be a good signal for specific industries, such as defense. But with volatility expected to continue through 2023 and to flirt with a possible recession, we offer a Base, Bearish, and Bullish case outlook for 2023.

Bearish Case	Base Case	Bullish Case
Inflation accelerates	Smaller FOMC rate hikes in early 2023	Inflation falls faster than expected
More rate hikes	CPI falls to 5%	Geopolitical issues ease
Consumer spending slump extends	GDP slows down moderately	Dollar retreats
Recession declared	S&P 500 rises 8%-12% with a strong 2nd half	Earning surprises
Bear market continues		S&P 500 rises 15% - 20%

While no one has a crystal ball, we will remain vigilant for developments that may tilt the scales one direction or the other. Either way, 2023 is likely to be an "interesting" ride. Best wishes for a healthy and prosperous new year!

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