

Market Commentary
2022 Year-End Recap:

Inflation: Post-pandemic inflation was *the* story for the global economy in 2022, as a combination of snarled supply chains and labor shortages were exacerbated by Russia's invasion of Ukraine, which sent energy prices skyrocketing. Inflation reached a 40-year high in the US in the late spring, but moderated somewhat in the second half thanks to falling energy prices, fewer supply problems, and a slowly-but-steadily normalizing labor market.

Monetary Policy: If inflation was the fuel for the 2022 bear market, monetary policy was the match that lit the flame. At the start of the year, the Fed still had overnight interest rates pinned at zero, and Fed Fund Futures markets were pricing in just *three* 25bp rate hikes in 2022. Fast forward 12 months, and the Fed has enacted the equivalent of *seventeen* 25bp hikes, including four consecutive 75bp increases, pushing its policy rate floor to 4.25%. Central banks around the world have followed suit in the fight against global inflation, including the Bank of England, the ECB, and even the Bank of Japan. Looking ahead to 2023, markets are expecting a much more balanced monetary posture, with two small rate hikes expected from the Fed early in the year, and the potential for cuts on the horizon towards the end.

Economy: The US economy normalized somewhat in 2022, with growth decelerating after a torrid +5.9% pace in 2021. GDP growth was mildly negative in the first two quarters this year, but the US has avoided recession thus far, thanks largely to a resilient consumer. Over the course of the year, most gauges of manufacturing activity weakened, and housing decelerated sharply thanks to soaring mortgage rates. Looking forward, Albion's expectation is that the Fed's monetary tightening will ultimately cause the economy to enter recession at some point in 2023.

Bond Market: Driven by the Fed's sharp pivot to inflation-fighting, US fixed income endured one of its worst years in history. Treasury yields rose by 200-350bp as the curve became almost completely inverted, and IG credit spreads widened by more than 30bp. No sector of the bond market was spared the decline in prices, although the restoration of yield to decade-plus highs helps to brighten the outlook for fixed income investors going forward.

Stock Market: After reaching an all-time high on the first trading day of 2022, the S&P 500 spent most of the year in a bear market. Equity returns were primarily driven by duration exposure, with long-dated growth sectors (especially technology) hit the hardest while dividend-rich sectors fared better. Energy was an upside outlier all year thanks to the dramatic rise in oil and gas prices following Russia's invasion of Ukraine. International stocks finished lower as well, with China giving investors a particularly turbulent ride in 2022 thanks to Beijing's ever-evolving Covid and economic policies.


Albion's "Four Pillars":

*Economy & Earnings - US GDP rebounded to +2.6% in Q3 after falling in 1H22, and corporate operating margins remain solid at -12% on the S&P 500. Albion's base case expectation is that the US economy will enter recession in 2023, putting downside pressure on earnings.

*Valuation - The S&P 500's forward P/E of 17x is slightly above the long run average. More predictive metrics like CAPE, Tobin's Q, and the Buffett Indicator (Mkt Cap / GDP) suggest that compound annual returns over the next decade are likely to be in the single digits. Most or all of this year's P/E multiple compression has been driven by rates, rather than an expansion of the equity risk premium.

*Interest Rates - Rates have risen across the curve in 2022 in response to a shift in monetary policy. Fed Fund Futures are pricing in two additional 25bp hikes in 2023, with a "terminal" Fed Funds rate slightly below 5% for this cycle.

*Inflation - After reaching 40yr highs in spring of 2022, inflation has begun to moderate in recent months. Headline inflation eased over the summer on falling energy prices, and core inflation has followed suit in Q4. Goods inflation has fallen due to softening demand and excess inventory, while heavily lagged housing data is helping to keep services inflation elevated.

2022 Market Recap
Market Data

Equity Indices	Close	Index Total Returns (%)			
		MTD	QTD	1 Year	3y Cum.
S&P 500	3,840	-5.8%	7.6%	-18.3%	25.2%
Dow Jones Indus. Avg.	33,147	-4.1%	16.0%	-7.0%	23.9%
NASDAQ	10,466	-8.7%	-0.8%	-32.9%	19.8%
S&P Midcap 400	2,430	-5.5%	10.8%	-13.0%	23.4%
Russell 2000 (Small Cap)	1,761	-6.5%	6.2%	-20.6%	9.9%
MSCI EAFE (Int'l Dev Mkt Eq)	1,944	0.1%	17.4%	-14.0%	4.1%
MSCI EM (Emerging Mkt Eq)	956	-1.4%	9.8%	-19.1%	-7.2%
MSCI World	2,607	-4.2%	9.8%	-18.3%	15.8%
S&P Global 1200	2,888	-4.2%	10.6%	-16.9%	17.1%

Fixed Income	Yield	Index Total Returns (%)			
		MTD	QTD	1 Year	3y Cum.
10y U.S. Treasuries	3.87%	-1.1%	0.6%	-16.2%	-10.9%
U.S. Bonds (Aggregate)	4.68%	-0.5%	1.9%	-12.9%	-8.0%
Global Bonds	3.73%	0.5%	4.5%	-16.1%	-12.7%
U.S. Munis	3.55%	0.3%	4.1%	-8.5%	-2.3%
U.S. Investment Grade Corp	5.42%	-0.4%	3.6%	-15.6%	-8.5%
U.S. High Yield Corporates	8.96%	-0.6%	4.2%	-11.2%	0.2%

US Interest Rates	Levels (%)				
	12/30/22	11/30/22	9/30/22	12/30/21	12/30/19
2y Treasuries	4.43	4.31	4.28	0.72	1.57
10y Treasuries	3.87	3.61	3.83	1.51	1.88
30y Treasuries	3.96	3.74	3.78	1.92	2.33
Fed Funds (Effective Rate)	4.33	3.83	3.08	0.08	1.55
SOFR (USD)	4.30	3.82	2.98	0.05	1.54
30y Fixed Mortgage	6.41	6.54	6.70	3.11	3.74

Commodity Prices	Levels				
	12/30/22	11/30/22	9/30/22	12/30/21	12/30/19
Oil (WTI)	80.26	80.55	79.49	76.99	61.68
Gasoline	3.23	3.47	3.80	3.29	2.58
Natural Gas	4.48	6.93	6.77	3.56	2.19
Gold	1,824	1,769	1,661	1,815	1,515

Currency Crosses	Levels				
	12/30/22	11/30/22	9/30/22	12/30/21	12/30/19
\$ per £	1.21	1.21	1.12	1.35	1.31
\$ per €	1.07	1.04	0.98	1.13	1.12
¥ per \$	131.1	138.1	144.7	115.1	108.9
¥ per Bitcoin	16,579	17,105	19,425	47,298	7,243

Macroeconomic Data	Value	Date	Next Rel.	Data Sources:
Inflation (Core PCE Deflator)	4.7%	11/30/22	01/27/23	
Inflation (Headline CPI)	7.1%	11/30/22	01/12/23	
Unemployment (U-3)	3.7%	11/30/22	01/06/23	
GDP Growth (Q/Q SAAR)	3.2%	09/30/22	01/26/23	
ISM Manufacturing PMI	49.0	12/30/22	01/04/23	
Consumer Confidence	108.3	12/30/22	01/31/23	

Albion's Dashboard of Key Leading Economic Indicators as of 12/30/22

- Initial Jobless Claims (221k 4wk m/a) - Steady: settled into low-200k range after a summer peak
- Conference Board LEI (-4.5% y/y) - Weaker: has declined significantly since peaking in Feb 2022
- Building Permits (1,351k) - Weaker: has declined since spring 2022 on rising mortgage rates
- Corporate Bond Spreads (1.21%) - Steady: IG spreads have stabilized near their long run average
- Treasury Yield Curves (84.4% inv) - Weaker: most Treasury curve points are inverted
- Consumer Confidence (108.3) - Stronger: rebound sharply in December to an 8-month high
- Real Final Sales (+1.5% y/y) - Stronger: rebounded in Q3 '22, growth rate still far below cycle peak

Legend: ● = All Clear; ● = Caution; ● = Strong Warning

2022 S&P 500 Total Return by Sector
