Market Commentary – January 2023

This year started off with the lingering pain of 2022's interest rate increase binge. In 2022 the FED raised interest rates more in less time than any time in our history. We have mentioned numerous times that the FED was in denial, way behind and not proactive in addressing inflation. Artificially low interest rates resulted in an overpriced stock market. Reality finally set in, and the FED played catch up for most of 2022.

The FED rate is currently at 4.25 to 4.5%, and will probably go to 5 to 5.1% before the FED stops. This is called the "terminal rate" or the rate they settle on as sufficient. This is what the FED should have started before inflation peaked at 9.1% last June. Once we see a "positive rate," meaning the interest rate is higher than rate of inflation, the financial markets will turn positive if history is any indication of what we can expect. The market knows this and that is why the market began to recover this quarter, anticipating that since inflation has slowed, the FED will soon stop increasing the rate. The FED's December DOT Plot projected a terminal rate of 5.10% with small rate hikes in February, March, May and maybe June. If GDP and corporate earnings are solid then we may see a terminal rate sooner.

We are in the earnings reporting season for the fourth quarter of 2022 now. So far over 120 of the S & P 500 companies have reported earnings. Tech stocks have led a rally and GDP is tracking at about 4% growth. We will see in the next few weeks of earnings reports if corporate earnings continue this momentum. Markets are forward-looking, and current prices tend to reflect expectations for the future. When expectations for a recession are prevalent among investors, as they are now, it is likely already reflected in stock prices. This is one reason investors are often rewarded even when economic activity has slowed down. For example, over the past 100 years, investors in the U.S. have experienced 15 recessions. In 11 of the 15 (73% of the time), returns on stocks were positive two years after the recession began, with an annual average return of 7.8%. So, there are ends to recessions, and they are usually positive.

We follow many analysts and study their predictions about what the financial markets will do and why. Usually there is a consensus or similarity in opinions in a majority of those making predictions. Not now, not this time. We see a positive and recovering market from some and a stagnant and weak market from others. The opinions and predictions are very polarized. We tend to look at historical occurrences and how the markets behaved in similar corrections or recessions. This gives us more confidence than opinions or projections. One observation, however, seems to be shared by most projecting long -term market behavior: the best option for the long-term investor is to maintain the course with their portfolio. The returns over time available to long-term investors are the reward for patience through short-term market movements or macroeconomic events.

There are some important economic developments in China that are having an effect in China and beyond. The sudden end to China's "Covid Zero" policy has created a health care and economic disaster. Since last November, China has been under the government's "Zero Covid" policy. With a rapid rise in Covid cases, the government ordered people to stay inside and not leave their apartments and homes. Alternately, they could quarantine in government shelters. Food was delivered, masks were furnished, and doctors were dispatched to severely sick residents. The effect was a dramatic slowdown in the economy. The Chinese economy slowed more than any time in the past 30 years. After a few months, people began to protest at a level not seen since Tiananmen Square. People were frustrated by not being able to leave their homes and work or have any social contact. Abruptly, the government ended the program on January 8th. Lockdowns have been abolished and a negative Covid test is no longer required to enter public transportation, restaurants, gyms and other public buildings. China also fully opened its borders with no travel restrictions or quarantine requirements for people entering the country.

This policy reversal has two short-term effects. First, the number of Covid cases is expected to skyrocket, and second, the economy has made a quick rise in activity as people have returned to work. While the return of a stronger economy is welcome, the unknown number of infections and deaths are real concerns for healthcare workers and the aging population. China's medical facilities and funeral and cremation facilities were already overrun. In fact, that was the primary reason for the policy in the first place. The numbers for infections and deaths coming from China's government agencies are not accepted as accurate and we won't ever really know what the truth is. The government also stopped updating daily Covid case numbers. But, most health organizations believe the near-term affects will be devastating to the Chinese population. On January 8th, several countries including the U.S. and the UK, have imposed Covid testing on Chinese visitors. If the effects of this policy reversal play out as international health organizations predict, this will be a human tragedy and could have widespread economic repercussions.

Finally, the $1.7T Omnibus spending package comes with some good and bad news. This puts the number of new dollars into the system at over $6T in the last two years. Some things that made it into the bill are of importance. The biggest change is to retirement accounts, all types, thanks to Secure Act 2.0. The act contains new retirement rules to allow us to save more, delaying required minimum distributions (RMD's) to an older age and increasing "catch up "provisions. The bill also makes employer sponsored retirement plans available to more people.

On the other hand, bonus depreciation is being reduced and phased out in 2027. Research and development expense deduction parameters are being changed, business interest expense deductions are being reduced. Of course, the bottom line on government spending is that these dollars have to come from somewhere. They will come from increased revenue to the Treasury, or as they are commonly known, taxes.

2023 will be an interesting year for all of us, and expectations are at both ends of the spectrum. We appreciate the trust you place in us and consider that trust our biggest asset. We look forward to visiting with you and answering any questions you may have. If your financial situation has changed, or you would like to re-evaluate your risk tolerance, please contact us.

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Please be so kind as to inform us of any and all changes that may affect our ability to service your accounts. In particular, please inform us immediately if:

1) You have any changes to your financial condition or would like to reevaluate your risk tolerance.
2) You change your "mailing" or "physical" address.
3) You change banks thereby impacting a standing "MoneyLink" or other money movement instructions.

If you wish to schedule a phone conference or meeting with your advisor, please contact our office.

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FMI maintains a current Business Continuity and Disaster Recovery Plan to address the actions we will take should we encounter events similar to the Katrina floods, 911 attacks, or other similar disasters. The plan also addresses our response to short-term business interruptions—ice storms, extended power and/or internet outages, etc.

In the event of a <u>bona fide disaster or short-term interruption</u>, we will be available via normal communication modes – email and phone.

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Schwab Alliance: 800-515-2157

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Please take note of our upcoming holiday office closures:

Monday, February 20, 2023 (Presidents' Day)

Friday, April 7, 2023 (Good Friday)

Monday, May 29, 2023 (Memorial Day)

Monday, June 19, 2023 (Juneteenth National Independence Day)

Tuesday, July 4, 2023 (Independence Day)

OFFICE HOURS

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Monday – Friday

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FINANCIAL MANAGEMENT, INC.
P. O. Box 17590
Little Rock, AR 72222-7590
(501) 227-7400
(800) 719-2796
(501) 227-9422 (FAX)
www.fmioffice.com

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