Birch Hill
INVESTMENT ADVISORS

Market View

January 2023

FINANCIAL MARKETS

Strong pessimism at the end of September set the stage for a rebound in equity prices in October and November before the markets faded in December. For the fourth quarter, the Standard & Poor's 500 Index returned +7.6% while the higher-quality Dow Jones Industrials surged +16.0%. For the year, the two indexes returned –18.1% and –6.9%, respectively. As seen in the Market Indicators box to the right, other domestic and international indices produced negative total returns ranging from –20.7% to –13.1% last year. The technology-heavy NASDAQ index returned –32.5% in 2022.

EQUITY VALUATIONS SOMEWHAT ABOVE AVERAGE

Equities continue to trade at somewhat above-average valuations. While earnings expectations for 2023 and beyond have started to soften, analysts may still be too optimistic, particularly if the US enters a recession. While the broad market appears somewhat over-valued, there are individual stocks that represent attractive long-term values in almost every sector of the large and mid-cap markets.

UNCERTAIN IMPACT OF CHINA'S COVID POLICY

China's COVID policy changes might disrupt the global economy in 2023. Until early December, under China's Zero COVID policy, Chinese residents had to present a 48-hour negative test certificate before accessing most public spaces. Anti-COVID policy protests in November, possibly combined with financial strains due to high testing costs incurred by the government, resulted in an end to testing requirements. Since then, COVID cases have ballooned. The situation is worsened by Chinese vaccines that don't work nearly as well as Western mRNA vaccines.

While most of the world faced pandemic-induced worker absences and slow supply chains in 2020 and early 2021, China's policies may have delayed such challenges until 2023. The results could hamper worldwide efforts to reduce inflation and avoid an economic slowdown this year. However, in the longer term, the new policy could be positive for China and world trade.

Market Indicators		12/31/2022
TOTAL RETURN		
US Stock Markets	4th Qtr	2022
S&P 500 Index	7.6%	-18.1%
S&P 400 Mid Cap	10.8%	-13.1%
Russell 2000 Small Cap	6.2%	-20.5%
Int'l Stock Markets		
ETF Returns in US$		
EAFE Index (Europe, Australia, Asia, Far East)	17.7%	-14.4%
Japan (MSCI Index)	11.7%	-17.7%
China (FTSE 50)	11.7%	-20.7%
Emerging Mkts Index	10.3%	-20.6%
US Fixed Income Yield	12/31/2021	12/31/2022
6 Mo US T-Bill	0.19%	4.76%
2 Yr US T-Note	0.73%	4.41%
10 Yr US T-Note	1.52%	3.88%

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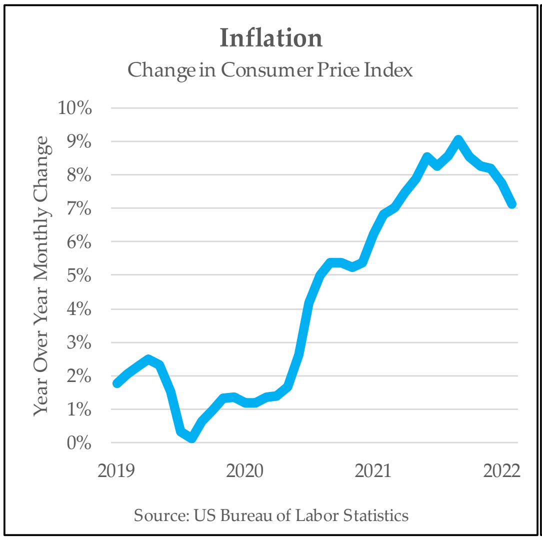
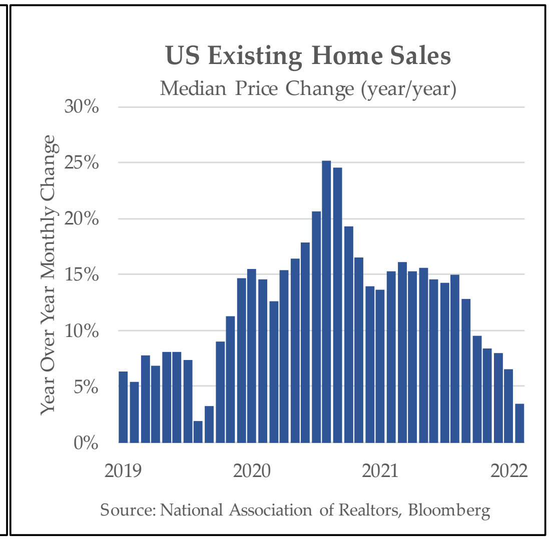
THE ECONOMY'S DIRECTION: "IT'S JUST NOT KNOWABLE"

Over the last three years, many measures of the US economy have changed at lightning speed and to unprecedented extremes as high levels of fiscal and monetary stimulus from mid-2020 through mid-2021 eased the pandemic's economic impact. In 2022, the Federal Reserve and all other major central banks raised interest rates to try to slow economic growth and reduce inflation. By mid-year, the impact of higher interest rates began nudging down the rate of inflation and the housing market started to cool.





Economic forecasts are generally based on how the economy performed in similar circumstances in the past. But many aspects of the current economic landscape—such as low levels of job seekers, persistent inflation, and an ongoing war with a nuclear superpower—have little precedent or have not been seen in many decades. Economists and investors are left not knowing if inflation will cool sufficiently in 2023 to allow the Federal Reserve to halt—and possibly begin to reverse—its interest rate increases. Many are concerned that those interest rate increases will lead to a recession this year. Economists currently offer an unusually wide range of predictions ranging from cooling inflation accompanied by continued economic growth to persistently high inflation along with a severe recession.

As we enter the New Year, even those who are best positioned to offer economic insight are uncertain. When asked at a December press conference about the likelihood of a 2023 recession, Federal Reserve Chair Jerome Powell said "I don't think anyone knows whether we're going to have a recession or not and, if we do, whether it's going to be a deep one or not. It's just not knowable."

MAINTAIN ABOVE-AVERAGE CASH LEVELS AND A FOCUS ON QUALITY

Equity markets had a difficult 2022 while the bond market had unprecedented losses. Markets were volatile throughout the year. By year-end, equities traded at somewhat above-average valuation levels and did not discount the possibility of a significant 2023 recession. Bonds appeared to offer better values than seen in many years. The New Year brings a continuation of major uncertainties: a possible recession, persistent inflation, and the economic impact of war and China's COVID policy. As we start 2023, the best position is similar to our preferred approach in 2022: above-average cash levels and a focus on quality companies with attractive and under-appreciated long-term prospects.

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