

2022 MARKET REVIEW

Inflation, the Fed, and falling stocks marked 2022

By Gene Walden, Senior Finance Editor | 01/10/2023



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In a nutshell

	Dec. 31, 2021	Sept. 30, 2022	Dec. 31, 2022	% Change quarter	% Change year
S&P 500 Index	4,766.18	3,585.62	3,839.50	7.08%	-19.44%
NASDAQ Composite Index	15,644.97	10,575.62	10,466.48	-1.03%	-33.10%
MSCI EAFE Index	2,336.07	1,661.48	1,943.93	17.00%	-16.79%
US 10-Yr Treasury	1.51%	3.80%	3.88%	N/A	N/A
Oil (West Texas Intermediate)	75.21	79.49	80.26	0.97%	6.71%

Source: FactSet, Morningstar. Performance quoted for the S&P 500 Index exclude dividends.

2022 was the year of inflation and the Federal Reserve (Fed). The combination of the two – rising prices and a tightening monetary policy – contributed to a slowing economy, rapidly rising interest rates, and significant losses in the stock market. The war in Ukraine also contributed to global economic adversity, particularly in Europe.

The Fed raised rates 0.5% in December, bringing the total increase for the year to 4.25%. The hikes have helped slow the economy, while raising rates on credit cards and other debt. Rising mortgages rates have also put a damper on home sales. Thirty-year mortgages have climbed more than 3%, from 3.11% at the end of 2021 to 6.42% at the close of 2022, according to the Fed. On the flip side, savers and investors are now earning a better return on their savings and bond investments, with yields climbing more than 2% on 10-year Treasuries.

But while inflation continues to impact the economy, the Fed's monetary tightening efforts have started to have an effect on prices. The Consumer Price Index (CPI), a common measure of inflation, was up just 0.1% over the previous month in November, according to the December 13 report from Bureau of Labor Statistics (BEA). Over the previous 12 months through November, the cost of goods and services, as measured by CPI, increased by 7.1%. That was the lowest 12-month increase since December 2021.

Excluding food and energy, the CPI increased just 6.0% over that 12-month period. The energy index jumped 13.1% during that period, while the food index rose 10.6%. However, both increases were smaller than for the 12-month period ending the previous month.

Despite the rate hikes, gross domestic product (GDP) growth was strong in the 3rd quarter, up 3.2%, after a 0.6% decline in the 2nd quarter. According to the BEA, the 3rd quarter increase was due primarily to an upsurge in exports and rising consumer health care expenditures.

Employment has remained strong, with job growth reaching 24 consecutive months in December. However, wage growth has slowed, with average earnings increasing by just 0.3% in December.

Fed Chair Jerome Powell has indicated that the rate hikes will continue until inflation is under control, with more increases expected during the first two quarters of 2023.

The higher rates have already affected the once-thriving manufacturing sector. Manufacturing activity declined in December for the second straight month after 30 consecutive months of growth, according to the Institute for Supply Management (ISM) report issued January 2. Aside from growth in the energy and metals industries, all 13 other industries reported a slow-down in activity. On the positive side, delivery times have improved, and prices have retreated modestly.

Drilling down

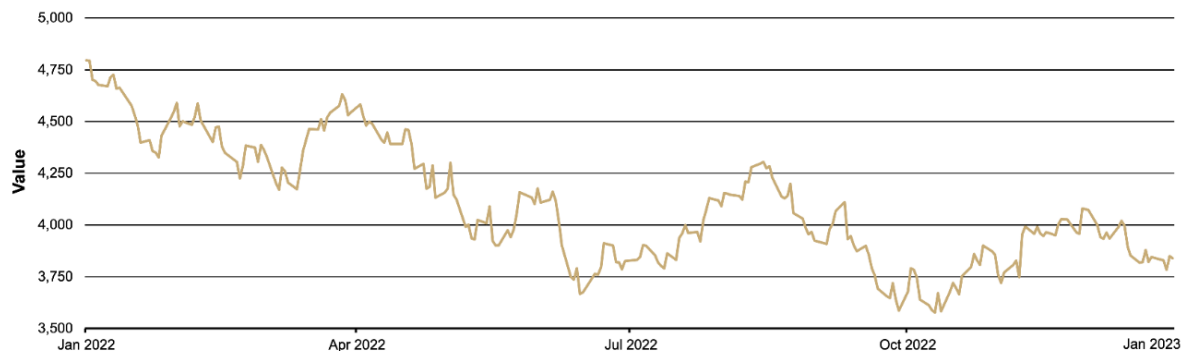
U.S. stocks down nearly 20% in 2022

Even after a 7.08% gain in the 4th quarter, the S&P 500® Index was down 19.44% for all of 2022, from 4,766.18 at the end of 2021 to 3,839.50 at the 2022 close. The total return of the S&P 500 (including dividends) was down 18.11%. (The S&P 500 is a market-cap-weighted index that represents the average performance of a group of 500 large capitalization stocks.)

The tech-heavy NASDAQ Index fared even worse than the S&P 500 in 2022. It was down 33.10% for the year, from 15,644.97 at the end of 2021 to 10,466.48 at the close of 2022. (The NASDAQ – National Association of Securities Dealers Automated Quotations – is an electronic stock exchange with more than 3,300 company listings.)

S&P 500 Index

January 1, 2022 – December 31, 2022



Source: FactSet

Retail sales up

Retail sales were up 6.5% over a year ago in November, as the economy recovered from the pandemic, according to the Department of Commerce retail report issued December 15. Total sales for the three-month period of September through November were up 7.7% from the same period a year ago. However, sales were down 0.6% from the previous month in November, as the effects of the Fed rate cut took its toll on the economy.

Building material sales were down 2.5% in November from the previous month but up 3.6% from a year earlier, while department store sales were down 2.9% for the month and down 3.0% from a year earlier. Auto sales were down 2.6% from the previous month but up 0.5% from a year earlier. Non-store retailers (primarily online) were down 0.9% from the previous month, but up 7.7% from a year earlier.

With consumers returning to restaurants and bars, sales at food services and drinking establishments were up 0.9% from the previous month, and up 14.1% from a year earlier.

Job market remains strong

The economy added 223,000 new jobs in December, according to the Employment Situation Report issued January 6 by the Department of Labor. It was the 24th consecutive month of job growth in the U.S. For the year, the economy added 4.5 million jobs.

The growth in new jobs has continued unabated despite the Fed's efforts to cool off the economy by tightening the money supply. The unemployment rate dropped to just 3.5% in December, matching a 54-year low, as more individuals entered the work force.

Although wages continued to rise, earnings increased by just 0.3% in December, with average hourly earnings increasing by just \$0.09 for the month to \$32.82. Over the past 12 months, wages have increased by 4.6%.

Energy & Utilities lead 2022 market

The Energy sector of the S&P 500 was up 65.72% in 2022 to lead all sectors, while Utilities was up 1.57%. The other nine sectors were in negative territory. Falling the furthest were Communications Services, down 39.89%, and Consumer Discretionary, down 37.03%.

The chart below shows the results of the 11 sectors for the past month, 4th quarter, and all of 2022:

S&P 500 sectors

	December 2022 returns	4th quarter 2022 returns	2022 returns
Utilities	-0.53%	8.64%	1.57%
Health Care	-1.91%	12.80%	-1.95%
Consumer Staples	-2.82%	12.72%	-0.62%
Energy	-2.94%	22.81%	65.72%
Industrials	-2.97%	19.22%	-5.48%
Real Estate	-4.83%	3.82%	-26.13%
Financials	-5.23%	13.61%	-10.53%
Materials	-5.56%	15.05%	-12.27%
Comm Services	-7.84%	-1.38%	-39.89%
Information Technology	-8.37%	4.74%	-28.19%
Consumer Discretionary	-11.26%	-10.18%	-37.03%
S&P 500 total return	-5.76%	7.56%	-18.11%

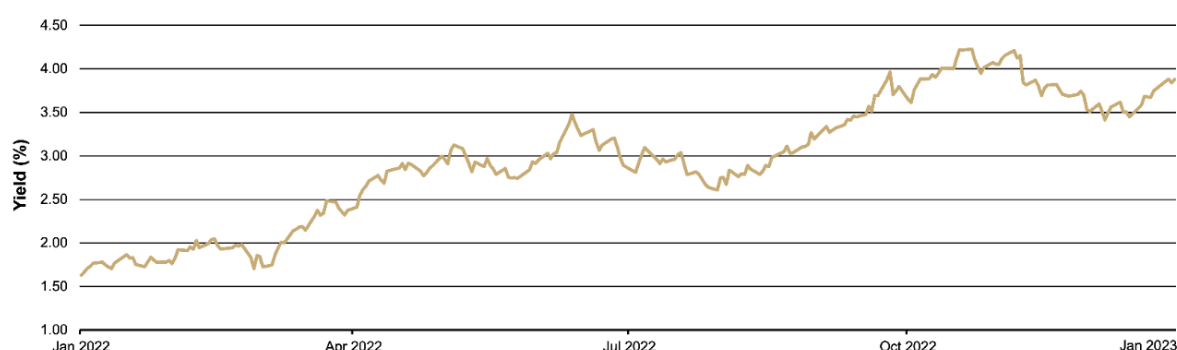
Source: Morningstar

Treasury yields rise in 2022

With the Fed raising rates persistently throughout the year, bond yields rose significantly in 2022. The yield on 10-year U.S. Treasuries climbed more than 2% for the year, from 1.51% at the end of 2021 to 3.88% at the close of 2022. For the month of December, the yield edged up 0.18%.

U.S. Treasury 10-year bond yields

January 1, 2022 – December 31, 2022



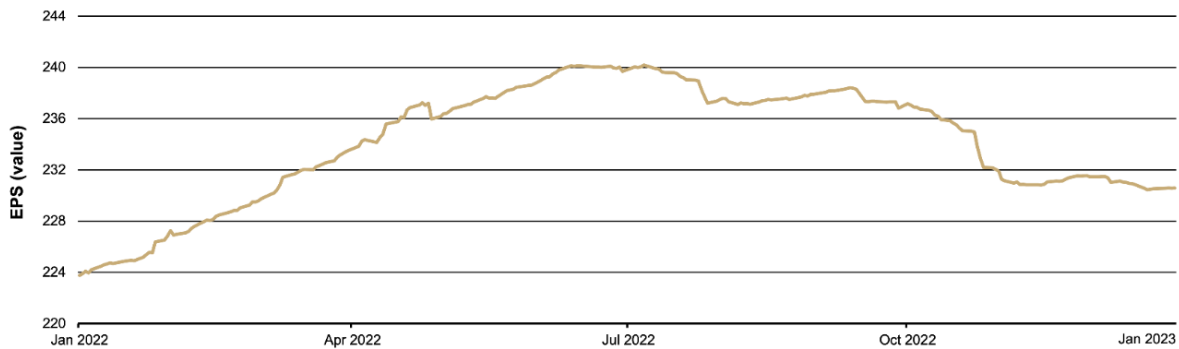
Source: FactSet

Corporate earnings falter in 4th quarter

Corporate earnings projections for the S&P 500 declined 2.63% in the 4th quarter, as the monetary tightening policies of the Fed continued to take the air out of the economy. But for the year, the forward 12-month projected earnings edged up 3.19%.

S&P 500 Index – Forward 12-month earnings per aggregate share

January 1, 2022 – December 31, 2022



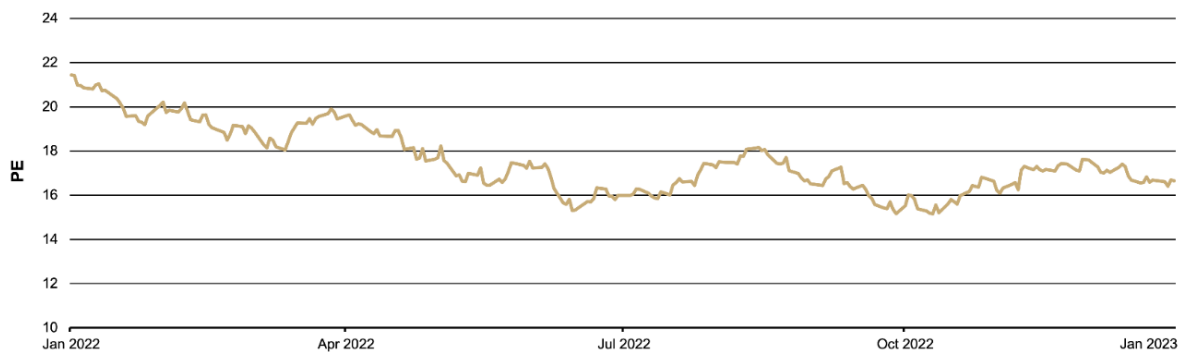
Source: FactSet

Forward P/E ratio falls in 2022

The forward 12-month price-earnings ratio (P/E) of the S&P 500 fell from 20.96 at the end of 2021 to 16.65 at the close of 2022. A lower P/E means stocks are less expensive relative to their earnings per share. But the downward trend in corporate earnings expectations has contributed to the declining valuations in stock prices.

S&P 500 Index – Forward 12-month price/earnings ratio

January 1, 2022 – December 31, 2022

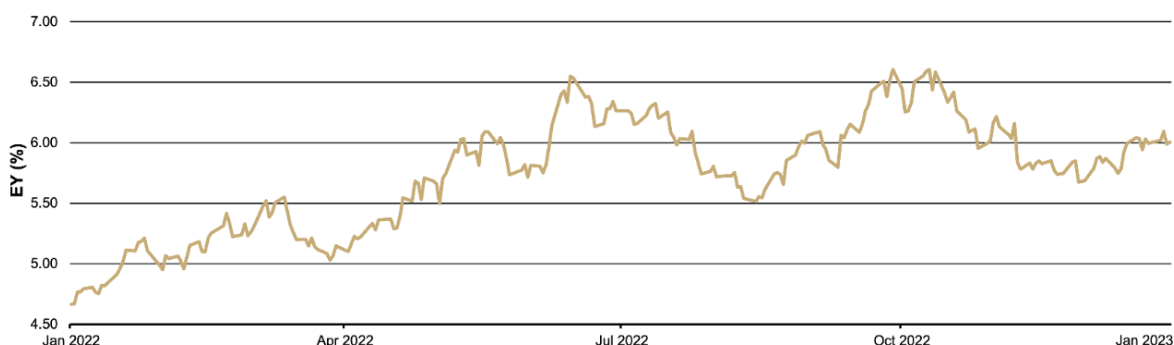


Source: FactSet

The forward 12-month earnings yield for the S&P 500, which is the inverse of the P/E, ended the year at 6.01%. That is well above the 4.77% at the close 2021. The 12-month forward earnings yield can be helpful in comparing equity earnings yields with current bond yields. Although bond yields have increased significantly this year, the 6.01% earnings yield is still well above the 3.88% market rate of 10-year U.S. Treasuries.

S&P 500 Index – Forward 12-month earnings yield

January 1, 2022 – December 31, 2022



Source: FactSet

Dollar gains vs. Euro and Yen in 2022

After reaching a 20-year high versus the Euro and Yen, the dollar retreated in the 4th quarter against both currencies. The Euro appreciated 8.94% versus the dollar for the quarter. However, for the year, the Euro has depreciated 6.15% versus the dollar, due, in part, to the impact that the war in Ukraine has had on the European economy.

Euro/U.S. Dollar exchange rate

January 1, 2021 – December 31, 2022

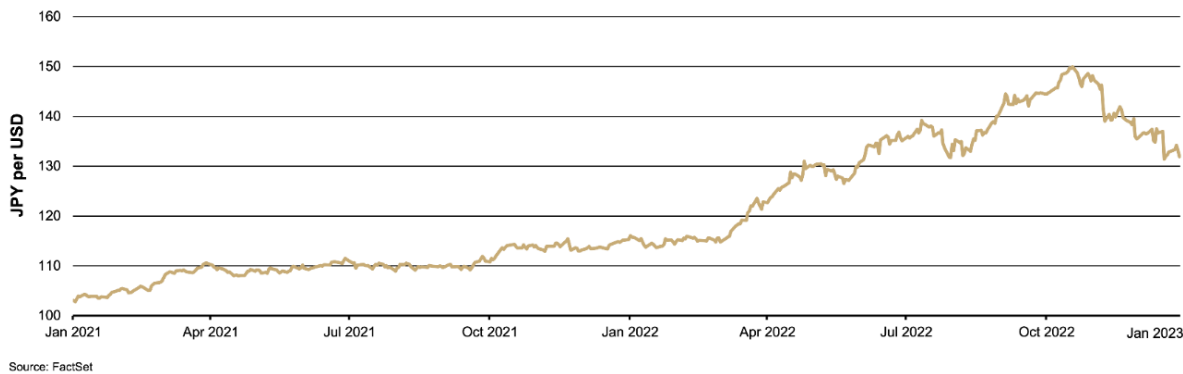


Source: FactSet

The dollar also dropped versus the Yen in the 4th quarter, depreciating 8.84% against the Yen. For the year, however, the dollar made a significant gain versus the Yen, up 14.58%. The increase in the relative value of the dollar has been attributed to the Fed's intensive monetary tightening policy versus a relatively loose monetary policy by the Bank of Japan.

U.S. Dollar/Japanese Yen exchange rate

January 1, 2021 – December 31, 2022



Oil prices stabilize

After a mid-year spike, oil prices remained fairly stable through the 4th quarter as the global economy slowed. The price of West Texas Intermediate, a grade of crude oil used as a benchmark in oil pricing, ended the 4th quarter up less than a dollar per barrel higher than its 3rd quarter closing price. For the year, the price increased 6.71% from \$75.21 at the end of 2021 to \$80.26 at the close of 2022.

Gasoline prices ended the year lower than they started. The average price per gallon dropped 16.41% in the 4th quarter to end the year at \$3.20 per gallon, which was 5.10% below the \$3.38 pump price at the end of 2021.

Oil price – West Texas Intermediate

January 1, 2021 – December 31, 2022

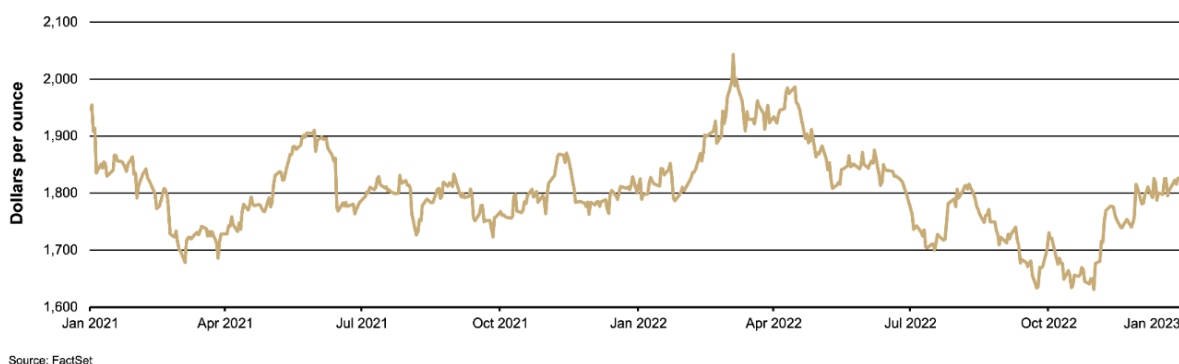


Gold prices slipped slightly in 2022

After a strong 4th quarter, the price of gold ended the year almost exactly where it started. Gold was up 9.22% in the 4th quarter to end the year at \$1,826.20 per ounce – just \$2.40 below its 2021 closing price of \$1,828.60.

Price of gold

January 1, 2021 – December 31, 2022

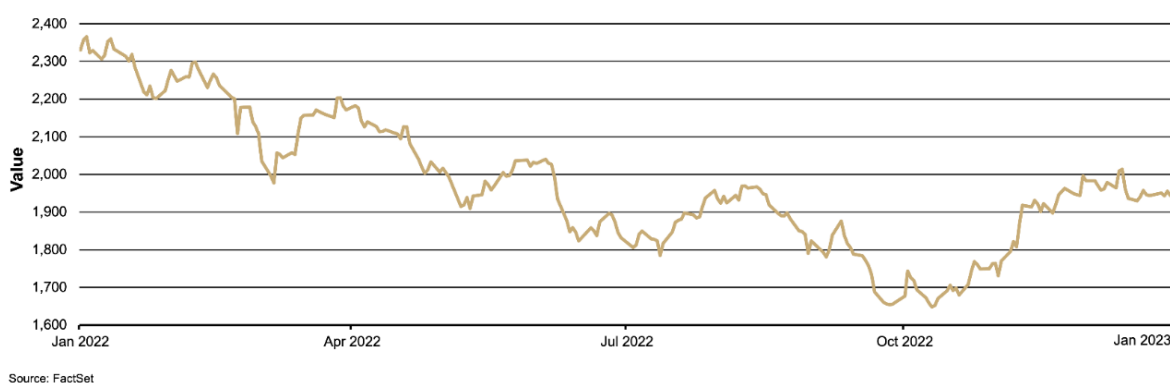


International equities finish strong

International equities had a strong 4th quarter, as the MSCI EAFE Index rallied 17.00%. But for the year, the index experienced a decline similar to the U.S. market, as economies around the world were stymied by the effects of rising inflation. For the year, the index, which tracks developed-economy stocks in Europe, Asia, and Australia, was down 16.79%, from 2,336.07 at the end of 2021 to 1,943.93 at the close of 2022.

MSCI EAFE Index

January 1, 2022 – December 31, 2022



What can you expect from the economy and the markets in 2023? See: The Thrivent 2023 Outlook, by Steve Lowe, Chief Investment Strategist.

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