



Artemis
FINANCIAL ADVISORS LLC

Market Outlook & Strategy

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Executive Summary

- Q4 2022 marked a nice break from an otherwise awful year. Both stocks and bonds had robust gains in response to seemingly good news on the inflation front, giving investors hope that central banks will be able to pause the increases and, perhaps, begin reducing rates in 2023.
- The overall U.S. equity market inched up +7.2% for the quarter. U.S. value-oriented stocks (+12.2%) far outpaced growth-oriented stocks (+2.2%) once again, and larger companies (+7.6%) did a bit better than smaller companies (+6.3%).
- The surprise winner this quarter was international developed stocks, which clocked in at a healthy +16.2%. Even emerging market returns were up +9.7%. Fixed income returns were also positive, ranging from +1.0%-6.8%.
- Despite a positive Q4, the year 2022 was a bust, with sizeable losses in both equities (-19.5% in the U.S) and fixed income, and the worst performance for the standard 60/40 portfolio in many years. The only positive category was commodities, largely due to oil and natural gas prices surging in early 2022 because of the Russia/Ukraine war.
- **2023 Outlook.** The outlook for 2023 is foggy, with little agreement amongst forecasters on how the year may shake out. But everyone agrees that inflation and monetary policy will continue to be the main drivers of asset prices over the year.
- The bull case for equities rests on the idea that inflation will come down faster than the economy slows, enabling the Fed to begin easing interest rates before too much damage has been done. If this scenario unfolds, we might expect a nice rally in the second half of the year. The most bullish case is for the S&P 500 to increase by +17% in 2023.
- The bears see the Fed as likely to keep interest rates higher for longer, even if inflation starts to ease, and that corporate earnings are due for a larger than expected downturn. Also, they believe that inflation will not come down quickly, forcing the Fed to keep rates higher for longer. The most bearish forecast we reviewed was for the S&P 500 to decline a further 13% in 2023.
- **Artemis Strategy.** We see opportunities to capture some bond price appreciation as inflation and interest rates decline in 2023. We also like emerging markets, given China's reopening and a prospectively weaker U.S. dollar. Finally, we are looking at some newer thematic opportunities that might be very relevant and attractive in the decade ahead.



2022 Q4 and Year in Review

Q4 marked a nice break from an otherwise awful year. Both stocks and bonds had robust gains in response to seemingly good news about inflation, giving investors hope that central banks will be able to pause the interest rate increases and, perhaps, begin reducing rates in 2023.

The overall U.S. equity market inched up +7.2% for the quarter, despite giving back some gains in December, after Fed Chair Jerome Powell re-iterated the Fed's commitment to fighting inflation until it reaches the Fed's target of 2.0%. U.S. value-oriented stocks (+12.2%) far outpaced growth-oriented stocks (+2.2%), and larger companies did a bit better than smaller companies. See Figure 1.

Figure 1. Asset Class Returns in USD for 2022 (%)

Asset Class	2022					Index
	Q1	Q2	Q3	Q4	Total Year	
Equities						
All Markets - Global*	(5.4)	(15.7)	(6.5)	10.0	(18.0)	MSCI ACWI IMI (net)
U.S. Large Companies	(4.6)	(16.1)	(4.9)	7.6	(18.1)	S&P 500
U.S. Small Companies	(7.5)	(17.2)	(2.2)	6.3	(20.4)	Russell 2000
U.S. Growth	(9.0)	(20.9)	(3.6)	2.2	(29.1)	Russell 1000 Growth
U.S. Value	(0.7)	(12.2)	(5.6)	12.2	(7.5)	Russell 1000 Value
Tech Disruptors**	(13.3)	(22.8)	(6.5)	10.2	(31.0)	MSCI ACWI IMI (net)
Int'l Developed Markets	(4.8)	(14.7)	(9.2)	16.2	(14.3)	MSCI EAFE & Canada (net)
Emerging Markets	(7.0)	(11.3)	(11.6)	9.7	(19.7)	MSCI Emerging Markets
Fixed Income						
All Segments - U.S.*	(5.9)	(4.7)	(4.8)	1.9	(13.0)	Bloomberg U.S. Aggregate
U.S. Treasuries	(6.5)	(4.3)	(5.8)	1.0	(14.9)	Merrill Lynch U.S. Treasuries, 7-10 Years
U.S. Short Term Treasuries	(2.5)	(0.6)	(1.5)	0.9	(3.7)	Bloomberg US Government/Credit 1-3 Year
U.S. Municipal Bonds*	(6.2)	(2.9)	(3.5)	4.1	(8.5)	Bloomberg Municipal Bonds, 1-15 Years
U.S. Corporate *	(7.7)	(7.3)	(5.1)	3.6	(15.8)	Bloomberg US Corporate
U.S. High Yield	(4.8)	(9.8)	(0.7)	4.2	(11.2)	Bloomberg US Corporate High Yield
Int'l Bonds	(6.2)	(11.0)	(8.9)	6.8	(18.7)	Bloomberg Global Aggregate ex-USD
EM Bonds	(9.2)	(8.7)	(4.1)	6.6	(15.3)	Bloomberg EM USD Aggregate
Floating Rate Bonds	(0.3)	(1.1)	1.2	1.5	1.3	S&P.LSTA U.S. Leveraged Loan 100 Index
Real Assets						
U.S. Tips	(3.0)	(6.1)	(5.1)	2.0	(11.9)	Barclays Capital U.S. TIPS
Commodities	25.6	(5.7)	(4.1)	2.2	16.1	iPath Bloomberg Commodity
U.S. Real Estate Income*	(6.6)	(8.9)	(6.3)	1.1	(18.8)	Fidelity Series Real Estate Income Composite
Global Real Estate - REITS	(3.9)	(17.1)	(11.2)	7.1	(24.3)	S&P Global REIT TR

*Used to create Artemis portfolio benchmarks

** XT, ARKG, ARKQ were sold in Q1 and replaced with ROBO and PGINX. SKYY was sold in Q4 and replaced with SHSSX
Current lineup is equal-weighted CIBR, ROBO, PGINX and SHSSX



The surprise winner this quarter was international developed stocks, which clocked in at a healthy +16.2%. Falling energy prices due to Europe's unusually mild winter, and dollar depreciation of about 9% relative to the euro, gave a real boost to returns in dollar terms. After a very tough third quarter, even emerging market returns were up a healthy +9.7%, helped by China's relaxation of its zero-Covid policy and a weaker U.S. dollar.

The other nice surprise was the outperformance of our latest lineup in our technology innovation sleeve (which is evolving to become a more heterogeneous 'best ideas' thematic sleeve – more on this in the last section of our report). This allocation is now a mix of clean environmental and healthcare opportunities (mix of all segments of the healthcare industry), cybersecurity and robotics. Together, this exposure returned +10.2% during the quarter, led by our environmental opportunities fund (+15.7%).

Fixed income (a.k.a. bond) returns were also nicely positive for a change. (See Figure 1 again.) International bond returns outpaced U.S. bond returns, in large part due to currency movements. In the U.S., high yield and municipal debt returned +4.2% and 4.1% respectively, with investment grade credit not far behind at +3.6%. All three outperformed U.S. Treasuries, which rose around +1.0% (both 2-year and 10-year Treasuries).

Finally, real assets such as real estate and commodities lagged but were still positive at +7.1% and +2.2% respectively.

2022 in Review

Despite nicely positive Q4 returns, the year ended in negative territory across the board, with the exception of commodities and floating rate bonds. The U.S. equity market was down -19.5% on the year, matching emerging market equity returns (-19.7%) and underperforming international developed market returns (-14.3%). The spread between value-oriented stocks (-7.5%) and growth-oriented stocks (-29.1%) was large and marked a stark reversal from recent years, with some growth-oriented companies such as Meta, Amazon, Alphabet and Tesla experiencing dramatic declines in their share prices. So-called meme stocks and cryptocurrencies fared even worse. Bitcoin, for example, ended the year at about \$17,000, from a peak of around \$67,000 in late 2021, proving that it is neither a unit of account nor a store of value (and has never been a useful means of payment). See Figure 2 (next page).



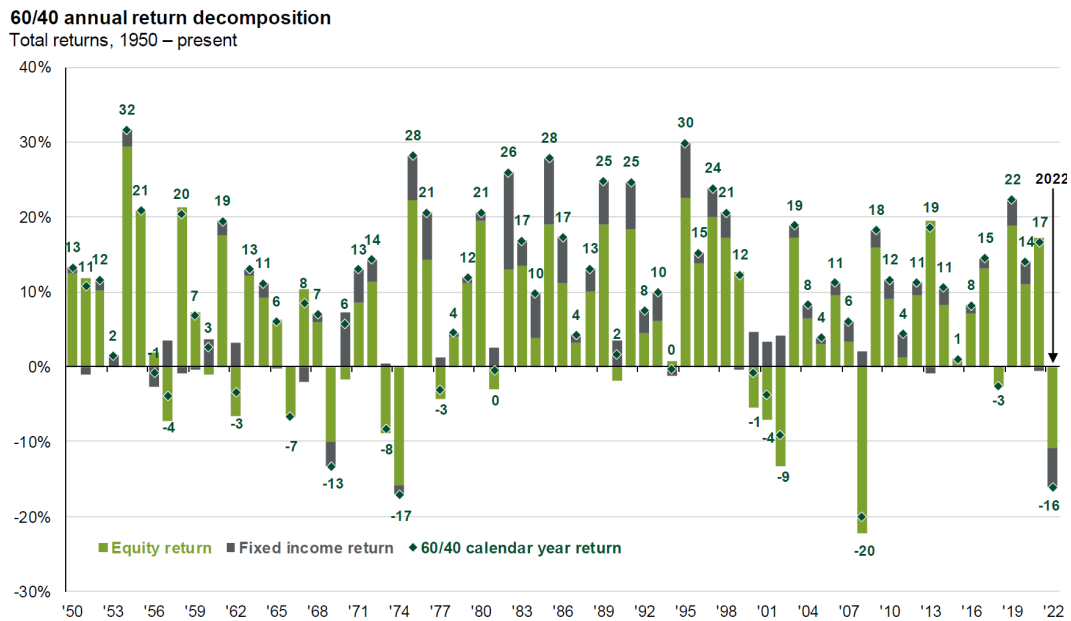
Figure 2. Bitcoin Price in Perspective



Source: Google finance

From a financial perspective, perhaps the biggest disappointment was the failure of the so-called balanced portfolio – one that holds stocks and bonds. See Figure 3 (below). Such an outcome is thankfully rare as shown in the chart and tends to be followed by sharply positive returns in the succeeding year (hope for 2023?).

Figure 3. 60/40 Returns (S&P 500 Total Return and Bloomberg U.S. Bond Index).





2023 Outlook

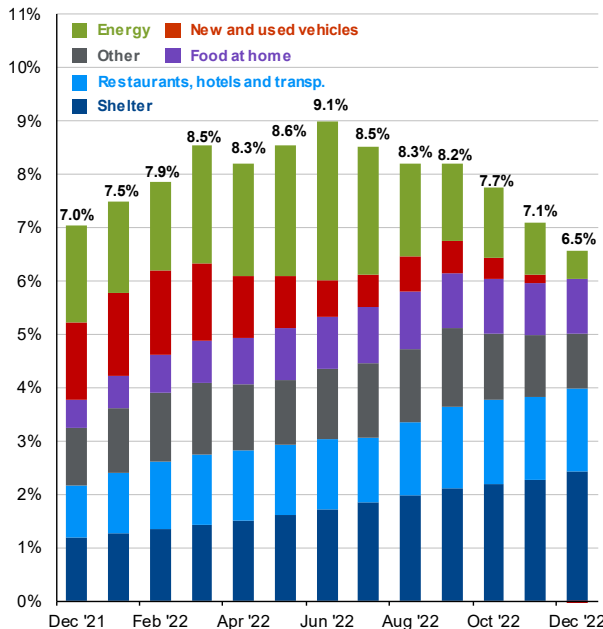
Having reviewed quite a few Wall Street market outlook reports in the last month, the one thing that stands out is how divided the Street is over the prospects for 2023. But everyone agrees that inflation and monetary policy will continue to be the main drivers of asset prices over the year.

There is also a consensus that inflation is falling and will continue to do so in 2023. As shown in Figure 4, inflation appears to have peaked in June and has been falling ever since. Importantly, longer-term inflation expectations have also come down and have stabilized slightly above 10-yr averages.

Figure 4: Recent Inflation Trends in the U.S.

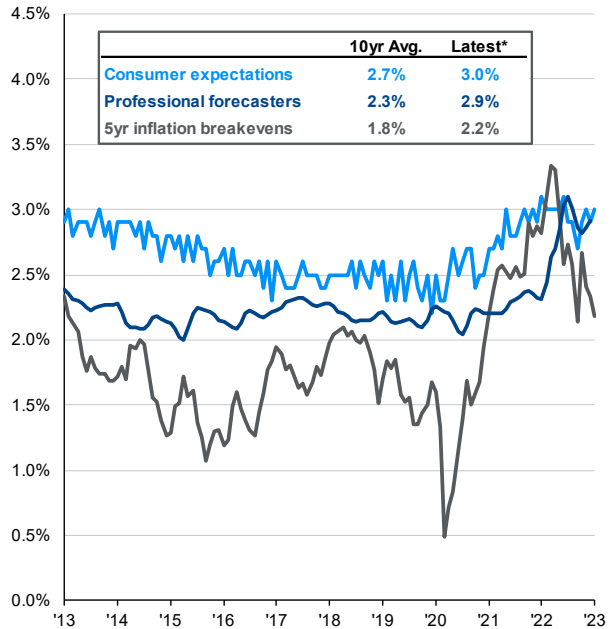
Contributors to headline inflation

Contribution to y/y % change in CPI, not seasonally adjusted



Inflation expectations, next 5 years

% change vs. prior year, non-seasonally adjusted



Source: Bureau of Labor Statistics, FactSet, Federal Reserve Bank of Philadelphia, University of Michigan, J.P. Morgan Asset Management.

The inflation optimism is not unfounded as supply chain woes and Covid lockdowns are largely behind us, energy prices have fallen, and the Federal Reserve has reduced the money supply and raised interest rates at a breathtaking pace from 0% in December 2021 to 4.25% (with a highly debated terminal rate of around ~5.0%, +/-). These increases are



already slowing the economy and reducing price pressures. The trajectory for inflation from here is unknown and another supply shock could foil progress made thus far, but at the moment all signs are pointing toward a continued decline in inflation, especially once current shelter deflation shows up in full in the official numbers. (Shelter is the largest component in inflation indices but the formula to calculate the changes uses trailing figures, so it has a lagged effect on inflation.)

Where Wall Street is divided is how rapidly inflation is going to decline from here and, importantly, when the Fed might start easing its interest rate policy. The bullish camp believes that inflation is going to fall faster in the first half of 2023 than the economy slows in response to higher interest rates. This is the so-called “soft landing” scenario, which allows the Fed to pause (stop raising rates), and ultimately pivot (begin to cut them) such that the economic slowing is shallow and brief. Some in this camp argue that even if the Fed waits to cut interest rates for a time, markets will inevitably front run prospective easing and start rising (which appears to be the reason the market has been rising of late). The most bullish forecast is for the S&P 500 to close out 2023 at 17% higher than it ended in 2022, led by a rebound in technology and financial stocks.

The bears tend to argue that inflation is more likely to be sticky in 2023 with resilient consumers continuing to spend in a still robust labor market. They are also quick to point out that China is about to re-enter the global market with huge pent-up savings after three years in some form of lockdown, which will put upward pressure on food, energy, and other commodity prices. They also argue that even if there is decent progress on inflation, the Fed is highly unlikely to ease very quickly, having made that mistake in the 1970s and leading to back-to-back recessions. This camp believes we are most likely in for another bad year in capital markets. The most bearish of forecasters in this camp suggest the S&P 500 might fall a further 13% in 2023.

Like many, we at Artemis suspect the market will end somewhere in the middle of these forecasts. We believe that growth is due for a bit more of a slowdown than a soft landing, largely due to the Fed’s stated determination to prioritize hitting its inflation target rather than maintaining full employment. But we are also not in the camp that the world is in for a deep recession and 6% unemployment as some have predicted. Interestingly, this middle ground view seems to be percolating at the Davos conference underway as we write, an encouraging sign.



Artemis Strategy

Given our view on the outlook for 2023, we have several ideas that we are in the midst of researching and implementing to position portfolios going forward. Most immediately, we see an opportunity to increase duration in our fixed income portfolios.¹ An environment of falling inflation and slowing economic growth is favorable for bond price appreciation because falling inflation will temper the Fed, and slowing growth typically leads investors to favor bonds over stocks.

We also see an opportunity in emerging markets, largely due to China abandoning its zero-Covid policy and starting to provide more fiscal support to its economy, coupled with further U.S. dollar depreciation in 2023. As already discussed, early indications are that once the avalanche of Covid-19 infections runs its course, Chinese consumers are going to unleash their pent-up demand, not a small sum after nearly three years in some form of lockdown. However, we plan to tread carefully as the ongoing contraction in the country's property sector and U.S. chip export restrictions are creating headwinds for domestic growth.

Also as mentioned earlier, we are in the midst of 'reimagining' our technology innovation sleeve. For those of you who follow our portfolio moves, we initiated exposure to the wave of technological innovation underway in the U.S. and abroad (mainly China) several years ago and invested in a very diversified range of technology companies, some of which are not yet profitable. However, the stock prices of many of these companies rose rapidly and were subsequently battered down by rising interest rates and we believe have lower appeal in the current (some say pre-recessionary) environment. We were not blind to this outcome and so have cut most allocations over the last year or so and repositioned. To that end, we exited a few of the more speculative bets in favor of more established companies in both healthcare and clean technology, two very durable trends for the next decade.

Our current, albeit smaller, lineup is performing much better in today's environment and even outperformed U.S. equities in Q4. This year we seek to continue to broaden our approach to thematic investing to better capture a wider range of opportunities relevant to the decade ahead.

¹ Duration is a measure of how sensitive the price of a bond is to interest rate changes. The longer the duration, the more the price of the bond will increase for any given decrease in interest rates.