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February 8, 2023

The Ups and Downs of the Stock Market

The headline on page one of The Wall Street Journal on January 1st, 2023, was dire: "Stocks Log Worst Year Since 2008." The stock market, as represented by the S&P 500 index including dividends, fell 18.1% for the year. Ouch! What the Journal did not mention was that the S&P 500 index had done especially well during the preceding three years: 2019 +31.5%, 2020 +18.4%, and 2021 +28.7%. In fact, the yearly return for the S&P 500 over the past 5 years ending 12/31/22 was 9.4% per year despite the poor 2022 results. The 10-year return was an even better 12.6% while the 20-year return was 9.0%. Furthermore, these returns all occurred while inflation was low by historical standards. In short, while the stock market did poorly in 2022, it continues to be a very good place to invest for the long-term.

Why did the stock market have a bad year in 2022?

There are many reasons why the stock market did poorly last year. First, the stock market rarely goes up in a straight line. In fact, since the modern S&P 500 index was created in 1957, the stock market has only gone up by double digits for more than three years straight once when it went up by double digits four years straight during the so-called "tech bubble" in the late 1990's. Thus, by historical standards, the stock market was vulnerable to bad news in 2022.

The bad news to which the stock market reacted was that heightened inflationary trends, which began during the Covid shutdown and were thought by the Federal Reserve Bank to be only "transitory," continued to endure as the year unfolded. Exacerbating this situation was the inflationary impact of the war in Ukraine. The Federal Reserve Bank had to play catchup.

In response to the inflation threat, the Federal Reserve Bank raised interest rates 7 times in 2022 from 0.25% to 4.5% (the Fed has raised rates once in 2023 to 4.75%). The Fed also reduced its balance sheet, which had grown significantly during the Covid lockdown. The exact impact of these two steps on our economy remains unclear. Some believe that most of the effects of the Fed's actions have already affected the economy while others believe we have not seen their full impact.

What we do know is that inflationary trends have decelerated. In response, the Fed's interest rate increases have also slowed. Still, inflation continues to run well above the Fed's 2% goal. Also, there is concern about the inflationary impact of our tight labor market (the January 2023 jobless rate was the lowest we had since 1969), the reopening of China's economy after the termination of their Covid lockdown, and the on-going war in Ukraine.

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Secure 2.0 and its impact on you

Congress recently passed what is known as the Secure Act 2.0. This builds upon a previous law (Secure 1.0) passed in December 2019. The legislation contains many different provisions. The provisions that are most likely to impact you include:

-- For those of you who were born between 1951 and 1959, your first required minimum distribution will be due when you turn 73 (Secure 1.0 raised this age from 70 ½ to 72).

-- For those born in 1960 or later, your required minimum distribution will start when you turn 75.

-- For those who use the Qualified Charitable Distribution provision to make charitable contributions in lieu of Required Minimum Distribution payments, the maximum amount (currently $100,000 per year) will now be indexed to inflation starting in 2024.

-- There is also a provision expanding the options of surviving spouses when they inherit an IRA from their spouse.

What's Next?

After a tough 2022, the stock market has begun 2023 with a strong rebound. The S&P 500 index, including dividends, climbed 6.3% in January. There are two events that could derail the current stock market rally.

First, the current financial markets' consensus, as shown by the pricing of interest rate futures contacts, is that inflation has been brought under control and that the Federal Reserve Bank will be lowering interest rates by the end of this year. The Fed does not agree with this rosy forecast and is telling the financial markets that interest rates are likely to go higher and stay higher than the current financial market consensus believes. If the Fed's forecast is correct, the stock market could weaken.

Second, the debt ceiling issue remains unresolved. According to Treasury Secretary Janet Yellen, the United States hit its debt ceiling limit in late January. However, through "extraordinary measures" the Treasury Department is still able to pay our nation's debts for several more months (current estimates suggest these extraordinary measures will postpone the deadline for avoiding financial default until "early June"). The new Republican majority in the US House of Representatives has promised to use this issue to create a showdown with the President and US Senate in an effort to reduce overall government spending. A similar debate occurred during the summer of 2011 which resulted in both a large short-term drop in the stock market and a downgrade in our nation's credit rating. How things play out this time remains unclear, but it could result in significant stock market volatility before things are resolved.

Regardless of what happens in the short run, I remain bullish on our economy and our stock market in the long run. America has faced adversity throughout its history, yet our economy has continued to grow significantly over time. I see no reason to dim my optimism.

Thank you for your confidence.