

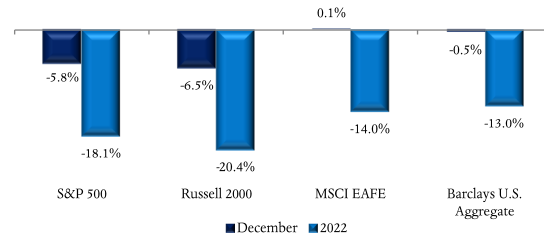


2022 YEAR IN REVIEW

2022 was a challenging year for investors. The war in Ukraine and the battle, by global central banks, against inflation negatively affected financial markets. For the year, the S&P 500 equity index declined -18.1%, while the tech-heavy Nasdaq composite dropped -32.5%, and the small capitalization Russell 2000 benchmark ended down -20.4%. The most resilient stocks were the quality constituents of the Dow Jones Industrials, which fell -6.9%. Overseas stocks also declined, as seen by the MSCI EAFE index's -13.9% total return. European stocks fared a bit better than average, with the Stoxx 600 retreating -9.9%. In Asia, the MSCI China Index displayed tremendous volatility, declining -22.0% in 2022, to trade at half its 2021 peak, despite a +34% rally off of the October lows, driven by the country's zero Covid policy. Japanese stocks in the Nikkei 225 were resilient, falling -7.3% in 2022, flattered by the sharp -16% decline in the Yen against the US Dollar, boosting the local currency value of foreign earnings.

Arguably the most painful move in markets was the sharp decline in bond prices. On account of runaway inflation, global central banks raised interest rates 284 times, far higher and more quickly than investors had expected. As a result, the 30-year US Treasury Bond declined -35%, the most in over a century, while the benchmark Barclays US Aggregate index fell by -13%, marking the largest annual loss since its 1979 inception.

Commodities were the best performing asset class for the second consecutive year, rising +16.1%, led by a 90% rise in natural gas prices. WTI crude oil spiked as high as \$125/bbl early in the year, driven by the Russo-Ukrainian war. A gradual normalization of supply ensued, aided by the release of 381 million barrels of the US's strategic petroleum reserve (to the lowest level since 1984), driving the price to \$80/bbl at year-end.



The energy market will now attempt to balance between the pick-up in demand from China's economic reopening, and the risk of recession in the developed world, with OPEC playing the role of moderator.

GEOPOLITICS

Future historians may come to regard 2022 as a pivot in history, marking the end of one era and the beginning of another. Major war returned to Europe, as Russia invaded Ukraine. Western nations rallied behind Kyiv, which initially lost much ground but then turned the tide against Russia. Unfortunately, the war of attrition continues, with no end in sight to the humanitarian crisis. 2022 was also the year that ended a four decade streak of low inflation. The great power competition between China and the United States continued, with both sides intent on winning. Beijing's militarization of the South China Sea, its support for Russia's invasion of Ukraine, its efforts to intimidate Taiwan, and its rampant theft of intellectual property led America to deny it access to advanced semiconductor chips and technology essential to develop artificial intelligence, among a host of other actions. Climate change has intensified, with once rare weather events becoming commonplace. The COP27 meeting ended with a loss and damage agreement but no breakthroughs in cutting emissions. Instead, the share of carbon dioxide in the atmosphere continued to rise in 2022. While politics in the US remained divided post mid-term elections, Latin America continued shifting to the left. Turmoil rocked Britain,

which shuffled through three prime ministers in just two months and lost the world's longest reigning monarch. Thankfully 2022 was a year in which the COVID-19 pandemic, and the associated social distancing, eased in many countries.

UNITED STATES

The pandemic-led economic shock necessitated significant monetary stimulus by the Federal Reserve in order to soften the impact, compounded by fiscal support by the government. In the aftermath, as demand rose, prices increased, and inflation crossed desirable thresholds (US CPI peaked at 9.1% in June, a 40-year high). Fast-forwarding to December, the Federal Reserve raised its policy rate, for the seventh time in 2022, by 50 basis points, for a total annual increase of 4.25%. This was the most aggressive rate hike cycle in four decades and marked a significant shift from the Fed's earlier belief that inflation would be transitory. Short-term interest rates are now expected to peak between 5% and 5.5%. In addition, the Fed began reducing the size of its \$9 trillion balance sheet by selling treasuries and mortgage backed securities, otherwise known as Quantitative Tightening (QT). By year-end \$400 billion of assets had been sold, with a current annual run rate of \$1.14 trillion. As a result of persistent (albeit downward trending) inflation and rising hawkishness by the Federal Reserve, the Conference Board forecast that 2022 GDP growth will come in at 1.9%, 2023 will slow to zero percent, and 2024 growth will rebound to 1.7%. The one area of the economy that has thus far refused to bow down to the Fed, the labor market, still remains resilient. The record low 3.5% unemployment, and robust wage growth, likely have to reverse before the Fed pauses its tightening.

EUROPE

Following in the footsteps of its Covid-19 induced support, the EU instituted a €750 billion fiscal stimulus program to assist Ukraine in its struggle against Russia. The war and associated sanctions also triggered a European energy crisis, given the union's reliance on Rus-

December 2022 Economic Statistics

	Dec-22	Dec-21	Dec-20
Federal Funds Target Rate	4.25 - 4.50%	0 - 0.25%	0 - 0.25%
Consumer Confidence Index	108.3	115.8	88.6
Manufacturing PMI Index	48.4%	58.7%	60.7%
Unemployment Rate	3.5%	3.9%	6.7%
JPY/USD	131.11	115.08	103.24
USD/EUR	1.0702	1.1368	1.2213
Gold/oz.	\$1,824.40	\$1,828.39	\$1,896.49
Oil (WTI)/bbl	\$80.26	\$75.21	\$48.52

sian natural gas. Against this backdrop, the European Central Bank was very reluctant to raise interest rates, even in the face of record inflation, which peaked at 10.1% in November. Nevertheless, the ECB and the Bank of England both raised their policy rates by 50 bps in December, to 2.5% and 3.5% respectively, in an effort to quell inflation, with several more rate hikes telegraphed for 2023. As a result, the European Commission projects Eurozone Gross Domestic Product (GDP) will have grown 3.2% in 2022, slow down to 0.3% growth in 2023, and re-accelerate to 1.5% in 2024.

ASIA

After an extended period of confrontation, newly re-elected Chinese leader Xi Jinping signaled a desire to improve US-China relations. China also embarked on a reopening of its economy and borders from stringent Covid-19 management. Borrowing from the experience of other major economies, the rise in infections is likely to put downward pressure on domestic demand in the near term. Thereafter, the potential for consumption and investment recovery is likely to stimulate Chinese and other developed economies in 2023.

Japan succeeded in escaping from its multi-decade deflationary spiral as inflation hit 3.7%, the highest level since 1981. The stigma of past failed efforts, and still stagnant wages, had led the Bank of Japan to maintain its ultra-loose monetary policy. Yet, market pressure on the government bond market and a weaker Japanese Yen meant the central bank needed to make some technical adjustments to reduce market distortions.

Finally, on December 20 the central bank made the subtle first step towards normalizing its monetary policy, widening the permitted trading range for Japanese 10-year government bonds to 0.5% from 0.25%. As a result the Yen spiked against the US Dollar, hitting 151 for the time since 1981 (note this was the same year as the previous peak in Japanese inflation), before retracing a fair amount.

OUTLOOK

2022 will be remembered as a year when markets priced in the unpleasant consequences of higher inflation and higher interest rates. Developed market central banks will face a more challenging economic backdrop in 2023, which raises the risk of policy errors. Headline inflation should continue coming down as food and energy prices moderate, combined with favorable high base effects from 2022. Meanwhile, prices for cars, health care and electric appliances are declining on an absolute basis, as post-Covid supply disruptions normalize. However, the shelter component of CPI, which adjusts with a 12-18 month lag, and service oriented inputs, which tend to be stickier, create an uncertainty as to how quickly prices will drop toward the Federal Reserve's 2.0% inflation target. In the Fed's December Summary of Economic Projections, the rate setting committee forecast inflation falling to 3.1% in 4Q 2023, and 2.5% in 4Q 2024. These above-target inflation levels may require the central bank to keep interest rates higher for longer.

Economic growth momentum is slowing. The delayed effect from tightening monetary policy is starting to appear in the form of cooling demand, which should accelerate as the year progresses. Corporate spending and the housing market are already experiencing some contraction in the US, and they have been responsible for 11 out of 12 recessions since World War II. But the European Union may be the first developed economy to enter recession, despite its success in stocking up sufficient natural gas for the winter months. Central bankers have the unenviable task of stifling demand just enough to bring inflation down. Over-tightening will likely lead to suffering for both households and businesses, especially given that the

full impact of peak interest rates is still to come.

The difficult financial market performance of 2022 sets a more constructive backdrop for 2023. At the start of last year, the valuation of growth stocks had reached frothy levels, with the MSCI World Growth Index trading at 31x expected earnings, compared with only 14x for the MSCI World Value Index. By the end of the year, the valuations had fallen to 21 and 12x respectively. Value stocks were supported by the outperformance of more defensive sectors such as healthcare, consumer staples and utilities, along with the strong returns for energy stocks. Looking ahead, with recessionary conditions expected, and markets already starting to anticipate a decline in inflation, and in-turn a peak in interest rates, there appears to be light at the end of the tunnel.

Fixed income markets have done an abrupt about face over the past year, with the US Aggregate bond index marking the largest annual loss since its 1979 inception. Rising interest rates and wider credit spreads have led to healthy, and in some cases robust, opportunities for income seeking investors, featuring mid-to-high single digit yields. Positive real returns over a multi-year time frame should finally be possible, to the benefit of savers.

Financial markets are better positioned than a year ago, but there are still potential risks that may lead to periods of heightened volatility and thus prudence in asset allocation is advised. Credit markets have rapidly revalued and offer some compelling opportunities, with the potential for outsized returns should a dislocation occur. Commodities, especially energy and agriculture related ones, should benefit from supply shortages stemming from extended periods of underinvestment and associated bottlenecks. For long-term investors, seeking to capitalize on disruptive technology trends, there are opportunities in the food and beverage, edu-tech and cybersecurity sectors. We also wish to reiterate the growth prospects of the disruptive companies in our Nordic Technology and Innovation Fund, whose valuations have contracted meaningfully.

Wishing you and your families a happy, healthy and prosperous 2023!

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Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal.