THE GORTON
WEALTH MANAGEMENT GROUP
of Wells Fargo Advisors

2022 Annual Review

January 2023

An update of performance, trends, research, and topics for the long-term investor

Relevant rates of return a/o 12/31:	2022	vs. 2021
Russell 1000® Growth Index: Stocks within this index include: Apple, Microsoft, Amazon, Alphabet A, Tesla	-29.14%	+27.60%
Russell 1000® Value Index: Stocks within this index include: Berkshire Hathaway B, Exxon, Chevron Johnson & Johnson, JP Morgan	-7.54%	+25.16%
Bloomberg U.S. Agg Bond Index:	-13.01%	-1.54%
S&P 500 Index:	-18.11%	+28.71%
Russell 2000® Value Index:	-14.48%	+28.27%
MSCI EAFE® Index:	-14.45%	+11.26%

Long Term Historic Returns, compounded annually (1970-2021)[1]

- Small Value +13.9%
- Large Value +10.5%
- Small Growth +9.7%
- Large Growth +9.7%

Growth and value stocks in this example are represented by the Ibbotson Associates Growth and Value Indexes for 1970–1997 and the Morningstar Style Indexes thereafter. The Ibbotson Associates Growth and Value Indexes are calculated based on data from CRSP US Stock and Index Databases, the Center for Research in Security Prices (CRSP®) and the University of Chicago Booth School of Business. Used with permission.. The data assumes reinvestment of income and does not account for transaction costs or taxes.

Practice news:

Our team is continuing to grow and develop to improve our service and support. Both Brian and Mike will be delivering annual reviews this year to streamline and expedite the process for you. Brian also sits on the research committee to help gather and process information to support the management of your portfolios. Jonathan will be starting the Financial Advisor training program in the Spring and is joining the research committee as he goes through the program. Therefore, we are in the process of adding a new assistant to help Emma with daily operations.

"Only when the tide goes out, do you discover who's been swimming naked."

—Warren Buffett[2]

2022 – A return to quality and value

As you review the value and growth indexes on the left you may have noticed that the "boring" value companies significantly outperformed in 2022. The new and exciting growth companies that many investors dove into, retreated. We have previously talked about value and growth cycles in the markets, and it looks like this year's pull back may have ended a 13-year run for growth stocks. The last value cycle was from the mid-90s to the mid-2000s and ended as interest rates dropped significantly during and post the financial crisis. As we watch the Fed increase interest rates from their historical lows we may be in for another period where value begins to outperform growth.[1]

Forecasting and predicting the future of markets.

You have likely watched or read about the future of our economy in the media. If you have then you "know" we are going to have a recession next year.... Since this is the most anticipated recession in recent history, we thought we would revisit the accuracy of forecasting. When forecasting articles are written you often see headlines stating that you are missing out on the holy grail of markets, or the economy and markets are about to crash and you better run for the hills. These articles are designed to capture your attention as your readership allows them to sell more ad space.

There use to be a writer in Forbes years ago, Ken Fisher, who would wait until all the forecasts had been made and a consensus formed before making his forecast. He knew that market consensus would rarely occur and would make his market predictions on whether he thought things would be better or worse than the consensus. As we embrace Ken's philosophy we worry when any of our views of the future is in line with the consensus and wonder what we could be missing in the big picture.[3]

Below we will look at the last couple of years of forecasts and what actually happened in the markets.

	2021[4]		2022[4]		2023[4]	
	Consensus	Actual	Consensus	Actual	Consensus	Actual
US GDP/Recession*	4.2%	5.9%	3.9%	TBD	0.4%	TBD
Inflation	1.8%	4.7%	3.9%	6.5%[5]	3.8%	TBD
S&P 500	$4,044.44	$4,766.18	$5,264.47	$3,892.09	$4,505.92	TBD
Crude Oil $/BBL	$45.75	$75.21	$70.22	$80.26	$87.45	TBD

* Recession = 2 quarters of negative GDP.

Interesting as you can see how far off the 2022 forecasts were from what actually occurred. Some blame it on the Ukraine war, but I think most of the cause should go to the Fed raising rates to try and tame inflation. This triggered a market reaction that caused many of the very overpriced, popular stocks and cryptocurrency to drop precipitously in value. That bubble bursting was reflected in the Russell 1000® Growth Index highlighted in the left column on Page 1. Instead of forecasting the future, we try to look at valuations and stay away from high multiple, overvalued companies relative to their profitability and growth rate and look to buy those that look reasonable relative to both metrics. And of course, be patient and forget market predictions.

Interest rates

Interest rates have been falling for 40 years, creating a great tailwind for bonds. This tailwind ended abruptly in 2022 with bonds faring almost as poorly as stocks with the index down 13.1%.[6] The protection bonds have historically provided for portfolios in down markets did not work in 2022. We have not felt comfortable with the low yields in bonds since the financial crisis and tended to underweight them in portfolios for that reason. With rates rising substantially last year it may be time to revisit this asset class.

What were the surprises in 2022?

- The Fed followed through on its monetary tightening and continued to raise rates to combat inflation. There have been a lot of rate raises discussed in the last decade with little follow through. Although we expected rates to rise, it was the speed and increment that surprised us.
  - Fed funds rate started the year at 0%-0.25% and ended the year at 4.25%-4.5%.[7]
- Covid is still with us.
- Obviously, the Russia Ukrainian war was unexpected as we ended 2021.
  - But the real surprise was the tenacity of the Ukrainians to fight. What had been predicted as a war that would last only a few days is still going on and the Ukrainians seem to still have fight left, but can turn on a dime as the Russians move to using air warfare with drones, missiles and bombs.
- People not coming back to work.

- Companies having significant difficulties in finding employees and the subsequent unemployment rate staying low, in defiance of the slowing economy.

What did not surprise us in 2022:

- Precipitous drop in value and failures of select crypto tokens.
  - Subsequent failure of crypto trading firms.
- Steep drop in popular tech stocks, just never know the peak, the trigger or the timing (bubble bursting)
- Inflation peaking and starting to fall, coupled with interest rates rising.
- The silver lining was provided by the commodities index, up 15.8% in 2022, led by energy related stocks.[8]

What we want to pay attention to in 2023:

- With bond yields in the 5% range, this may make more sense for portfolios than the 0%-1% range we have seen over the past number of years.[9]
- If inflation averaged 8% last year, this is still a negative real rate of return of -3%.
- Stick with our overweight in energy.
- Look for bargains created by the fallout in the popular stocks, focusing on the tech industry.
- Consider investing internationally with the thought that the dollar has been very strong, gaining 50% against the Euro over the last 14 years from a peak exchange rate in 2008 of 1.6 Euros to the dollar, which ended this year at 1.06 Euros to the dollar. If the dollar weakens, it makes foreign holdings more valuable. The strong US dollar exchange rate is one of the primary reasons the international markets have performed so poorly over the last 10 years trimming 5% from average annual returns.[10]
- Interest rates to rise with a target for the 10-year treasury of 3.5%-4% vs. 3.6% to end 2022.
- Speed and breadth of deglobalization further destabilizing the world.

What we worry about:

- Recession and how deep it will be coupled with higher unemployment.
- Inflation being more persistent and the Fed raising rates more than expected.
- Russia doing something desperate as they seem to be struggling in the war.
- And still China, although less so, as they have watched NATO come together to support Ukraine in the war.
- Middle East, especially Iran, destabilizing the world.

As we continue to refine our practice, we are always looking for successful individuals like yourself to share our expertise in helping them realize their financial goals. There is no better compliment to our business than a referral and we would love the opportunity to share who we are and what we specialize in with individuals recommended by you.

We remain grateful for your trust, loyalty, and friendship!

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Investing in fixed income securities involves certain risks such as market risk if sold prior to maturity and credit risk especially if investing in high yield bonds, which have lower ratings and are subject to greater volatility. All fixed income investments may be worth less than original cost upon redemption or maturity.

The Energy sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions.

1. Wells Fargo Advisors. Growth and Value Investing Morningstar Market Charts 2022 Series. (CAR# 0822-00811)
2. Buffett, Warren. Quote retrieved 1/7/23 from www.goodreads.com
3. Fisher, Ken. The Only Three Questions That Count. Hoboken, NJ. John Wiley & Sons, Inc. 2012.
4. US GDP, Inflation, S&P 500 and Crude Oil Data retrieved 1/10/23, 1/11/23 and 1/12/23 from www.factset.com, https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20201216.pdf, Summary of Economic Projections - December 15, 2021 (federalreserve.gov), https://www.bls.gov/cpi/, https://www.gea.gov.news/schedule/full.
5. Barron's. Concerns remain as inflation falls for a 6th straight Month. Retrieved on 1/12/23 from https://www.barrons.com/articles/december-cpi-inflation-data-report-today-51673482251?mod=hp_LEAD_1
6. CNBC. 2022 was the worst-ever year for US bonds. How to position your portfolio for 2023, retrieved: 1/11/2023 from https://www.cnbc.com/2023/01/07/2022-was-the-worst-ever-year-for-us-bonds-how-to-position-for-2023.html
7. Wall Street Journal. Bonds & Rates. Retrieved 1/11/2023 from https://www.wsj.com/market-data/bonds
8. Bloomberg. Will commodities be spared from the great reversion of 2022, retrieved 1/11/2023 from https://www.bloomberg.com/professional/blog/will-commodities-be-spared-from-the-great-reversion-of-2022/
9. WSJ. Bond Bench Marks, Retrieved 1/11/2023 from https://www.wsj.com/market-data/bonds/benchmarks
10. Macrotrends. Euro Dollar Exchange Rate. Historical Chart. Retrieved 1/7/23 from www.macrotrends.net/2548/euro-dollar-exchange-rate-historical-chart

Description of Indexes

An index is unmanaged and not available for direct investment.
S&P 500 Index - a market capitalization-weighted index, composed of 500 widely held common stocks, including reinvestment of dividends, that is generally considered representative of the US stock market.
Russell 1000 Growth Index - offers investors access to the large-cap growth segment of the US equity universe. The index is constructed to provide a comprehensive and unbiased barometer of the large-cap growth market. Based on ongoing empirical research of investment manager behavior, the methodology used to determine growth probability approximates the aggregate large-cap growth managers' opportunity set.
Russell 1000 Value Index - measures the performance of those Russel 1000 companies with lower price-to-book ratios and lower forecasted growth values. These stocks are selected from the 1000 largest companies in the Russell 3000 Index.
MSCI EAFE Index - the MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US and Canada.
Russell 2000 Value Index - measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.
Barclays U.S. Aggregate Bond Index - an index comprised of approximately 6000 publicly traded bonds, including U.S. Government, mortgage-backed, corporate, and Yankee bonds with an approximate average maturity of 10 years.