CURBSTONE FINANCIAL
MANAGEMENT CORPORATION

From the Curb

Letter to Clients
Quarter Ending December 31, 2022

2022 will be a year to remember. On the positive side, the world has learned to live with COVID and, with the exception of China, lockdowns and travel restrictions have pretty much vanished. On the political front, mid-term elections in the US surprised, as the quality of the candidate ultimately mattered more than the party. Britain dealt with its own political turmoil as it turned its prime minister three times in two months and mourned the loss of the world's longest reigning monarch. On the geopolitical front, Russia invaded Ukraine and the war continues as it approaches its twelfth month. And, after a decade, inflation and higher interest rates returned sending both stock and bond returns into negative territory, a phenomenon last seen in 1969.

After years of zero interest rates, government intervention, physical stimulus and supply chain disruptions resulting from various pandemic responses, 2022 became the year of reckoning. Inflation, as measured by the Consumer Price Index (CPI), hit 9.1% in June of 2022 making it the largest increase in 40 years. Since then, it has trended down with a reading of 7.1% in November but still well above an acceptable level. In response, the Federal Reserve has aggressively raised interest rates in an attempt to dampen the rate of cost increases for goods and services. In 2022, the Federal Reserve raised rates seven times beginning with its meeting on March 17th and ending on December 14th for a total of 425 basis points or 4.25%. Currently the Fed Funds rate sits at 4.25% - 4.5% and the Fed is expected to raise an additional three-quarters of a percent (0.75%) in 2023 bringing the key benchmark rate to 5% - 5.25%.

With interest rates rising, bond prices declined resulting in negative returns as bond investors shunned existing debt for new issuance which provided higher yields. Equity investors were now faced with trying to figure out how higher interest rates would impact valuations, as the value of future earnings was unclear. Technology names and growth stocks were hardest hit as investors sought out more stable performers. Therefore, after a long period of very low inflation and interest rates, it made sense that a revaluation of assets occurred in 2022 and may continue into 2023, as investors try to sort out the degree to which circumstances may further change.

Inflection points, like the one we saw in 2022, tend to result in the biggest reactions. As the rate of change slows, markets begin to stabilize and investors can make decisions based on the underpinnings of what makes a stock or bond valuable. We are very focused on corporate performance. Will earnings and revenue grow in 2023 from 2022 levels? If yes, and that is supported by growth in GDP, then we would expect some level of positive returns in stocks. Bonds have once again become more attractive to investors, given yields of investment grade debt between 4% - 5%. Since most investors have portfolios that hold both stocks and bonds, we, as managers, have more options to consider as we balance growth, income generation and risk.

We expect the first half of the new year to remain volatile as the Fed still has work to do and geopolitical unrest remains. With employment strong, although increasing at a slower pace, we believe more people working is good for the economy and could help the US avoid entering a recession. Challenges remain but the stock market is forward-looking and many of the known risks are, at least, partially priced in already.

We thank you for your on-going confidence and trust. Know that our entire team remains committed to helping you successfully achieve your financial goals.