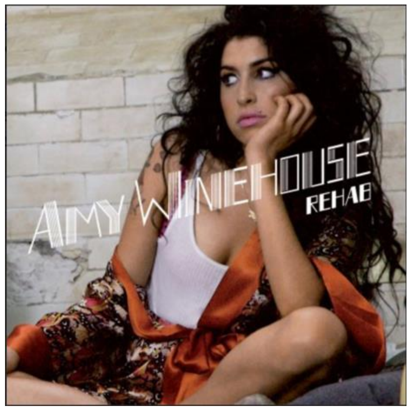
MEDALLION WEALTH MANAGEMENT

January 2023 Market Commentary

Rehab



They tried to make me go to Rehab
But I said no, no, no

Amy Winehouse - Rehab
https://www.youtube.com/watch?v=KUmZp8pR1uc

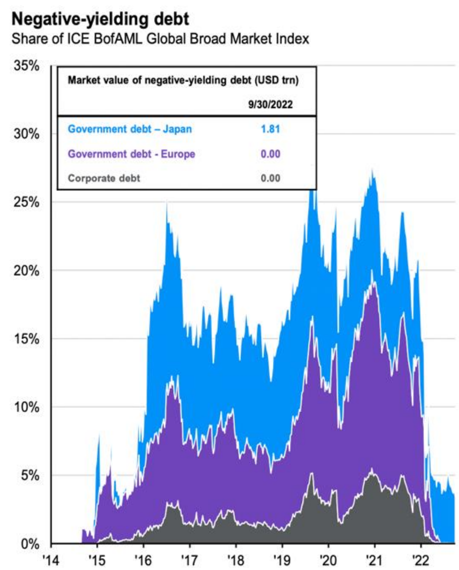
So, this is what rehab feels like, not fun! 2022 was the year that we began to sober up, the year that we began to pay for a decade plus of overindulgence. The year that the Central Bankers finally decided to remove the punch bowl.

Well, I really must be going...

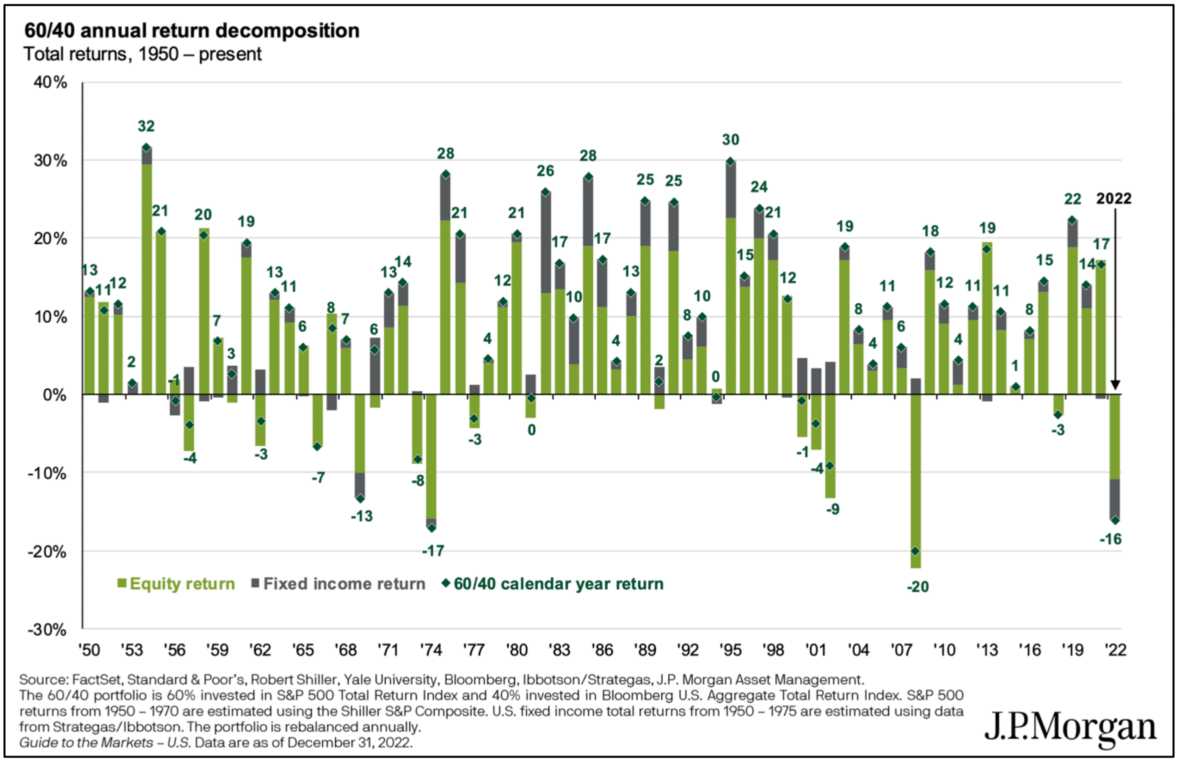
Sometime after the Great Financial Crisis, our Central Bankers decided to experiment with **"free money"**, cutting interest rates to zero in an audacious attempt to stimulate moribund economies that were struggling to register any signs of growth. Even with this massive amount of stimulus U.S. GDP growth only averaged 2.25% from 2010 – 2019. Then, when the pandemic struck in 2020 and the stimulus went into overdrive, we finally saw signs of runaway inflation. At first this inflation was deemed **"transitory"**, but by the end of 2021 the Fed and their Central Bank brethren decided that enough was enough and began rapidly raising rates.

During this period of "free money" investors were forced to take on more and more risk in order to earn a positive return. The charts below show just how crazy things got. **By 2020 the world was awash in $18 trillion of negative yielding debt (27% of all debt outstanding), and in just 18 months that has shrunk to nearly zero.**

Source: Bloomberg index data accessed via FactSet



After playing the role of the "enabler" for years, Chairman Powell is now trying to be the adult in the room, forcing everyone to sober up no matter the consequences. The consequences were harsh. By slamming on the brakes and going from zero (or negative) interest rates, to something more historically normal, has led to **one of the worst annual return for a 60/40 portfolio in the past 70 years!**



"I ain't got the time
And if my daddy thinks I'm fine
They tried to make me go to Rehab
But I won't go, go, go"

2022 was just the beginning of our forced rehab, and as any recovering addict will tell you, the journey to sobriety is often times a life-long struggle full of relapses. Will our "daddy" (Chairman Powell) have the will power to keep us in rehab even when he sees the pain it's causing? Will we (the economy) be able to survive the unemployment and losses to our wealth?

This is our 14th bear market in the last 100 years, and after the longest and nearly the strongest bull market in history, it wouldn't be surprising if it had a bit further to run. From March of 2009 the S&P 500 climbed 401% over 131 months! We may need to digest those gains for a bit longer.

Bear markets and subsequent bull runs

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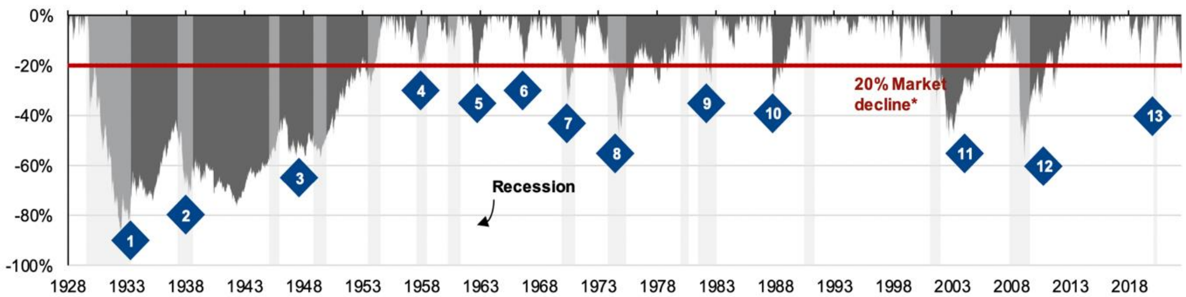
U.S. recessions and S&P 500 composite declines from all-time highs



Characteristics of bull and bear markets

	Market correction	Bear Market			Macro environment				Bull markets		
		Market peak	Bear return*	Duration (months)*	Recession	Commodity Spike	Aggressive Fed	Extreme Valuation	Bull begin date	Bull return	Duration (months)
1	Crash of 1929 - Excessive leverage, irrational exuberance	Sep 1929	-86%	32	◆			◆	Jul 1926	152%	37
2	1937 Fed Tightening - Premature policy tightening	Mar 1937	-60%	61	◆		◆		Mar 1935	129%	23
3	Post WWII Crash - Post-war demobilization, recession fears	May 1946	-30%	36	◆			◆	Apr 1942	158%	49
4	Eisenhower Recession - Worldwide recession	Aug 1956	-22%	14	◆		◆	◆	Jun 1949	267%	85
5	Flash Crash of 1962 - Flash crash, Cuban Missile Crisis	Dec 1961	-28%	6				◆	Oct 1960	39%	13
6	1966 Financial Crisis - Credit crunch	Feb 1966	-22%	7			◆	◆	Oct 1962	76%	39
7	Tech Crash of 1970 - Economic overheating, civil unrest	Nov 1968	-36%	17	◆	◆	◆		Oct 1966	48%	25
8	Stagflation - OPEC oil embargo	Jan 1973	-48%	20	◆	◆			May 1970	74%	31
9	Volcker Tightening - Whip Inflation Now	Nov 1980	-27%	20	◆	◆	◆		Mar 1978	62%	32
10	1987 Crash - Program trading, overheating markets	Aug 1987	-34%	3				◆	Aug 1982	229%	60
11	Tech Bubble - Extreme valuations, .com boom/bust	Mar 2000	-49%	30	◆			◆	Oct 1990	417%	113
12	Global Financial Crisis - Leverage/housing, Lehman collapse	Oct 2007	-57%	17	◆	◆	◆		Oct 2002	101%	60
13	Global Pandemic Recession	Feb 2020	-34%	1	◆				Mar 2009	401%	131
	Averages	-	**-41%**	**20**					-	**162%**	**51**

Source: FactSet, NBER, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.
*A bear market is defined as a 20% or more decline from the previous market high. The related market return is the peak to trough return over the cycle. Periods of "Recession" are defined using NBER business cycle dates. "Commodity spikes" are defined as movement in oil prices of over 100% over an 18-month period. Periods of "Extreme Valuations" are those where S&P 500 last 12-months P/E levels were approximately two standard deviations above long-run averages, or time periods where equity market valuations appeared expensive given the broader macroeconomic environment. "Aggressive Fed Tightening" is defined as Federal Reserve monetary tightening that was unexpected and/or significant in magnitude. Bear and bull returns are price returns.
Guide to the Markets – U.S. Data are as of September 30, 2022.

J.P.Morgan ASSET MANAGEMENT

Rehab is the abbreviation for rehabilitation, and often at the start of a new year we reflect on how we can rehabilitate ourselves in the coming year. I'm not really a "resolution" type of guy, but I do like to set goals for improvement. More exercise, more meditation, and more time in the outdoors.

One of the beauties of being an investment professional is that there are always ways to improve, more for us to learn, and more importantly more for us to try and control. When I say control, I don't mean outside forces but inside forces – our emotional intelligence.

Most humans have an inclination to be risk-averse. We have been wired since the beginning of time to avoid risk and seek safety. The problem with this deeply ingrained risk-aversion is that it often stifles our growth. We have to force ourselves out of that comfort zone to truly grow personally.

This is even more of a challenge for many of us investment professionals, myself included. We are charged with the task of protecting our client's assets. We are constantly on the lookout for risks, for what could go wrong, that we are often blind to opportunity.

Often, our biggest risk is actually being too risk-averse.

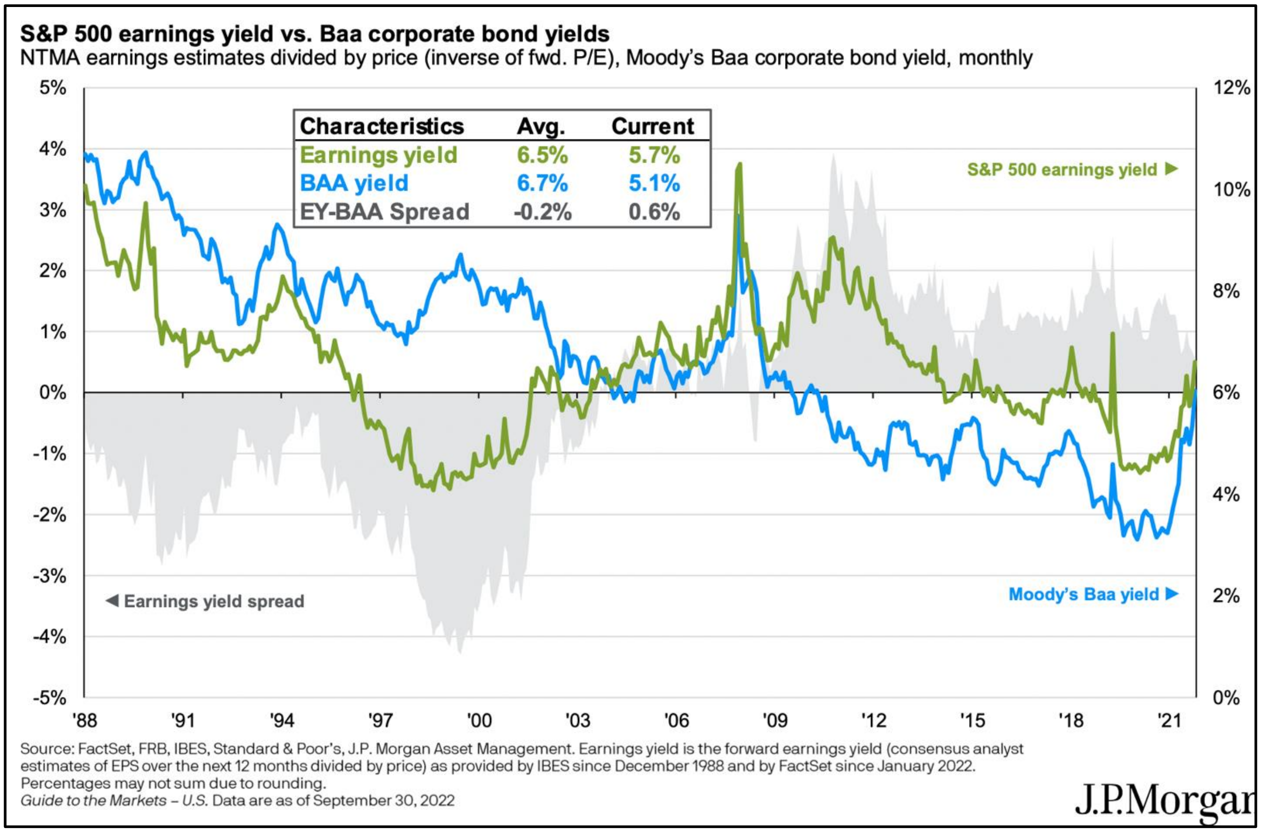
If I was ever going to get a tattoo, this would be it:

This is the Chinese symbol for Risk, which is made up of two separate words indicating both the "danger" of loss and the "opportunity" of success.

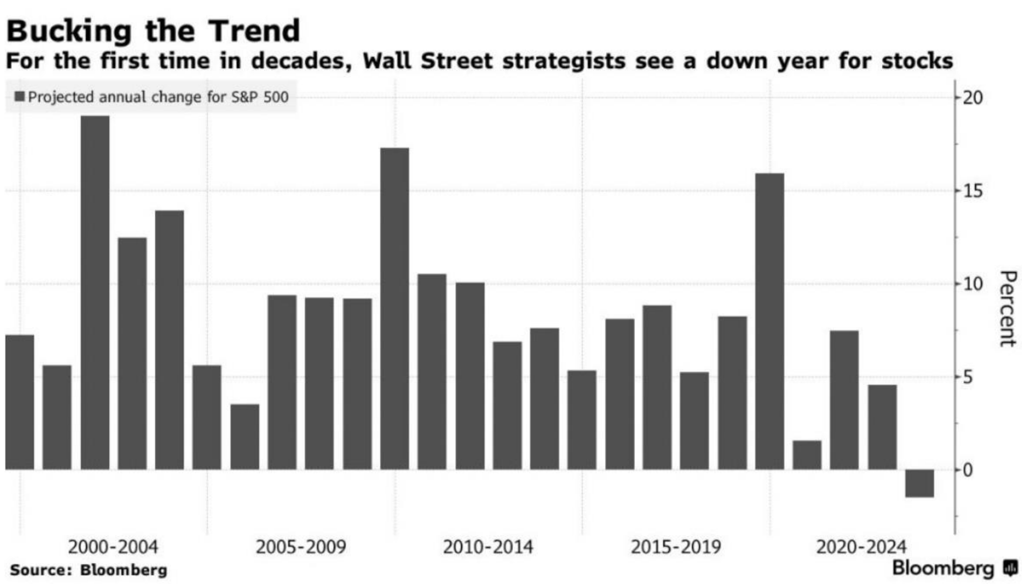
Last year, at the ripe old age of 62, I challenged myself to compete in my first ever triathlon (Just an Olympic distance; .70-mile swim, 25-mile bike, & 6.2-mile run). As someone who doesn't run, who hasn't swum in 30 years, and who rides bikes recreationally, it was a stretch goal. The risks were prolonged periods of discomfort, pain and injury, and embarrassment. The reward was the best physical shape I've been in for decades, and a real sense of accomplishment. My goal was to finish under the 4.5-hour cutoff, and my stretch goal was not to finish last. I accomplished both, but it wasn't pretty (finished 126th out of 132). This year I'll work on pretty.

Professionally, I'm going to work harder at recognizing opportunities. I could fill the next several pages enumerating the many dangers facing us; the Fed raising rates, a recession, Covid variants, economic war with China, real war with Russia, etc., etc. The truth of the matter is many of those dangers are already priced in the market.

The historic selloff in bonds means that for the first time since 2008 the yield on investment grade bonds nearly matches the earnings yield on stocks. Fixed-income looks fairly attractive.



Another sign of opportunity springing forth from an abundance of caution is the forecasts of Wall Street strategists. **For the first time ever, strategists expect stocks to be down in 2023**, and since their forecasting track-record is abysmal (none of them saw the decline last year) there is hope that 2023 may surprise to the upside.



I’m not saying that you should throw caution to the wind in 2023, but I am saying that the only way to grow (whether personally or your portfolio) is to step out of your comfort zone and embrace those opportunities that risk often presents.

“I don’t ever want to drink again
I just, ooh, I just need a friend
They try to make me go to Rehab
But I won’t go, go, go!”

I hope you have a very happy and prosperous New Year!

As always, be careful out there.

Chris Wiles, CFA

Where trust is Earned