Oakwood
FINANCIAL ADVISORS

Market Review & Comment – January 2023

Volatility & Markets

2022 was the year that inflation made its comeback. And as a result, volatility in markets spiked. Volatile markets occur just far enough apart that investors forget what it felt like the last time it happened. Each time it's accompanied by a worrying event and gives us an excuse to try to avoid it. However, volatility often provides an opportunity as it tends to lead to greater growth potential over the longer term.

As we have said before anytime volatility (that is the fluctuation in the asset price) picks up, or the market makes a big move higher or lower, investors should remember that the market sets prices based off of ***the collective wisdom and foolishness from millions of decisions.***

Also, financial journalism is a business. Its job is to sell advertisements. Negative news sells, good news not as much. Keep this in mind when you read or listen to most financial commentary.

2022 Review

Both global equities and bonds (Government and Corporate) suffered significant losses in 2022. High inflation led to sharp rises in interest rates along with growing fears over economic growth. Monetary policy was the key focus as rates were hiked by the world's major central banks. Thus ending a prolonged period of low to negative rates.

While equities suffered on the back of tight financial conditions, and reduced growth, there were some areas of outperformance. There was a shift in the prevailing sentiment away from growth stocks since higher discount rates made dividend paying value stocks more attractive than they have been to investors in previous years.

Bonds Suffered

Bonds underwent a significant change in circumstances as the interest rate environment evolved throughout 2022. The Federal Reserve (US Central Bank) increased rates in March for the first time since 2018. The Fed has so far raised rates seven times in 2022. Longer duration bonds which are more sensitive to changes in interest rates suffered in particular during 2022.

US Dollar At Parity With The Euro

The US Dollar continued to strengthen against a basket of peer currencies. Markets experienced a flight to safety in 2022 because of central bank tightening and lower growth prospects. In July the Dollar hit parity with the Euro for the first time in 2 decades. This is reflective of the general risk off sentiment that has presided over markets at key junctures during 2022.

2022 Returns	
Index, Currency, Bond	**Gain/Loss**
MSCI World Index (€)	-12.8%
FTSE World Index (€) (x-US)	-19.5%
Dow Jones Industrial Average	-8.8%
S&P 500 Index ($)	-18.1%
NASDAQ ($)	-33.1%
Emerging Markets Index (€)	-14.9%
Eurozone Equities (€)	-12.5%
ISEQ (Irish Stock Exchange)	-15.8%
Irish Property	-0.3%
Gold Price (€)	6.4%
Commodities Index (€)	23.8%
Eurozone Government Bonds	-24.4%
Eurozone Corporate Bonds	-14.1%
Eurozone Inflation Linked Bonds	-9.7%
Irish Inflation	8.36%
Irish Bank Deposits	0.2%

Interest Rates And Inflation

While there were a lot of moving parts in the markets, the core narrative still remained the concern around interest rates and inflation. The apparent persistence of high and rising inflation has spurred central banks to a hawkish stance. Sharp increases in interest rates are rarely welcomed by investors.

Interest Rate Increases

The US saw two interest rate hikes during Q4, bringing the official rate (upper end of target) from 3.25% to 4.5%. This is not far below the 5% peak priced into consensus expectations. Increases in November and December put the benchmark Deposit Facility up from 0.75% to 2.0%. The ECB was later into monetary tightening then its peers and rates may edge a little higher in early 2023.

Value Outperforming Growth

The *MSCI World Value* index gained 24% over its growth counterpart in 2022. Most of the 'FAANG' mega-cap IT and communication stocks which led the growth rally up to end-2021 have seen massive falls through the course of 2022. Meta (Facebook), Netflix and Amazon all lie currently more than 50% below their 2021 highs. The Oakwood Investment and Retirement Portfolios are based on a Value based apporach which has benefitted our clients.

Bond Market Carnage

2022 has been a traumatic year so far in Fixed Income (Bond) markets. The benchmark Eurozone sovereign bond index is down 16.8% in the first half and fell 10.4% in Q2 alone. The yield on that index is now up to 2.2%, having bottomed at zero in 2020. Inflation-linked bonds were more resilient, but also produced negative returns in Q2. Investment-grade corporate bonds also held up better than sovereigns, mainly thanks to their lower average durations.

The first few weeks of 2023 has already seen bonds starting to recover. Bonds have the potential to recoup a significant part of their 2022 losses and maybe more if a hard recession or deflation appears by year end.

Safe Haven – Property

Among other asset classes, Commercial Property proved a resilient one during the past twelve months. However, there are two major headwinds coming which will impact in 2023 – rising interest rates and reduced office occupancy arising from post-Covid working patterns.

One suspects that valuations are lagging fundamentals and a fall in values will occur over the coming year. The performance of listed property funds, where expectations are priced into the share price, may be an indicator of what is to come - as an example, the iShares European Property Yield ETF fell by 38% in 2022 while the IRIS REIT fund is down over 33% since its January 2022 high.

Commodity Prices Easing

Commodity had a year of two halves. A surge in the first part of the year and then prices slipped back in the closing months of the year. Most of the major commodity indices had made their highs during Q2. The fall in energy prices was particularly noteworthy, because of its importance for the European economy. **The next-day spot price for European gas is now down more than 70% from its August peak.** While very little trade is done at spot, it does indicate the easing of supply pressures which had threatened economic havoc on this side of the Atlantic.

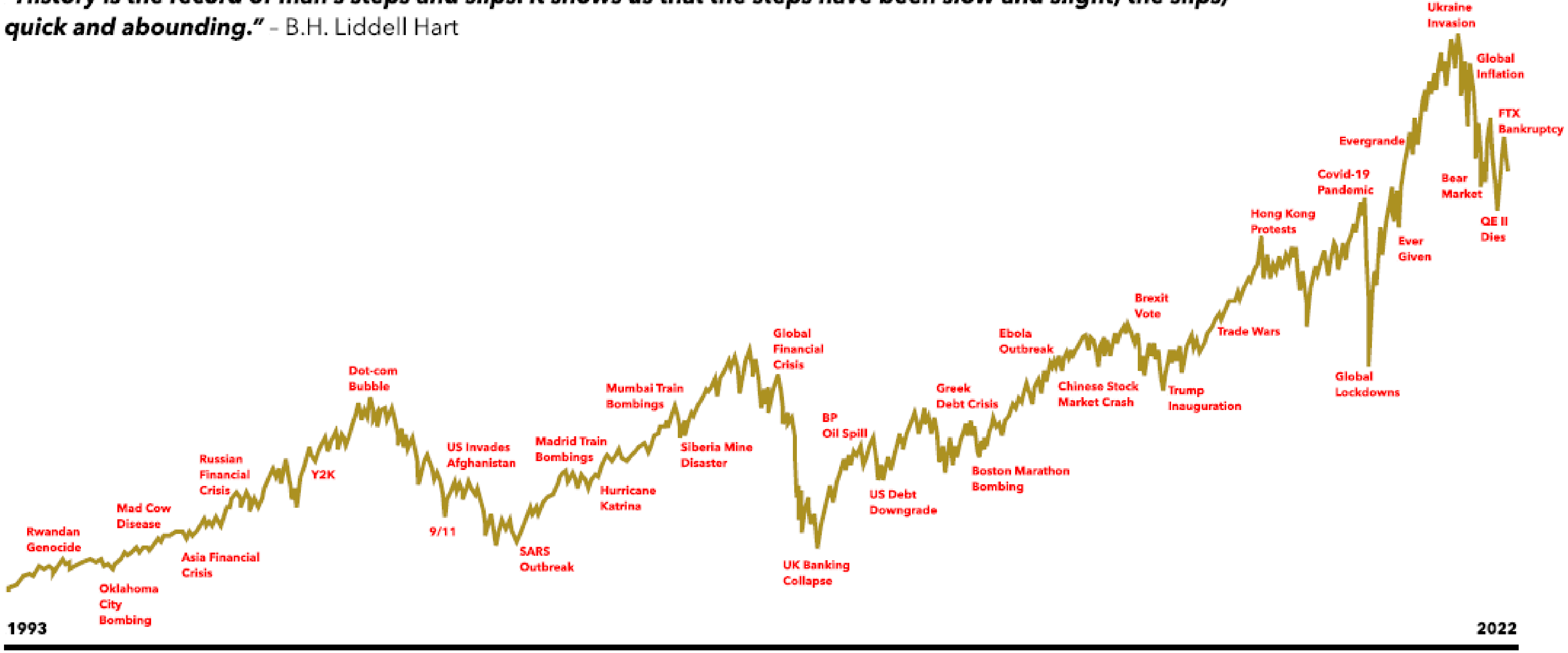
Wall of Worry

A Timeline of Negative World Events

The chart below shows the growth in world equity markets despite a never-ending stream of negative world events.

Despite ongoing uncertainty, $1 invested in January 1993 grew to $5.43 by the end of December 2022. This is an average annual return of 5.80%.

"History is the record of man's steps and slips. It shows us that the steps have been slow and slight; the slips, quick and abounding." – B.H. Liddell Hart



Source: MSCI, Humans Under Management.
Returns are based on the MSCI World price index from 1993 and do not include dividends. For illustrative purposes only.

Looking Forward

Controlling Inflation
Even as we are seeing some easing in recent inflation numbers, central bankers remain determined to make sure that inflation goes away. Inflation is likely to come down further from current high levels, but it may suit governments as it erodes high debt loads. If central banks decide to be more aggressive (e.g. target sub-2% inflation), then further rate rises may be on the cards. This would impact both equity and bond investors.

The most noteworthy adjustment in asset valuations during 2022 was in fixed income (bonds). The benchmark Euro nominal sovereign yield moved from 1.0% to 3.3%, while the core real yield (on inflation-linked bonds) went from roughly -1.5% to +0.5%. While we remain wary of the possibility of inflation staying higher than expected for longer than expected, the substantial yields now on offer are enough to prompt a re-weighting of model portfolios in favour of fixed income.

Equity valuations now look to be average to slightly cheap against their long-term history (notably outside the US), and they present value for those with a medium to long investment horizon. When it comes to equities, funds which are made up of high-quality companies with the ability to grow cash flows at above-inflation rates over the long-term are the most attractive.

Opportunities to protect against inflation
There is always the risk of a Black Swan event (an extremely negative incident or occurrence that is particularly difficult to predict) to upset markets. However, the outlook is looking up for investors. Not because markets have had a strong start to 2023 – the gains logged could reverse in a day – but because the pain of 2022 has set the stage for higher potential future returns.

The current volatility is gradually offering up opportunities to invest in asset classes that protect against inflation. Diversification across uncorrelated assets can also reduce your risk. For those with funds in cash, this may offer an opportunity to look at opportunities to protect against inflation.

I hope you have found this update useful and as always we remain on hand to help with any queries.

Ronan McGrath
Managing Director
Oakwood Financial Advisors

7th Jan 2023

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