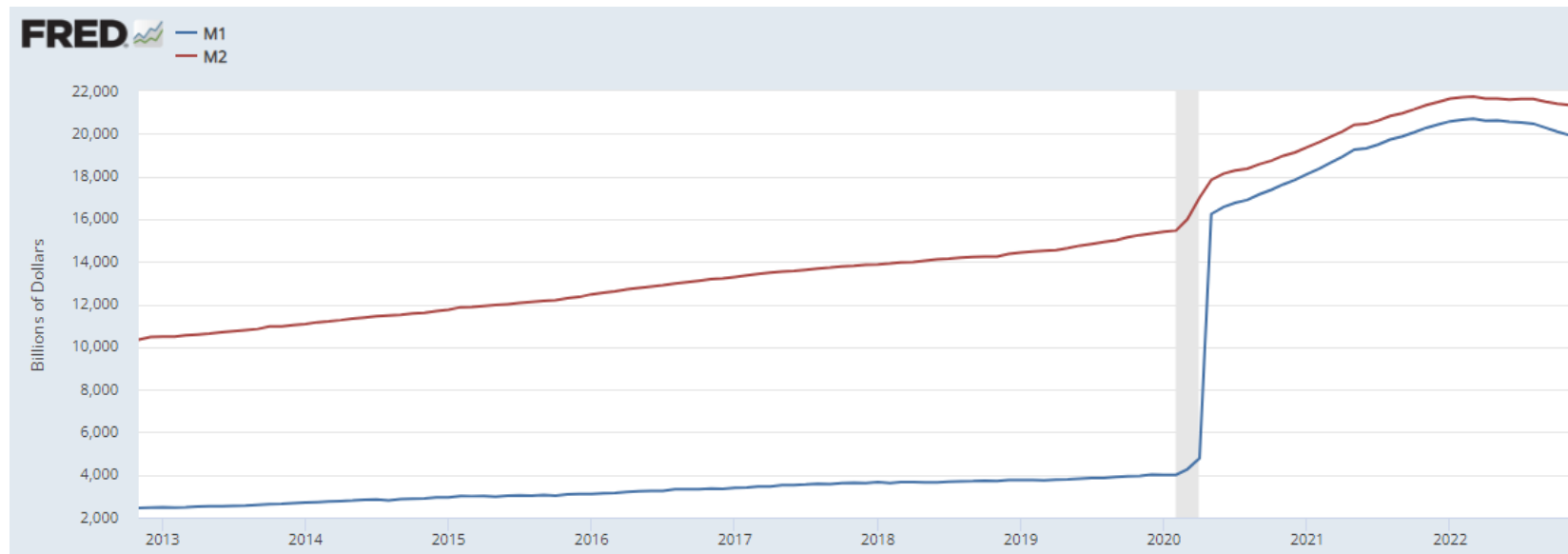


## BCA Market Perspective © The Bust of Stocks and Bonds in 2022 January 2023

We have to revisit 2008 to witness a similar collapse of U.S. and foreign stocks as we did this year. At that time, the trigger was exposing the pervasive mortgage market fraud that caught many investors, banks, and insurance companies by surprise. Major investment banks like Lehman Brothers and Merrill Lynch collapsed. In that year, high quality bonds performed well, providing the means to rebalance pension plan portfolios.

In 2022, the S&P 500 dropped 19% and the DJIA fell by 9%. The technology heavy Nasdaq composite gave away 33%. Bitcoin, which was intended to be a stock market hedge, fell 60%. What happened to bonds was unprecedented, as the Federal Reserve led the charge by aggressively raising the Fed Funds rate to 4.5% from zero. Inflation data was now front and center and this pushed the 10-year Treasury note up from 1.5% to 3.8%. The result was a 15% collapse of the Bloomberg Aggregate Bond Index.

For some perspective, the 1970's was a disastrous decade for the stock market, following President Nixon's decision to drop the U.S. dollar-based gold standard. Inflation moved from 4.7% to 12.3% in December 1974. Several months later, the Fed Reserve reset the fed funds rate to 7% and then to 11% by December. By March 1975, the rate had reached 16% only to worsen the recession. **But a month later, the Fed (under Arthur Burns) pivoted the fed funds rate back down to 5.25% to end the recession, but inflation remained at 12.2%. In 1980, inflation averaged 13.5%.** The collapse of the dollar in 1974 was a far greater cause of inflation than the 2020 to 2022 growth in the money supply (M1 & M2).



### Key intentions of Federal Reserve Policies in 2022:

- Further reduce the money supply (M1 & M2)
- Strengthen the U.S. dollar against all major currencies to slow the rise in oil prices and reduce U.S. imported goods costs
- Weaken the U.S. labor market to curb the rise in labor costs and reduce consumer demand
- Soften U.S. corporate earnings to curb capital investment and hiring
- Most importantly, to force the Consumer Price Index back to a 2.0% annual rate from 7.1%

### What is expected in 2023:

- 1) Hiring freezes and corporate lay offs
- 2) CPI continues a gradual decline
- 3) Consumer spending moderates as borrowing slows down
- 4) Corporate earnings growth moderates
- 5) Federal Reserve pivots to neutral – the timing being data driven

