Please note: This is a transcription so there may be slight grammatical errors.

Mike Vogelzang:

A year ago, markets were coming off one of the best performances in history. Our trepidation that these new highs were unsustainable, proved helpful, but still insufficient to prepare investors for the gut-wrenching volatility that followed. Like passengers roaming the aisle on a long flight, 2022 turbulence forced investors back to their seats to strap in for a bumpy ride.

The fourth quarter of 2022 offered a modest recovery for many types of investments, although not nearly enough to reverse the rough course of the year. US stocks rose more than 7% while international stocks fared even better. And after a historically brutal nine months, core US bonds also rebounded nearly 2% despite continued rate hikes by the Federal Reserve. Higher wages and plentiful jobs helped keep consumer activity robust with holiday spending. But that spending increase didn't mean extra boxes under the tree as consumers paid more due to the pernicious effects of inflation. As abnormally strong and smooth as 2021 was, 2022 proved abnormally unsettling. Even reliably conservative investments lost value. The investor's best friend, diversification, missed the flight altogether. Many of the sources of this prolonged turbulence could be seen on the radar. Inflation began the year at the highest level since the early 80s, asset prices approached historic highs, interest rates were rising, but even with these warning signs, unforeseen economic shocks catalyzed the real damage during the year.

Our first surprise was inflation rising faster than expected, forcing the Fed to turn on a dime and raise rates. Between March and December, the Fed hiked rates 7 times for a total increase of 4.25%. That's the historical equivalent of 12 to 24 months of rate hikes crammed into just 9 months with even more rate hikes expected this year. Shortly after, markets took a second blow with Russia's unprovoked invasion of Ukraine. This sent shockwaves through commodities markets, especially energy and food, adding jet fuel to inflation, while ratcheting up geopolitical risk. With unprecedented uncertainties heading into the year, we find it useful to contemplate four potential paths that the economy and markets may take in 2023.

The first and best case is that the Fed gets financial tightening just right, the Goldilocks scenario, the economy slows or cools a bit without causing a full recession. A very tricky task.

The second scenario sees inflation lasting longer than expected while the employment picture remains strong. This leaves the Fed no option but to keep raising rates, eventually pulling the economy into a mild recession.

The third potential path forward could find inflation receding faster than expected, but the Fed keeps policy tight anyway to avoid a rebound wave of inflation. This approach could cause a deeper but still controlled recession.

The fourth and most dire of these scenarios is that the Fed's tool simply prove inadequate to fight today's unique inflation. Rising rates, higher debt levels, and lower consumer spending force companies to cut jobs, all of which could usher in a deep and painful recession without an end in sight.

Our best educated guess is that the economy will meander down either the second or third paths, likely entering a mild Fed induced recession sometime this year. In this type of environment, we expect continued turbulence for markets during the first half of 2023, but uneasy investors should remember these two things. One, at this stage in the cycle, significant risks are already priced in. And two, as leading indicators, markets typically turn up before the economy bottoms. A year like 2022, while painful, also creates new opportunities for investors. The prices or entry points of stocks are lower today and bond yields, much higher. These both portend a brighter outlook in the years ahead, even if the flight path remains bumpy. In the meantime, we believe long-term investors should remain invested.

Some of the most explosive short-term returns occur during bear markets and timing them is simply impossible. But as always, the best move is to discuss your situation with your financial advisor to help navigate cloudy skies with the confidence that your financial plan will land you safely at your destination.

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