February 5, 2023	Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Bitcoin	Gold	Crude Oil
	33,926	4,136	12,007	1,986	3.53%	23,358	$1,878	$73.26

Investment Strategy Report

Stocks and Bonds Surge To Start The New Year

I ended last month's letter by saying that despite the widespread bearishness among investors, "there are reasons to be optimistic". But not even I was expecting the bolt out of the starting gates that saw stocks scream higher at the beginning of January. It was if someone flipped a switch, and it was out with the misery of 2022, and in with gains for 2023. Year to date, the S&P 500 is up 7.7%, the small cap Russell 2000 is up 12.8%, and the Nasdaq is up 14.7%. And that's after only 5 trading weeks of the year. Bonds are also on a tear. With the 10 year Treasury yield falling from 3.88% to 3.53%, intermediate term bonds are up about 3.5%. Longer term bonds (e.g., the 20 year Treasury) are up about 7.8%.

Nothing fundamentally changes when you cross over from one year to the next, but one explanation for the turn around is that tax loss selling at the end of December steepened the losses for many of the 2022 losers. And once that was over with, investors bought back those stocks with a vengeance, with many of last year's hardest hit stocks rebounding 30-50% this year.

None of this changes the fact that 2023 will still be a volatile and challenging year for investors. Despite a strong employment picture (the US economy added over 500,000 jobs in January, with the unemployment rate falling to 3.4%), the odds of a recession this year are still fairly high. Bob Brinker (2/23 newsletter) writes that The Conference Board Leading Economic Index (LEI) has declined for 10 straight months, and the 6 month annualized rate of change is minus 4.2%, suggesting that economic weakness is likely. He adds that the yield curve is severely inverted, meaning that the Fed Funds rate (overnight lending rate) of approximately 4.65% is substantially higher than the 3.53% yield of the 10 year Treasury. Recessions almost always occur after inverted yield curves. And we can add to these negatives the fact that the Federal Reserve seems intent on sticking to its hawkish policy of raising rates and keeping them higher for longer.

And yet, stocks are acting as if they don't have a care in the world. The reason for this might be that despite the negative economic indicators, the strong labor market is indicative of the schizophrenic nature of our economy. Many indicators are pointing to a slowdown and possible recession ahead, while the employment picture remains very strong. It's quite possible that we might either avoid a recession or experience only a mild one. And the stock market, which was down about 20% last year, might have already discounted a recession and is looking past it, towards a recovery.

One of the biggest factors causing last year's market fall was the fear of inflation and rising interest rates. Thus far this year, interest rates are coming down and so is inflation. While year over year inflation is still high at about 6.5%, Brinker notes that the 6 month rate of inflation is down to 1.8%, and over 3 months, it is down to 1.6%. With inflation falling, there is an expectation that the Fed might become more accommodative towards the end of the year.

Brett Eversole points out (Stansberry Daily Wealth, 1/26) that with inflation falling, "the odds of a stock market rally this year are darn high". His data from 1950 shows that in years when inflation is falling, the S&P 500 averages a 12.2% gain vs. a 9.1% gain for all years. And there is a 77% chance that stocks are positive in those years. While earnings and economic slowdowns can adversely affect the stock market, inflation can act like kryptonite to stocks. However, when it falls, that can be a powerful force to push stocks higher.

Cash Yields at Schwab – Those of you with large amounts of cash at Schwab should know that the current yield for cash is about 0.45%. However, if you intend to leave the money uninvested for a prolonged period of time, I am able to move the cash to a Schwab Value Advantage money market fund that is currently yielding 4.36%. I have already done this for most of you with large amounts of cash (usually > $20,000) who have asked me to keep it as cash for now.

Required IRA Distributions – Congress has made significant changes in the past few years to the age at which IRA owners are required to begin making distributions (RMDs). For those born in 1951 to 1959, the required age is now 73 (older IRA owners have already begun their withdrawals). For those born in 1960 or later, the required age is now 75. *Jeff Feldman*