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Wealth Advisors

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Market Update: The Year of The Yield

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One Down, Eleven to Go

We made it through January with the S&P 500 up 6.2% for the month, the best January in four years. Investors continue to be optimistic about lower inflation and the Federal Reserve (Fed) getting closer to the end of their interest rate hiking cycle.

As largely expected, the Fed hiked rates by only 0.25% at the February 1 meeting, the smallest increase since it began hiking last March. This is a signal that the Fed is getting more comfortable with a target level of interest rates that will help bring down inflation. Current expectations are for another one to two rate hikes of 0.25% in the coming month(s), followed by a pause, and an increasing probability of a cut for Christmas.

Corporate earnings added additional market support. According to the FactSet Jan. 27 Earnings Insight report, 29% of S&P 500 companies have reported Q4 earnings through January 27. Of those reported, 69% have posted a positive earnings surprise and 60% a positive revenue surprise. It appears that firms are faring better than expected amid high inflation and fears of slowing consumer demand.

There's an adage, "As goes January, so goes the year," hinting that a strong January for the stock market results in continued success for the remainder of the year. Only time will tell if we can prove that theory in 2023.

Bonds Are Back

Why do we typically talk about stocks in Dynamic Market Updates? That's easy as they're more exciting and flashy than boring bonds. Well, it's time to get boring again because bonds are back, baby!

While stock movements are generally random, often driven by investor emotions, bonds are about math. The best predictor of future return for a bond is the current yield. Can you believe that in late 2021, just over a year ago, the two-year Treasury yield was 0.2%, not much of an expected return. Currently it sits at 4.2%!

We haven't seen yields like that in 15 years; we've forgotten what bonds are and that they can yield meaningful returns. I'm officially marking 2023, "The Year of the Yield."

To add fuel to the fire, bonds have also been beaten up last year due to the strong interest rate hikes. By definition, bonds must return their principal at maturity, so as prices fall, the probability of a rebound continues to increase. With the Fed starting to signal a potential end to the rate hike cycle, what could that potentially mean for bonds going forward? The phrase, "spring loaded" comes to mind.

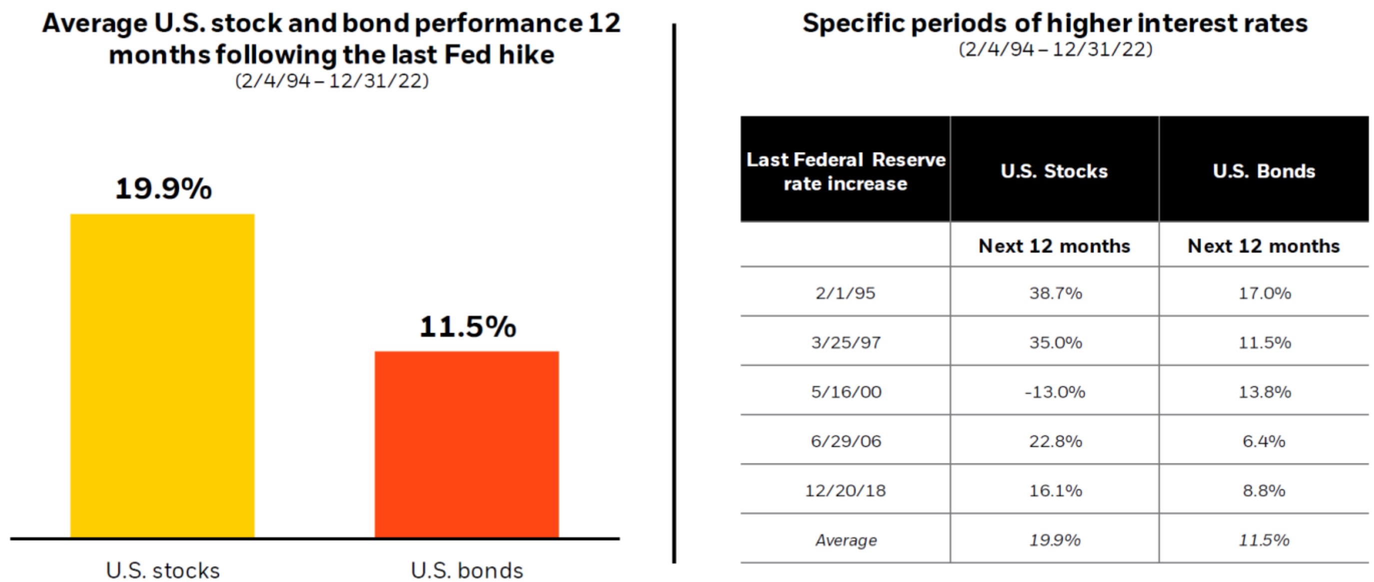
The chart below, “Average U.S. Stock and Bond Performance,” shows what has happened historically to stock and bond returns after the last Fed hike. A few things stand out:

1. **Stocks can’t give up the spotlight**, with an average return of nearly 20% in the year following the last Fed hike. That said, the variability of returns, including one that’s negative, reminds us how volatile the stock market is.

2. **Bonds have double digit returns** on average in the 12 months following the end of a hike cycle. The bond investments would have achieved their returns at significantly reduced levels of risk when compared to their stock market brethren.

3. **The 60/40 isn’t dead!** While not listed, you can see the returns of a diversified portfolio of 60% stocks and 40% bonds, which would achieve strong returns with lower volatility over the long-term.

Average U.S. Stock and Bond Performance
12 Months Following the Last Fed Hike
(2/4/94 - 12/31/22)



Specific periods of higher interest rates
(2/4/94 – 12/31/22)

Last Federal Reserve rate increase	U.S. Stocks	U.S. Bonds
	Next 12 months	**Next 12 months**
2/1/95	38.7%	17.0%
3/25/97	35.0%	11.5%
5/16/00	-13.0%	13.8%
6/29/06	22.8%	6.4%
12/20/18	16.1%	8.8%
Average	*19.9%*	*11.5%*

Source: Blackrock, with data from Morningstar as of 12/31/21. U.S. stocks are represented by the S&P 500 index. U.S. bonds are represented by the Bloomberg US Agg Bond TR Index. Past performance does not guarantee or indicate future results. Index performance is for illustrative purposes only. You cannot invest directly in the index.

As always, Dynamic recommends staying balanced, diversified and invested. Despite short-term market pullbacks, it’s more important than ever to focus on the long-term, improving the chances for investors to reach their goals.

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