Q4 2022 – The Quarter That Was

A YEAR OF EXTREME PUBLIC MARKET ACTIVITY

Kyle Smith

After two years of elevated gains, equity markets reversed and suffered a significant sell off in 2022. The bond market did not fare any better. Rising inflation required a year of interest rate hikes, resulting in one of the worst years ever for bonds.

As a result, 2022 lags only two Great Depression era years – 1931 and 1937 – for the distinction of having the worst annual performance for a traditional 60/40 equity-and-bond-only portfolio.

Thankfully, Newport is not bound by the limitations of the traditional 60/40 portfolio.

Diversification drives performance.

Alternative and private investments – income producing real estate, private debt, private equity, infrastructure, and mortgages – are an important component of Newport's diversification strategy. These asset classes are attractive because performance is largely uncorrelated to the direction of equity and bond market movements. In 2022 all five of Newport's alternative asset classes generated positive returns, despite the public market sell off.

Newport is also willing and able to hold cash. This is not the norm in the investment management world. When risk-reward dynamics are unappealing, we remain patient. We never rush into an investment decision.

As a result, Newport significantly outperformed its benchmarks and the broader public markets in 2022. Our performance over the last few years highlights the benefits of our multi-asset class approach. That's particularly meaningful with the constant market disruptions of recent note.

"It's not you, it's me."

We have witnessed a breakup or temporary split in many basic "Economics 101" type relationships since the onset of the pandemic. Consider 2022, as an example:

1) 4.5 million jobs were added in the U.S and at 3.5%, the unemployment rate finished the year at half-century lows.

2) Based on fourth quarter expectations, U.S GDP growth in the second half of 2022 will likely push 5%.

3) Corporate earnings remained strong, with S&P 500 EPS growth in the third and second quarters up over 10% and 9% year-over-year, respectively.

Despite this seemingly positive backdrop, the S&P 500 sold off 19% in 2022. However, the reverse of this occurred in 2020 and 2021. The S&P 500 returned 16% and 26% respectively, while the world dealt with the health, social and economic uncertainty associated with the first two years of the pandemic.

Looking ahead.

Interpreting conflicting economic data and financial market performance is one of many items on Newport's Investment Committee radar screen in 2023.

Higher interest rates and inflation have yet to negatively impact corporate earnings. This typically occurs when inflation, as opposed to credit concerns, drive the recession narrative. We are keen to see a continuation of this trend. Sustained corporate earnings resiliency would point towards a softer landing scenario, which would help set a positive tone for 2023.

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Interest rates and inflation remain important variables. Inflation growth remains a key fear factor for the markets and higher interest rates are considered an obstacle to economic growth. While near-term cuts are unlikely, a deceleration in the pace of inflation in 2023 could reduce the frequency and size of interest rate hikes. This would be viewed as a positive. It would also increase our confidence that equity markets will avoid a re-test of their 2022 lows, and it would help to stabilize bond prices.

We are no longer in a near-zero-interest rate environment and opportunities are emerging in the bond market that did not exist a year ago. However, investments in real estate, private mortgages and private debt provide attractive levels of income, without the price volatility. We plan to wait for interest rates to stabilize before increasing our public bond weighting.

The equity markets have also pivoted, with a renewed focus being placed on value versus growth. This should prove beneficial to the investment style of our public equity sub-advisors.

As 2023 unfolds, Newport remains steadfast in its long-term strategic approach, focusing on risk mitigation and capital preservation. To find out more about Newport's unique investment approach, **GET IN TOUCH**.

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