2023 Outlook

The Good News About A Bad Year

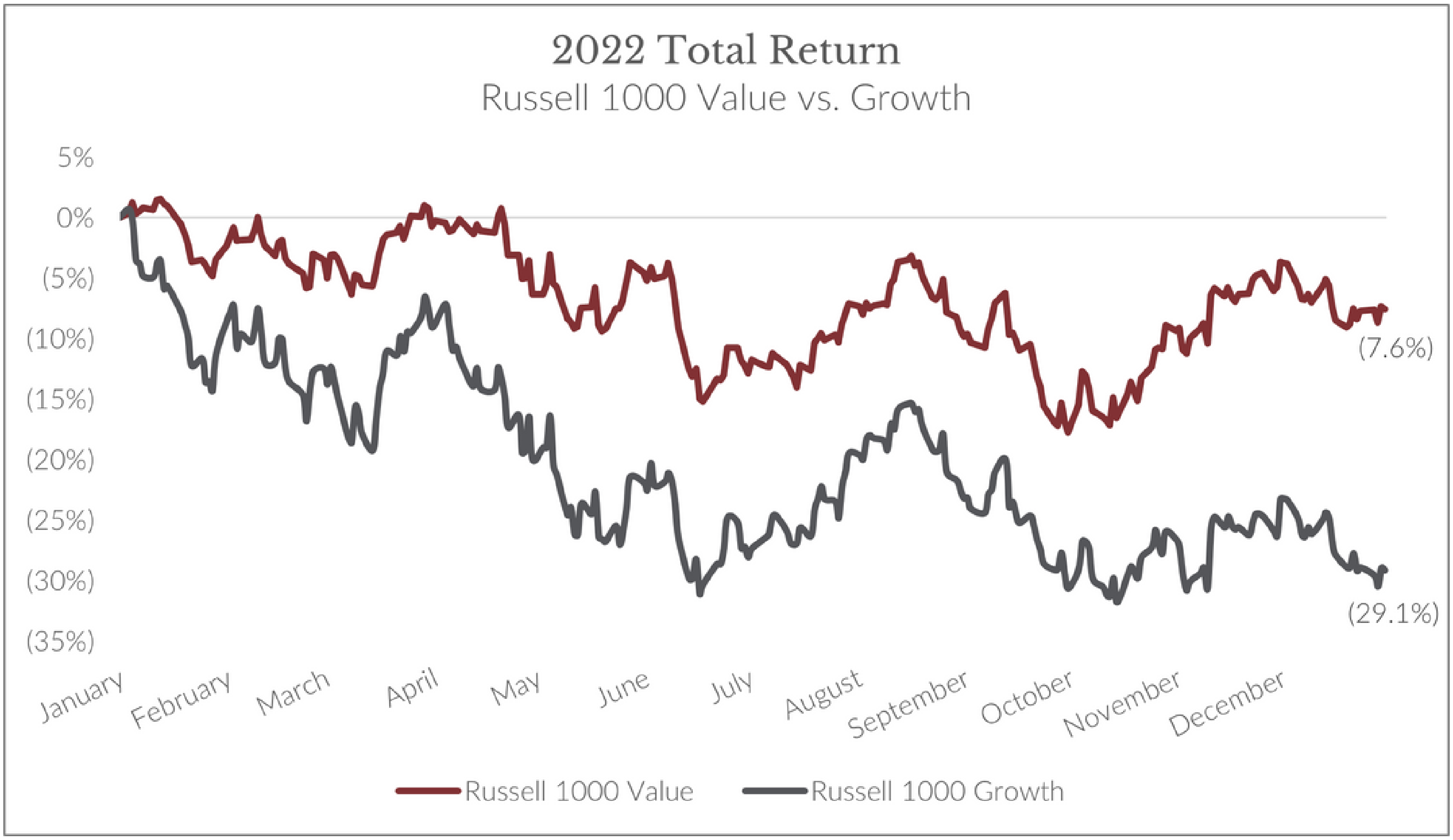
A Dividend Renaissance

2022 was a historically difficult year. There is no sugarcoating this fact. As we wrote this past summer, "If it's felt like it's been a painful year, it's because it has been." A traditional balanced portfolio with 60% in stocks and 40% in bonds had its worst performance since 1937. You read that right, worse than the dreary times of 2008 during the global financial crisis and worse than the inflationary bear market of 1973/74. In 2022, technology stocks ended the year down almost -30% and consumer discretionary stocks as a group (i.e. Amazon, Tesla, Nike for example) were down almost -40%. The S&P 500 still sits around bear market territory. Inflation is here in a big way and is likely to persist in some form for a while. Combine that lingering inflation with a war in Ukraine, a nearly complete collapse of the cryptocurrency market, and an aggressive Federal Reserve raising interest rates to the highest level in nearly two decades, and you have the recipe for a difficult year.

However, it is not all bad news. Despite the pain, 2022 produced some significant silver linings.

1. Dividend stocks held up relatively well.

Despite the deluge of scary market headlines and large negative returns from irresponsible investing styles, income-oriented investors held up very well on a relative basis. Don't get us wrong, it wasn't a good year, but investing with an eye toward stock dividends held up as it should in times of stress. Dividend/Value-oriented stocks as measured by the Russell 1000 Value Index ended 2022 down 8%, while non-dividend stocks/growth-oriented stocks as measured by the Russell 1000 Growth Index finished down 29%. See the chart below.



Source: Capital Investment Advisors; Bloomberg data

2. Bond yields rose to attractive levels.

The 10-year treasury now yields almost 4%, its highest level since the Fall of 2008 and well above the 0.5% (not a typo) during the midst of COVID. What this means is that many investment grade bonds are starting out 2023 paying interest in the 4 to 5% range. This is welcome news for income-oriented investors.

3. Many excesses in the market have been wrung out of the system.

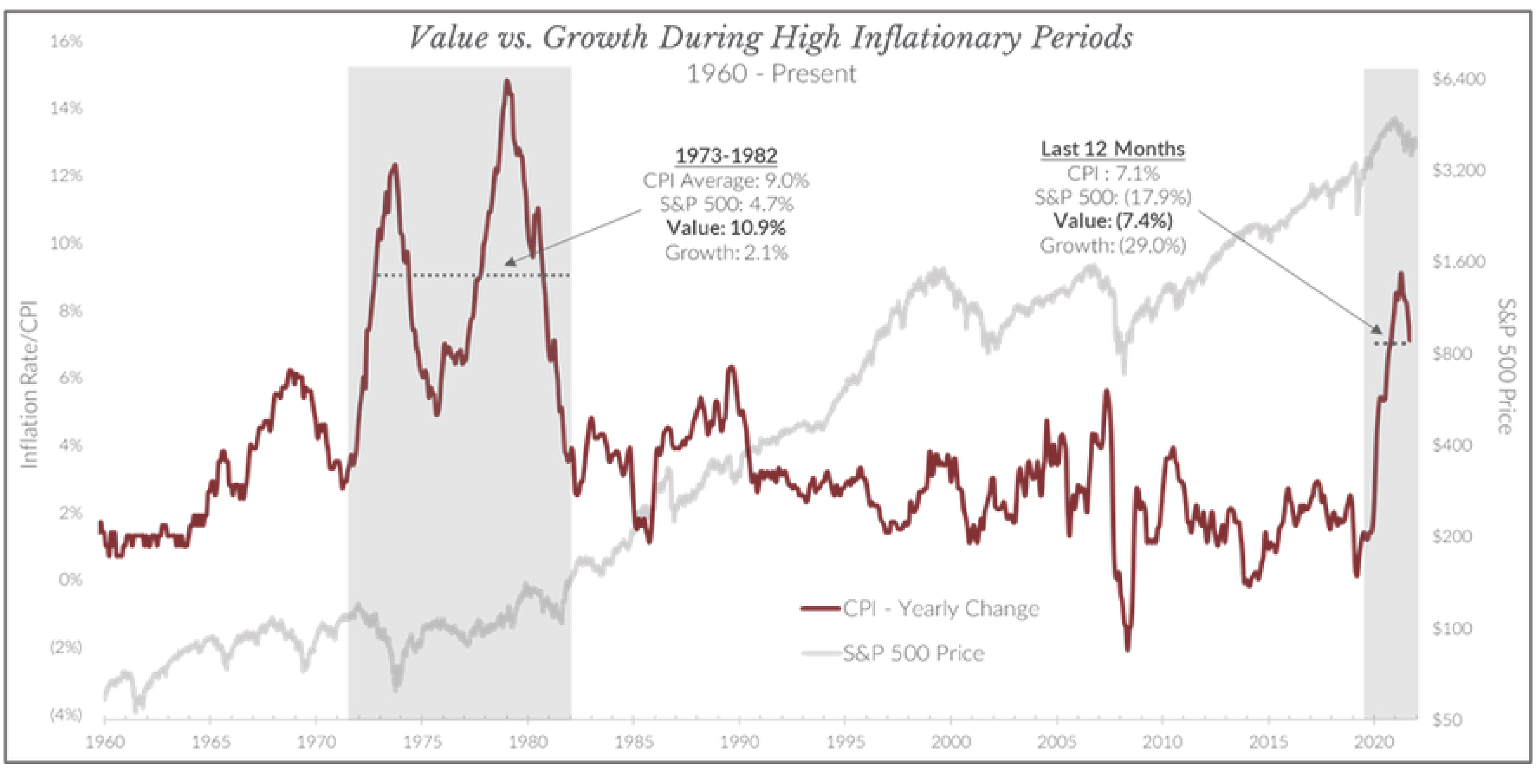
Another silver lining, and not one to be understated, is that many pockets of excess which have been bubbling up in the near-zero interest rate environment – have finally burst. Think cryptocurrencies, pandemic "stay at home stocks" like Zoom and Peloton, and tech stocks with sky-high valuations despite little to no earnings. With that era in the rearview mirror, the market has begun to place a higher value on real companies with real earnings.

Looking ahead to 2023 – We think inflation will remain a key theme.

While we think inflation has peaked – meaning price increases should continue to slow - we also believe inflation could remain somewhat elevated. The Fed can only do so much to combat inflation. Their primary tool to combat inflation is raising interest rates, which they aggressively did in 2022. However, there's little they can do to solve for a world economy moving towards less globalization and a decade of under-investment in energy resources. Less globalization (onshoring to the US) and dampened supply for oil and natural gas lead us to believe that inflation should linger and remain higher than we would like. We do not forecast a 5%+ period of inflation as far as the eye can see, but we certainly believe we are entering an environment where inflation remains higher than the 1%-2% range it has been for over a decade. What does this mean? Here are two major investment themes to keep in mind.

1. Dividend Stocks can help combat higher inflation.

If inflation stays elevated, history shows us that value stocks (which tend to pay higher dividends) have historically weathered the storm better than growth-oriented stocks. If inflation is eating away at the value of a dollar, investors typically want cash in their hands sooner rather than later. And what helps to solve that problem? Companies that pay dividends today (value stocks) not a promise to pay in the future (growth stocks). We've already seen this start to play out in 2022, and we think this could be the start of a multi-year dividend renaissance. We believe this is one of the most important charts to understand as we move into 2023, as the last period of sustained inflation in the 1970s and the last 12 months both saw value stocks significantly outperform growth stocks. See below.

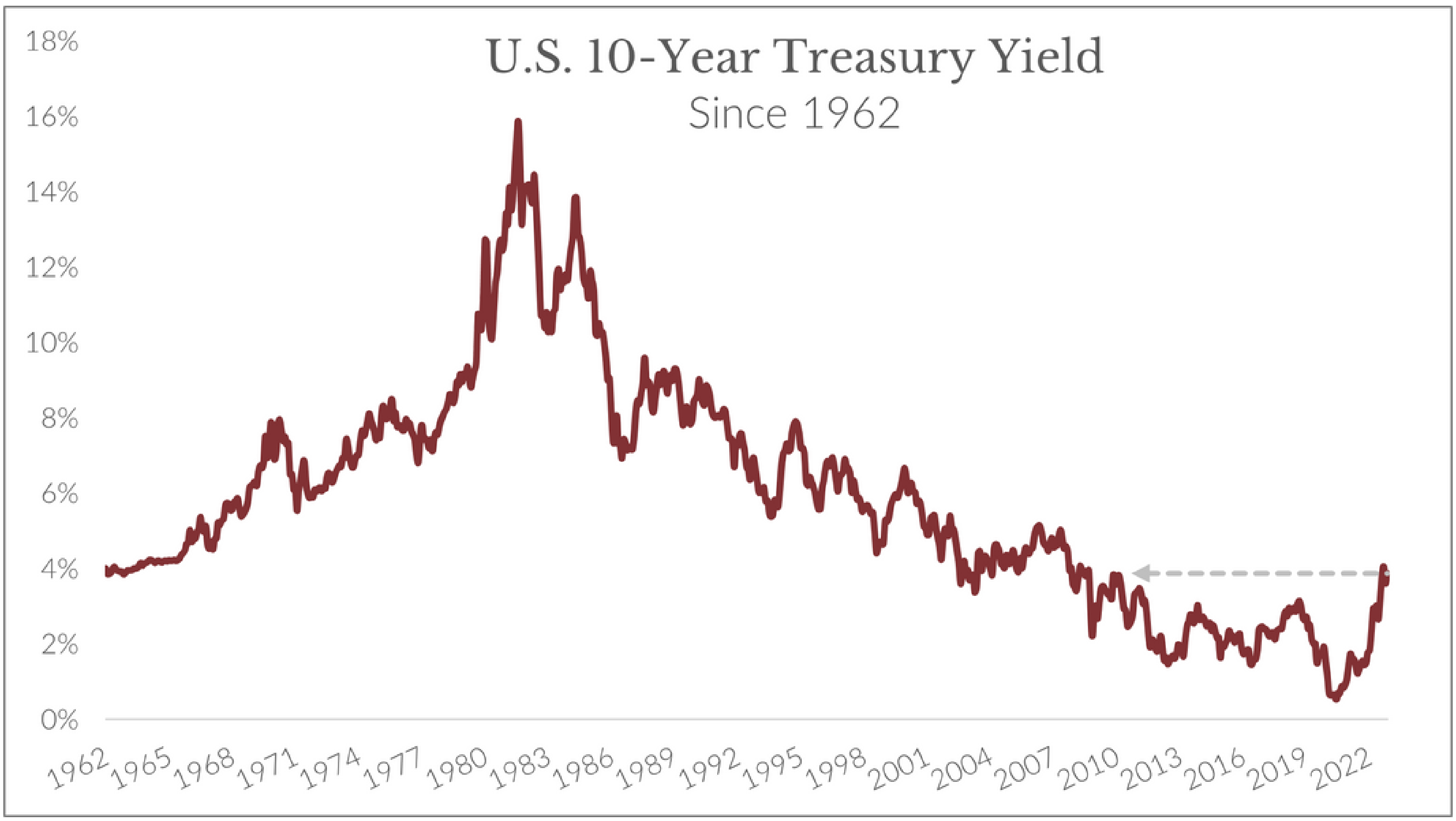


Source: Capital Investment Advisors; Bloomberg data

2. Bond yields are now at 15-year highs

Many high-quality bonds are now paying 4%-5%, around the highest in nearly 15 years. While the road to get here has been rough, as income-oriented investors, we are happy to get a much better rate of return in bonds. That said, given our belief inflation is here to stay, prudence is still required. Still, we should all toast to the fact that we can invest in high-quality bonds and generate higher interest payments than we've seen in 15 years!

> **WE THINK THIS COULD BE THE START OF A MULTI-YEAR DIVIDEND RENAISSANCE.**
>
> *Robert Sanders, co-CIO of Capital Investment Advisors*



Source: Capital Investment Advisors; Bloomberg data

Bottom line

2022 was a historically difficult year, but we're pleased that the consistent income we aim to deliver provided some cushion and safety in a difficult market with very few places to hide.

As Peter Lynch reminds us, "The real key to making money in stocks is not to get scared out of them." While we do not know specifically what 2023 will have in store for us, we do believe a continued focus on high-quality stocks and bonds that provide consistent and growing income will remain as important as ever.

> **THE REAL KEY TO MAKING MONEY IN STOCKS IS NOT TO GET SCARED OUT OF THEM.**
>
> *Peter Lynch*

P.S. We are pleased to announce that Connor Miller, who has been with CIA for eight years has been promoted to the position of co-CIO (Chief Investment Officer), along with his long-time mentor and now current co-CIO Robert Sanders.

We are optimistic about what the future holds and, as always, are here to help in any way.

Happy New Year!

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