# MARKET MINUTE
## WITH McGAREL


**Dave McGarel, CFA, CPA**
Chief Investment Officer


**January 2023**

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

The **S&P 500 Index** - An unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index.

### Setting Expectations

In October's Market Minute, we wrote, "Fed Chairman Jerome Powell was very clear in his September 21st press conference when he said "First, we'll want to see growth continuing to run below trend [. . .] We think of trend as being about 1.8% or in that range." And in December we started the Market Minute with "For the three calendar years ending in 2021, the price appreciation of the S&P 500 Index was 90%."

Those comments alone tell us that equity investors should expect a more challenging environment in the near future. Slower GDP growth ultimately leads to slower earnings growth. Slower earnings growth means no multiple expansion to goose stock returns. We expect lower than average equity returns in the years ahead.

Even with 2022's decline of 18% in the S&P 500 Index, equities produced an average annual return of 13% over the last four calendar years. Historically low interest rates in 2019 through 2021 along with massive fiscal stimulus helped GDP grow at an unsustainable 5.7% in 2021. In our view, huge earnings beats, multiple price-to-earnings expansion, a large dose of speculation plus a lack of regard for valuation drove stocks higher. What do we have in front of us today?

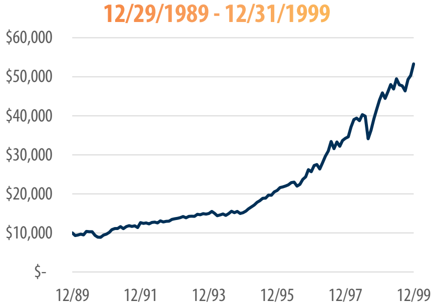
Whether we have a recession starting tomorrow or next December, we all know that higher rates and slower GDP growth will affect earnings. We believe earnings are going to grow slower than in the past several years as the Fed Funds rate stays higher and the Fed is determined to hold down the potential growth of the economy. It will certainly show up in earnings starting this year and that means equity returns are going to be more muted, in our opinion.

In fact, we don't expect the market to return the 90% price appreciation it achieved in 2019-2021 through the rest of this decade. That's seven more years! If the market appreciates just 6% on average through the end of 2029, the cumulative price return would be 50%. Add in 2% in dividends per year and the total cumulative return is just over 70%. Not so bad. Entering 2023, that seems about right from a starting point of reasonable but not cheap valuations, a recession at some point this decade if not very soon, and a GDP forecast averaging closer to 2% than 5% for the next seven years.

Why own stocks at all? Lots of reasons. U.S. companies can navigate a higher interest rate environment that actually just looks normal for most seasoned investors. We believe stocks are still better hedges against inflation than bonds. The capital that, in hindsight, was misallocated to speculative "story" stocks or make believe currencies or Non-Fungible Tokens, etc. is ending and will no longer distract investors who are afraid of missing out. Investors will look to fundamentals, cash flows, dividends, in other words the quality and value themes we have advocated in previous Market Minutes. Stay in that lane and we believe it can still be a good time for stock investors. And, always remember, the U.S. stock market is the greatest wealth engine ever created and it has everything to do with time and almost nothing to do with timing.

### S&P 500 Index Decade Returns and Valuation

**12/29/1989 - 12/31/1999**




| Yearly Returns | |
|---|---|
| 1990 | -3.1% |
| 1991 | 30.5% |
| 1992 | 7.6% |
| 1993 | 10.1% |
| 1994 | 1.3% |
| 1995 | 37.6% |
| 1996 | 23.0% |
| 1997 | 33.4% |
| 1998 | 28.6% |
| 1999 | 21.0% |
| **AAR** | **18.2%** |

12/31/1999

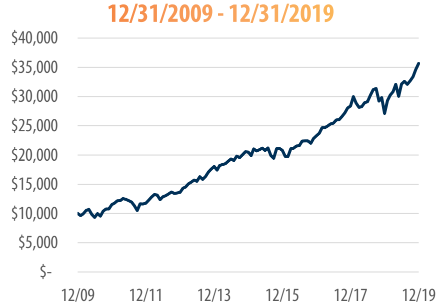
**Price-to-Cash Flow**
19.4

**Price-to-Earnings**
30.8

**Price-to-Book**
5.4

**1990s**

**12/31/2009 - 12/31/2019**




| Yearly Returns | |
|---|---|
| 2010 | 15.1% |
| 2011 | 2.1% |
| 2012 | 16.0% |
| 2013 | 32.4% |
| 2014 | 13.7% |
| 2015 | 1.4% |
| 2016 | 12.0% |
| 2017 | 21.8% |
| 2018 | -4.4% |
| 2019 | 31.5% |
| **AAR** | **13.6%** |

12/31/2019

**Price-to-Cash Flow**
16.1

**Price-to-Earnings**
22.2

**Price-to-Book**
3.4

**2010s**

**12/31/1999 - 12/31/2009**


| Yearly Returns | |
|---|---|
| 2000 | -9.1% |
| 2001 | -11.9% |
| 2002 | -22.1% |
| 2003 | 28.7% |
| 2004 | 10.9% |
| 2005 | 4.9% |
| 2006 | 15.8% |
| 2007 | 5.5% |
| 2008 | -37.0% |
| 2009 | 26.5% |
| **AAR** | **-0.9%** |

12/31/2009

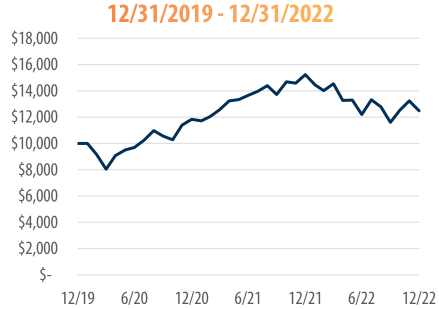
**Price-to-Cash Flow**
12.7

**Price-to-Earnings**
18.4

**Price-to-Book**
2.3

**2000s**

**12/31/2019 - 12/31/2022**




| Yearly Returns | |
|---|---|
| 2020 | 18.4% |
| 2021 | 28.7% |
| 2022 | -18.1% |

12/31/2022

**Price-to-Cash Flow**
14.5

**Price-to-Earnings**
20.4

**Price-to-Book**
4.1

**2020s**

Source: Bloomberg and Compustat. **Past performance is no guarantee of future results.** For illustrative purposes only and not indicative of any investment. Indexes do not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown.