



Five Key Insights From 2022

January 2023



KEY INSIGHTS

- The Fed is committed to do whatever it takes to curb inflation. Meanwhile, a focus on socially oriented goals could impact economic policies in China.
- The rout in bonds helped to restore healthy yields but reminded investors that stocks and bonds can sometimes sell off at the same time.



Tim Murray, CFA
*Capital Markets Strategist,
Multi-Asset Division*

As we reflect on a momentous year, I would like to share these five insights from 2022 that I believe will continue to influence financial markets in the new year.

1. Valuation matters.

After starting the year at elevated levels, equity valuations quickly adjusted downward once investors realized that steep interest rate hikes were imminent. While equity markets sold

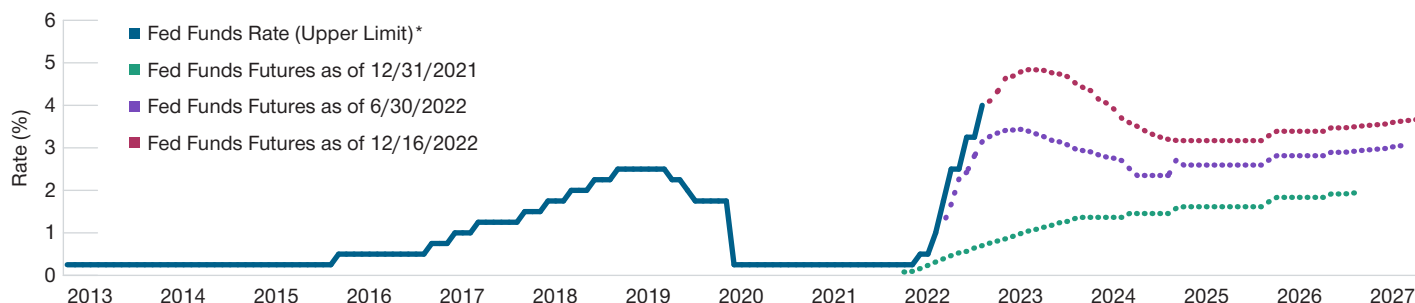
off meaningfully during 2022, earnings expectations fell only modestly. This, unfortunately, means that a decline in earnings expectations in 2023 due to a global recession could worsen the sell-off in stocks.

2. The Fed remains committed to fighting inflation.

Market expectations for the federal funds rate were consistently too low in 2022 (Figure 1). In fact, how high the Federal

The Evolution of Fed Market Expectations

(Fig. 1) The Fed will choose fighting inflation over supporting the economy



* January 2013 to November 2022, futures estimates through August 2027.

Actual outcomes may differ materially from estimates. Estimates are subject to change.

Source: Bloomberg Finance L.P.

Reserve will raise rates and how long they will hold them at elevated levels remains unknown. What is clear is that they are determined to avoid a replay of the 1970s and will do whatever it takes to get inflation back to healthy levels, even if their actions push the U.S. economy into recession. In 2023, the Fed's primary focus will be on lowering wage inflation, and we should not expect a shift in policy unless the labor market also weakens considerably.



3. China has changed.

The year 2022 proved to be one of considerable change in China, which saw the leadership of President Xi Jinping extended. Notably, while the Chinese government has indicated that economic growth remains important, it intends to reinvigorate socially oriented goals. This could lead to less predictable economic policy changes in the future. We were surprised by the easing of COVID restrictions in December, and investors should be prepared for more uncertainty going forward.



4. Stocks and bonds can sell off simultaneously.

Bonds have historically offered ballast to investors' portfolios when equities

flattered. However, this has not always been the case, particularly in periods when the Fed embarks on a new hiking cycle, as happened in 2022. Further, 2022 was somewhat of an outlier because the Fed usually tightens when growth is accelerating—which was not the case in 2022—and interest rate hikes are typically more gradual. Fortunately, stock/bond correlations should likely fall in 2023, as the Fed appears close to the end of its hiking cycle.



5. Yield is back.

The silver lining to the rout in bonds during 2022 is that bonds have healthy yields once again. This means that investors no longer have to take significant credit risk to get a healthy yield from their bond portfolio. In addition, investors can also enjoy a potentially larger income buffer to help offset any further increases in interest rates and/or credit spreads¹.

As we welcome 2023, we will continue to monitor these market themes and provide updates accordingly.

¹ Credit spreads measure the additional yield that investors demand for holding a bond with credit risk over a similar-maturity, high-quality government security.

INVEST WITH CONFIDENCE®

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term. To learn more, please visit troweprice.com.

T.RowePrice®

Important Information

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action.

The views contained herein are those of the authors as of January 2023 and are subject to change without notice; these views may differ from those of other T. Rowe Price associates.

This information is not intended to reflect a current or past recommendation concerning investments, investment strategies, or account types, advice of any kind, or a solicitation of an offer to buy or sell any securities or investment services. The opinions and commentary provided do not take into account the investment objectives or financial situation of any particular investor or class of investor. Please consider your own circumstances before making an investment decision.

Information contained herein is based upon sources we consider to be reliable; we do not, however, guarantee its accuracy. **Actual future outcomes may differ materially from any estimates and forward-looking statements made.**

Past performance is not a reliable indicator of future performance. All investments are subject to market risk, including the possible loss of principal. Fixed-income securities are subject to credit risk, liquidity risk, call risk, and interest-rate risk. As interest rates rise, bond prices generally fall. International investments can be riskier than U.S. investments due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional, and economic developments. These risks are generally greater for investments in emerging markets. All charts and tables are shown for illustrative purposes only.

T. Rowe Price Investment Services, Inc.

© 2023 T. Rowe Price. All Rights Reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.