SIACharts Quarterly Outlook & Chartbook – Winter 2023

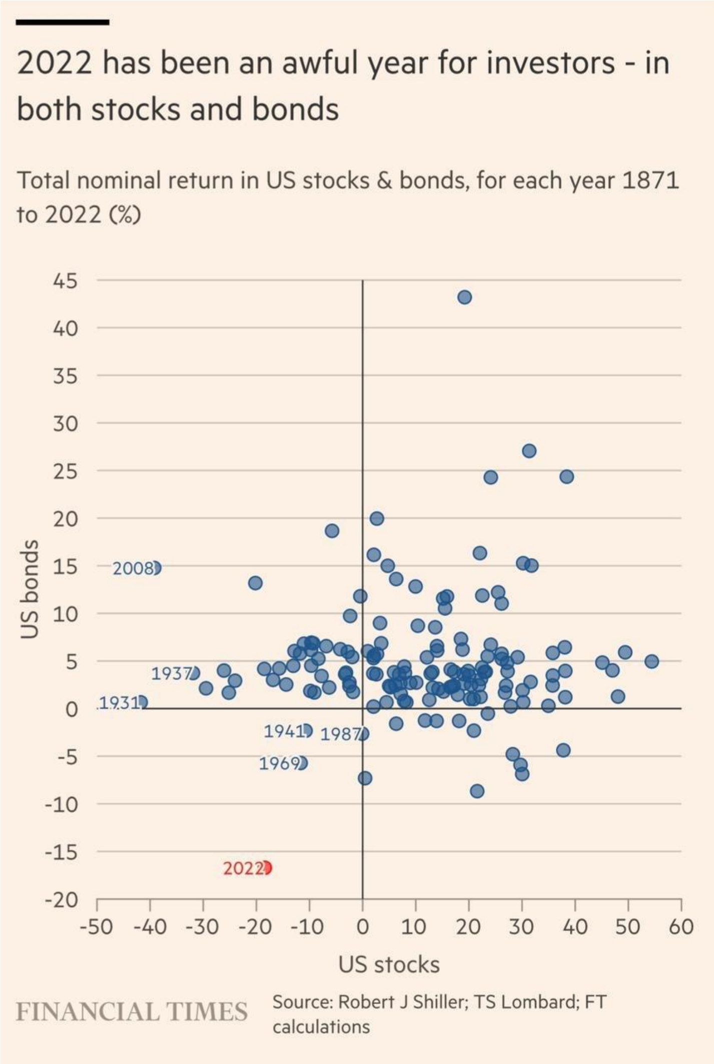
In this Q1 Outlook, we review some of the key monetary, economic and political trends which impacted equity markets and captial flows across asset classes in 2022. We then move into how factors driving market action changed in Q4 and how investors focus has changed heading into 2023.

Summary: 2022 was a volatile year for world markets where investors struggled with tightening monetary policy, change in a 40-year trend for bonds, Ukrainian War, and political tensions having a significant impact on the world economy. Entering 2023, capital flows between asset classes remain active but leadership has started to change. The SIA Equity Action Call™ has returned to the Favored Zone, where equities have once again started to exhibit some strength and Fixed Income looks for a bounce back year with interest rates expected to slow down.

Tel: 1-877-668-1332
Email: siateam@siacharts.com
Web: www.SIACharts.com

Changing of the Guard: Presidential Cycle, China Reopening, Interest Rates and Relative Strength Analysis suggest Shifts in Focus may be under Way

2022 was a turbulent year for world markets which turned out to be one of the worst years for combined US equity and bond market total nominal returns since the 1870s. There have been worse years for the equity markets like 1931, 2008, 1937, etc., with 2022 coming in around 7th worst year since 1920s down -19.4%. The benchmark U.S. Government bond index was down more than -15% in 2022, making it the worst year ever for US bonds. Looking at a 60/40 portfolio of US stocks and bonds, 2022 came out around -17% which marks the worst year since 1937 for a 60/40 portfolio.



Soaring inflation caused interest rates to break out of a forty-year downtrend, sparking a big rally in the US Dollar and a crunch in equity market vaulations, particulary for "Growth" stocks in the Technology and Communications sectors.

Several other factors converged to weigh on equity and commodity markets around the world including US midterm elections, the Ukraine War and related sanctions, and ongoing COVID restrictions in China.

Analysis of relative strength and capital flows indicated that some of the trends which dominated the first three quarters of 2022 started to change and/or reverse course in the fourth quarter of 2022, potentially setting the stage for a different year in 2023 in terms of investor focus and capital flows. Specifically, bonds should have a bounce back year with interest rates expected to slow in 2023 and the asset class has already moved up in relative strength rankings in the top 3 asset classes after spending all of 2022 near or at the bottom of the rankings.

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Email: siateam@siacharts.com
Web: www.SIACharts.com

Key Themes for Investors to Consider in the Winter of 2023

Presidential Cycle Shifts from Historically Weakest Year to Historically Strongest

Dow Jones Industrial Average Returns				
Presidential Year	**1**	**2**	**3**	**4**
All Cycles				
Average 1913-2000	3.53%	6.91%	21.88%	11.83%
Average 2001-2022	13.57%	0.61%	11.48%	(0.55%)
First Term Only				
Average 1913-2000	5.86%	5.86%	24.37%	12.83%
Average 2001-2022	13.89%	(5.04%)	17.73%	5.89%
President Trump	25.08%	(5.63%)	22.34%	7.25%
President Biden	18.73%	(8.78%)		
Source: SIA Charts				

2022 was the second year of the current Presidential cycle, a year that historically has been the worst of the four years, but entering 2023, we are now in Year 3 of the current cycle, the year which has historically been the strongest.

The Presidential Cycle suggests that Presidents tend to spend their first two years in office bringing in controversial or unpopular measures, often culminating in some kind of repudiation at midterm elections that often coincide with equity market volatility and cycle lows, as was seen in 1998, 2002, and 2018. Years' 3 and 4 have historically seen presidents shift to policies friedlier to the economy and stock markets as focus shifts toward getting themselves and/or their parties re-elected.

The table above shows that Year 2 for first-term presidents has been negative on average since 2001, including the second years of both President Biden and President Trump. The table also shows that equity markets have staged a strong rebound in Year 3, particularly in a President's first term.

Inflation, Interest Rates, & Bear Markets

Perhaps the biggest headwind that equity and fixed income investors faced in 2022 was the sudden shift by the Fed from dovish to hawkish monetary policy which was forced by the need to get soaring inflation under control and meet its mandate.

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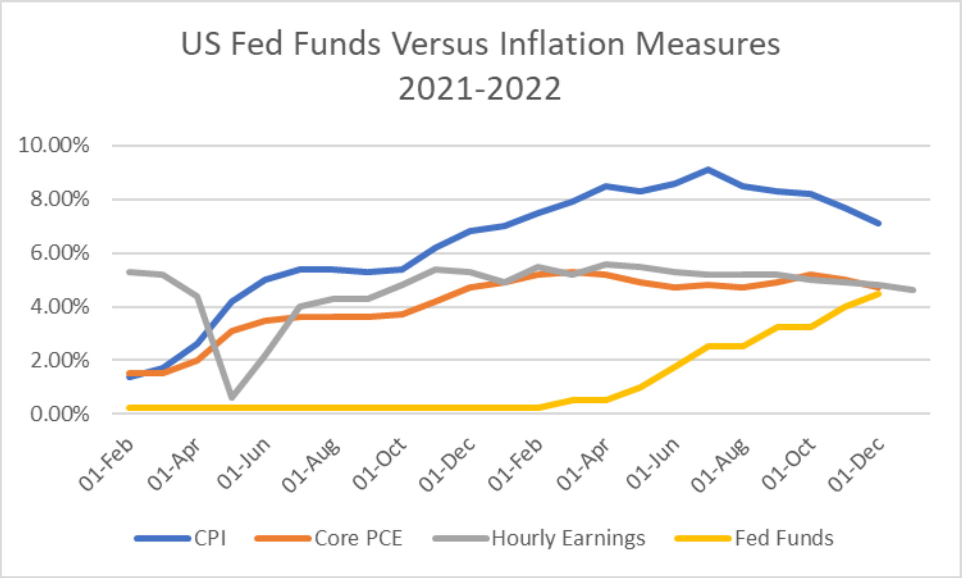
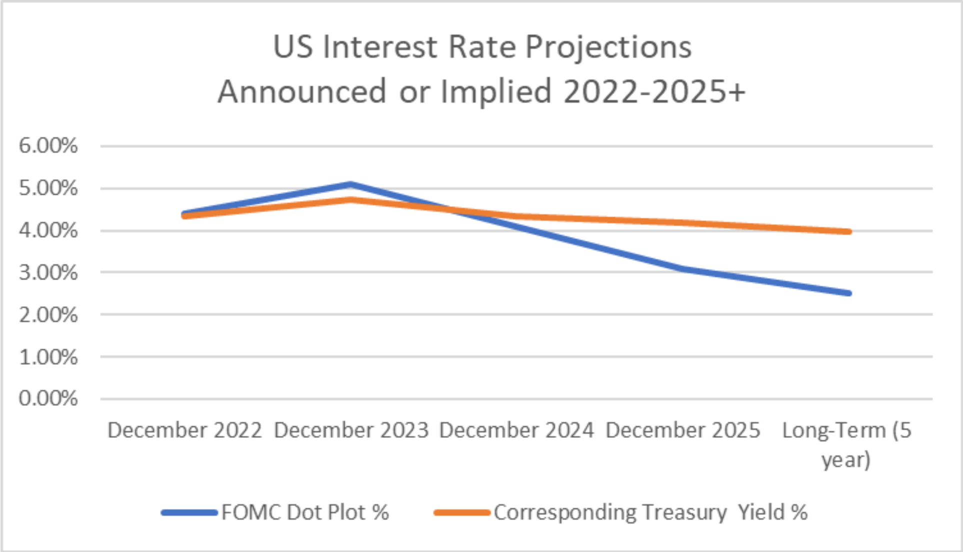


The chart shows how the Fed Funds rate (orange) steadily climbed through 2022 in a bid to catch up with inflation.

Historically, monetary tightening cycles in the US have not come to an end until the Fed Funds rate was higher than the Consumer Price Index. The question for investors in the second half of 2022 has been where may the two rates meet in the middle, and how long may the Fed have to keep interest rates at a higher level to get inflation back down? The potentially good news is that the US Consumer Price Index (blue) peaked back in the summer and has been trending downward in recent months. Heading into 2023, investor focus may turn more toward wage inflation, noted here in hourly earnings growth (grey), which historically has been more difficult to contain than commodity inflation.

Toward the end of 2022, the Fed started to slow the pace of interest rate increases but also moved up its terminal interest rate forecast.



Comparing the Fed Funds forecasts of FOMC Members (blue) with the implied forecast of investors based on treasury yields (orange) has positive and negative implicaitons.

On the negative side, investors appear to be more dovish than FOMC members for 2023, which could set the stage for a

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Email: siateam@siacharts.com
Web: www.SIACharts.com

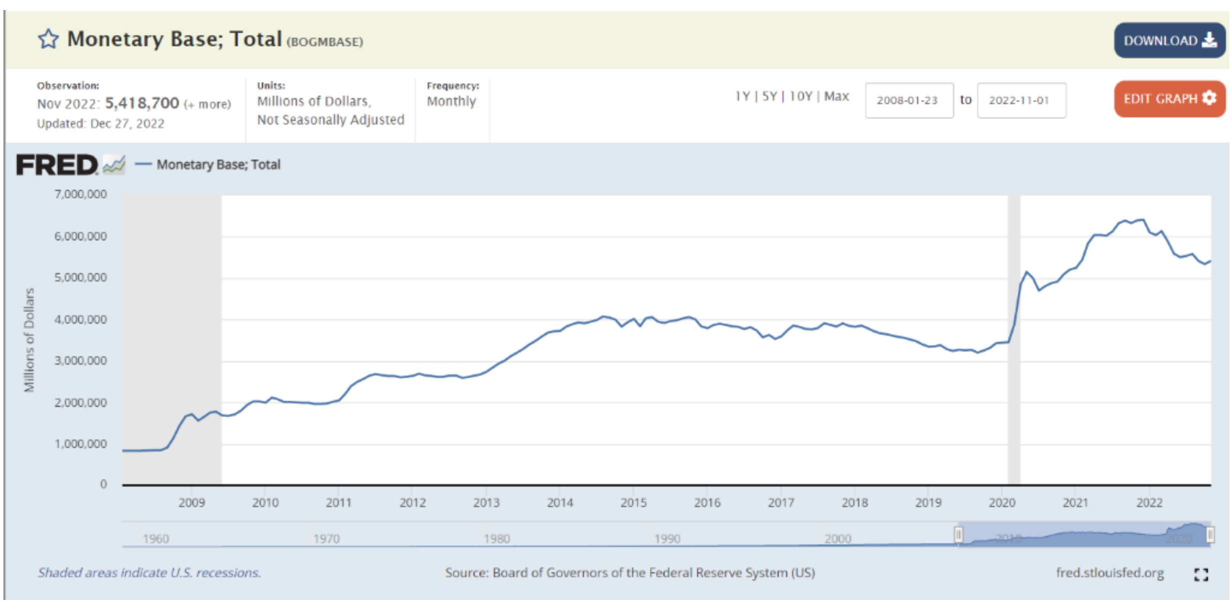
negative surprise at some point this year. From 2024 onward, however, FOMC member forecasts are more dovish than investors implied forecasts which could become a positive in the longer term. A change in the outlook for interest rates could particularly infuence trading in bonds.

However, the big question facing equity investors in 2023 is what could the end of the current hiking cycle mean for equity markets? Historically, tightening monetary policy has led to a slowdown in the economy and had a negative impact on corporate earnings. In each cycle so far this century, equity markets have declined after interest rates peaked.

Fed Funds Peak Month	Dow Jones Peak Month	Dow Jones Bottom Month	Change in Monthly Close Fed Funds Peak to Market Bottom
June 2000	December 1999	September 2002	-27.3%
June 2007	October 2007	March 2009	-50.6%
April 2019	December 2019	March 2020	-23.1%
TBD	December 2021	September 2022 (For Now)	

Source: SIA Wealth Management

How equity and bond markets respond to changes in interest rates may also depend on how much consideration investors may give to Quantitative Tightening programs which may run and present a potential headwind to markets for the next several years.



The chart shows that so far, the Fed has reduced its balance sheet from near 6.4 Trillion toward 5.4 Trillion last year, but it still has some way to go to return to the 3-4 Trillion range that persisted in the 2014 to 2019 time frame.

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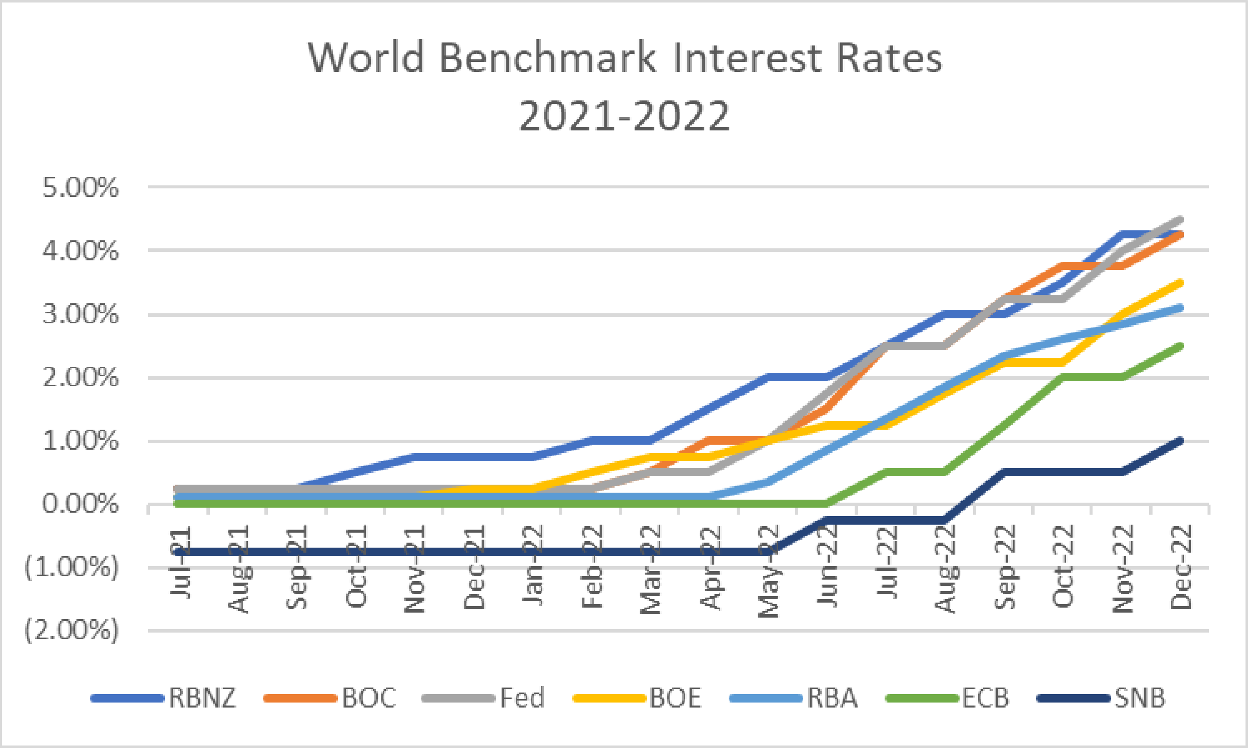
Email: siateam@siacharts.com
Web: www.SIACharts.com

Monetary Policy, Gold, & Currency Markets

Over the course of 2022, most of the major central banks around the world shifted their stance from dovish to hawkish. But at different times, when combined with differing economic performance across regions, central banks drove significant differences in performance between different currencies and various equity markets.



The chart demonstrates the Reserve Bank of New Zealand (RBNZ – dark blue) was the first central bank to start tightening, followed by the Bank of Canada (BOC – dark orange), and the US Federal Reserve Board (Fed – grey).

The Bank of England (BOE – orange) also started early but raised at a slower pace, while the Reserve Bank of Australia (RBA – light blue), started later but moved at a faster pace. The European Central Bank (ECB – green) and the Swiss National Bank (SNB – purple) started later as well.

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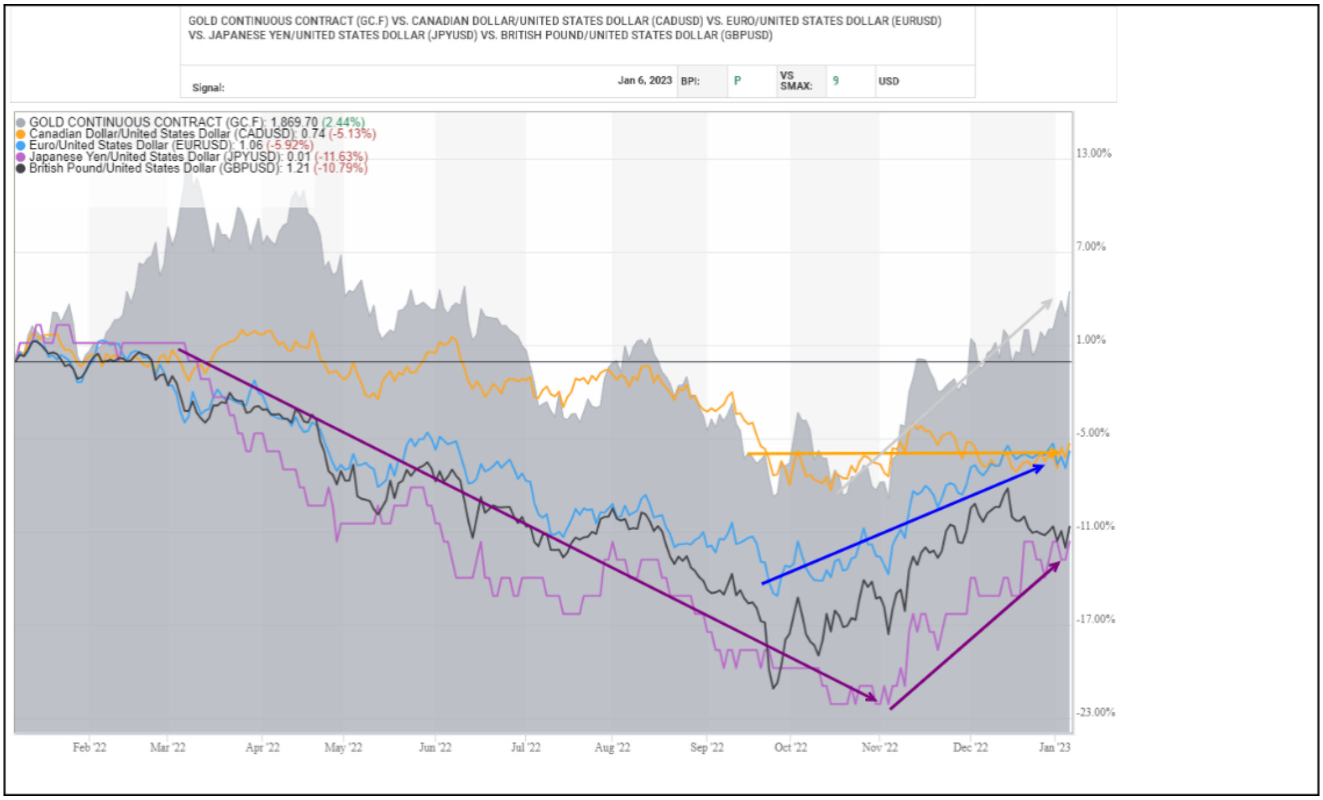
The Bank of Japan remained dovish through the year but started to talk hawkish at the end of the year after seeing their currency (JPYUSD – purple) crushed. The most interesting part of the chart below is the defensive haven relationship between the Yen and Gold (GC.F - grey) which historically had made them fellow travellers was shattered in 2022 as Gold maintained its role as a store of value.



The general downtrend of all the currecies in the chart is indicative of the strength of the US Dollar which steamrolled over nearly everyting in its path for most of the year. In the fourth quarter, Gold (grey), the Pound (black), and Euro (blue) all started to recovery in Q4 as the US Dollar rally relented. The Canadian Dollar (orange) which had performed similar to Gold and better than many of its paper peers for much of the year, struggled in late 2022 along with the oil price, and signalled that the Bank of Canada was also starting to slow the pace of interest rate increases.

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Email: siateam@siacharts.com
Web: www.SIACharts.com

International Equity Markets Leading the Latest Market Rebound

2022 was an active year for US markets with six swings (up or down) of more than 10%, particularly in comparison with 2021 where there were no corrections of 10% or more! For most of the year, US equities outperformed overseas equity markets for similar reasons to the US Dollar outperformance, primarily because the North American economy ended up being an island of stability in a turbulent world where external factors such as the war in Ukraine on Europe and COVID measures in China on Asia Pacific countries, had a negative impact on overseas economies.

The chart above compares overseas equity markets in Hong Kong (black), Germany (blue) and Japan (purple) started to turn downward in the second half of 2021 and underperformed dramatically compared with US equities (grey) which peaked in January of 2021 and Canadian Equities (orange), which did not peak until April of 2022 after benefitting from their higher exposure to energy stocks.

The chart also shows Hong Kong and Germany staged stronger rebounds in the fourth quarter and continuing into this year so far, with Hong Kong benefitting from positively received moves toward reopening the Chinese economy.

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Capital Rotaton between Defense and Offense in Equity Markets

One of the main themes of 2022 was an increase in fear among investors who retrenched away from traditional “risk on” plays like growth stocks/sectors and emerging markets and moved back toward “risk off” defensive havens for capital like value stocks/sectors and gold. Perhaps the most high-profile example of this was the implosion of cryptocurrency values, companies, and exchanges over the course of the year.

The chart below compares the performance of the S&P 500 (grey) over the last year in comparison with US Value stocks (blue), US Growth stocks (orange), Emerging Markets (purple), and US Small Cap stocks (black) the last three of which have historically been favored when investors have been confident and willing to take on risk for potential enhanced returns.

For most of 2022, Growth stocks and Emerging Markets were particularly weak, while Value stocks outperformed by falling less, confirming their role as a more defensive part of the market.   Toward the end of the year, Emerging Markets started to rebound strongly likely due to the sensitivity of many Emerging Markets to Commodity stocks or to Chinese demand both of which may benefit from China reopening. Sentiment otherwise remained cautious with Value outperforming Growth in recent weeks, and an October bounce in small caps stalling out.

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Email: siateam@siacharts.com
Web: www.SIACharts.com

Leadership Changes in Commodity Markets

Over the course of 2022, leadership among commodities changed sigificantly.

Crude Oil (blue) dominated the first half of the year as investors focused on supply issues related to the war in Ukraine and related sanctions. In the second half of the year, oil retreated as focus shifted to demand issues with Chinese resource demand slumping.

With China starting to reopen, Crude Oil has stabilized while metals have shifted into a leadership role, as Copper (purple) and Platinum (black) rallied toward the end of the year.

In altenative currencies, Gold (grey) increasingly outperformed Bitcoin (orange) as cryptocurrencies increasely fell out of favor with investors, a series of crypto related bankruptcies shattered investor confidence and investor appetite for risk markets remained soft.

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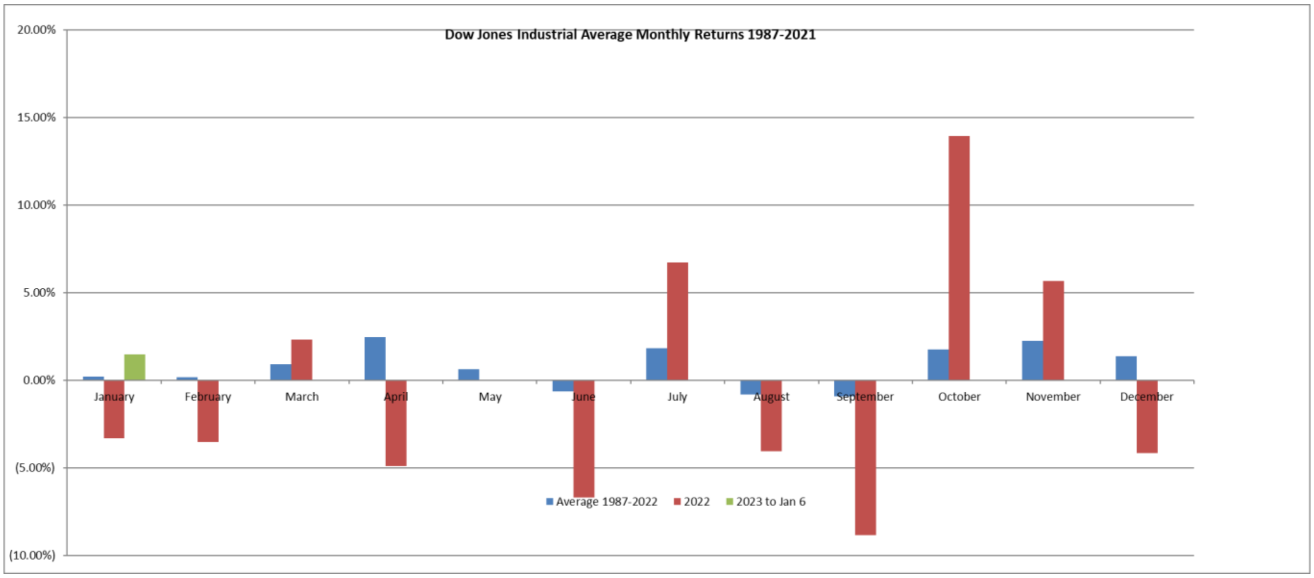
Equity Market Seasonality



For the most part, montly equity market movement in 2022 followed a similar pattern to historical direction, but the moves tended to be more extreme. For example seasonal selloffs in June and August-September were significantly worse than average, while seasonal bounces in July and October-November were stronger than average. January-February, April, and December saw markets drop in months where the average historical return was positive.

The December decline can partly be blamed on the impact of tax loss selling and with that over, equity markets have started to rebound with the first week of January coming in stronger than average.

Summary: 2022 was a volatile year for world markets where investors struggled with tightening monetary policy, a change in a 40-year trend in bonds, and political tensions and decisions having a significant impact on the world economy. Entering 2023, capital flows between asset classes remain active but leadership has started to change. The SIA Equity Action Call™ has returned to Favored Zone, indicating that equities have once again started to exhibit strength relative to non-equity asset classes.

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Asset Class and Sector Ranking Analysis

SIA Charts Asset Class Ranking		
As of Dec 31, 2022		
Asset Class	Change*	
Interational Equity	+5	
US Equity	+2	
Bond	+2	
CAD Equity	+3	
Cash	-4	
Currency	-4	
Commodities	-4	
*Change in Ranking Since Sept 30, 2022		
Source: SIA Charts		

The fourth quarter was one of the most active we have seen in the SIA Charts Asset Class Rankings in many years. There was a seismic shift over the quarter with the defensive Cash and Currency asset classes dropping from the top of the rankings to the bottom, and Commodities plunged down the rankings as energy commodities fell back to Earth.

Conversely, the three equity asset classes soared back up the rankings led by International Equity and Bonds climbing up off the mat for the first time in several quarters.

As a result of this dramatic pendulum swing back toward equities and improving general sentiment toward risk, the **SIA Equity Action Call™ moved from the Unfavored zone to the Neutral to the Favored zone over the course of November.**

Although the top of the chart remained unchanged, there were several significant changes farther down in the SIACharts' Sector rankings.

With metal prices on the rebound in Q4, Materials jumped up three spots in the rankings.

The most significant changes were down in the Unfavored zone where the defensive Health Care and Consumer Staples sectors jumped 4 and 2 positions respectively, while the more "growth/momentum" sectors of Information Technology and Communications sectors dropped to the bottom of the pile.

SIA Charts Sectors Ranking		
As of Dec 31, 2022		
Sector	Group	Change*
Energy	Resource	none
Consumer Discretionary	Cyclical	none
Materials	Resource	+3
Industrials	Cyclical	-1
Utilities	Interest Sensitive	-1
Financials	Interest Sensitive	-1
Health Care	Defensive	+4
Consumer Staples	Defensive	+2
Real Estate	Interest Sensitive	-1
Information Techology	Cyclical	-1
Commuications Services	Cyclical	-4
*Change in Ranking Since Sept 30, 2022		
Source: SIA Charts		

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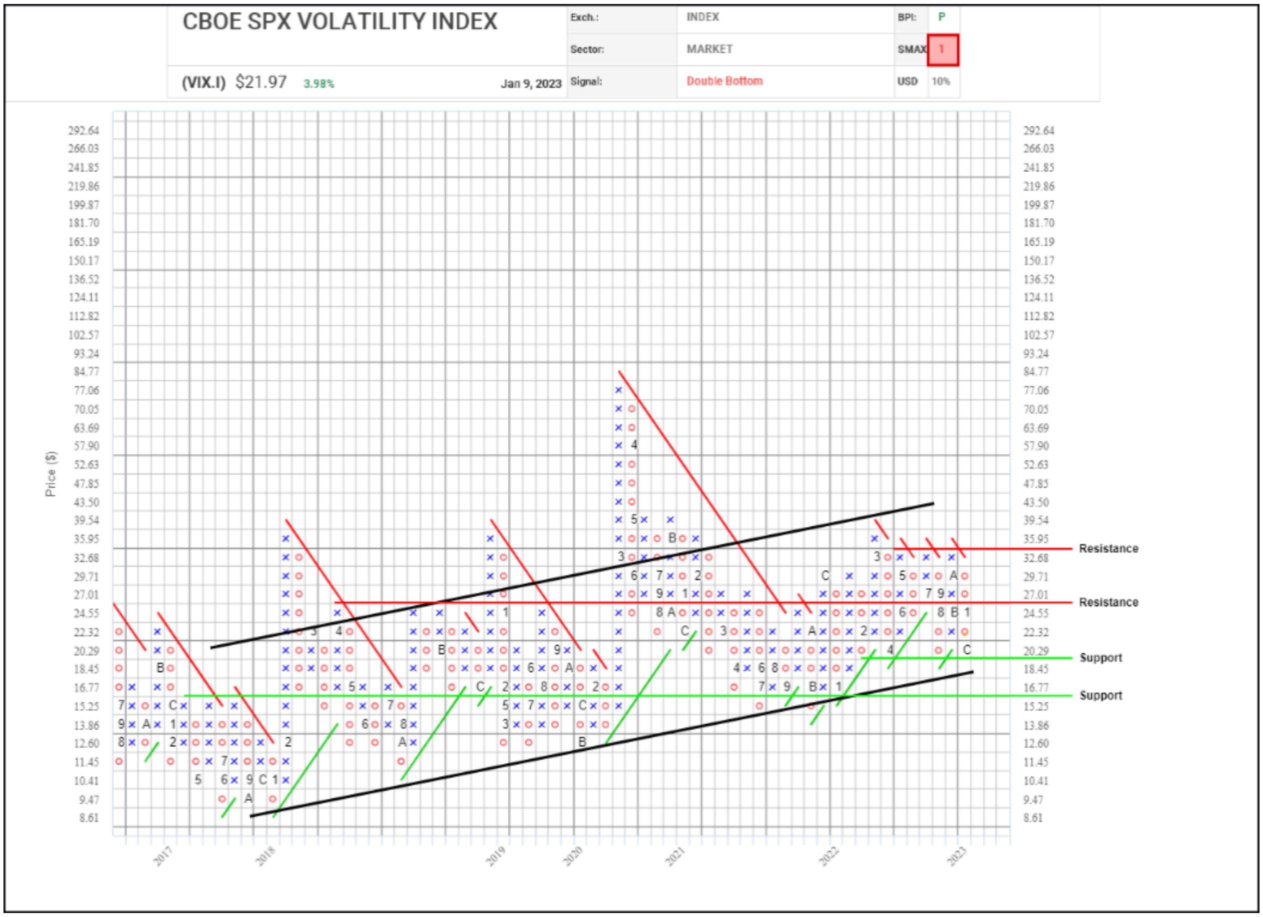
CBOE SPX Volatility Index (VIX.I)

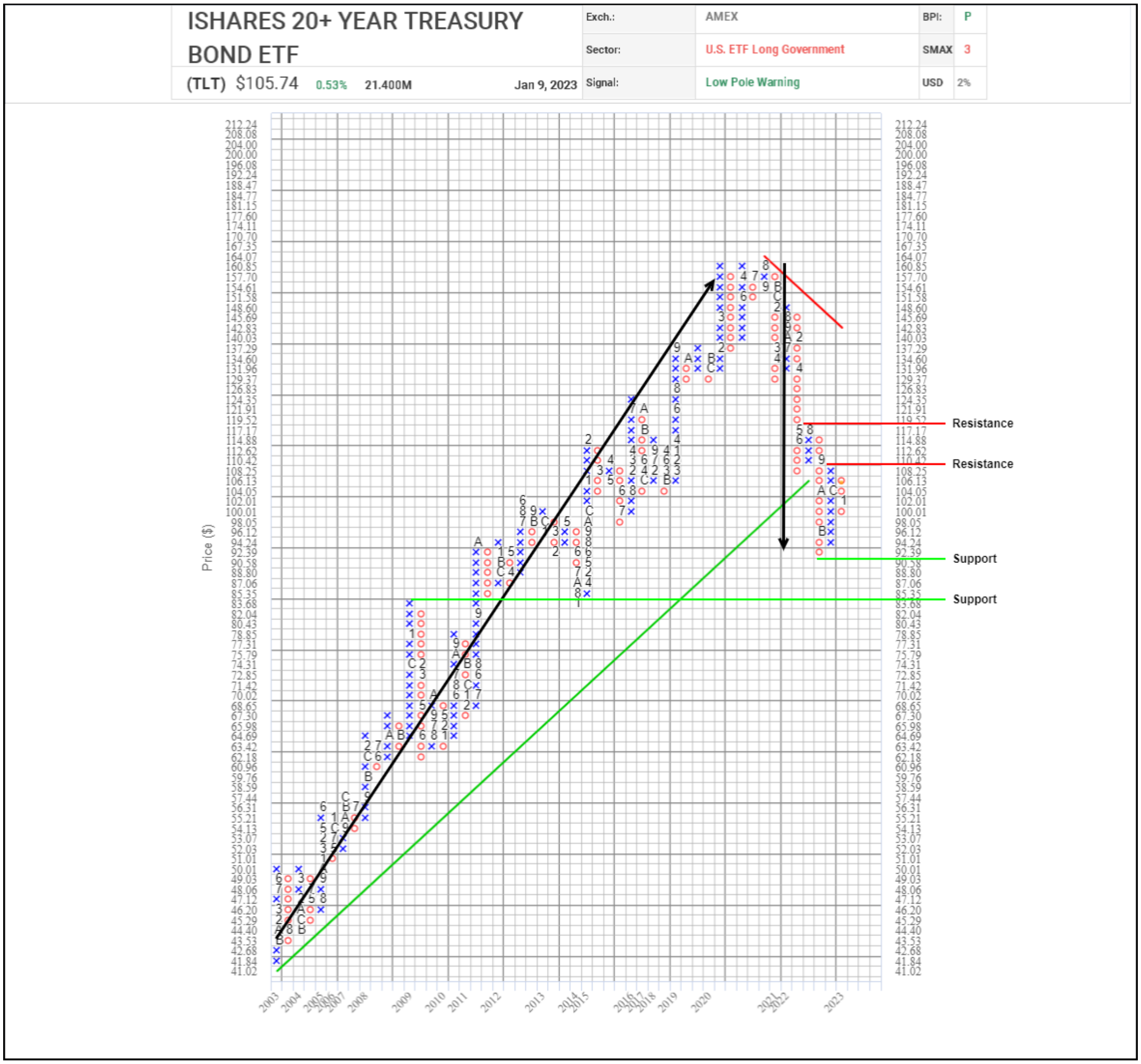


A look at the CBOE SPX Volatility Index (VIX.I) shows over the last few years, a general upward trend has emerged. Suggesting the era of complacency might have ended and as markets have become more volatile, investor sentiment has become more cautious or wary.

One notable feature of the 2022 bear market is unlike other times when equities ran aground, there was no big spike in the VIX, no extreme jump in fear. This suggests a period of "controlled demolition" or distribution rather and a possible shift into a longer-term primary bear market for equities rather than the previous sharp corrections within a primary bull market. Time will tell.

At a minimum, the VIX becoming more elevated over time suggests a general increase in volatility potentially favoring active, tactical investing strategies over passive strategies.

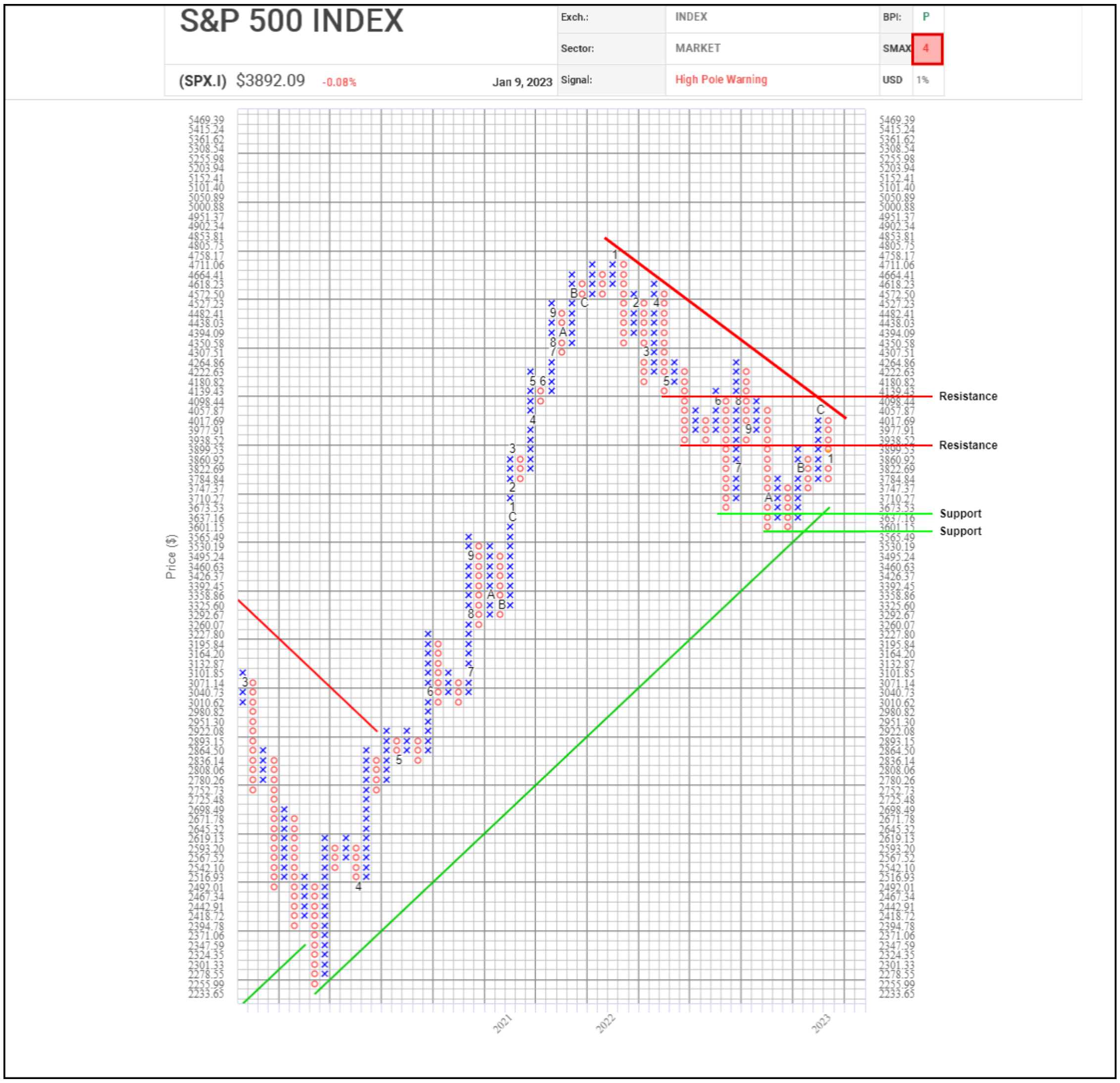
iShares US 20+ Year US Bond ETF (TLT)



A very long-term uptrend in US bond prices, exemplified here by iShares US 20+ Year bond ETF (TLT), peaked over the spring and summer of 2020 and then turned decisively downward over the course of 2021 and 2022.

In recent weeks, TLT has stabilized and a trading bounce has generated a bullish Low Pole Warning signal. It remains, however, in a downtrend of lower highs and it is too soon to tell if current trading is the start of a base forming or a pause within a continuing downtrend. A breakout over $108.25 would signal the start of a new uptrend while a drop below $90.55 would signal the start of a new down leg.

S&P 500 Index (SPX.I)



Since peaking a year ago, the S&P 500 Index (SPX.I) has been under distribution, steadily declining in a downtrend of lower highs. Along the way, the index has staged some notable trading bounces or bear market rallies.

One of these big bounces took place in the fourth quarter. A summer selloff was contained above a long-term 45-degree support line, then SPX.I rebounded, staging two bullish Double Top breakouts along the way.

However, this fall rally was contained by a downtrend line dating back to the 2022 peak, and since then, SPX.I has rolled down into a column of O's and a bearish High Pole Warning. A symmetrical triangle of higher lows and lower highs has emerged between 3,600 and 4,100, which is indicative of a sideways trend emerging. But it remains to be seen whether this is a base forming or a consolidation phase within a larger downtrend.

Tel: 1-877-668-1332
Email: siateam@siacharts.com
Web: www.SIACharts.com

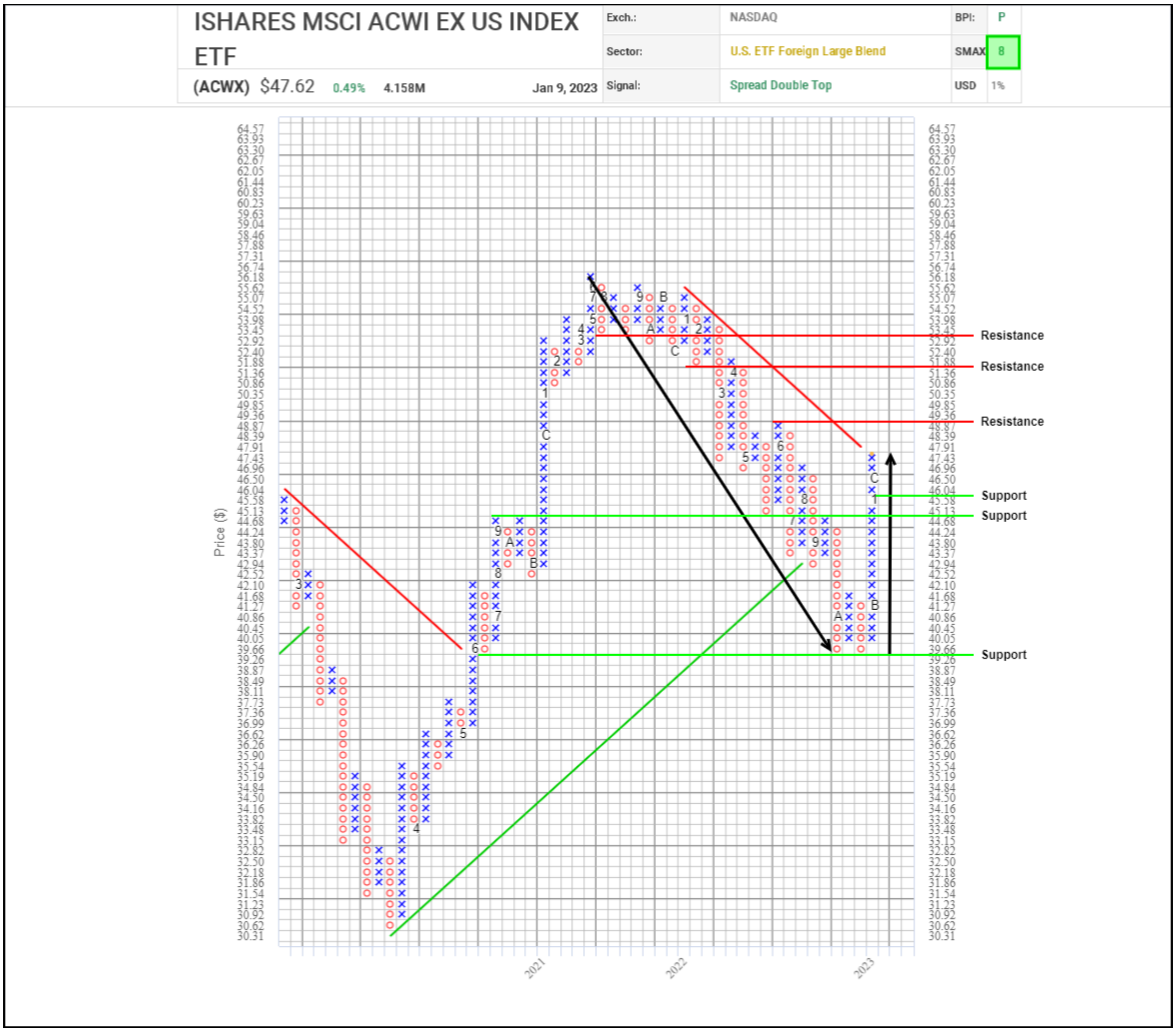
S&P/TSX Composite Index (TSX.I)

A higher concentration in Energy, Materials, and value sectors relative to the growth and Technology sector focus of many US indices enabled the Canadian equity market to outperform (decline less) than US equities in 2022.

A rally in energy prices and stocks particularly helped in the first few months of last year, so rather than peaking with the S&P 500 in January, the S&P/TSX Composite Index (TSX.I) did not peak until an April 2022 bull trap.

The recent rebound was technically stronger in Canada as well with TSX.I snapping out of a downtrend and building a bullish High Pole. The start of 2023 for TSX. I has been challenging, however, with the index rolling down into a bearish O column and triggering a bearish High Pole Warning. Now, a sideways trading range between 18,100 and 20,600 appears to be emerging.

iShares MSCI ACWI ex US Index ETF (ACWX)



The MSCI All Country ex US World Index ETF (ACWX) provides investors with insight into sentiment toward international equities.

Action in ACWX indicates international equities peaked in the middle of 2021 and formed a major top over the course of that whole year. ACWX then spent the first ten months of 2022 in a clear downtrend until bottoming out in October.

The last two months have seen a dramatic turnaround in International Equity markets. Starting with a bullish Double Top breakout in November, ACWX has been consistently climbing without even a 3% correction while building a bullish High Pole. Currently on a positive Spread Double Top signal, ACWX is approaching a long-term downtrend line near $48.00 where a breakout could confirm that a new uptrend is underway.

Tel: 1-877-668-1332
Email: siateam@siacharts.com
Web: www.SIACharts.com

US Dollar Index (DX2.F)

Part of the reason for the rebound in the US Dollar price of international equities and commodities toward the end of 2022, and the concurrent drop of Cash down the SIACharts Asset Class Rankings is the major US Dollar bull market relented and rolled over.

On a combination of relatively hawkish monetary policy and relative political and economic stability, the US Dollar Index soared from the middle of 2021 through to September of 2022 with a final buying climax rally playing out last summer.

The US Dollar Index formed a bearish Descending Triangle Top over a two-month period. It then decisively broke down in November with a bearish Double Bottom followed by a bearish Spread Double Bottom and the current down leg extending into a bearish Low Pole.

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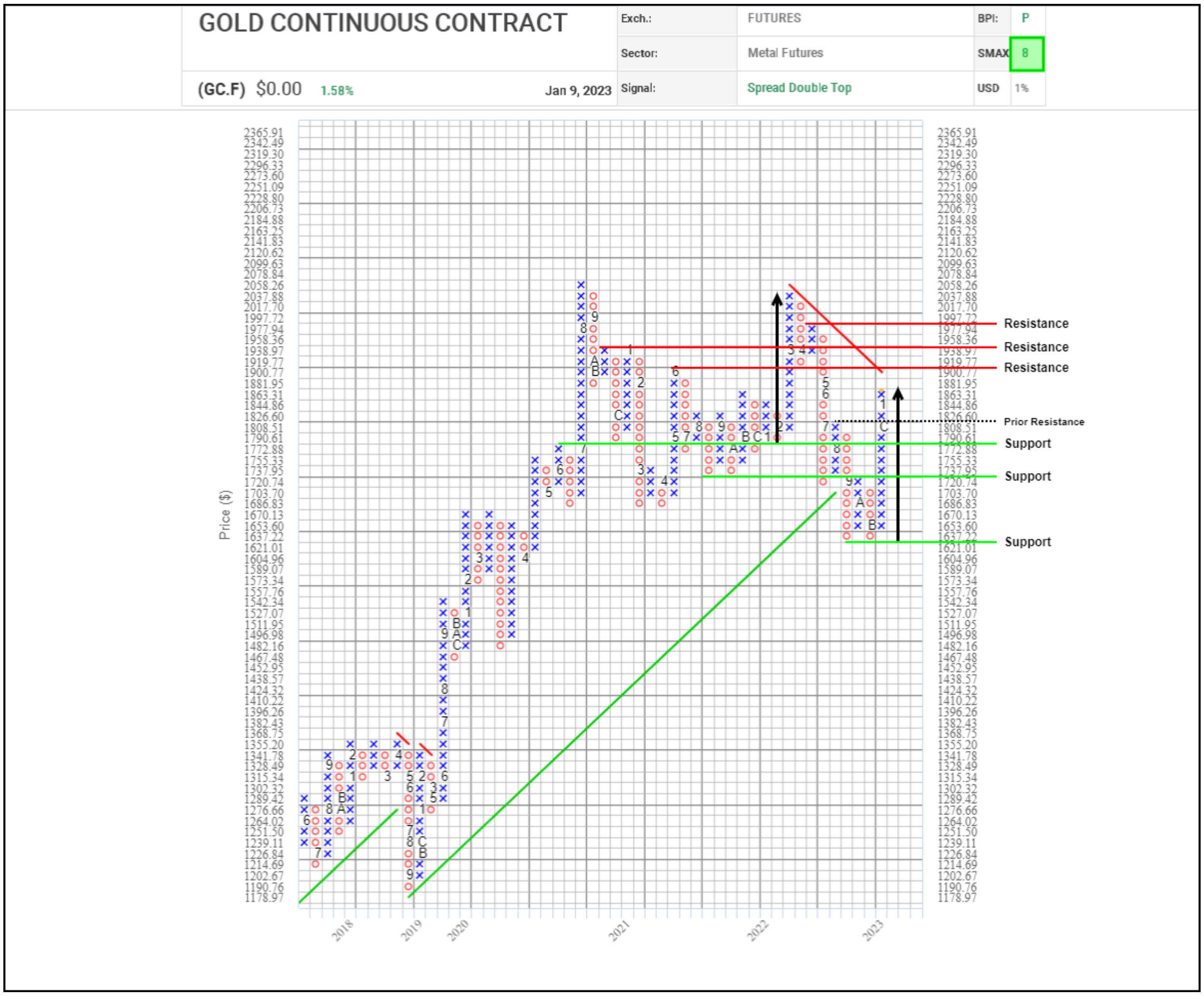
Gold (GC.F)



2022 was a big year for Gold with its role as a store of value being more strongly recognized by investors. Gold started off the year as a haven from political turmoil, soaring back up above the $2,000/oz level when the Ukraine war started.

Gold then had a very mixed middle of 2022. Although it was steamrolled by the US Dollar between March and October, gold otherwise held its value and outperformed other major currencies including the Euro, Pound, and Yen. Gold also reasserted itself as the world's primary alternative currency as cryptocurrency markets collapsed.

Gold finished the year strong launching into a bullish High Pole out of bullish Double Top and Spread Double Top breakouts.

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Web: www.SIACharts.com

Crude Oil Continuous Contract (CL.F)

Last winter, ignited by supply concerns related to the war in Ukraine and related sanctions, the price of Crude Oil (CL.F) soared up toward a peak near $123.50.

As the year progressed, supply concerns were overtaken by concerns about weakening demand and with the exception of a brief bounce in June, Oil spent most of the year under distribution with a downtrend of consistently lower highs and lower lows emerging.

Although the potenital for demand to improve has emerged with China starting to reopen, there has not been any impact on Crude Oil as of yet, which remains on a bearish Spread Double Bottom signal. It would require a breakout over resistance near $80.00/bbl at this point to signal an upturn.

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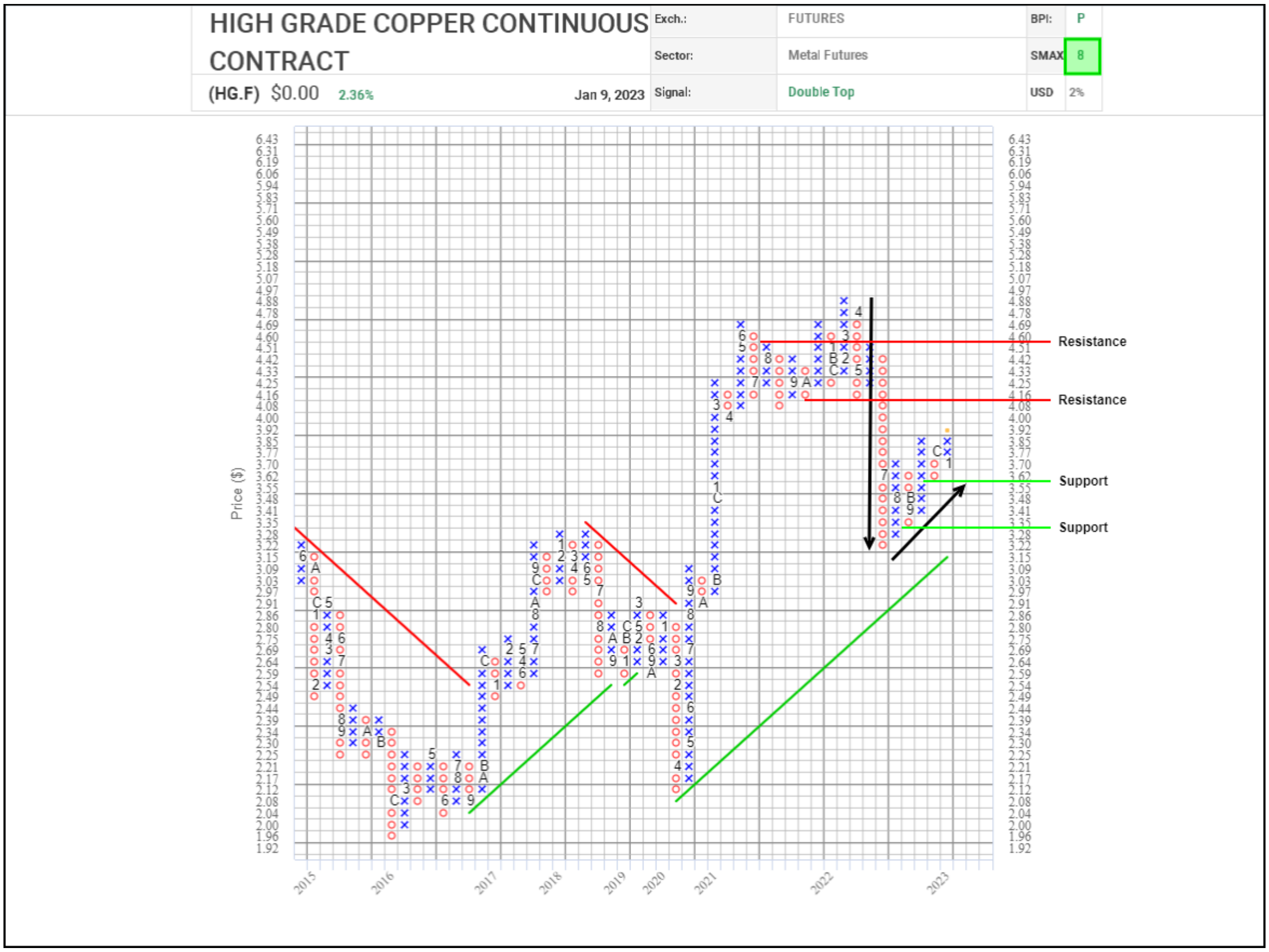
Copper Continuous Contract (HG.F)



Copper (HG.F), with its wide variety of applications, is widely considered by investors, as an indicator of the current health of the global economy and of China's demand for resources in particular.

Trading action seems to particularly reflect when investors tend to look to Copper (HG.F) for indications of the health of the global economy through the demand for industrial metals. After stagnating through much of 2021 and the first part of 2022, Copper plunged off a cliff last June-July when the latest round of Chinese COVID lockdowns started.

Since August, and particularly into the end of the year as China started to ease restrictions and reopen its economy, Copper has been on the rebound. In recent months, a new uptrend of higher lows has emerged, confirmed by a bullish Double Top breakout.