Three Surprising Risk Management Ideas for 2023

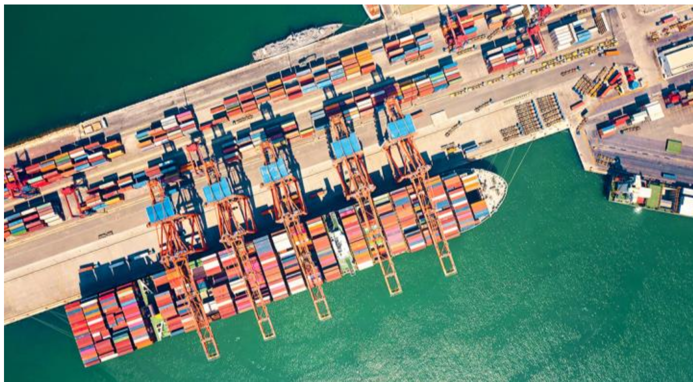
Year-ahead commentary is challenging for us: We believe predictions contribute more to investment mistakes than outperformance. But the New Year does offer opportunity to consider recent experiences in long-run, strategic terms.

(If our look ahead to 2023 sounds similar to **what we published in 2022**, it's because we believe in a consistent approach to risk management. Although our methods are consistent, the themes for the coming year are fresh – as you'll see below.)

Looking back on our 2022 commentary, we've identified three key risk factors for 2023 and ways to manage them:

- **Inflation:** Stay humble and consider the whole range of possibilities.
- **Stock Valuations:** Consider your approach to company valuations.
- **Interest Rate Risk:** The Fed and the market disagree about what's coming in 2023 – increasing the potential for volatility.

Inflation, China & Supply Chains: Many Predictions Will Be Wrong



This year we urged investors to measure the interest rate risk in their fixed income portfolios and consider strategies that could mitigate that risk. The suggestion wasn't about making an incredible call on the direction of rates or even trying to generate outperformance within portfolios. Instead, it resulted from an evaluation what has happened in the past after sharp rises in inflation.

The bond market's challenges in the past year have shown us that the consensus view can easily be challenged in a high-inflation environment. We believe the same holds true today: Any single estimate for where CPI will end up next year stands a good chance of leaving an investor wrong-footed. After a year that surprised many market participants, we think humility remains in order when it comes to predictions for the year ahead.

Looking at the macroeconomic landscape ahead, we see many diverging pathways. China's recent reversal of its "Zero-COVID" policy and the war in Ukraine are potentially powerful triggers of supply chain disruption – or massive shifts in global demand. These emotionally gripping news headlines can create temptation to steer portfolios into or out of apparent macroeconomic tides. Investors will likely be better off reviewing their strategic allocations and evaluating their risk tolerance so they're well prepared for surprises. High-leverage policy choices often have unexpected policy consequences – and the markets' responses add a further layer of ambiguity. Aggressive portfolio positioning with respect to these headlines is as likely to create further headaches as it is to generate outperformance.

Meme Stock Mischief Moderates, Fundamentals to the Fore – For Now

This time a year ago, attention driven "meme stocks[1]" were still a major force in US equity markets. Their influence has since moderated, and stock returns have been better explained by academic factors –well-studied drivers of stock performance like value, profitability, and momentum. Strategies geared toward these fundamental-oriented factors have been a bright spot amid a difficult year for most asset classes.

Speculative enthusiasm has also declined in other risky parts of the market: Venture capital investment is on the decline, and 2022 has been a year dominated by scandalous headlines in cryptocurrency markets. Commodities enjoyed a great inflation-driven rise in the first half of the year but have given back many of those gains.

We remain mindful that anything can happen among the more volatile asset classes – that's part of what volatility means. However, we remain alert to a potential ongoing shift in investors' views as less risky assets have begun to deliver more reasonable returns. Investors should carefully assess which parts of their portfolio may be vulnerable to sudden shifts in sentiment. Then, they may want to consider strategies with a more dispassionate approach to price and valuation, along with how to fit them alongside more traditional asset classes.

Interest Rates (as Usual) Are in Focus

The Federal Reserve is faced with a challenging task to keep inflation under control while seeking to avoid the difficulties associated with a potential recession. An inverted yield curve further complicates any forecast for interest rate levels in the coming year.

We are focused on a single key observation: The market is expecting the Federal Reserve to turn dovish faster than either economists - or the Fed itself - are predicting. While the Fed and the market could both be wrong at the same time, they can't both be right. That disconnect is a potential source of further volatility in fixed income markets.

The past year has taught us that duration is a meaningful risk factor and driver of fixed income returns. Investors should continue to monitor the level of interest rate risk within their portfolios and measure how they can expect to perform should rates continue to rise. Investors who are looking to be opportunistic following a major rise in interest rates should also be mindful of how those potential opportunities affect their portfolio's exposure to interest rate risk.

Conclusion

We believe bold market predictions often leave investors worse off. On the other hand, our strongest belief is in systematic processes that prepares portfolios for many scenarios.

[1] The "meme stocks" definition can be found can be found on page 3.

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Uncorrelated systematic strategies can have the paradoxical effect of freeing investors from focusing too heavily on big drivers of traditional asset class performance – things like inflation, meme stocks, and interest rates. When a portion of a portfolio includes systematic alternatives, an investor can afford to be a little less focused on making big predictions, a little more humble about what we actually know about the future, and a lot more focused on achieving favorable long term results.

Important information about the funds are available in their prospectuses, which can be obtained at counterpointmutualfunds.com or by calling 844-273-8637. The prospectuses should be read carefully before investing. Investors should carefully consider the investment objectives, risks, charges, and expenses of the funds managed by Counterpoint Mutual Funds. The Counterpoint Mutual Funds fund family is distributed by Northern Lights Distributors, LLC member FINRA/SIPC. Counterpoint Mutual Funds, LLC is not affiliated with Northern Lights Distributors, LLC member FINRA/SIPC.

Important Risk Information

The forecast and/or opinions may not come to pass and are subject to change. Investing in Meme stocks and or High attention stocks involves risk. These stocks may experience major volatility. High interest in these types of stocks may encourage rapid into or out of "buzzy" stocks. Technology and social media can pump up interest in stock, and it can also create an echo chamber, one in which investors may find themselves communicating most frequently with others with similar interests and views, thereby reinforcing their views, even if these views are speculative or biased.

Definitions

[1] Meme stocks are defined as stocks whose trading volume (a measure of investor attention) has risen out of proportion to their size (measured by market capitalization). Stocks with monthly trading volume greater than their market cap are classified as "meme stocks."

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