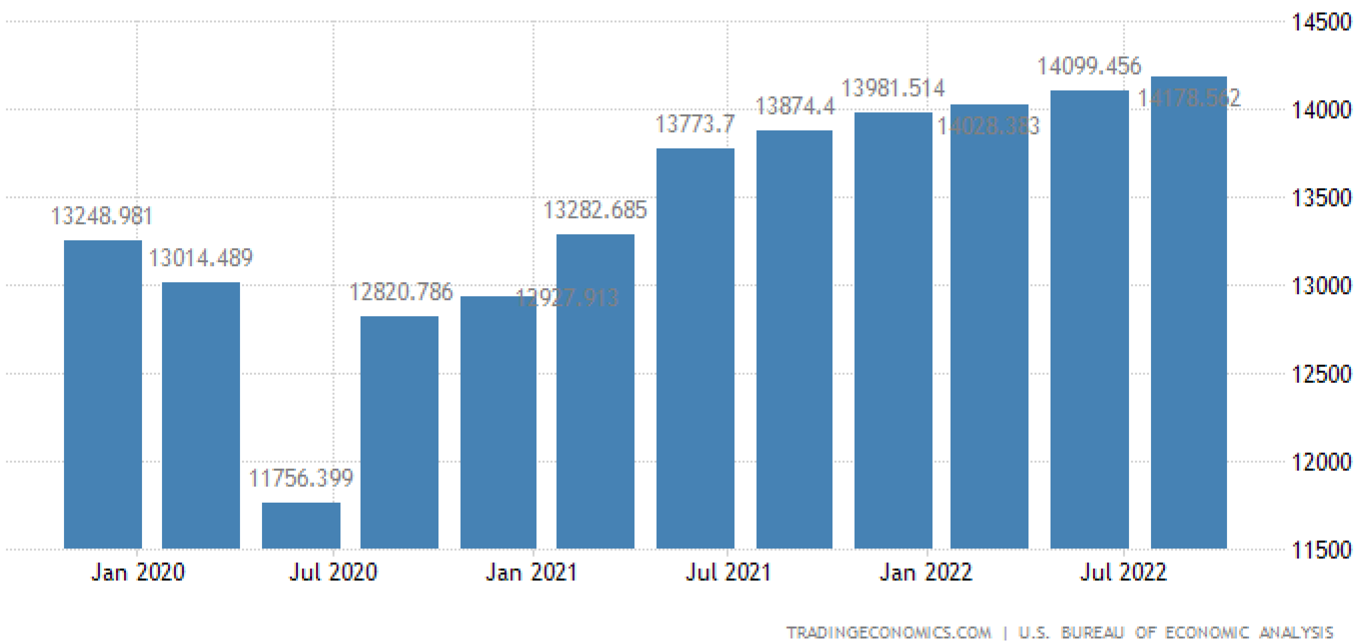
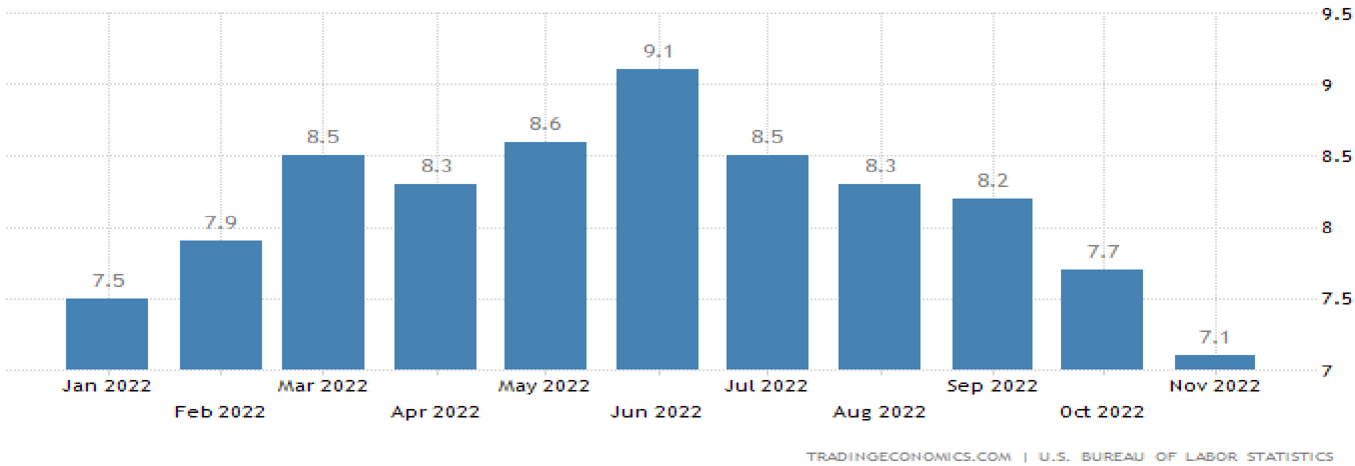
ECONOMIC AND INVESTMENT OUTLOOK
Winter 2023

The Economy The losses in stocks and bonds were driven by high inflation, a historic Fed rate hike campaign and geopolitical unrest. But while those factors were clearly negative for asset prices in 2022, it's important to note as we enter 2023, the economy is approaching a potentially important transition period that could see each of these headwinds ease in the months ahead. First, inflation has shown definitive signs of peaking and declining. The CPI has fallen from a high of 9.1% in June to 7.1% in November. Second, after a historically aggressive rate hiking campaign in 2022, the current Fed hiking cycle is likely nearly complete. Finally, if the economy or corporate America proves to be more resilient than forecasts, it could provide a positive spark for asset markets in early 2023. On the war in Ukraine, any sort of a truce between Russia and Ukraine will likely reduce commodity prices and global recession fears should decline as a result.

Sales and Spending Retail sales have likely plateaued this year as consumers turn cautious. November sales, excluding motor vehicles and gasoline, edged down 0.2%, after a 0.8% rise in October. Sales declines were significant at department, electronics, furniture and building materials stores. These drops may indicate the retailers will have incentive to offer discounts going forward. The drop in e-commerce sales was expected after sales jumped during Amazon's Prime Day sale in October. Sales increases occurred at restaurants, grocery and personal care stores. We should continue to see retail inventories high as we move past the holiday, season which will likely cause discounting for major retailers. (See chart Consumer Spending).



Inflation While gasoline prices continue to drop for the fifth straight month through December, other prices accelerated, such as food (eggs, milk, bacon, water) leaving the inflation rate still high at 7.1%. While the yearly rate is still high, this marks a shift away from strong monthly price increases. The slowing economy is likely to bring the yearly inflation rate down to 3.2% by the end of 2023. Used car prices declined in November, and new vehicles prices didn't rise for the first time in almost a year. Energy costs, which tend to be volatile, helped lower overall inflation this time, and continue to moderate. Overall, goods prices declined for the second month in a row, but services price inflation is strong. Rent prices have slowed and should continue to see a slowing. The Federal Reserve will likely see the latest report that was better with inflation moving down as justification to dial back its next short term interest rate hike at its policy meeting in February. (See chart Inflation Rate).



Monetary Policy comprises the Federal Reserve's actions and communications to promote maximum employment, stable prices and moderate long-term interest rates. The Federal Reserve capped a year of dramatic policy moves in December 2022, raising its short-term target federal funds rate to a range of 4.25% to 4.5%. Since March, the Fed moved the target rate off a 0% level that it had maintained for two years, all to fight persistently high inflation that began in 2021.

Fiscal Policy It will be a messy winter in the US Congress as several fiscal decisions converge on the legislative calendar, including the budget reconciliation bill, the infrastructure bill, the debt ceiling and the regular budget. The reconciliation bill is the most consequential as it would increase the federal deficit by up to 1.7 trillion USD, or around 8% of GDP, and fundamentally change big parts of the US social insurance system over the next decade.

The Dollar The dollar index started slowly in 2023 and was most recently down 0.029% at 103.610. Due to the Fed hiking interest rates to combat inflation, the dollar index increased 8% last year, its largest annual increase since 2015. Additionally, according to IMF Managing Director Kristalina Georgieva, all three major global growth drivers—the United States, Europe, and China—are slowing and concurrently, making the year 2023 more challenging than 2022.

Corporate Profits in the United States rose 0.8% to USD 2.54 trillion in the third quarter of 2022, following a 6.2% gain in the previous period and compared with preliminary estimates of 0.2% drop. Net cash flow with inventory valuation adjustment, the internal funds available to corporations for investment, rose 6.2% to 3.14 trillion, while net dividends fell 3.2% to USD 1.68.

MARKETS

Uncertainties The United States inflation problem along with supply chain issues seemed to be on everyone's mind but there are other pressing issues. The flu season which is turning out be severe as well as the still ongoing Covid problems. The Ukraine /Russian war now shows much uncertainty and Putin's unpredictability in using nuclear weapons continues.

Positives The vaccines being distributed to most people now register more than 262 million people fully vaccinated. Approximately 79% of the U.S population has now been vaccinated with one dose and 33% of the population have received a booster dose. A fourth booster shot now available to people 50 and older as added protection is being administered. All children ages 6 months through 5 years are eligible for a pediatric three-dose vaccine. The virus does not seem to be life threating now that many are vaccinated. Looks like inflation has reached its pinnacle and should be headed lower in the coming months.

Negatives The BA.2 strain is still the dominant strain of Covid-19 which seems to be a very contagious virus but less likely to be hospitalized if vaccinated. There are the lingering supply chain constraints hampering many companies and still a shortage of workers primarily in the hospitality business. Washington still seems behind the curve on a number of issues in the economy.

Interest Rates the Federal Reserve raised short-term rates by a half a percentage point Dec 14, an easing from the Fed's previous rate hikes of three-quarters of a point, but Chair Jerome Powell was careful to say that more rate hikes are coming. The financial markets had hoped that the Fed might be willing to reduce rates in 2023 if the economy falls into recession, but Powell was not willing to discuss that possibility yet. Currently, committee members expect short-term to be about a percentage point higher by this time next year. Mortgage rates will continue to trend higher along with home equity lines of credit. Currently the Treasury 10-year trades close to 3.7%.

Common Stocks Wall Street wrapped up the year of 2022 with a loss of almost 20% on the S&P 500 and ended around 3,839. Stocks had a rally early in the fourth quarter, but hawkish Fed guidance, disappointing economic data, and rising bond yields weighed on markets in December and the S&P 500 finished the fourth quarter with only modest gains that capped the worst year for the index since 2008. In summary, 2022 was the most difficult year for investors from a return and volatility standpoint since the financial crisis. The S&P 500 posted its worst performance since 2008 while major benchmarks for both stock and bonds declined together for the first time since the 1960s, punctuating just how disappointing the year was for investors. As always, remain patient, and rest assured that we remained dedicated to helping you successfully navigate this market environment.

January 10, 2023