2023 Research Investment Themes Scorecard

Theme	Our Prediction	Results	Score
First value, when growth?	In general, many growth companies that generate cash flows further into the future (duration assets) will probably continue to struggle as inflation persists in the first half of 2023. Value oriented sectors of the market, companies that are well-capitalized and trade at reasonable valuations may continue to be more appealing in the first half of 2023. However, as the Federal Reserve calms or pauses their pace of rate hikes, we can see growth stocks (specifically, those with strong cash flow and solid balance sheets that could take advantage of easing input costs), again take leadership in the market.	This year was largely defined by a very narrow market breadth with concentrated returns in seven mega-cap Tech stocks, often referred to as the 'Magnificent Seven' (Apple, Microsoft, Google, Amazon, Tesla, Nvidia, Meta). These seven stocks, constituting 31% of the S&P 500's total market capitalization, led indices higher and accounted for over 100% of index-level, calendar-year S&P 500 returns.[2] As a group, they returned a staggering +109.22% in 2023.[2] Meanwhile, the remaining "S&P 493" was negative, and returned -0.02%. At the final tally, growth stocks were up 42.68%, while value equities only returned 11.46%.[1]	✗
Longer duration/higher quality bonds will outperform	The Fed will keep hiking, but at a slower pace; we think we're closer to the end of the rate hike cycle than the beginning and look for the Fed to pause in 2023. We would not be surprised to see a mild US recession at some point in 2023 as jobs numbers could soften and corporate earnings growth is poised to slow. In the seven previous market corrections, intermediate term bonds, as measured by the Bloomberg U.S. Aggregate Index, rose four times, and never declined more than 1%[1], significantly outperforming lower credit quality fixed income securities. As such, high quality credit bonds have the potential to outperform. The yield at the end of 2022 on the US Broad Market index was 4.70% which could result in annualized average returns of 5% for the coming five-year period. Ultimately, we are slowly moving back into an environment	Despite three rate hikes in 2023, the yield on the 10-year US Treasury coincidentally ended the year at the same place it started (3.87%).[1] However, the yield on the 10-year Treasury fluctuated between roughly 3.3% and over 5.0% throughout the year.[1] Higher volatility provided a better environment for shorter-duration bonds. As a result, long-term bonds, measured by the Bloomberg US Government Long TR USD returned 3.11%[1], underperforming shorter duration bonds, as measured by the Bloomberg 1-3 Yr US Treasury TR USD, which returned 4.29%.[1] Lower-quality bonds also outperformed high quality, fueled by the risk-on environment in equity markets and better-than-expected corporate earnings. Bloomberg US Credit Baa TR USD returned 9.41%1 versus the Bloomberg US Credit Aaa TR USD, which returned 5.03%.[1]	✗
International and Emerging Market stocks become interesting again	With elevated risks of recession looming in the U.S. and abroad, especially in Europe where inflation is running at double-digit rates and energy shortages are looming, we are not predicting a negative return for international and emerging market equities, but simply underperformance relative to domestic equities. We expect that China's zero-Covid policy will be largely removed by the summer of 2023, a big deal for European and EM stocks, which could rally in advance of a rebound in the Chinese economy. Similarly, any decline in the US Dollar value could support developed and emerging market stocks.	As expected, returns in both international and EM stocks were still positive as the US dollar, measured by the Bloomberg Dollar Spot index, fell by 2.0% in 2023.[1] However, despite a weaker dollar, International and Emerging Market stocks have underperformed US equities in 2023, hindered by geopolitical headwinds due to the ongoing Russia-Ukraine conflict as well as the war between Hamas and Israel. Even with attractive valuations in international stocks, due to resilient earnings, investors have preferred domestic equities.	✓

Overall scoring: ✓ Right call ✗ Wrong call — Neutral

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Stocks will finish positive next year	The S&P 500 Index has only generated a negative total annual return for two straight years eight times since 1928. These years occurred during the Great Depression, WWII, the 1973-1974 oil crisis and recession, and the bursting of the dot com bubble (2000-2002).[3] For the S&P to fall for a second consecutive year in 2023, there would likely need to be another major economic or geo-political shock, or a combination of both as shown by our previous examples. History says the odds are in the stock market's favor for a positive 2023 after a down year. We believe that the narrative around inflation will begin to shift, and as a result, the Fed may be able to pause further monetary tightening, which would allow stocks to finally climb higher, driving positive returns in 2023. Historically, over the 12-months following a Fed pause, on average, the S&P 500 Index returns 15%.[4]	Stocks rebounded strongly in 2023 following the 2022 downturn. The S&P 500 returned +26.29%[1], the NASDAQ returned +44.64%[1] and the Dow Jones Industrial Average returned +16.18%.[1]	✓
The Federal Reserve will stop rate hikes in March of 2023	There are two main reasons that the Fed could realistically stop hiking rates in March of 2023. First, we may have already seen the peak in inflation: In June 2022, the Consumer Price Index (CPI) year-over-year (YoY) reading peaked at 9.1%. Since then, we have had five consecutive months of falling YoY CPI numbers of 8.5%, 8.3%, 8.2%, 7.7%, and 7.1% from July through November 2022.[5] Second, the labor market will likely begin softening: The Fed projected that the unemployment rate would increase to 4.6% next year, which equates to an estimated 1.5 million people losing their jobs.[5] After a deceleration in rate hikes from 0.75% to 0.50% in December, it appears that the Fed is laying the groundwork for an additional step down to a 0.25% hike in February.[5] In our view, if inflation continues to moderate and the economy is weakening, the Fed may not need to keep interest rates at peak restrictive levels. Notably, markets also continue to expect rate cuts towards the end of 2023, predicting the Fed Funds rate to peak at 5.0% in March 2023, remaining there until September 2023 and subsequently falling to 4.75% in November of 2023.[6]	Although the Consumer Price Index (CPI) fell from 6.5% at the end of 2022 to 5.0%[1] at the time of the Federal Reserve (Fed) March meeting, the Fed felt that additional rate hikes were needed to bring inflation down further. Ultimately, the Federal Reserve (Fed) hiked rates by 0.25% in January, March, and May, with the final hike coming in July 2023.[1]	✗
We will have a mild US recession in 2023	A recession could materialize in 2023 as consumers continue to dip into excess cash piles and interest rates remain elevated. November was the 20th consecutive month in which the rate of inflation outpaced the growth in hourly wages, leading to a decline in prosperity for the American consumer.[5] Consumers accumulated $2.6 trillion during COVID, due to historically loose fiscal and monetary policy, and have spent $546 billion of that excess savings.[7] When this happens, something has to give, and thus far it's translated into rising credit card balances and lower savings rates. The Savings Rate in the US has moved down to 2.4%, the second lowest level on record with data going back to 1959.[8] However, with continued levels of low unemployment and higher wages, we think any recession will be fairly mild. Over the longer term, a lower savings rate can be outweighed by the overall increase in the wealth of the American consumer and for once, it's not just the top 10% or the top 1% that's benefitted. The net worth of the bottom 50% has increased by $2.4 trillion since the start of the pandemic in early 2020, meaning it has more than doubled in less than three years.[9]	In 2023, markets witnessed a rolling recession — implying that some industries are contracting while others continue to expand. For example, the housing industry was the first to suffer a tailspin after the Fed began sending interest rates sharply higher. As mortgage rates nearly doubled, home sales plunged. Manufacturing soon followed as demand shifted from goods to services and factory production fell. However, we were able to avoid a simultaneous and comprehensive downturn as the consumer and job market remained more resilient than we even expected. Consumers are estimated to have spent a record $966.6 billion[10] this past holiday season and the Unemployment Rate has now been below 4% for 22 straight months, the longest streak since the late 1960s.[1]	—

Overall scoring: ✓ Right call ✗ Wrong call — Neutral

Economic Definitions

CPI (headline and core): Consumer prices (CPI) are a measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate.

Federal Reserve (Fed): The Federal Reserve System is the central banking system of the United States of America.

Federal Funds Rates (Fed Funds rate): The Federal funds rate refers to the target interest rate set by the Federal Open Market Committee (FOMC). This target is the rate at which commercial banks borrow and lend their excess reserves to each other overnight.

Unemployment Rate: The unemployment rate tracks the number of unemployed persons as a percentage of the labor force (the total number of employed plus unemployed). These figures generally come from a household labor force survey.

Personal Savings Rate: The personal saving rate is personal saving as a percentage of disposable personal income.

Index Definitions

S&P 500: The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

NASDAQ: The NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

Dow Jones Industrial Average: The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Bloomberg Barclays US Agg Bond: The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

The U.S. Dollar Index: is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies. The Index goes up when the U.S. dollar gains "strength" when compared to other currencies.

Bloomberg US Government Long TR USD: The Bloomberg US Government Long TR USD is comprised of the Long US Treasury and US Agency Indices. The index includes US dollar-denominated, fixed-rate, nominal US Treasuries and US agency debentures with 10 or more years to maturity.

Bloomberg 1-3 Yr US Treasury TR USD: The Bloomberg 1-3 Yr US Treasury TR USD is a broad-based benchmark that measures the non-securitized component of the US Aggregate Index. It includes investment grade, US dollar-denominated, fixed-rate Treasuries, and government-related securities with maturities between 1 and 2.9999 years.

Bloomberg US Credit Baa TR USD: Bloomberg US Credit Baa TR USD measures the Baa-rated, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

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1 https://www.capitalgroup.com/advisor/insights/articles/guide-to-recessions.html

2 https://www.twentyfouram.com/insights/highest-starting-yields-since-08-predict-strong-five-year-returns

3 https://www.datatrekresearch.com/category/blog/

4 Apollo Global Management, Inc. Insights.

5 Data obtained from Bloomberg as of 12/31/2022.

6 https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html

7 Mercer LLC, Economic and Market Outlook 2023.

8 https://compoundadvisors.com/2022/the-week-in-charts-12-4-22

9 Data obtained from FRED, Federal Reserve Bank of St. Louis.

10 https://nrf.com/media-center/press-releases/2023-holiday-reach-record-spending-levels#:~:text=WASHINGTON%20%E2%80%93%20The%20National%20Retail%20Federation,returning%20to%20pre%2Dpandemic%20levels

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