CERITY PARTNERS®

Economic & Market Update

FEBRUARY 2023 OUTLOOK

Markets have recently been and will continue to be driven by three key influences:

- Monetary policy primarily emanating from the Federal Reserve
- China's COVID reopening and the growth potential therein
- Earnings and guidance reported by leading S&P 500 firms

While we remain cautiously optimistic that inflation will continue to abate, rates will stabilize, and the global economy will not fall into recession, the market's assessment of the three key influences will determine the short-to-mid-term path forward.

ceritypartners.com

GLOBAL ECONOMY

- The U.S. economy rebounded quite nicely in the second half of 2022 from its first half malaise on the back of continued strong consumer spending, although consumption began to fade a bit at year end. Strong jobs and wage growth, in addition to falling energy prices, should prevent any major pullback in consumer spending. Businesses have grown more cautious as their ability to pass through input price increases to the ultimate consumer has declined. High profile layoff announcements have yet to noticeably loosen tight labor markets but should be an impediment to future wage growth, thus preventing a wage/price spiral, which was a hallmark of the 1970s inflation cycle.
- Inflation in the U.S. and other global economies has begun to steadily decline as supply chain delays have eased and energy prices have settled into somewhat of a trading range at lower levels. Services inflation may prove to be stickier, as many goods prices have fallen into outright deflation. That said, expect overall core inflation to move down closer to the Fed's 2.0% target by year end.
- The mild winter to date has given the European economy a reprieve from what was expected to be economically damaging energy price spikes as the UK and the continent have been able to build sufficient natural gas stockpiles. The reopening of the economy from Covid lockdowns has helped the tourism and services industries of southern Europe, while the end of the Chinese zero Covid policies should support exports in the industrialized northern tier, especially Germany (by far the leading manufacturer in Europe).
- The long awaited and eagerly anticipated about-face on the zero Covid policies in China should boost manufacturing and industrial production, although the inevitable Covid outbreaks are likely to sporadically impact economic growth as natural immunity needs to form in this vaccine deficient economy. The government is promising some fiscal support for its beleaguered property sector, and they are toning down the rhetoric against their industry champions. Longer term demographic challenges will be a secular headwind but look for improved GDP growth in 2023 for both mainland China and Hong Kong.

MONETARY POLICY

- As inflation is notably slowing at both the headline and core (ex-food and energy) levels, the Federal Reserve has slowed the fed funds rate increases to 25 bps and should be at an end of their rate tightening cycle after one more 25 bps rate increase in March. The terminal rate of 5.00% should hold for a while as the Fed assesses the economic impact of its aggressive rate increase and balance sheet reduction campaign. Markets will be watching for signs that the policies may have thrown the economy into recession as opposed to merely slowing economic growth.
- Growing indications that the UK and European economies may not be falling into widely predicted recessions will embolden the Bank of England and European Central Bank to continue hiking their policy rates to fight inflation. Both central banks see the need to catch up to the rate levels the Fed has already achieved in its inflation battle, so the tightening moves over coming meetings are expected to be 50 bps, although there has been some dissension within the committees, with some of the more dovish members warning about the economic consequences of excessive tightening.
- Dollar weakness, which began in the fall of 2022, has continued into 2023, providing sufficient cover for the Bank of Japan to continue defying the tightening trend of the other major central banks. The BOJ announced a slight widening of the allowable bands in their yield curve control policy but remains committed to short term rates at roughly zero, at least until the next governor is appointed in April.
- The Peoples Bank of China has often professed their flexibility and ability to decrease rates if needed to support the economy, but it has been wary of capital flight and the impact on the domestic currency. Dollar weakness and the economic rebound expected (due to the end of zero Covid policies) should keep the PBOC steady at the helm regarding interest rates while allowing the fiscal policymakers to provide more targeted support to the weaker sectors of the economy.

BOND MARKETS

- Intermediate to longer maturity bond markets have gotten off to a good start this year as the yield curve has become even more inverted. As the Fed ends their tightening initiative and the economy slows but does not fall into recession, the inverted curve should be resolved through longer term rates moving up to the higher levels of short-term rates established by the Fed. Therefore, we continue to advise caution in our duration positioning and remain underweight in core taxable and tax-exempt bond allocations.
- High yield bond spreads against like maturity treasuries have remained remarkably stable over the past few months considering the deeper inversion of the yield curve and continued warnings about an oncoming recession. While this can be considered a market interpretation that the economy is not about to enter recession, the asset class seems fairly valued at these levels given the risks inherent in this monetary tightening cycle.

EQUITY MARKETS

- With the focus of 2023 moving away from interest rates and concentrating more on earnings, the fourth quarter 2022 earnings season has been lighter than expectations, but by no means terrible. Management commentary accompanying earnings have led to downward revisions to 2023 estimates. The decline in intermediate to longer term interest rates was a major contributor to the January rally as was the growing belief the Fed is near the end of their tightening cycle. The outlook for earnings is for only slight year-over-year declines in the first half of the year, with a pickup in the second half as the economy settles into a slow growth mode. Despite having gotten off to a strong start, expect volatility around the remainder of the earnings season and some mixed signals likely to be gleaned from the Fed around the end of the monetary tightening cycle.
- Developed market international equities performed in line with those in the U.S. in January, with the weaker dollar providing a further boost for U.S. investors. Surprisingly resilient economies are forestalling the seemingly inevitable recessions in the UK, continental Europe, and Japan. The pressures emanating from higher energy prices and central bank tightening remain, but continued growth in the U.S. and better growth in China should be supportive of the equity markets that are largely comprised of multinational companies that are impacted by global growth as much as the health of their domestic economies.
- Emerging market equities have also had strong absolute and relative performance compared to the US, coming off the mid-October global equity market lows. In addition to a weaker dollar, the relaxation of pandemic-driven mobility restrictions in China and the continued strong performance of the commodity-based Latin American markets have helped sustain the performance of the asset class. Looking into the rest of 2023, revived Chinese economic growth should be the driver of performance in the asset class, but slower global growth will be a constraint on the commodity-sensitive markets in Latin America.

COMMODITIES & CURRENCIES

- Defying calls for a supply induced price spike, crude oil prices have remained in a rather tight trading range since the Fall, as unseasonably warm winter weather and increased production from non-OPEC countries have helped stabilize the price. The expected increase in demand from China and the uncertain progression of the Russia/Ukraine war should combine to exert upward pressure on energy prices, but not to such an extent that it will impact the global economy or provide exceptional investment opportunity.
- Industrial metals are also highly levered to revived Chinese economic growth and have increased notably at the beginning of the year. These price increases confirm the somewhat surprising strength of the global economy moving into 2023, but the expected growth slowdown should help limit much further appreciation from current levels.
- Gold has participated alongside other risky asset classes in this rally off

the October lows, as the catalyst has generally been the expectation of the end of monetary tightening and an ultimate reduction in rates implemented by the Fed sometime in 2023. As it is more likely the Fed will hold the fed funds rate around the 5.0% level for most of the year, short term rates will remain competitive and a headwind to further appreciation of the yellow metal.

- The dollar has continued to decline into 2023 but the descent has flattened out somewhat and is likely near an end. The somewhat surprising resilience of the European economies, along with the revival of Chinese growth, have been supportive of foreign currencies. However, the global economy remains susceptible to growing geopolitical risk, which will maintain safe-haven demand for dollars.

WHAT THIS MEANS FOR INVESTORS

- The bear market lows have likely been achieved in this cycle as inflation is dissipating and monetary tightening is near an end. The full impact of the sharp rise in interest rates on the global economy and corporate earnings has yet to be determined, but a generally healthy consumer should prevent any deep recession in both the developed and emerging market economies. Having experienced a painful revaluation in 2022, global equities are much more fairly valued and could be viewed as rather cheap if there was greater confidence around earnings growth. Fixed income securities are now viable competitors with equities in the portfolio construction process, although we are cautious around intermediate and longer-term maturities as rates are likely to rise given the forecast for continued, albeit slow, U.S. economic growth.

Cerity Partners LLC ("Cerity Partners") is an SEC-registered investment adviser with office locations throughout the United States. Registration of an Investment Advisor does not imply any level of skill or training. The foregoing is limited to general information about Cerity Partners' financial market outlook. You should not construe the information contained herein as personalized investment, tax, or legal advice. There is no guarantee that the views and opinions expressed in this commentary will come to pass. The information presented is subject to change without notice and should not be considered as an offer to sell or a solicitation of an offer to buy any security. Material economic conditions and/or events may affect future results. All information is deemed reliable as of the date of this commentary but is not guaranteed. Before making any decision or taking any action that may affect your finances or your company's finances, you should consult a qualified professional adviser. For information pertaining to the registration status of Cerity Partners, please contact us or refer to the Investment Adviser Public Disclosure website (www.adviserinfo.sec.gov). For additional information about Cerity Partners, including fees, conflicts of interest, and services, send for our disclosure statement as set forth on Form CRS and ADV Part 2 using the contact information herein. Please read the disclosure statement carefully before you invest or send money.

Indices or other financial benchmarks are provided for illustration purposes only. Indices are unmanaged, statistical composites and an individual cannot directly invest in an index. Any returns portrayed do not reflect the deduction of underlying investment expenses and third-party fees to purchase the securities they represent. Past performance is no guarantee of future results. Data from indices (i.e., the S&P 500) are supplied by third party suppliers. Cerity Partners does not attest to the accuracy or reliability of these numbers nor the methods of calculation from which they are derived. Investing in the financial markets involves risk, including the loss of the principal amount invested; and may not be appropriate for everyone.

Certain information contained herein concerning economic trends and market performance trends are based on or derived from information provided by independent third-party sources that, in certain cases, may not have been updated through the date of this information. While such information is believed to be reliable for the purposes used herein, Cerity Partners has not independently verified the assumptions on which such information is based nor assumes any responsibility for the accuracy or completeness of such information.

ceritypartners.com/contact

©2023 Cerity Partners LLC, an SEC-registered investment adviser. All Rights Reserved. (2/23)