NewEdge WEALTH

2023 Outlook:

Enjoy What You Can, Endure What you Must

January 18, 2023

“Enjoy What You Can, Endure What You Must”

-Johann Wolfgang von Goethe

The Paths of 2023

“Can’t Touch This” Resilient Growth High Inflation	“PTSD” Resilient Growth Lower Inflation	“Stag-Do” Weak Growth High Inflation	“Pain and Gain” Weak Growth Low Inflation
Economy: Positive GDP in 2023 (no recession), no meaningful ↑ unemployment, inflation remains >4%	**Economy:** Positive GDP in 2023 (no recession), no meaningful ↑ unemployment, inflation 2-4%	**Economy:** Negative GDP in 2023 (recession), ↑ unemployment, inflation remains >4%, exogenous shock	**Economy:** Negative GDP in 2023 (recession), ↑ unemployment, inflation 2-4%
Fed: Stays hawkish, higher terminal Fed Funds (>5.25%), no cuts in 2023 or early 2024, continued QT	**Fed:** Raises to 5-5.25% and pauses (per the dot plot), no cuts in 2023 (on risk of inflation return), continued QT	**Fed:** Raises to 5-5.25% and pauses, talks about “balance of risks”, but no cuts with inflation high, cont’d QT	**Fed:** With growth and inflation low, can be accommodative, but not as much as 2019 or 2020, risk they are slow
Macro: ↑ Interest rates across curve ↑ USD	**Macro:** ↑ Interest rates across curve ? USD (depends ECB/BOJ)	**Macro:** Interest rates mixed USD (starts weak, ends strong)	**Macro:** ↓ Interest rates across curve ↓ USD (maybe ↑ safety)
Markets: - Negative-neutral equities with ↓ P/E from higher rates but ↑ EPS on better growth and inflation -Credit spreads contained Helps: Value, int’l (USD headwind), cyclicals, real assets Hurts: Growth, FI duration Strategy: stay quality, valuation discipline	**Markets:** - ST ↑ equities on relief rally, but then flat/ ↓ with ↓ P/E from higher rates and ↓ EPS on less inflation/revenue growth - Credit spreads ok Helps: Value, cyclicals, international Hurts: Growth, FI duration Strategy: stay quality, valuation discipline	**Markets:** - Negative equities/sideways chop with ↓ P/E from Fed pushback against cuts and ↓EPS from lower growth, -Credit spreads widen, credit event Helps: real assets Hurts: cyclicals Strategy: stay quality and defensive, take advantage volatility	**Markets:** -**Stage 1** bad equities on recession ↓ PE and ↓ EPS; **Stage 2** good equities on Fed pivot ↑ PE -Credit spreads widen, credit event Strategy: **Stage 1** stay defensive (quality equities and bonds, cash), **Stage 2** risk-on (HY, high beta/low quality equities, small cap)

How Soon is Now?:

When Could the U.S. Economy Enter a Recession?

When you say it's gonna happen now
When exactly do you mean?

-The Smiths, *How Soon is Now?*

Key Assertions: U.S. Economy

1. U.S. economic growth in 2023 has the potential to be stronger than current expectations, as a recession is avoided in the first half of the year.

2. We will watch for signs of deterioration in broad labor data (not happening yet) to judge the risk of a 2H23 recession; while if we do avoid a recession in 2023, it likely raises the risk for a 2024 recession (due to lagged impact from policy).

3. We expect inflation to continue to moderate in 2023, but remain above the Fed's 2% target.

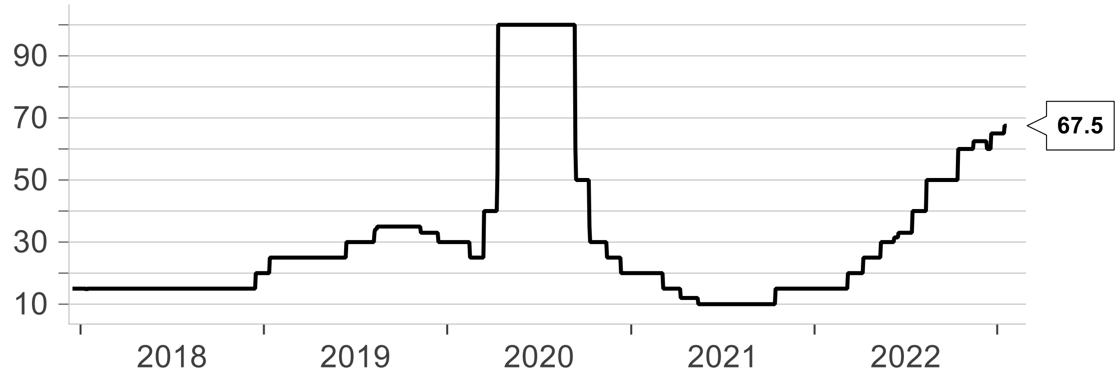
4. We see China reopening and oil prices as the key wildcards for 2023 inflation data; the risk is either factor could contribute to a reacceleration in month over month inflation readings.

Are 2023 U.S. Growth Estimates Too Low? Possibly Yes

US Economic Forecasts (Bloomberg Consensus and Fed)	Street 2022E	Street 2023E	*Fed 2023E*	Street 2024E	*Fed 2024E*
Real GDP	**1.9%**	**0.3%**	***0.5%***	**1.3%**	***1.6%***
Consumer Spending	2.3%	1.0%		1.4%	
Government	-0.8%	1.1%		1.0%	
Private Investment	3.7%	-2.4%		1.7%	
Exports	7.3%	2.2%		2.2%	
Imports	8.7%	0.3%		1.7%	
PCE	**6.3%**	**3.5%**	***3.1%***	**2.3%**	***2.5%***
Core PCE	5.0%	3.6%	*3.5%*	2.4%	*2.5%*
Unemployment	**3.6%**	**4.4%**	***4.6%***	**4.8%**	***4.6%***

Source: Bloomberg, as of 1/10/23; Federal Reserve December 2022 Summary Economic Projections

United States Recession in 1 Year Probability Forecast (%)



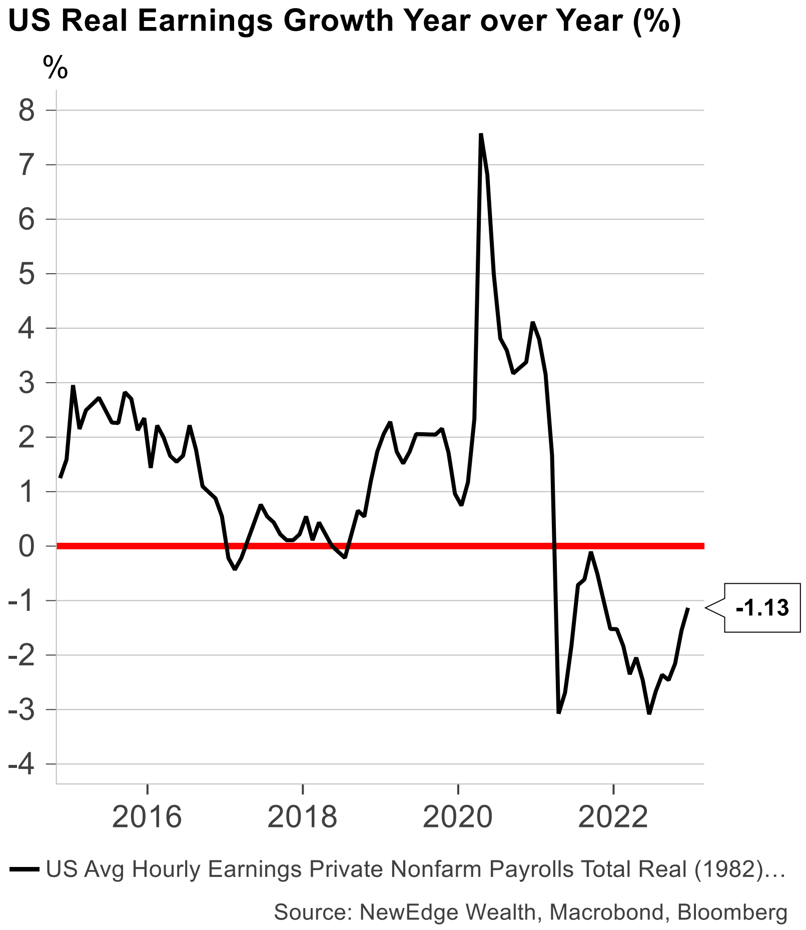
Source: NewEdge Wealth, Macrobond, Bloomberg

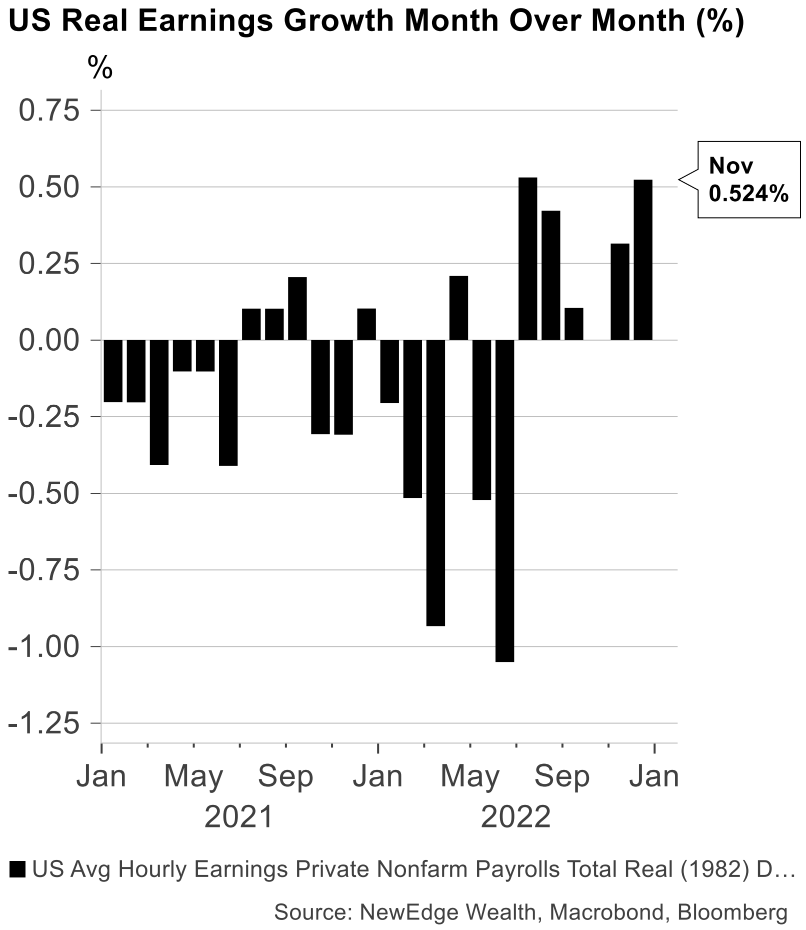
Forecasters expect very little for U.S. economic growth in 2023, with a currently forecasted 65% probability of a recession in 2023.

However, based on strong data exiting 2022, we see potential that U.S. growth surprises to the upside in 2023, at least in 1H23.

We do not think we will experience a recession in 1H23, but will watch labor data closely to judge the likelihood of slipping into a recession in 2H23.

U.S. Consumer Recently Helped By Falling Inflation

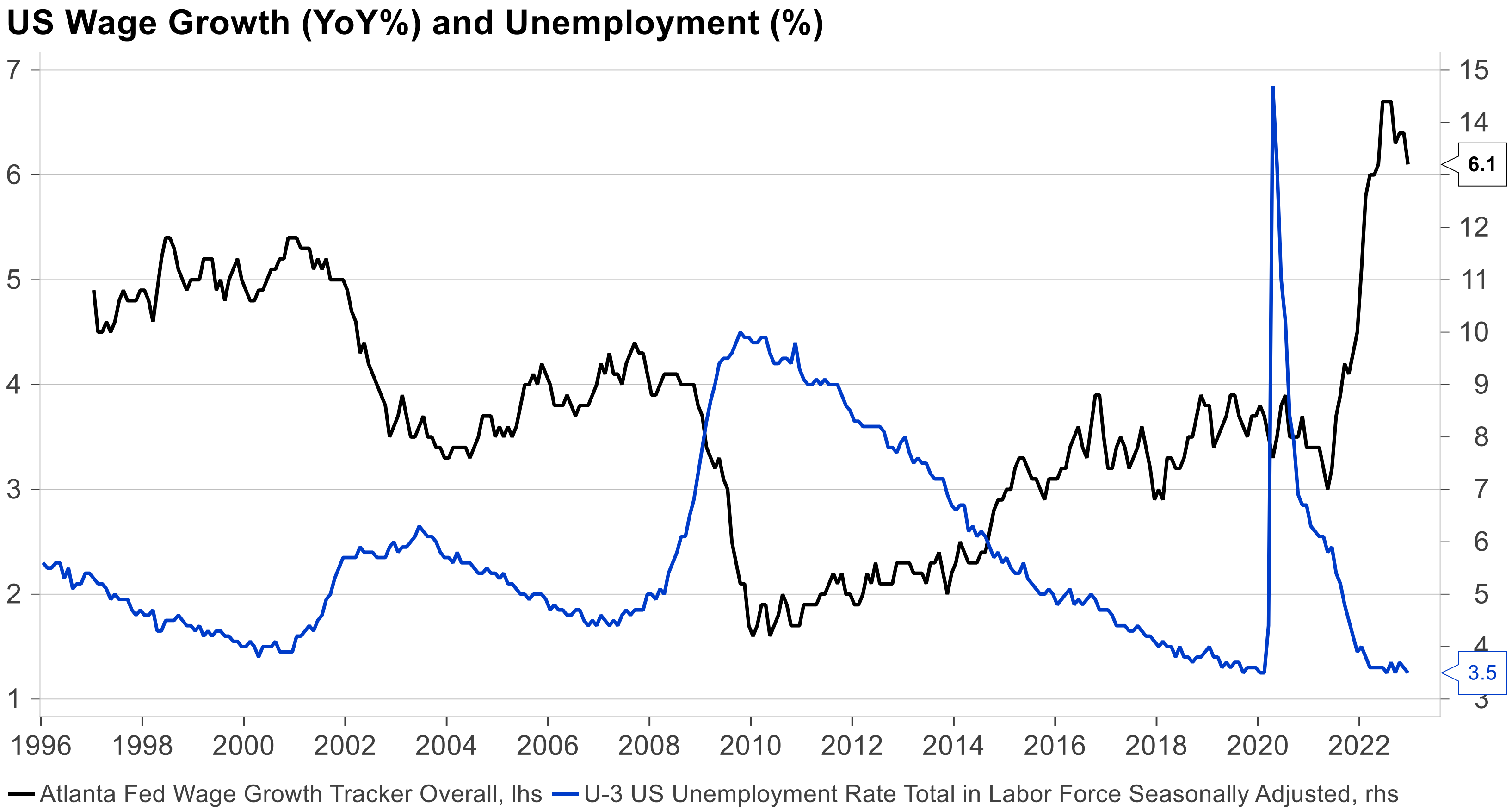




Wage growth has started to slow in the U.S., however, so has inflation to an even greater degree (mostly driven by falling gasoline prices).

This means that *real* wage growth has been improving. Better real wage growth means that consumers' money goes further, allowing them to spend more in real terms. Along with this rebound in real wage growth, we have seen a rebound in consumer sentiment.

The Labor Market is Still Tight



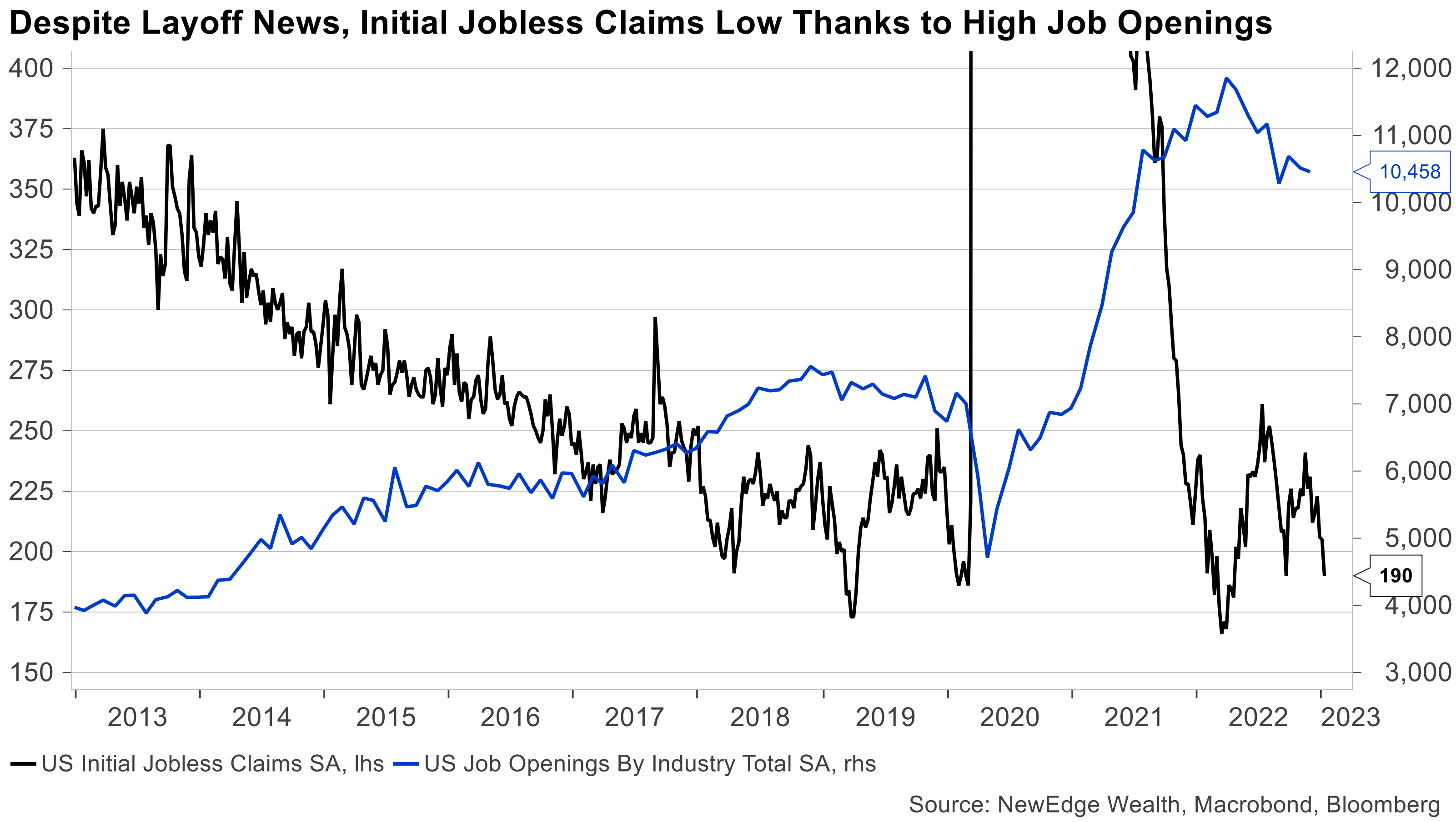
Source: NewEdge Wealth, Macrobond, Bloomberg

The labor market remains resilient (unemployment near a 50-year low at 3.5%), while wage growth remains robust.

There are early signs that wage growth is starting to moderate, but for now, there is little slack in the labor force, keeping wage inflation a key risk for the Fed.

The progression of labor data in 2023 will be critically important for predicting if and/or when the U.S. economy slips into recession.

Fired Workers Are Quickly Finding New Jobs



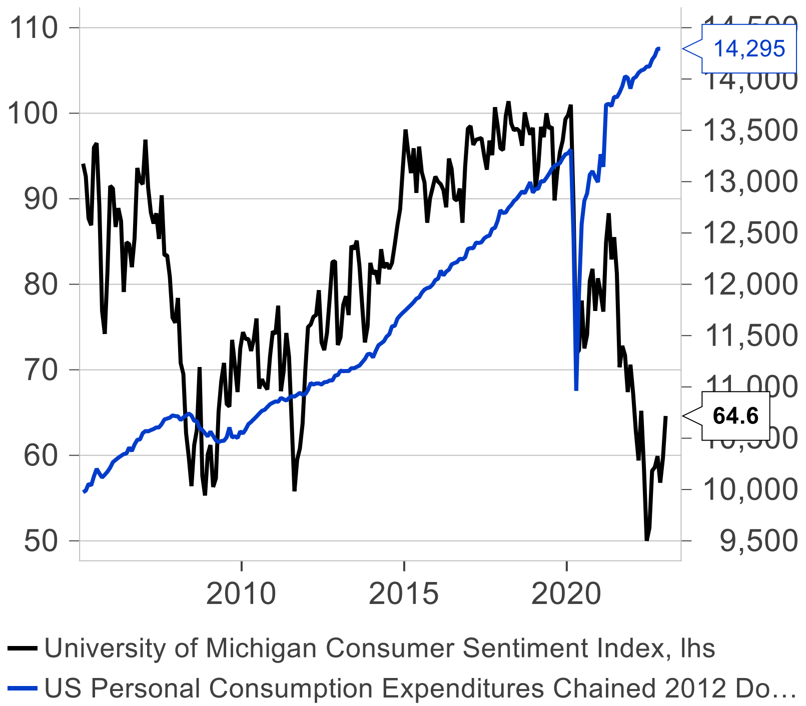
One reason for the tight labor market is that despite big headlines of layoffs, many laid-off workers have been able to find jobs quickly (so we haven't seen an uptick in initial jobless claims yet). This is partially due to the large number of job openings that remain well above pre-pandemic levels.

The key question for 2023 will be one of contagion: will job losses in a few sectors (like tech) spread to other parts of the economy?

Watch What They Do, Not What They Say: Soft vs. Hard Data

Consumer Sentiment Terrible, But Consumer Spending Resilient

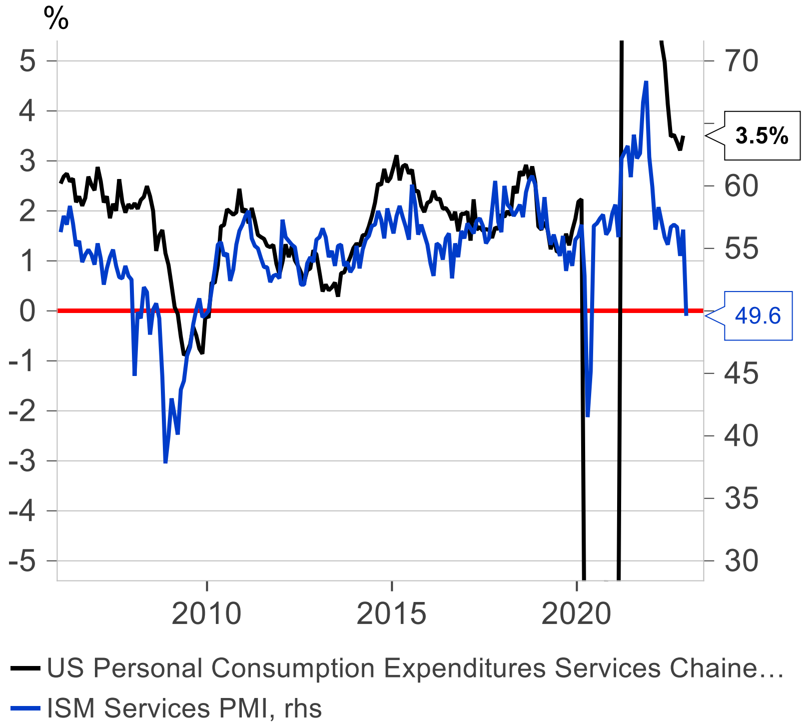
University of Michigan Consumer Sentiment and US Real Personal Consumption Expenditures



Source: NewEdge Wealth, Macrobond, Bloomberg

Services PMI Sips Into Contraction While Services Spending Growth Still Strong

US PCE Services (YoY%) and ISM Services PMI



Source: NewEdge Wealth, Macrobond, Bloomberg

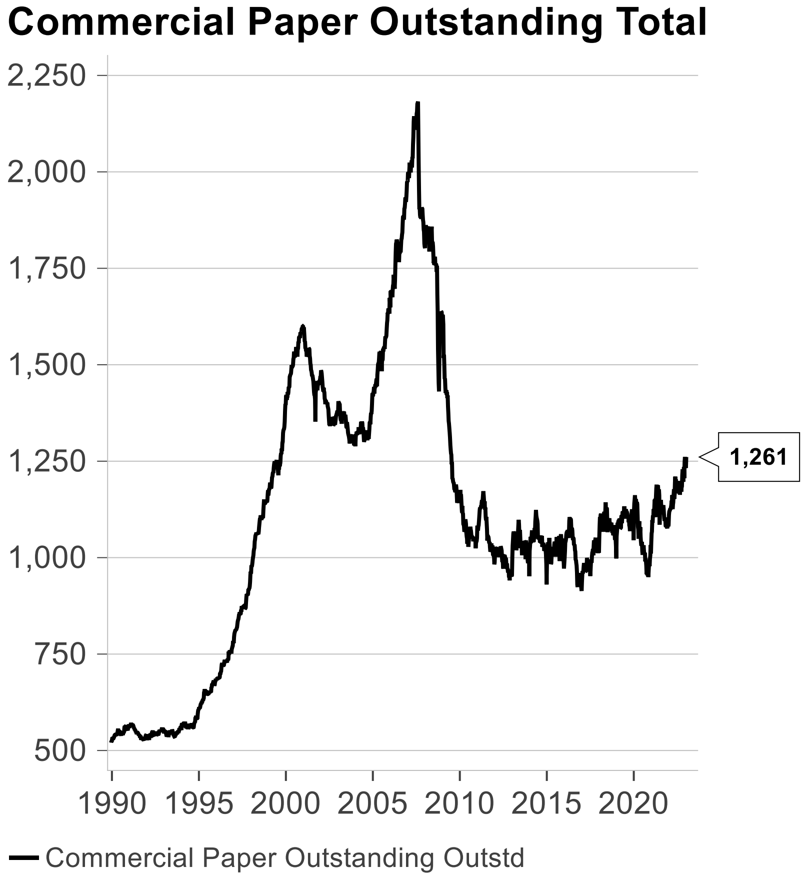
All through 2022, consumers and businesses *felt* awful, but despite this sour sentiment, they continued to spend, hire, and grow.

Said another way, soft data was very weak in 2022, while hard data was resilient.

The key question for 2023 is if this weak soft data and weak sentiment is a false signal, or a valid leading indicator of more pronounced weakness to come.

Why So Resilient, U.S. Economy? Possibly Less Sensitivity to Short Term Rates

Source: NewEdge Wealth, Macrobond, Bloomberg



Source: NewEdge Wealth, Macrobond, Bloomberg

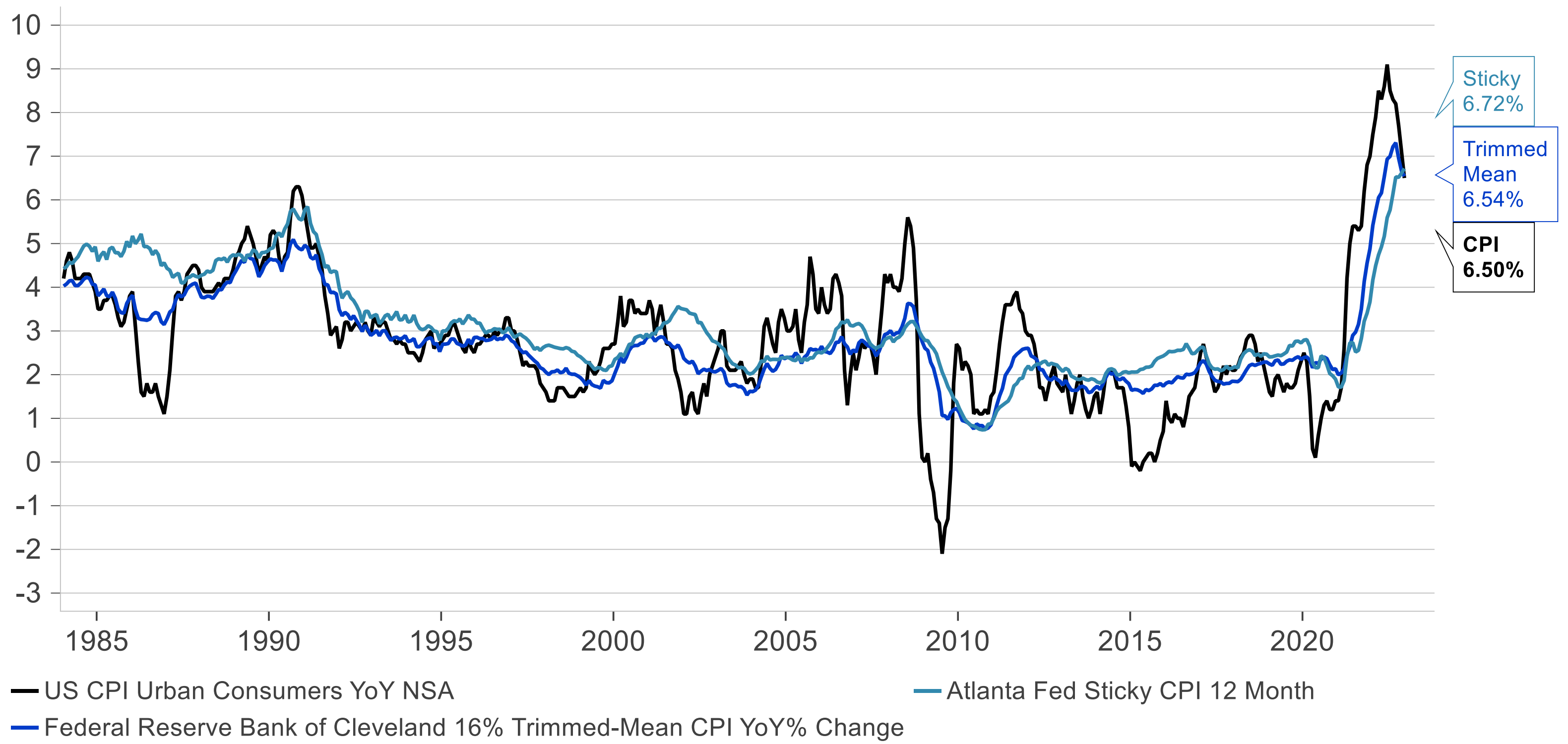
Over a decade of zero interest rate policy allowed borrowers to extend the duration of their loans. The end result of more longer-term/less variable-rate debt is that, despite higher overall debt levels, as interest rates have risen, both consumers and corporates have not been impacted as much, or as quickly, as they were in prior cycles.

Consider the much lower % of floating rate mortgages for consumers compared to pre-GFC, and the lower use of very short-term commercial paper by corporates.

Inflation Peaked in 2022, But Price Increases Still Broad and Sticky

Inflation Peaked but Broad and Sticky Inflation Makes Fed's Job Difficult

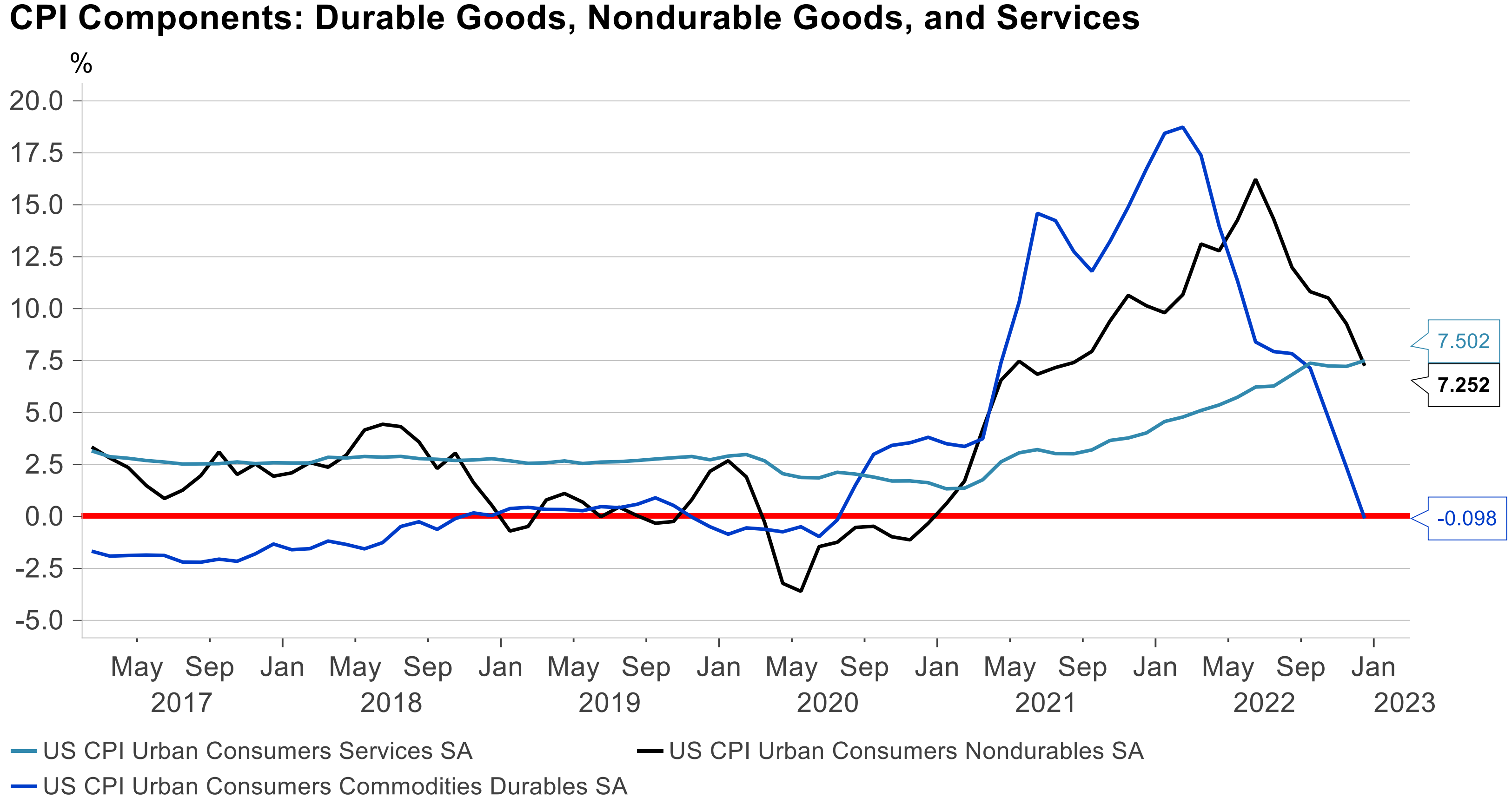
Headline CPI YoY%,Trimmed-Mean CPI YoY%, and Atlanta Fed Sticky CPI YoY%



Source: NewEdge Wealth, Macrobond, Bloomberg

Rapid declines in a few items (gasoline, used car prices) contributed to falling inflation rates in 2H22. However, measures of inflation breadth (like Trimmed Mean which throws out extreme readings on the high and low end) and Stickiness (those components that are less volatile) remain elevated and point to inflation readings staying above the Fed’s 2% target in 2023.

Goods Disinflation Was Well Underway in 2022



Source: NewEdge Wealth, Macrobond, Bloomberg

Economy watchers should note that Goods disinflation has been occurring since the beginning of 2022.

Durable Goods inflation peaked at 18% in February 2022 and fell all the way down to -0.1% in December (tracked the falling container shipping prices as supply chains healed).

Nondurable Goods inflation (includes food and energy) has been moderating since summer 2022, when gasoline prices peaked.

Services inflation remains elevated due to high shelter/housing inflation, along with elevated wage growth.

Hate to Say I Told You So:

The Fed's Path in 2023

Hate to say I told you so, all right!
Come on!
Do believe I told you so

-The Hives, *Hate to Say I Told You So*

Key Assertions: Federal Reserve Policy

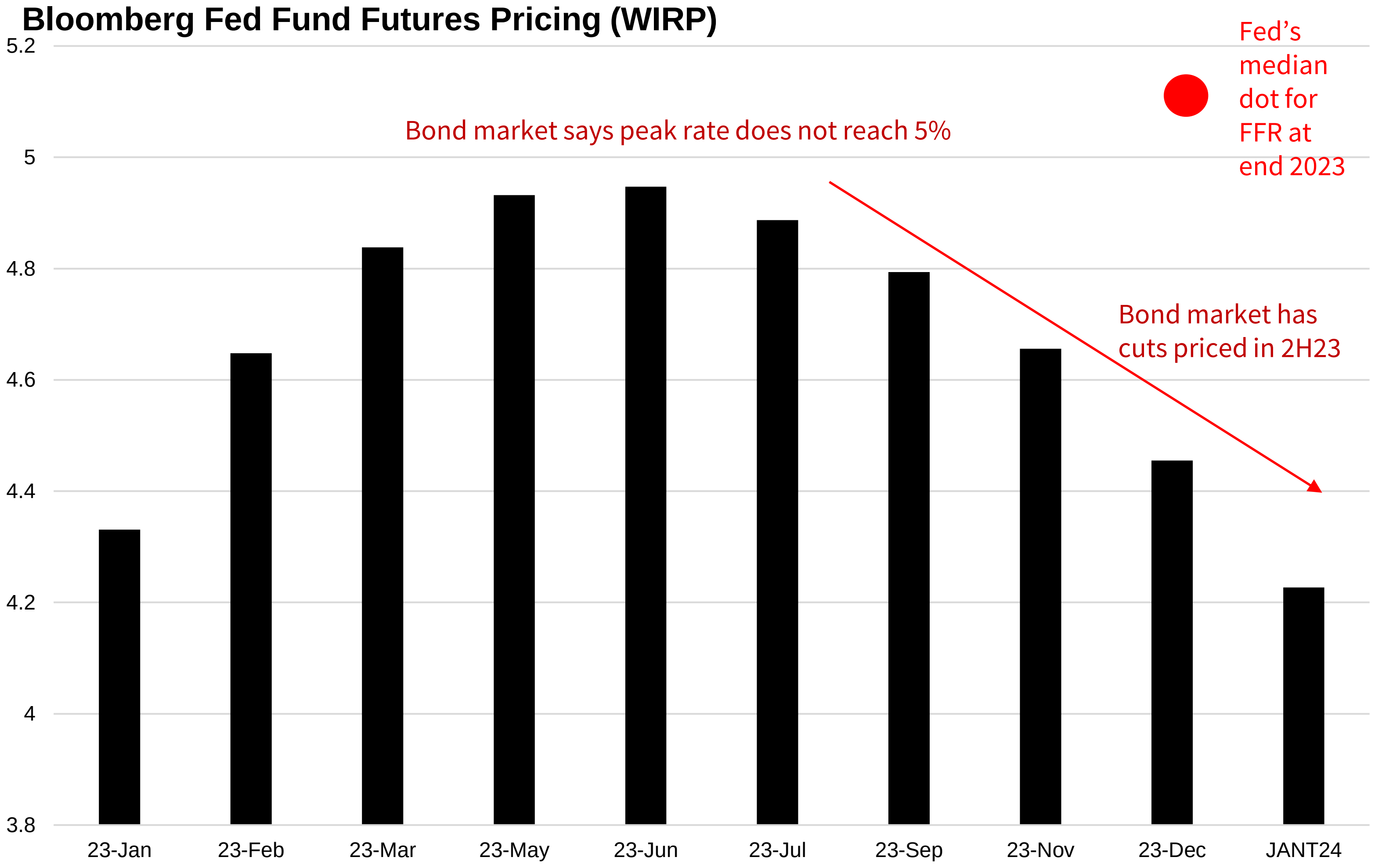
1. We think the Fed will hike rates to 5-5.25% and pauses.

2. We do not think the Fed will cut interest rates in 2023 for fear that inflation will return if they ease policy, while growth may not be weak enough to justify cutting.

3. We think the bond market is ahead of itself, pricing in a sub-5% terminal rate and 40bps of cuts in 2H23.

4. We watch closely for how much the Fed pushes back against financial conditions, which are now the easiest since the start of the tightening cycle!

The Bond Market Doesn't Believe the Fed



Source: Bloomberg, NewEdge Wealth, as of 1/11/23

Despite the Fed's assertions that it wants to raise rates above 5% and keep them there through the end of 2023, the Fed Funds Futures market is pricing in that the Fed both doesn't reach 5% and begins to cut in 2H23.

This is a very dovish pivot forecast already built into current bond pricing.

But Before We Believe the Bond Market Blindly…

Futures Only Expected a 1% Fed Funds Rate for Feb 2023 This Time Last Year

WIRP Fed Funds Futures Rate Projection for February 2023

Source: NewEdge Wealth, Macrobond, Bloomberg

The bond market has been just as off-base as the Fed in its 1-year ahead projection of policy rates.

Back in January of 2022, the futures market only expected the Fed Funds rate to be 1% in February of 2023, compared to the current projection of 4.65%.

So, when we look at bond market pricing 1+ years out, remember that these forecasts have a poor track record and are very sensitive to the progression of data and Fed policy/speak.

Are Easy Financial Conditions Testing the Fed's Resolve?

Bloomberg United States Financial Conditions Index

Source: NewEdge Wealth, Macrobond, Bloomberg

Financial conditions have eased (lower USD, tighter credit spreads, lower yields, higher equity valuations) in recent months back to easy levels not seen since the start of the tightening cycle.

The last time financial conditions rebounded like this, Powell came out at Jackson Hole and gave a very hawkish speech.

The Fed has expressed concern that easy financial conditions are working against their inflation fight.

Does this push the Fed to talk tough and potentially tighten policy even further?

The Long and Winding Road to Nowhere:

Equities in 2023

But still they lead me back
To the long winding road

-The Beatles, *The Long and Winding Road*

Well, we know where we're goin'
But we don't know where we've been
And we know what we're knowin'
But we can't say what we've seen

-The Talking Heads, *Road to Nowhere*

Key Assertions: Equities

1. U.S. equities could end 2023 with little change, but could experience a wide range of outcomes during the year.

2. Upside: Would be driven by better EPS growth than expected, but capped by multiples that become expensive after just a moderate rally.

3. Downside: Would be driven by both weaker EPS growth (driven by falling margins, and/or lower revenue in a weak growth environment) and falling PE valuation multiples (driven by the Fed staying tight and interest rates remaining high).

4. Strategy:
   1. Quality emphasis
   2. Value over Growth, still with Quality
   3. Equal Weight over Capitalization Weight
   4. Sectors to start 2023: Energy, Healthcare, Financials, Materials
   5. More constructive on non-U.S.

Potential S&P 500 Outcomes

S&P 500 2023 Potential Price Levels at Various EPS and PE

Change vs. 2022	2023 EPS	PE on 2023 EPS							
		14x	15x	16x	17x	18x	19x	20x	21x
-24%	$170	2,380	2,550	2,720	2,890	3,060	3,230	3,400	3,570
-19%	$180	2,520	2,700	2,880	3,060	3,240	3,420	3,600	3,780
-15%	$190	2,660	2,850	3,040	3,230	3,420	3,610	3,800	3,990
-10%	$200	2,800	3,000	3,200	3,400	3,600	3,800	4,000	4,200
-6%	$210	2,940	3,150	3,360	3,570	3,780	3,990	4,200	4,410
-1%	$220	3,080	3,300	3,520	3,740	3,960	4,180	4,400	4,620
3%	$230	3,220	3,450	3,680	3,910	4,140	4,370	4,600	4,830
8%	$240	3,360	3,600	3,840	4,080	4,320	4,560	4,800	5,040
12%	$250	3,500	3,750	4,000	4,250	4,500	4,750	5,000	5,250

S&P 500 2023 Potential % Change from 2022 Close at Various EPS and PE

Change vs. 2022	2023 EPS	PE on 2023 EPS							
		14x	15x	16x	17x	18x	19x	20x	21x
-24%	$170	-38%	-34%	-29%	-25%	-20%	-16%	-11%	-7%
-19%	$180	-34%	-30%	-25%	-20%	-16%	-11%	-6%	-2%
-15%	$190	-31%	-26%	-21%	-16%	-11%	-6%	-1%	4%
-10%	$200	-27%	-22%	-17%	-11%	-6%	-1%	4%	9%
-6%	$210	-23%	-18%	-12%	-7%	-2%	4%	9%	15%
-1%	$220	-20%	-14%	-8%	-3%	3%	9%	15%	20%
3%	$230	-16%	-10%	-4%	2%	8%	14%	20%	26%
8%	$240	-12%	-6%	0%	6%	13%	19%	25%	31%
12%	$250	-9%	-2%	4%	11%	17%	24%	30%	37%

Source: Bloomberg, NewEdge Wealth, as of 1/18/23

The blue outlined box shows our expectations for potential upside and downside based on fundamentals for the S&P 500 in 2023.

Of course, we can trade outside of these bands at any given time. Oftentimes technicals, positioning, and sentiment can cause short term prices to diverge from medium-term fundamentals.

We use a range of $200-220 (-10% to flat) for our 2023 EPS and a wide range of 16x-19x for the PE multiple.

We lean towards the lower end of this valuation band given Fed hawkishness and the level of interest rates, which could put downward pressure on valuations.

The current PE is 17.1x forward, which is slightly above the long-term average.

Wall Street Consensus for 2023
Low: 3,200
High: 4,750
2022 Close: 3,839

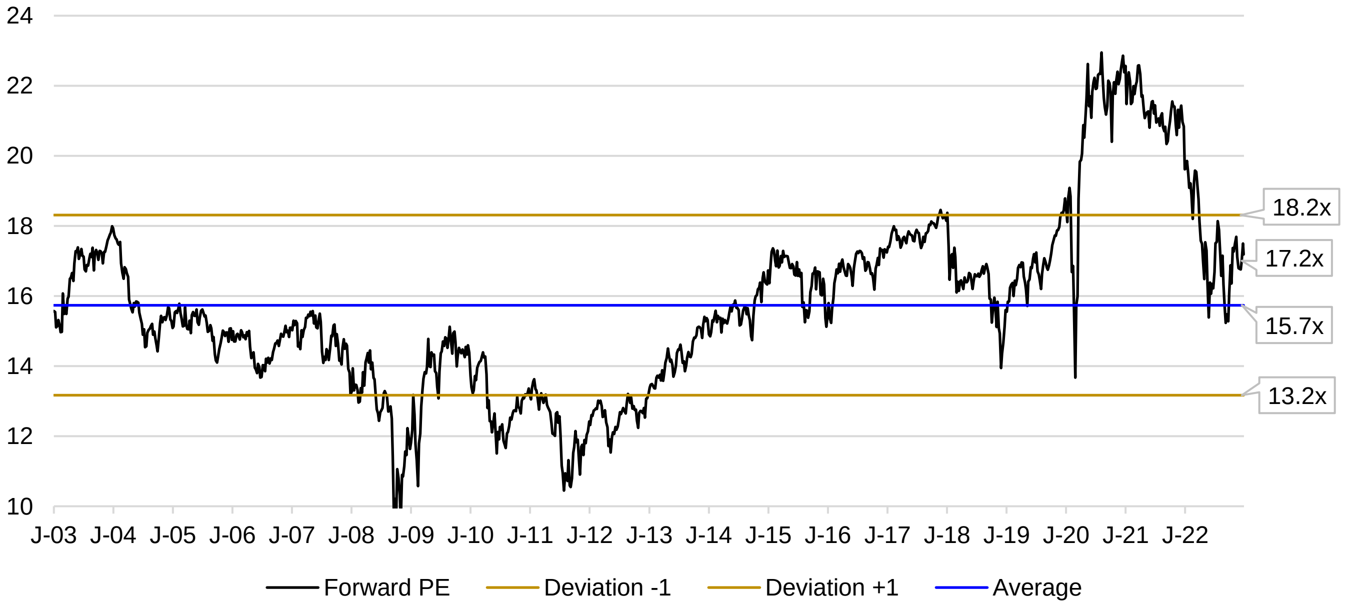
What is the Right PE Multiple?

S&P 500 Forward PE Ratios

	Over 10 Years	Over 20 Years	2010-2019
Average	17.3x	15.7x	15.2x
Standard Deviation +1	19.6x	18.2x	17.2x
Standard Deviation -1	15.1x	13.2x	13.1x
High	22.3x	22.3x	18.3x
Low	13.1x	10.5x	10.5x
Current Forward PE	**17.2x**		

Source: Bloomberg, NewEdge Wealth, as of 1/18/23

S&P 500 PE with 20 Year Statistics



Source: Bloomberg, NewEdge Wealth, as of 1/18/23

We think that one of the biggest impediments to significant and sustainable near-term upside for the S&P 500 is valuation.

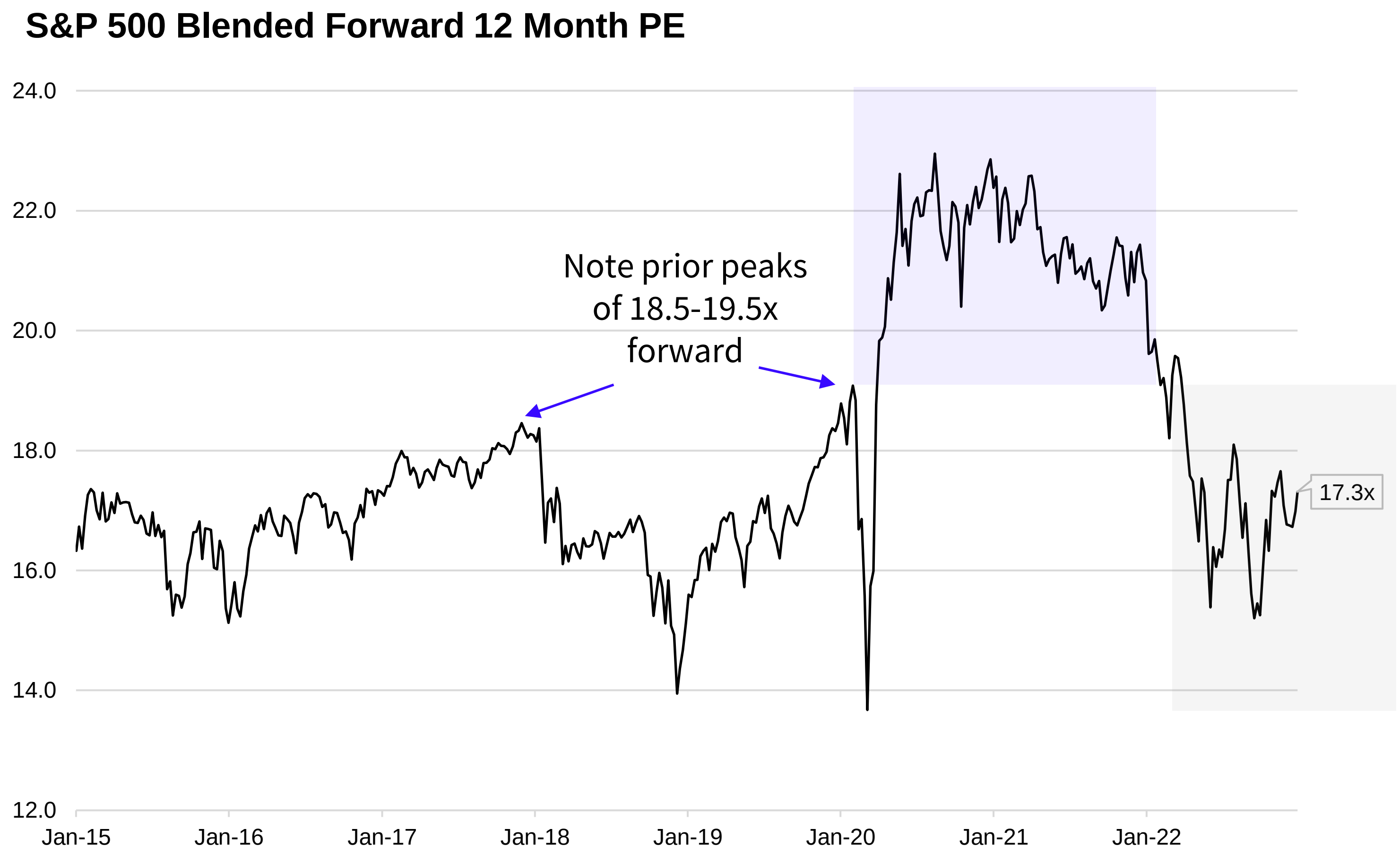
Today's valuation is just about average, not "cheap". The still-full multiple after a 20%+ drawdown is because we entered the bear market from bubble-like valuations.

We do not think that the 2020-2021 valuation highs are achievable in the near term and likely not until the next cycle (we had not traded to such high valuations since the tech bubble of the 1990s).

We do not think it is prudent to count on returning to this high valuation level sustainably, even if we get a Fed pivot, given the pivot is unlikely to be as powerful as the COVID rescue.

We think 15-17x forward is reasonable given the current liquidity and interest rate backdrop.

Why Stocks Are Unlikely to Trade Back to COVID Era Valuations



Source: Bloomberg, NewEdge Wealth, as of 1/11/23

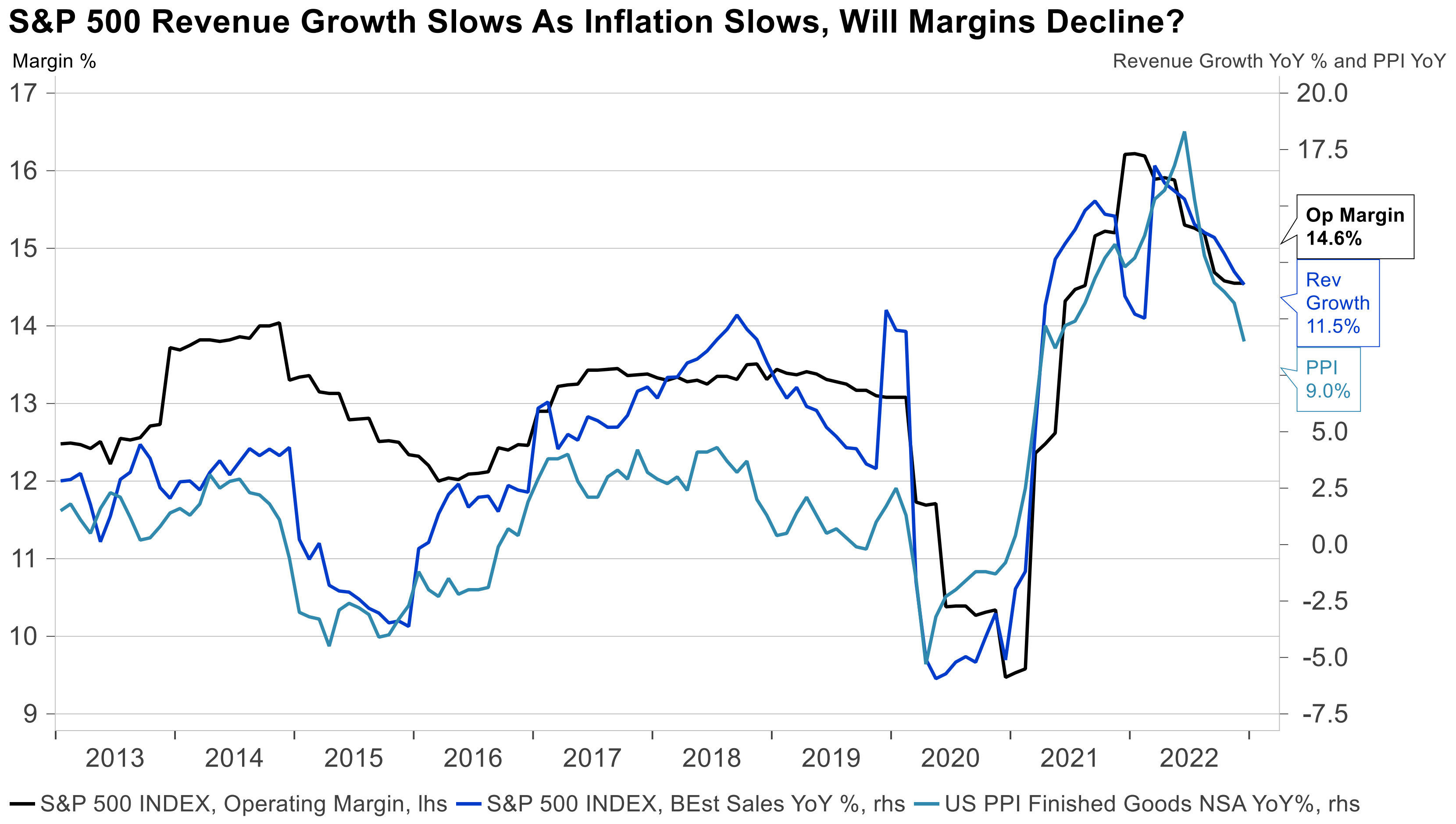
COVID Era:

- M2 Money Supply Growth 15-20%
- Fed Balance Sheet expansion +$5T
- Interest rates 0%

Today:

- M2 Money Supply Growth 0%
- Fed Balance Sheet expansion -$1T
- Interest rates 4.5%+

An Earnings Recession Without an Economic Recession?

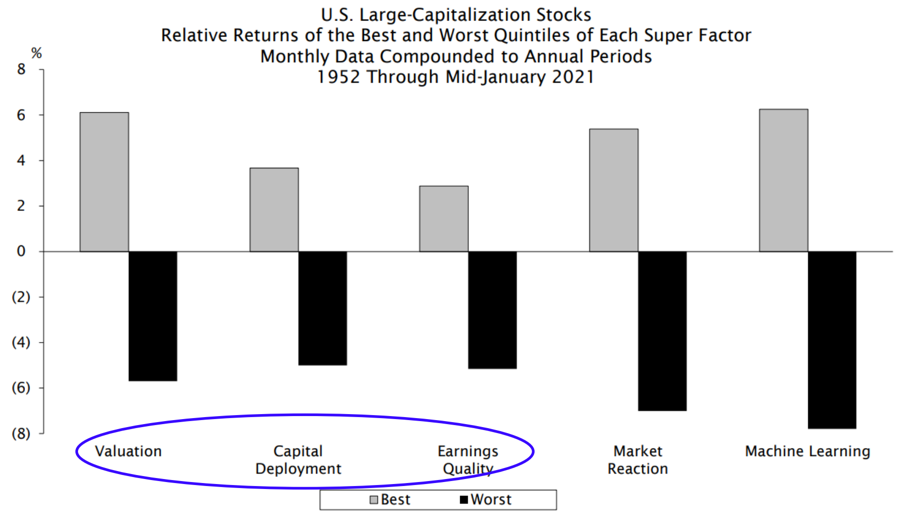


Source: NewEdge Wealth, Macrobond, Bloomberg
As of 1/18/23

The biggest driver of upside to S&P 500 margins in 2021 was strong revenue growth (creates operating leverage, high incremental margins) made possible by high inflation (gave companies pricing power).

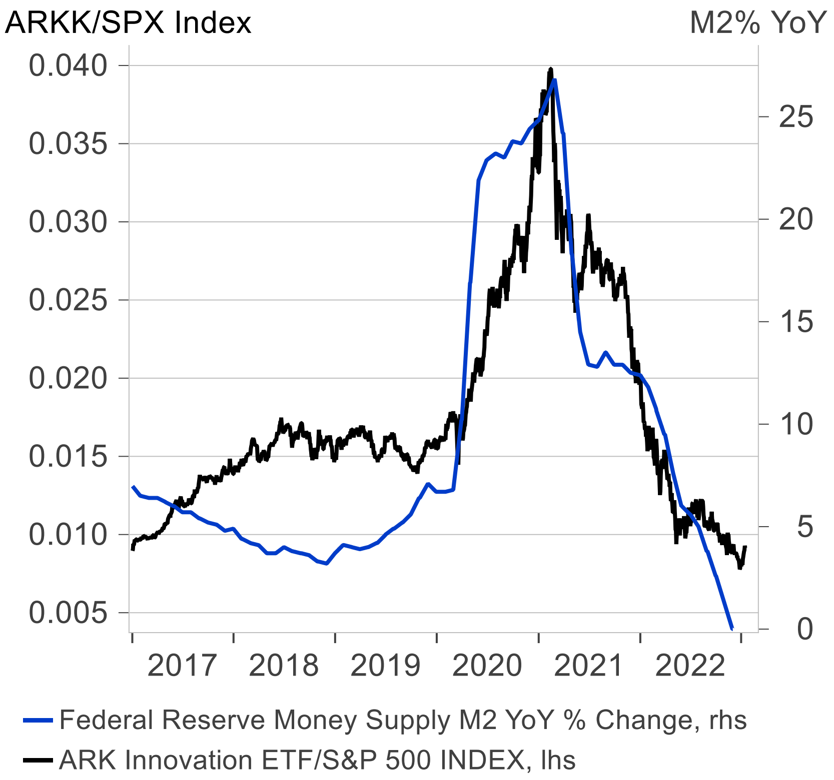
As inflation slows, so will pricing power, and thus revenue growth should slow as well. The risk is that as revenue growth slows, margins will fall, creating a headwind for earnings.

Long Term Quality, Short-Term Low-Quality Beta Not Supported by Liquidity



Source: Empirical Research Partners Analysis.

"Innovation" Relative to S&P 500 & M2 Money Supply Growth



Source: NewEdge Wealth, Macrobond, Bloomberg

As of 1/18/23

For the long-term, quality continues to be a key driver of relative equity performance, with the Empirical Research Partners showing the long-term outperformance of high-quality companies (those with strong balance sheets, good earnings quality/cash generation, and disciplined capital deployment) over low quality companies.

There are times that low quality companies have huge outperformance, such as 2020-2021. The risk is that low quality companies often “give back” their outperformance during downturns, as they did in 2022.

To start 2023, we have seen low quality lead the market, but would note that we have not seen a turn in the liquidity cycle that would make this low-quality outperformance sustainable.

Growth vs. Value: The Bubble is Over, Be Aware of Mean Reversion

Source: NewEdge Wealth, Macrobond, Bloomberg

Source: NewEdge Wealth, Macrobond, Bloomberg

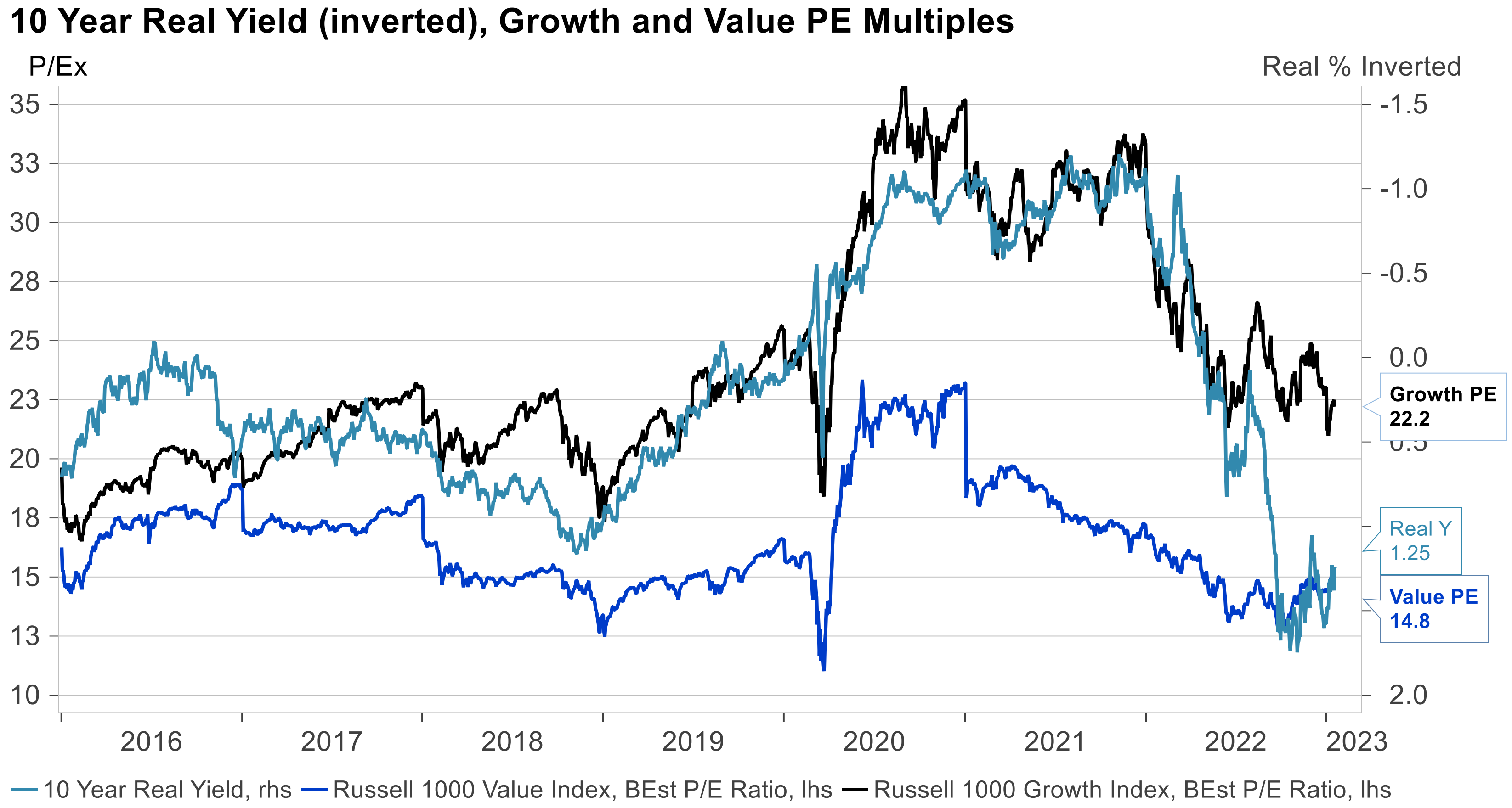
As of 1/18/23

The blow-off top of the post-COVID bubble in Growth stocks over Value stocks ended and began to unwind in 2022.

Given such sharp underperformance in 2022, Growth stocks could briefly bounce in 2023, but the trend is lower for Growth vs. Value (meaning any relief rally in Growth could be short lived).

We consider this dynamic as we think about leadership in the next cycle, which could look different from the 2010-2021 cycle that clearly favored expensive Growth darlings.

Valuation Still a Risk for Growth, While Value Less Stretched



Source: NewEdge Wealth, Macrobond, Bloomberg
As of 1/18/23

Growth stocks still trade at a 50% premium to Value stocks. This is down from a 100% premium at the peak in late 2-2021 during the COVID bubble, however above the 20-40% premium range experienced in the prior cycle before the late-2018 "Powell pivot" that saw real interest rates plunge.

Some Growth names face earnings risk as well, as many of them were the greatest beneficiaries of COVID dynamics that pulled forward demand.

Sectors: Searching for Low Bars

Sector	2022E EPS Growth	2023E EPS Growth	Forward PE	12 Month Price Change
Communication Services	-14%	8%	14.1X	-34%
Consumer Discretionary	9%	20%	22.2X	-29%
Consumer Staples	5%	0%	20.8X	-4%
Energy	172%	-15%	10.2X	39%
Financials	-16%	9%	12.9X	-11%
Real Estate	16%	2%	35.0X	-18%
Health Care	4%	-5%	17.2X	1%
Industrials	22%	13%	18.6X	-4%
Information Technology	10%	-2%	22.0X	-20%
Materials	3%	-12%	16.9X	-6%
Utilities	2%	7%	18.7X	2%
S&P 500	**8%**	**5%**	**17.6X**	**-14%**

Source: Bloomberg, NewEdge Wealth

As of: 1/18/2023

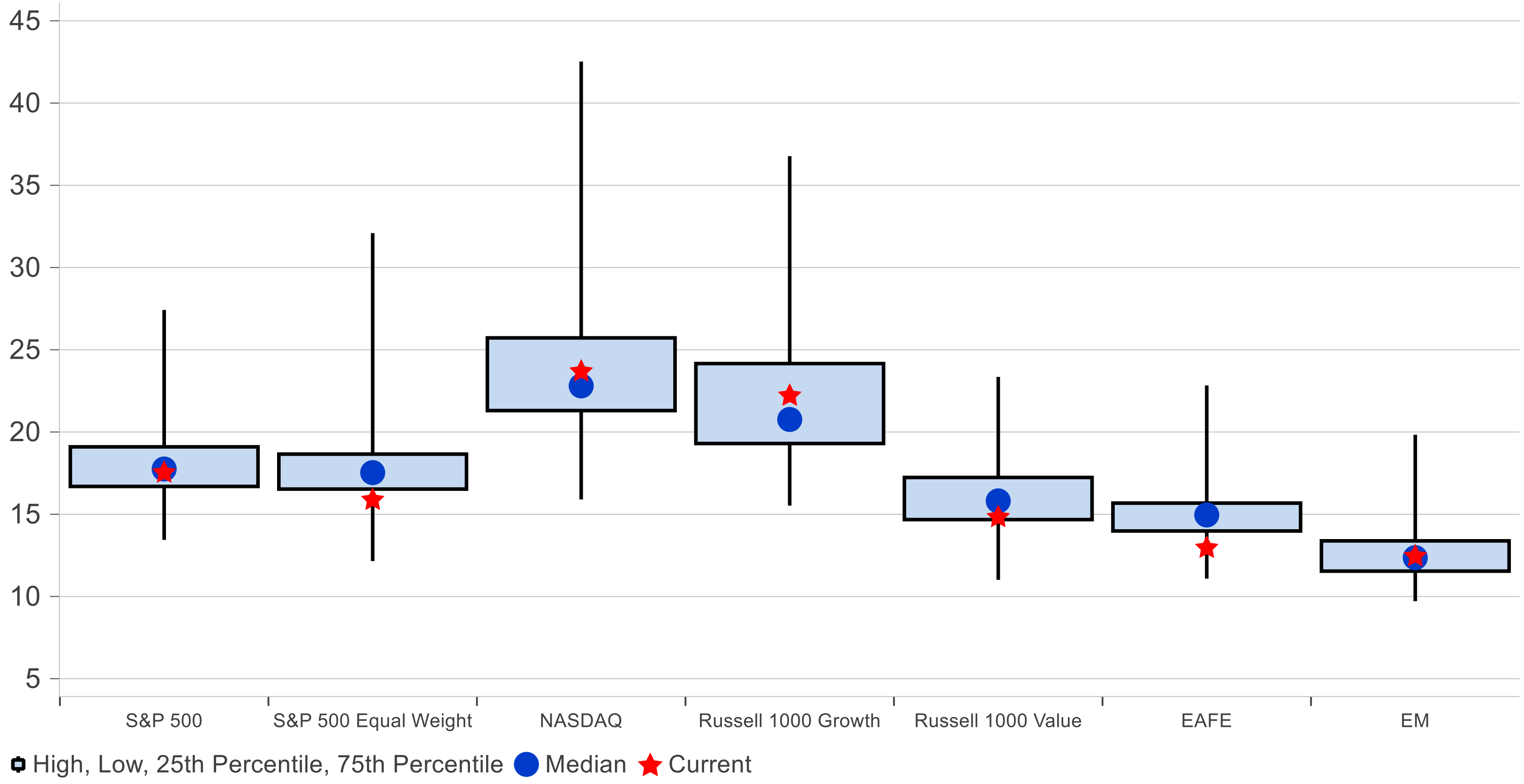
To start 2023, we find the following sectors potentially attractive:

- Energy: Inexpensive valuations, provides a hedge against higher oil prices/higher energy-related inflation, noting the risk of earnings declines in 2023 after huge growth in 2022.
- Health Care: The lowest valuation of the defensive sectors (compared to Utilities and Staples).
- Financials: The lowest bar for earnings growth in 2023 after earnings declines in 2022, plus low valuations.
- Materials: Cyclical exposure that benefits from potential USD weakening and/or China reopening/stimulus dynamics.

Most Equity Markets Have Average Valuations, Not Cheap, Not Expensive

Some Markets are Cheaper Than Others

10 Year Valuation Statistics for Major Equity Indices



Source: NewEdge Wealth, Macrobond, Bloomberg

As of 1/18/23

Despite 2022's weak markets, most major equity indices have valuations in line with their 10-year median multiples.

Not cheap, but also not expensive.

Notably, some indices (NASDAQ, Growth) still have valuations above their 10-year medians, while other indices (Equal Weight S&P, Value, EAFE) have valuations below their 10-year medians.

We expect relative valuation to continue to be a driver of returns in 2023, as it was in 2022.

International Shaping Up

MSCI International Developed EAFE Index (MXEA) Absolute and Relative to U.S.

Non-U.S. stocks are staging on the most powerful absolute and relative rallies that we have seen in many years.

Unlike major U.S. indices (S&P 500 and NASDAQ), the EAFE index is now trading above its 200-day moving average.

This trend improvement has been driven by the sharp weakness in the USD (which drove large rallies in commodity-sensitive and Value companies and are a larger weighting in the EAFE compared to the U.S. overweight to Growth).

Signs of Life in Emerging Markets

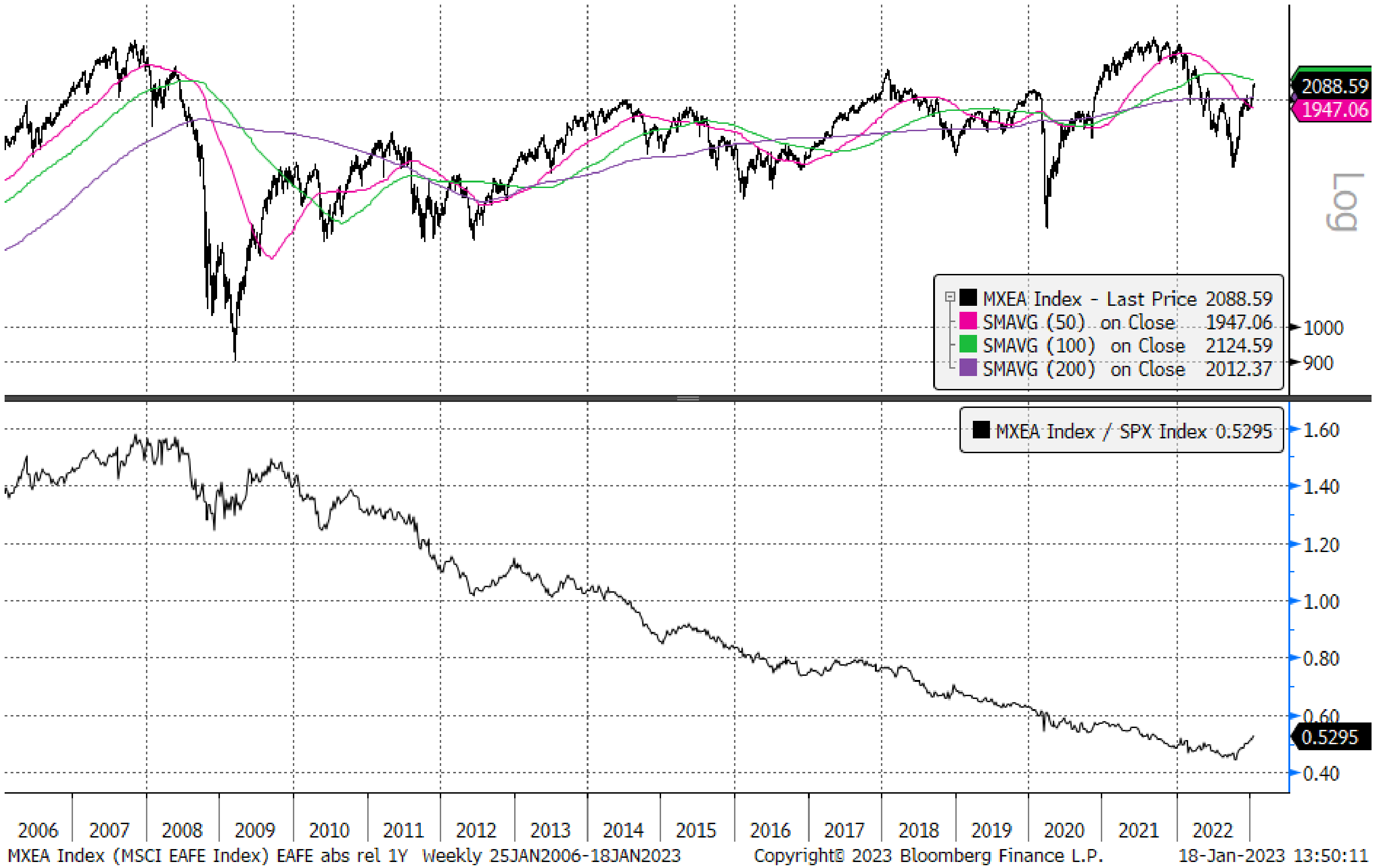
MSCI Emerging Markets Index (MXEF) Absolute and Relative to U.S.

A similar dynamic is happening in Emerging Markets (EM), where recent USD strength has spurred a huge rally.

Further contributing to this rally has been more optimism around global growth, partially driven by a reopening of and potential stimulus for the Chinese economy.

But Remember the Long-Term, Structural Underperformance

MSCI International Developed EAFE Index (MXEA) Absolute and Relative to U.S.



This time may be different with non-U.S. stocks, meaning the recent rally we have seen could be the start of a sustained period of non-U.S. outperformance.

However, it is important to keep this move in context: the relative performance of EAFE vs. the U.S. remains in a 15-year downtrend, while the absolute performance still has not taken out the 2007 highs.

The strength of the recent bounce is more reflective of how *oversold* non-U.S. stocks got in 2H22.

This bounce can continue if we see continued USD weakness.

World Turning:

Macro Factors (Yields and the USD)

Everybody's trying to say I'm wrong
I just wanna be back where I belong

-Fleetwood Mac, *World Turning*

Key Assertions: Macro Factors

1. Yields: A stronger economy that results in a tighter Fed policy likely puts upward pressure on rates across the curve; while a weaker economy will ignite rate cut bets and a flight to safety that could result in falling yields.

    A. 10 Year: Potential for a choppy range of 3.25-4.25%.

    B. 2 Year: Potential for a choppy range of 3.75-4.75%.

2. Yield Curve: Look to the re-steepening of the curve (driven by a falling short end) as a helpful signal about the timing of a recession.

3. USD: More crosscurrents in 2023, compared to the bullish uptrend of 2022; we note drivers like technicals, positioning, relative monetary policy, and recession/risk-off risks as key considerations.

10 Year: Are the Highs In?

U.S. 10 Year Treasury Yield

We see a range of 3.25-4.25% for the 10 year in the early days of 2023.

The downside would be driven by weaker economic data (including lower inflation data), that would fuel fears of a recession, and drive flight to safety and rate cut trades.

The upside would be driven by better economic data (including higher inflation data), that would keep pressure on the Fed to stay tight.

Note 10 year inflation expectations are ~2.16%, which reflects the bond market's confidence that the Fed will be successful in returning inflation to its 2% target.

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2 Year: Watch for Recession Pricing

U.S. 2 Year Treasury Yield

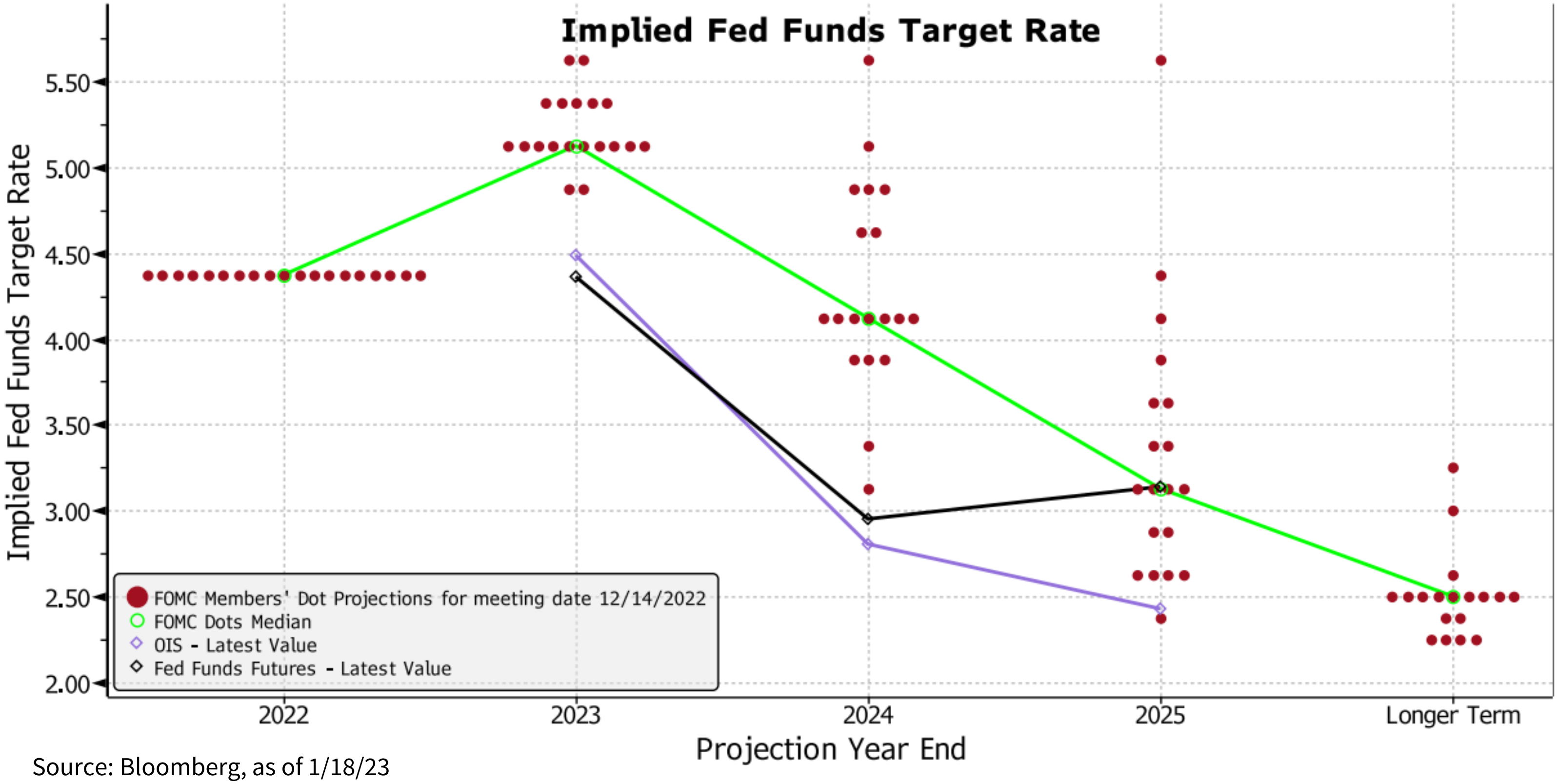
A rapidly falling 2 Year yield is one of the most important signals that a recession, and concomitant rate cuts, are imminent.

The current 2 Year yield of ~4.1% is below the Fed's target for a 5% terminal rate, implying cuts sometime in the next 2 years. But NOTE, the Fed median forecast for 2024 is ~100bps of cuts to ~4.2%. The 2 Year is simply reflecting the Fed's own forecast for cuts and rates in 2024.

NewEdge WEALTH

Dots Are Divergent in 2024 and Beyond

Fed Dot Plot as of December FOMC Meeting with 1/18/23 Market Pricing



Source: Bloomberg, as of 1/18/23

In making use of the 2 Year at 4.1%, below the Fed's projection of a 5%+ terminal rate this year, note that this 2 Year yield simply corresponds with the Fed's own forecast of where rates will be in 2 Years, as seen in the median dot in 2024 at 4.1%.

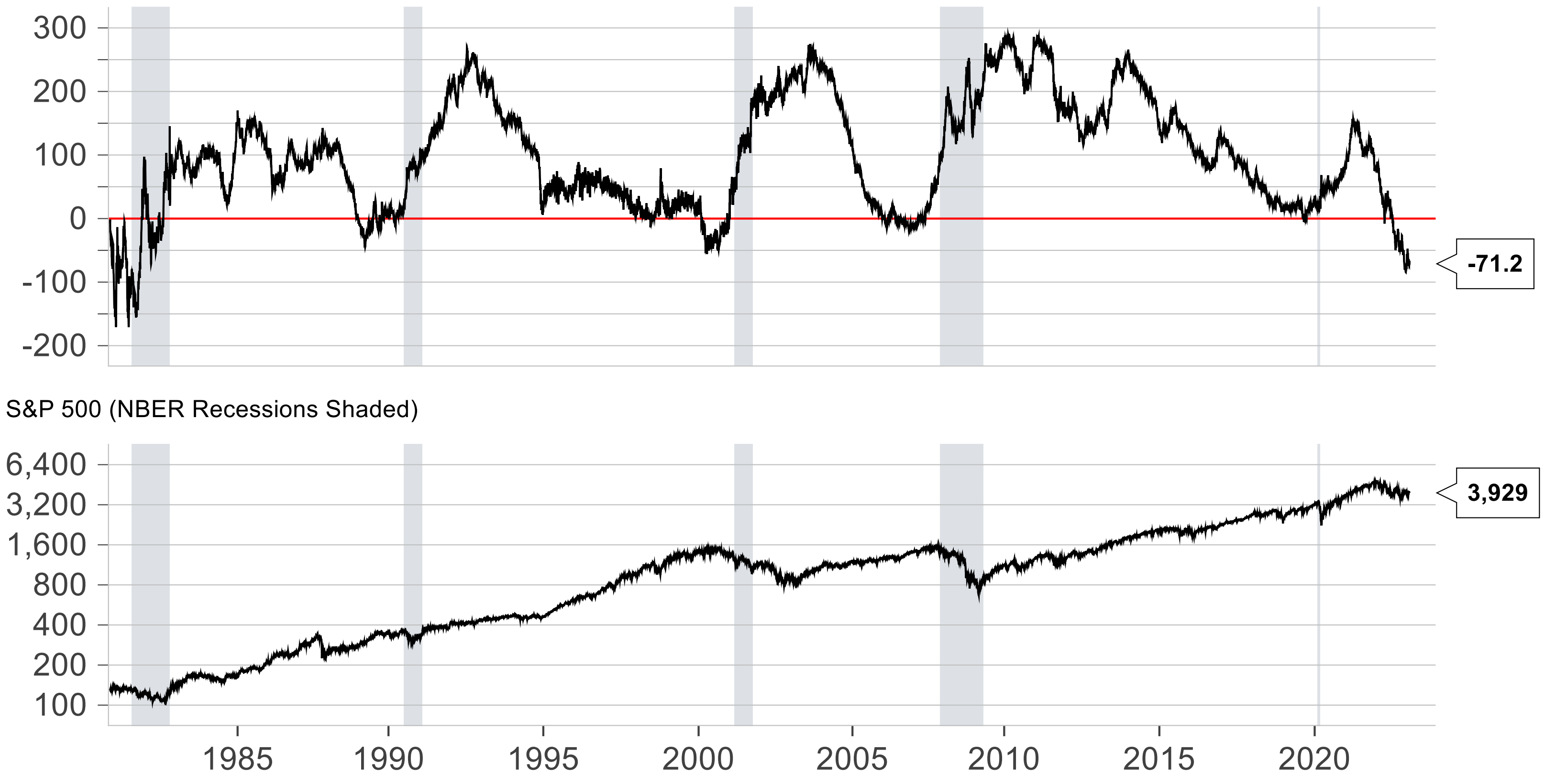
Be aware that the range of Fed forecasts in 2024 is very wide (3.25%-5.75%), so it is likely that this median dot (and thus the 2 Year) could move around in 2023 as the Fed.

Further, when combined with the Fed's Summary Economic Projections from December 2022, this forecast implies 100 bps of cuts in 2024 while real GDP growth is accelerated, unemployment is not increasing, and inflation is still above their target. Likely a dreamland forecast.

It's Not the Inversion, It's the Re-Steepening That Gets You

Re-Steepening of the Yield Curve Occurs Before Recessions Begin and Risk Assets Bottom

US Treasury 2s10s Curve (NBER Recessions Shaded)



Source: NewEdge Wealth, Macrobond, Bloomberg

As of 1/18/23

As mentioned with the 2 Year, a sharp drop in short-term yields signals an imminent recession and rate cuts.

This is why a re-steepening of the yield curve (when short-term yields start to drop faster than long-term yields, called a bull steepener) is a much better signal for the timing of a recession than the inversion of the curve itself.

Note that the re-steepening has typically begun before or in the early days of a recession, while risk assets have not bottomed until the re-steepening is well underway.

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USD: Technicals Weaken Significantly

USD (DXY Index)

The powerful uptrend in the USD in 2022 is over, with a breakdown in the USD below its 50-week moving average and now a "death cross" where the 50-day has crossed below the 200-day (often seen as a sign of a weakening trend and further weakness to come).

This weakness was driven by stepped up hawkishness by the Bank of Japan (softening the stance on yield curve control), and a return to optimism about European growth/stability as the worst-case scenario of an energy crisis was avoided. The deceleration in U.S. Fed hikes also contributed to USD weakness.

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Back in Black:

Fixed Income in 2023

Back in black
I hit the sack
I've been too long, I'm glad to be back

-AC/DC, *Back in Black*

Key Assertions: Fixed Income

1. The Great Bond Bear Market of 2022 likely does not continue into 2023, and at the very least to a lesser degree, as inflation abates.

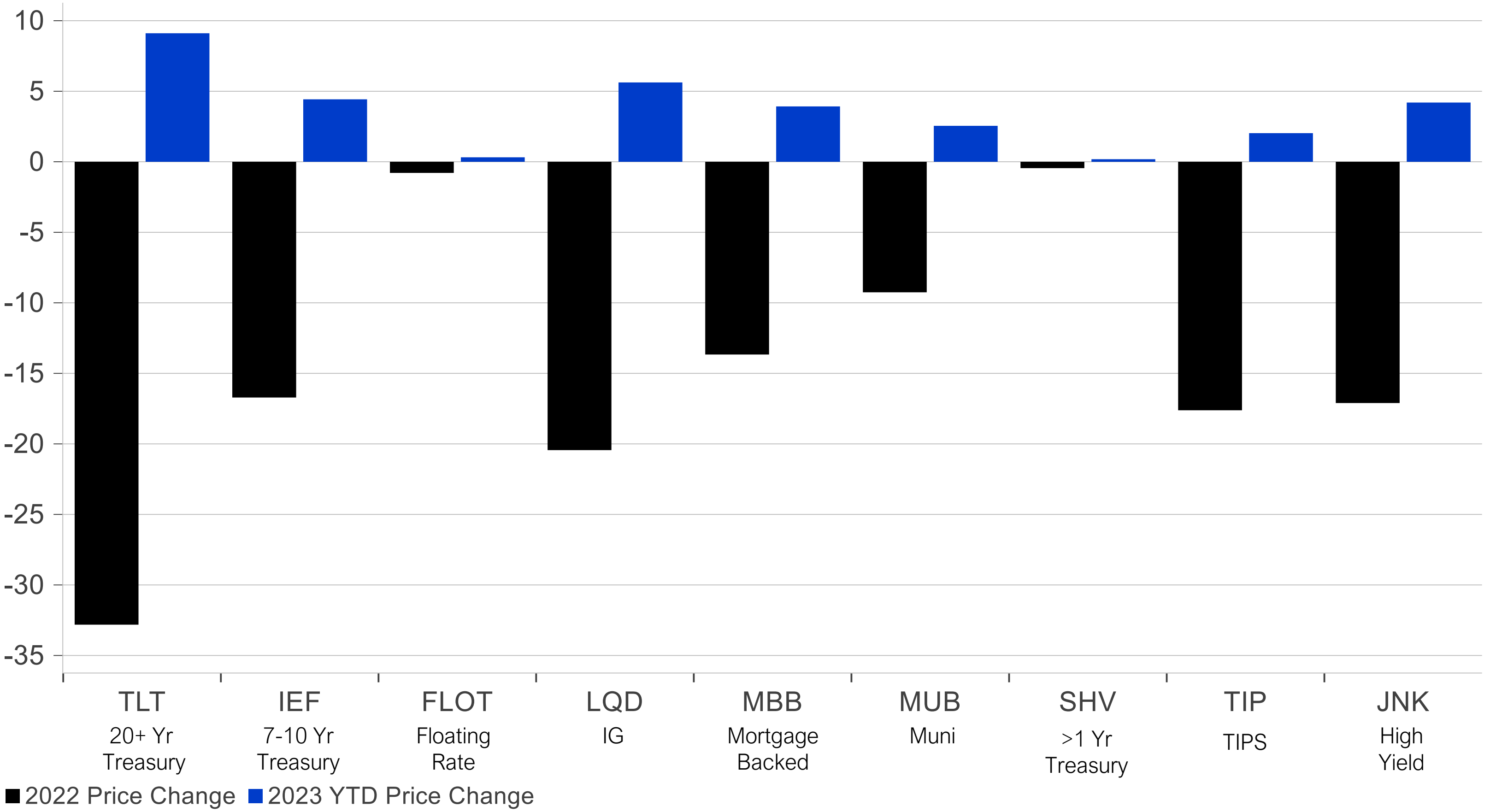
2. Positioning within Treasury bonds is short (betting on higher rates), which can make Treasuries very sensitive to incoming data.

3. Current Investment Grade (IG) and High Yield (HY) spreads are not priced for an impending recession, or at least not one that causes credit issues.

4. Selectivity within Municipal Bonds is key given the recent rally has reduced spreads over Treasuries to below-average levels in some places on the curve.

After an Ugly 2022, Stabilization to Start 2023

Fixed Income ETF Price Change (2022 and 2023 YTD)



Source: NewEdge Wealth, Macrobond, Bloomberg

As of: 1/18/22

We do not expect the Great Bond Bear Market of 2022 to continue into 2023, helped by moderating inflation and the likelihood that most Central Banks around the world have completed the majority of their rate hikes for this cycle.

Of course, if economic data comes in better than expected (including higher inflation), this could cause bond yields to rise/bond prices to fall again. However, given the reset higher in rates that already occurred in 2023, we would not expect a repeat of 2022's degree of losses in this scenario.

Traders Are Betting On/Staying Hedged For Higher Rates

CFTC Net Futures Positioning, Sum of 2-Year, 5-Year, and 10-Year Treasuries

Source: NewEdge Wealth, Macrobond, Bloomberg

As of 1/18/23

Over the course of 2022's Great Bond Bear Market, large traders (captured by the Commodity Futures Trading Commission report on net futures positioning) became very short Treasuries across the curve, essentially betting on further rate rises.

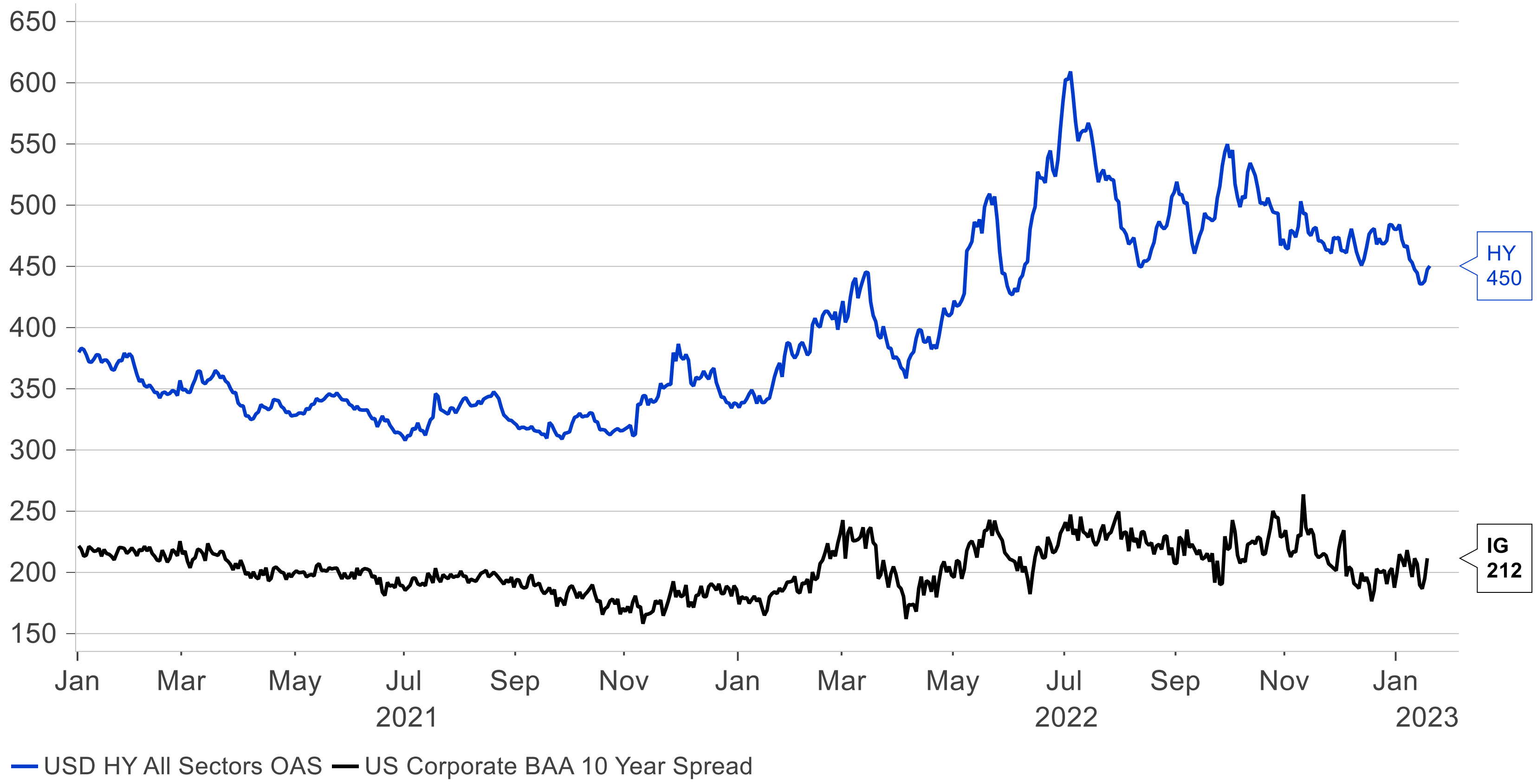
This short positioning could be quickly/sharply unwound (meaning traders have to buy Treasuries, causing yields to fall and prices to rise) if economic data comes in weaker, inflation comes in lower, and/or the Fed signals greater accommodation.

We have started to see these shorts get covered to start 2023.

Credit Spreads Show Few Signs of Stress

Nothing to See Here: Credit Spreads Remain Contained

High Yield and Investment Grade (Baa) Credit Spreads



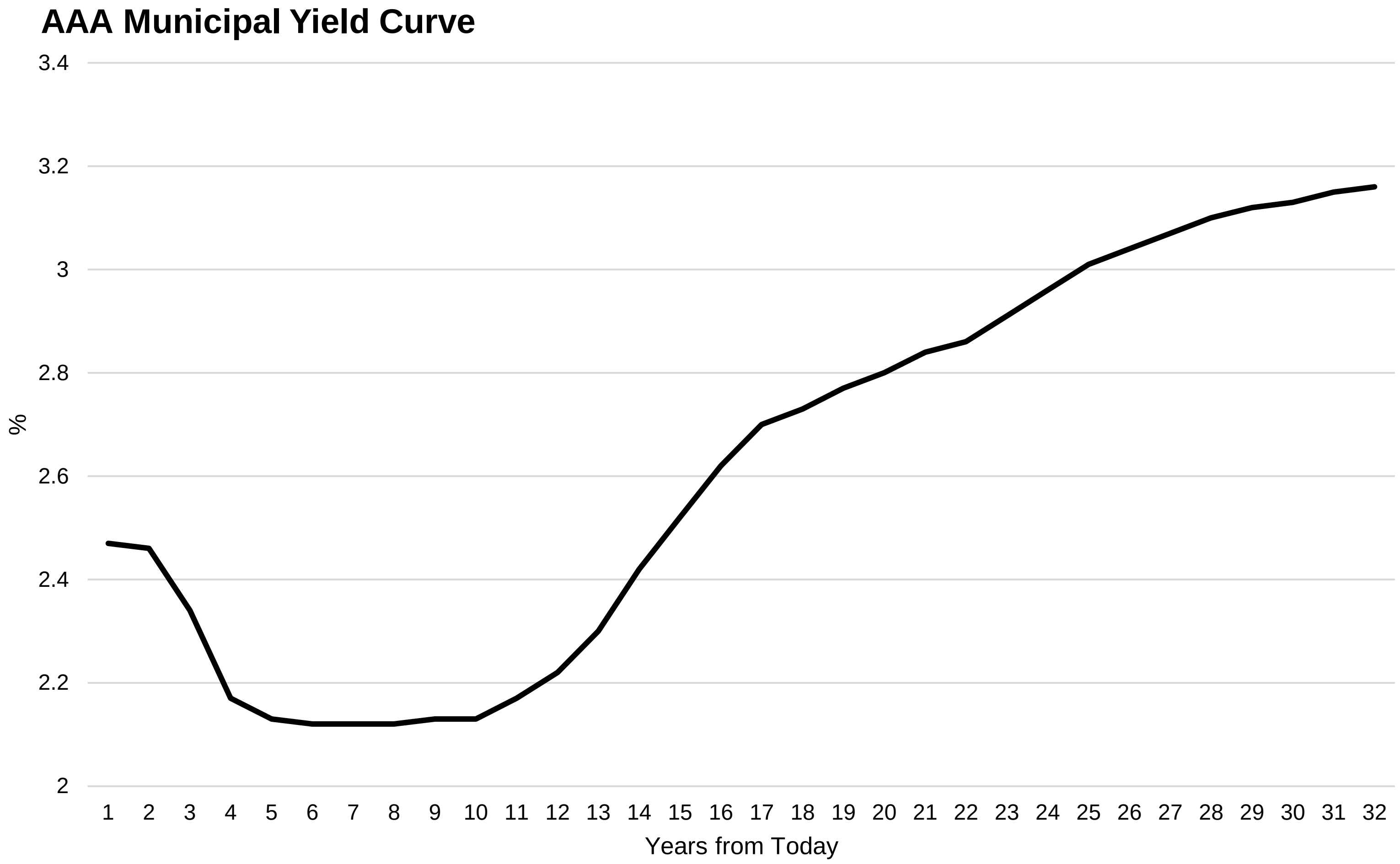
Source: NewEdge Wealth, Macrobond, Bloomberg

As of 1/18/23

Despite fears of a recession, credit spreads (the extra compensation lenders demand for lending to riskier borrowers) have been falling since mid-2022.

If a recession does materialize in 2023, we would expect credit spreads to widen again as investors grow concerned about borrowers' financial health.

Selectivity in Munis After the Rally



Source: Bloomberg, NewEdge Wealth, as of 1/18/23

We think municipal bond investors will need to be selective as they look for opportunities in munis, as the recent rally in munis have left the after-tax spreads that munis yield over Treasuries more attractive (higher) at some maturities than others.

Display 1: AAA Muni/US Treasury After-Tax Spread (Basis Points)

	Jan 13, 2023	Oct 28, 2022	5-Yr. Average
Two-Year	–24	53	16
Five-Year	2	73	23
10-Year	26	105	52
15-Year	76	125	74
20-Year	78	131	81
30-Year	109	168	91

As of January 13, 2023
Source: Municipal Market Data and AllianceBernstein (AB)

Running on Empty:

Real Assets in 2023

Running on (running on empty)
Running on (running blind)
Running on (running into the sun)
But I'm running behind

-Jackson Browne, *Running on Empty*

Key Assertions: Real Assets

1. Real Estate: 2023 is likely to be another challenging year as higher interest rates weigh on transaction volumes and pricing, while rent growth likely slows from 2020-2022 breakneck pace.

2. Tight inventories across the industrial commodities complex is a key watch item for 2023.

3. Oil prices could find a floor ~$70 due to U.S. Strategic Petroleum Reserve replenishment, OPEC+ defensive production cuts, and China's nadir for oil demand being in December 2022.

4. Watch China reopening and possible stimulus as a signal for price increases for base metals.

5. Gold's inverse relationship with real yields has broken down, while its inverse relationship with the USD has become very tight.

Could WTI Crude Have a Floor ~$70?

WTI Oil Price

As of: 12/27/22

Oil prices falling in 2H22 were a key driver of falling headline inflation, moderating inflation expectations, improving consumer sentiment, and recovering real wage growth.

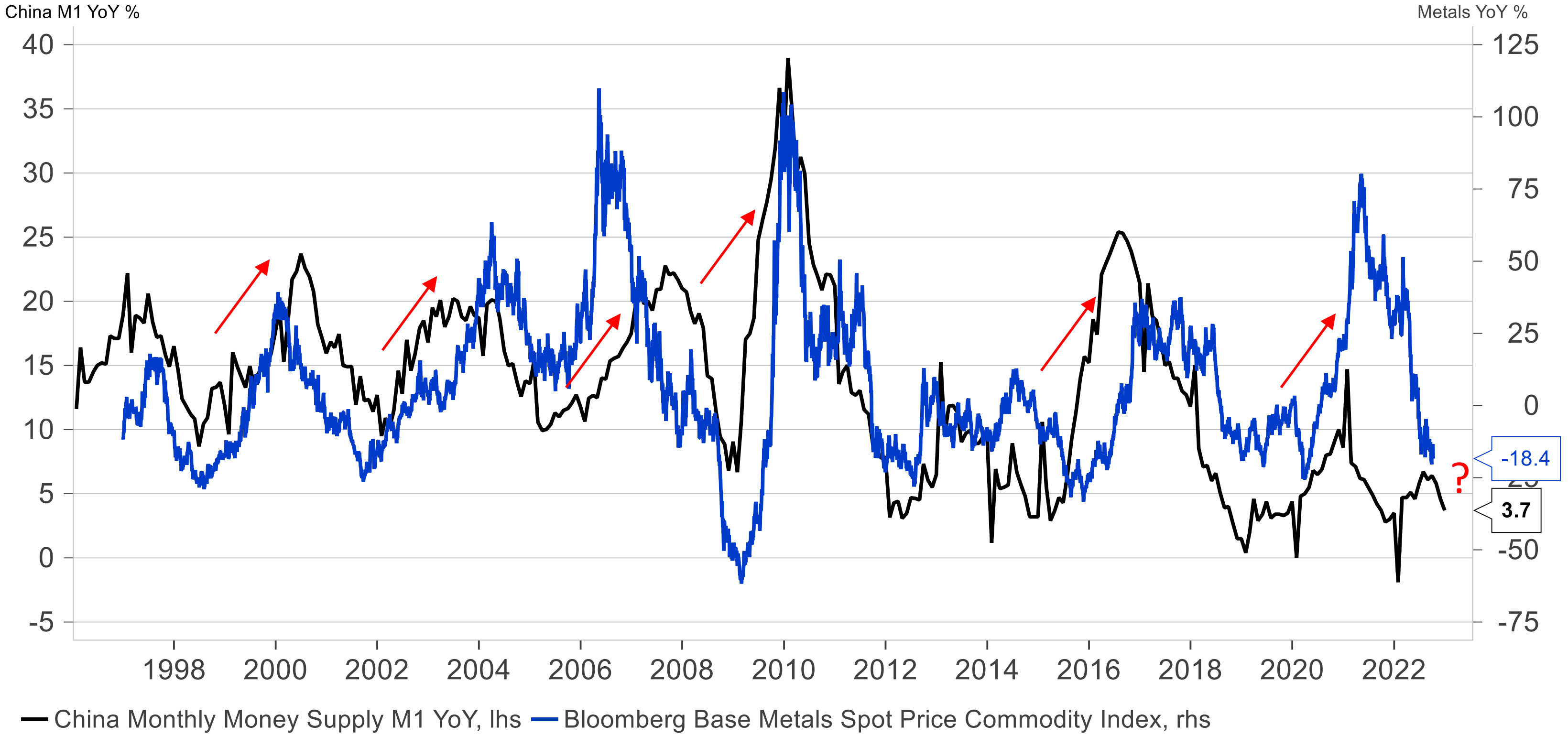
But could crude be finding a floor ~$70, with the U.S. signaling that it would consider replenishing the Strategic Petroleum Reserve below $70, OPEC+ signaling greater production cuts below $70, and the likelihood that Chinese oil demand reached its near-term nadir in December 2022?

Tight global inventories are an upside driver, while risk of a recession is a downside driver.

If China Stimulates as it Reopens, Will We See Base Metals Rally?

Greater China Stimulus Has Coincided with Higher Base Metals Prices

China M1 Money Supply YoY % and Bloomberg Base Metals YoY %



Source: NewEdge Wealth, Macrobond, Bloomberg

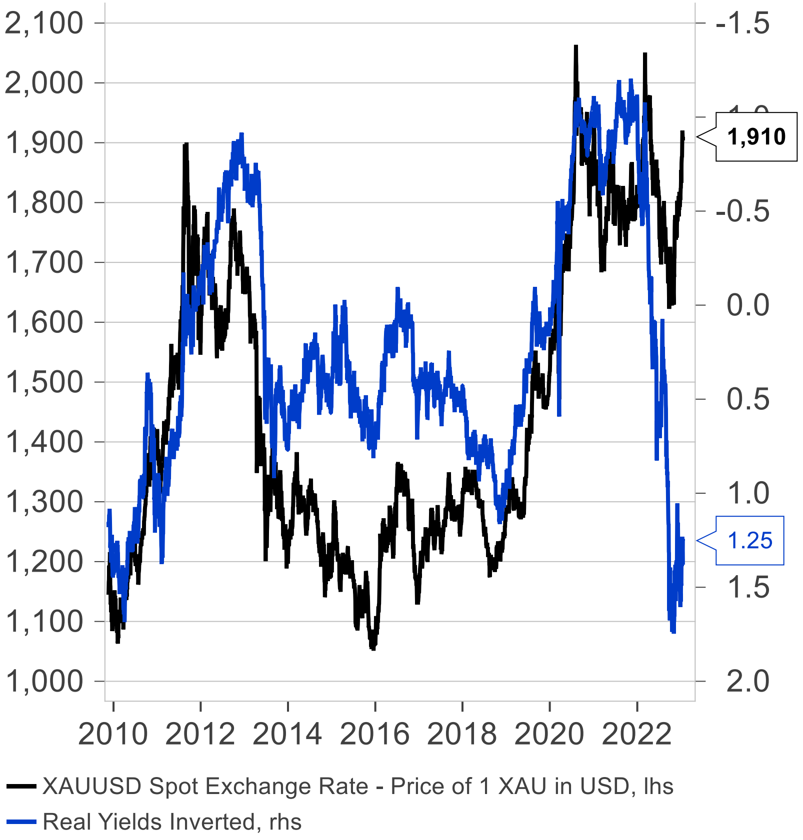
As of 1/18/23

In past easing/stimulus cycles by the Chinese government, we have seen base metals (copper, iron ore, etc.) respond with jumps in their prices on a YoY basis due to the greater demand from China.

There are two questions for 2023: Will China stimulate (accelerate money supply growth) as it reopens? And will this stimulus benefit the "old economy" infrastructure/construction (which boosts base metals), or will the stimulus be more consumer-focused?

Gold and Real Yields Divergence, But Gold Lockstep with the USD

Gold Prices and Real Yields Inverted (10 Year)



Source: NewEdge Wealth, Macrobond, Bloomberg

Gold Prices and USD Inverted (1 Year)

Source: NewEdge Wealth, Macrobond, Bloomberg

As of 1/18/23

For most of the prior cycle, Gold traded inversely with real yields (10 Year Treasury Yield minus inflation).

In late 2022 this relationship broke down, with Gold rallying despite the rise in real yields.

Instead, Gold has been trading lockstep with the USD inversely, with a weaker USD sparking higher Gold prices.

Heavy central bank buying likely also contributed to higher Gold prices.

Disclosures

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When referencing asset class returns or statistics, the following indices are used to represent those asset classes, unless otherwise notes. You cannot invest directly in an index. Index returns shown are total returns which includes interest, capital gains, dividends, and distributions realized over a given period of time. An individual who purchases an investment product which attempts to mimic the performance of a benchmark or index will incur expenses such as management fees and transaction costs which reduce returns.

TIPS: Bloomberg Barclays Global Inflation-Linked: U.S. TIPS Total Return Index Unhedged
Municipals 5-Year: Bloomberg Barclays Municipal Bond 5 Year (4-6) Total Return Index Unhedged USD
Core Bond: Bloomberg Barclays US Agg Total Return Value Unhedged USD
U.S. MBS: Bloomberg Barclays US MBS Index
High Yield Municipals: Bloomberg Barclays Muni High Yield Total Return Index Value Unhedged USD
High Yield: Bloomberg Barclays US Corporate High Yield Total Return Index Value Unhedged USD
Foreign Bond: Bloomberg Barclays Global Aggregate ex-USD Total Return Index Value USD (50/50 blend of hedged and unhedged)
EM Debt (unhedged): J.P. Morgan GBI-EM Global Diversified Composite Unhedged USD
U.S. Large Cap: S&P 500 Total Return Index
U.S. Small Cap : Russell 2000 Total Return Index
International Developed: MSCI EAFE Net Total Return USD Index
Emerging Markets: MSCI Emerging Markets Net Total Return USD Index
World: MSCI ACWI Net Total Return USD Index
U.S. Equity REITs: FTSE Nareit Equity REITs Total Return Index USD
Commodities: Bloomberg Commodity Total Return Index
Midstream Energy: Alerian MLP Total Return Index
Hedge Funds: Hedge Fund Research HFRI Fund of Funds Composite Index
U.S.: MSCI USA Net Total Return USD Index

Europe: Euro Stoxx 50
United Kingdom: UK FTSE 100
Japan: Tokyo TOPIX Stock Exchange Index
China: Hang Seng Index
Brazil: Ibovespa Brasil Sao Paulo Stock Exchange Index
India: NSE Nifty Index
South Korea: Korea Stock Exchange KOSPI Index
Taiwan: Taiwan Stock Exchange Index

REITS Diversified: FTSE Nareit Eqty Diversified Total Return Index
REITS Healthcare: FTSE Nareit Eqty Health Care Total Return Index
REITS Industrial: FTSE Nareit Eqty Industrial Total Return Index
REITS Lodging/Resorts: FTSE Nareit Eqty Lodging/Resorts Total Return Index
REITS Office: FTSE Nareit Eqty Office Total Return Index
REITS Residential: FTSE Nareit Eqty Residential Total Return Index
REITS Retail: FTSE Nareit Eqty Retail Total Return Index
REITS Self Storage: FTSE Nareit Eqty Self Storage Total Return Index
REITS Data Centers: FTSE Nareit Equity Data Centers Total Return Index
REITS Specialty: FTSE Nareit Equity Specialty Total Return Index
Real Assets Agriculture: Bloomberg Sub Agriculture Total Return Index
Real Assets Industrial Metals: Bloomberg Sub Industrial Metals Total Return Index
Real Assets Precious Metals: Bloomberg Sub Precious Metals Total Return Index
Real Assets Energy: Bloomberg Sub Energy Total Return Index

Any questions?

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