2023 ECONOMIC OUTLOOK

JAMES

INVESTMENT

A Long-Range Economic Look at the Year 2023

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ECONOMY

POSITIVES

- Labor Market Remains Strong, As Jobs Are Plentiful
- Consumer Balance Sheets Are Strong
- Excess Cash Above Pre-Pandemic Levels
- Inflation May Have Peaked / Potential Fed Policy Change

NEGATIVES

- Rising Risks Of A Recession In 2023
    - The Lag Effects Of 2022 Fed Rate Hikes
    - Quantitative Tightening
        - $90 Billion / Month
- Global Growth Slowdown
- Manufacturing-New Orders Deteriorate, Suggest Slower Growth
- Tightening Lending Standards

The U.S. economy is currently in a late-cycle environment. The odds of a recession are elevated and rising as we enter the New Year. Consumer spending remains resilient, boosted by a tight labor market. The consumers' balance sheet is strong as they have built up a cash reserve over the past couple of years. Inflation is still a concern, but the excess cash should provide a buffer to rising costs.

However, leading economic indicators are pointing to a downturn in 2023. These include a struggling housing market due to the Fed's rapid monetary tightening and rising mortgage rates which negatively impact housing affordability. Additionally, the manufacturing sector is showing signs of contraction while consumer sentiment levels are near historic lows.

The Chinese restrictive COVID policies and the Russia-Ukraine war continue to be a headwind for global economic growth.

STOCKS

POSITIVES

- Inflation May Have Peaked / Potential Fed Policy Change
- Easing Of Supply Chain Bottlenecks
- Potential China Reopening

NEGATIVES

- Below Average Earnings Growth
- Less Accommodative Fed
- Deteriorating Economic Indicators

In our view, the market may face major headwinds in early 2023 as earnings get downgraded, and economic deterioration shows up in the hard data, such as the lagging indicators of payroll and inflation.

While the labor market remains strong and cash in household bank accounts is high, most of the evidence supports a slowing economy.

We believe there is an opportunity for long-term investors to pick great buying opportunities as the market starts to price in an economic recovery. The timing of this inflection point will depend on the incoming data from the leading economic indicators mentioned above. So, staying nimble, open-minded, and most of all humble is paramount as the uncertainty is unprecedented.

Conclusion For 2023 ECONOMIC OUTLOOK

BONDS

POSITIVES

- Bonds May Provide Diversification
- Meaningful Bond Income
- Strong Corporate Fundamentals
- Yields More Attractive Than Stocks

NEGATIVES

- Persistent Higher Inflation
- Rising Interest Rates
- Increasing Credit Spreads
- Challenging Liquidity Conditions

The year 2022 was a very challenging year for fixed-income investments. In fact, it may go down as the worst year for bonds since 1931, and the first-time bonds were down by double-digits in a year. These higher yields and lower prices were due to higher inflation rates and the subsequent reaction by the U.S. Federal Reserve (Fed).

The silver lining is the higher yield investors can get now from fixed-income securities. For the first time in many years, investors can now purchase a one-year T-Bill and earn more than 4.5% at the end of November 2022. This is a much better return than 0.25% last seen at the end of 2021. After a long wait, bonds may be an attractive alternative when compared to the dividend yield on the S&P 500 Index.

Considering the deteriorating economic conditions that we are likely to see in 2023, it is advisable to have a defensive posture in fixed income, favoring Treasury securities with moderate duration and highly rated Municipal bonds. Historically, Treasury instruments do well in challenging economic environments. Municipal bonds have benefited from a sizable cash buffer accumulated from Covid stimulus plans.

FOR INVESTORS

Equities

- Increased Volatility
- Below Average Earnings Growth
- Continue To Favor Defensive Sectors: Healthcare, Consumer Staples, Utilities
- Begin To Add Selective Small Cap And Cyclical Stocks When Fed Policy Shifts
- Look For Companies with Pricing Power
- Favor High Quality Stocks

Fixed Income

- Bonds May Provide Diversification
- Inflation May Have Peaked But May Persist
- Bond Income Now An Alternative To Stocks
- Favor High Quality Treasury & Municipal Bonds

WHAT COULD GO WRONG

- Fed Pivoting In A Major Way
- U.S. Consumer And Corporations More Resilient Than Expected
- China Fully Reopening And Boosting Global Growth
- Europe's Recession Not As Severe As Forecasted
- Positive Development In The Russia-Ukraine Conflict
- Overall U.S. Economic Growth Holding Up Better Than Leading Indicators Suggest

Disclosure

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