
Monthly market update

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Takeaways

- The economy remains uncertain as we move into 2023. Inflation is improving and consumer spending has slowed sharply, resulting in layoffs in tech and consumer-driven sectors.
- Consensus economic forecasts suggest that flat-to-negative real growth is priced-in for the year. This is evident in earnings expectations, which have been revised downward.
- Throughout all this, the Fed is expected to keep rates high while other risks such as the debt ceiling and geopolitics loom large.

Market update

This update is provided in partnership with Clearnomics, a market insights platform for asset and wealth managers. Our goal is to help you stay abreast of ever-changing markets by putting current conditions into the context of economic and market history. Every monthly update will address key issues clients are asking about and share real-time insights you can use with your clients. The updates will also provide practical historical stress-testing scenarios to help you explore potential outcomes for portfolios in the current environment.

By raising rates, the Fed is increasing the possibility of a recession in 2023 as it tries to quell inflation. Many of the factors driving slower economic growth are mirror images of those that drove the post-pandemic recovery. Rather than being driven by fiscal and monetary stimulus, strong consumer demand and rapid business expansion, the market now must deal with ongoing Fed rate hikes, layoffs, slowing consumer spending and downward revisions to earnings. What's priced into the market today and how can investors maintain perspective?



Chart: This Fed rate hike cycle is one of the fastest in history

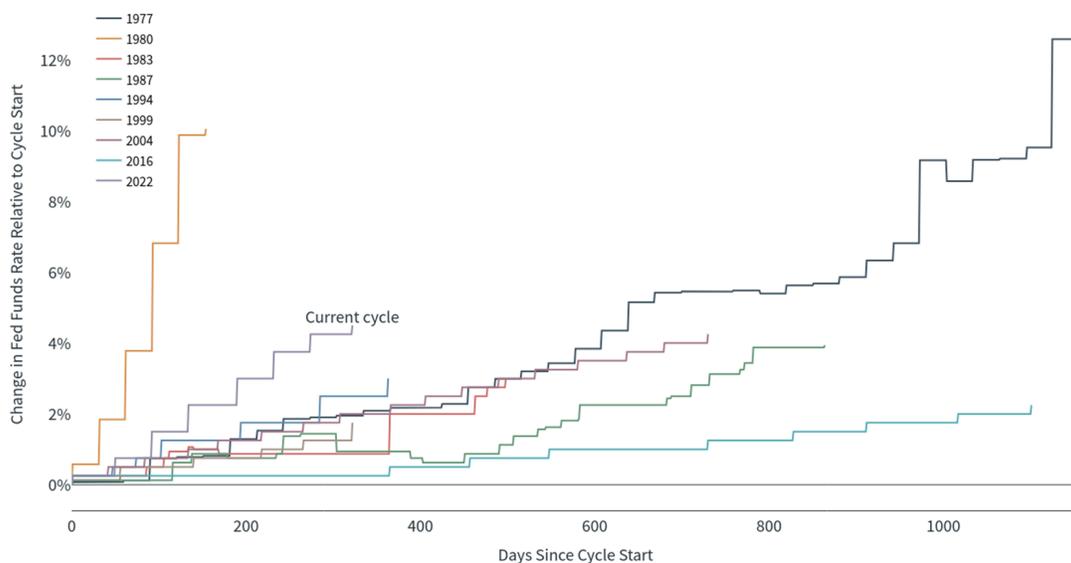
Market and Economic Chartbook | February 2, 2023



Central Banks

Fed Rate Hike Cycles

Increase in target range lower limit or effective rate since 1977



Sources: Clearnomics, Federal Reserve
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Sources: Clearnomics, Federal Reserve

The year started with confirmation that broad measures of inflation are easing. Headline Consumer Price Index (CPI) and Personal Consumption Expenditures Price Index (PCE) are both decelerating on a year-over-year basis, and both fell month-over-month in December. Core inflation is still elevated but has also improved with categories such as used cars plummeting 8.8% year-over-year. Shelter costs (consisting primarily of rent and “owner’s equivalent rent”) may improve over time due to the lagged nature of lease terms.

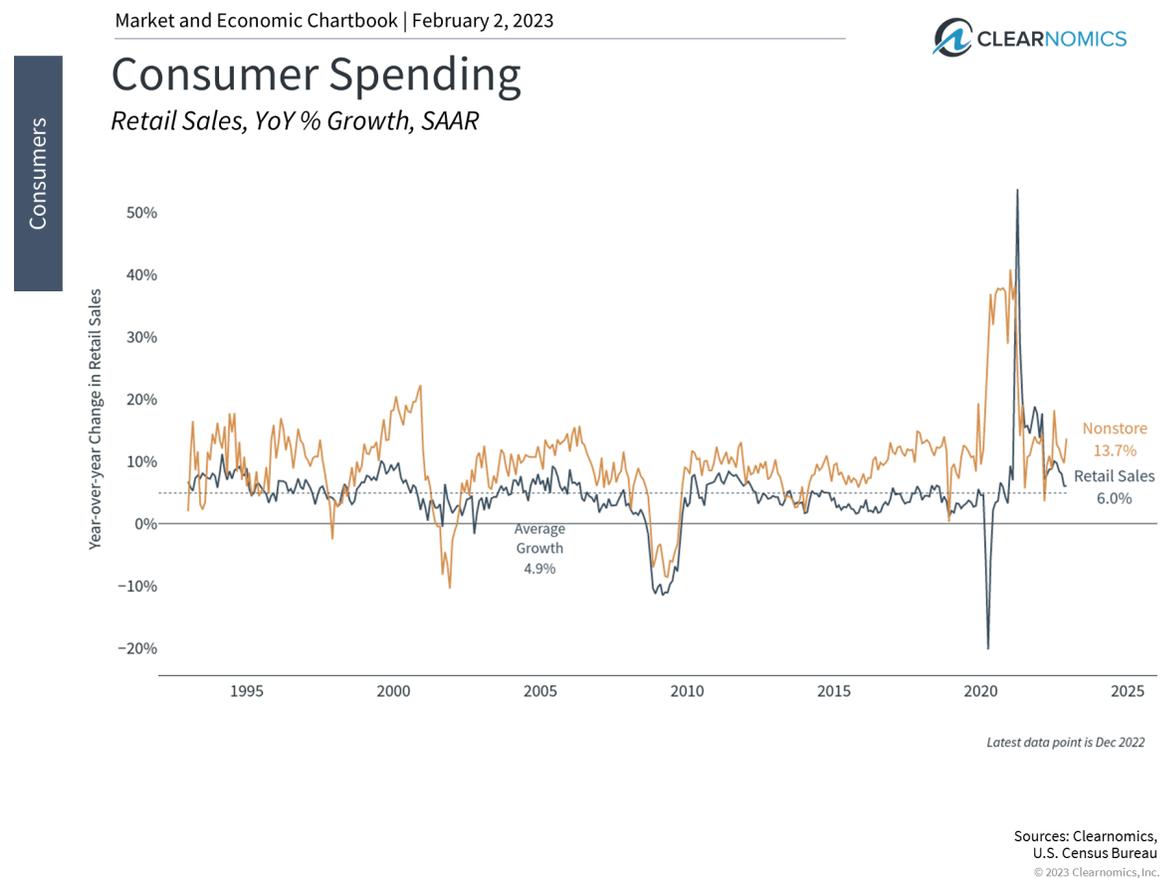
At the same time, it’s also clear that economic growth is slowing. Consensus forecasts anticipate flat real GDP growth this year, with the possibility of a couple negative quarters. This is by design because the Fed’s goal in raising interest rates is to tap the brakes on the economy in order to fight inflation. The latest GDP figures for 2022 show that the economy grew at a real annual pace of 2.1%, a marked slowdown from 5.9% in 2021. The most significant drag was “residential fixed



investment,” which declined 10.7% last year. Not surprisingly, this was due to the sudden spike in interest rates, which impacted the housing market and mortgage rates.

These factors have also resulted in slowing consumer spending. The U.S. Census Bureau’s monthly retail sales figures declined 1.1% in December and the Bureau of Economic Analysis’s personal consumption expenditures data, which are adjusted for inflation, fell 0.1% in November and 0.2% in December. This is arguably one of the biggest shifts in the economic data over the past few months and is related to poor consumer sentiment due to the state of the economy.

Chart: Retail sales have slowed in recent months



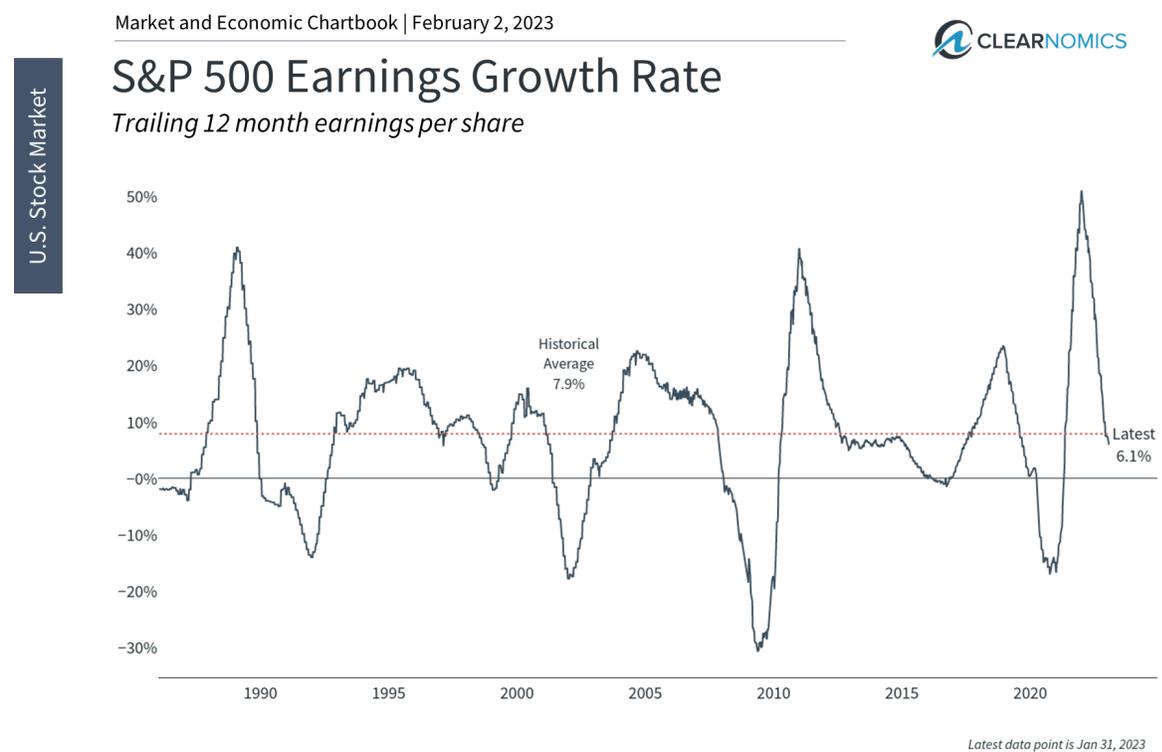
Sources: Clearnomics, U.S. Census Bureau



The weakness in consumer spending has put a damper on corporate revenues and profitability. This has been especially evident in tech and consumer-driven sectors, which have experienced sizable layoffs over the past few months as demand for personal computers, home furnishings and other goods have declined. This can have a feedback effect, which reduces business investment and results in additional job cuts.

Fortunately, this has not spilled over into other sectors just yet. Unemployment continues to hover near record lows and job openings are close to record highs. This is partly because while recent layoffs number in the hundreds of thousands, the economy added 4.5 million net new jobs last year and 6.7 million the year before. Many have referred to these job cuts as a “white-collar recession,” because it primarily affects high-skilled industries and professions.

Chart: Earnings growth has slowed alongside the economy



Sources: Clearnomics, Refinitiv



As the current earnings season evolves, full-year 2023 is expected to only experience earnings growth of 3%—far below the historical average as well as the rapid pace of the pandemic recovery. These same consensus forecasts also anticipate a recovery in 2024. In other words, what seems priced into the market is that 2023 is a “reset” year after the extreme swings since 2020.

But what might not be fully priced in? This is harder to predict because it’s often the unknown unknowns that derail markets. Still, it’s unlikely that a protracted debt ceiling crisis is a top concern for investors. A 2011-style debt crisis, if it were to emerge, would likely be a shock to markets. Similarly, geopolitics derailed markets last year. Global risks also continue as the Ukraine war continues and tensions with China rise. While Covid has largely become endemic in the U.S., it may still be a large problem in China, which could threaten supply chains.

Ultimately, investors ought to maintain a healthy perspective on everything priced into markets and the ongoing uncertainties. History shows that periods of stagnation and properly managed workforce reductions can be healthy for the economy because these adjustments allow for resources to be reallocated, setting the stage for future growth. As always, investors should carefully consider their asset allocations to stay invested across all phases of the business cycle.

Stress-testing scenarios:

History-driven simulation provides a principled, systematic way for advisors and investors to quantitatively stress test their portfolios based on these effects and understand the spectrum of likely outcomes. Please contact Addepar Research at research@addepar.com to model your portfolios through our new stress-testing capabilities. We’ll continue to add new scenarios every month.

New scenarios:

Scenario	Description
Fed rate hike cycles	Stress-test your portfolio through historical rate hike cycles



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