Market Perspectives

1st Quarter 2023

Market Outlook for Q1

2023 Expectations for The US Economy

We expect inflation to moderate and the Fed to back off in 2023. Inflation is expected to be below 3% by the end of the year. A mild recession is forecasted and during that time we expect the economy to stay flat and begin growing again in 2024. The Fed will continue increasing the fed funds rate until late March, which will take the terminal funds rate for this cycle 4.75% to 5.00%. Volatility is likely to continue for now, and the bottoming process and recovery may be elongated.

Positive Outlook

The Fed will likely need two years to decrease inflation and bring it back down. This process started in 2022, so we are probably halfway to achieving low and stable prices again.

We see the outcome of the midterm election of 2022 as a positive result for the market. Markets have historically favored a split government because it reduces policy uncertainty. Additionally, it can be noted that since 1946, the S&P 500 has been positive 12 months following a midterm election. The debt limit, China, antitrust, cryptocurrency, and oversight will all likely feature as core legislative themes this year.

Income and cash flow investors are presented with an opportunity to lock in higher yield levels. Locking in these rates may give investors strong income benefits to work alongside individual bonds' protective asset qualities. Whether you are an investor seeking total return or just earning income, there appears to be a window of opportunity in fixed income.

Don't lose sight of the bull market opportunity that will occur on the other side of the current weak trend. We expect a mild recession in 2023, but equities will bottom well ahead of the economy and corporate earnings.

Questions

If you have any questions about these topics, please let our team know.

Economic Snapshot

We've gone from global synchronized monetary easing to most central banks tightening monetary policy at unprecedented speeds. The Fed raised rates by 425 bps and despite that, the US economy has remained strong, but it's likely to moderate as the impact of tightening influences the real economy. The US labor market continues to be strong and beat expectations. Barring unexpected external shocks, inflation is on a clear disinflationary trajectory, and we expect it to continue on this path. Despite the current resilience of the US economy and our expectation that inflation will continue to decline, we expect the restrictive stance of monetary policy to push the economy into a mile recession. We expect three quarters of negative growth starting in the second quarter, with 0.0% growth for 2023, followed by a weak recovery of 0.8% in 2024.

	ECONOMIC INDICATOR	COMMENTARY
NEUTRAL	GROWTH	GDP growth is expected to continue to moderate in 1Q23 and enter negative territory over the following three quarters.
NEUTRAL	EMPLOYMENT	Nonfarm payrolls have slowed but are still very strong. Expectations are that nonfarm payrolls weaken in 2023 while the unemployment rate increases.
NEUTRAL	CONSUMER SPENDING	Despite inflation trending lower, prices remain elevated, and as excess savings from the pandemic continue to dwindle, consumer spending is likely to weaken next year.
NEUTRAL	BUSINESS INVESTMENT	Interest rates will continue to negatively impact the strength of business investment in 2023.
NEUTRAL	INFLATION	Inflation remains the biggest risk for the economic outlook but barring any external shock (such as energy prices increasing again), we believe the worst is behind us and we should see inflation below 3% by the end of 2023.
NEUTRAL	LONG-TERM INTEREST RATES	The yield curve ended the year near its deepest inversion in over four decades, but bond yields have retracted considerably since their highs. We expect long-term interest rates to decline further, especially toward the end of the year or in 2024 as the curve will likely remain inverted until the Fed pivots to an easier monetary policy stance.
NEUTRAL	FISCAL POLICY	Contributions to GDP from government spending in 2023 are unlikely to change significantly as it is improbable that with a gridlock scenario in Washington, Congress will be able to agree on items that will expand spending.
NEUTRAL	THE DOLLAR	The US dollar should remain strong relative to other currencies as the Fed maintains its hawkish stance and the global economy falls into recession. However, the US dollar has weakened recently, and should weaken further if and when the Fed pivots to an easier policy setting.
NEUTRAL	REST OF THE WORLD	COVID-19 is still a factor globally. The Russia-Ukraine war will have a bigger impact on Europe's economy than that of the US. Inflation is higher everywhere, which is an issue for emerging economies. Repeated droughts, floods, and other natural disasters continue to negatively impact crops, housing, and more.
UNFAVORABLE	MANUFACTURING	Manufacturing was supported by strong export demand in 2022 but has started to decline over the last few months, and we expect this trend to continue in 2023.
UNFAVORABLE	HOUSING AND RESIDENTIAL CONSTRUCTION	The housing market is and will remain in recession as the strong increase in mortgage rates impacts affordability. We should continue to see weaker housing data and further declines in home prices.
UNFAVORABLE	MONETARY POLICY	The Fed has slowed the pace of rate increases, and we believe it will slow it further in the first half of 2023. However, we estimate the terminal rate at 5%, and this restrictive level is likely to lead to a recession in 2023.

Raymond James, "January 2023 " *Investment Strategy Quarterly,* Pg. 9, 12,15, 19, 21, 28 Web.

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