CFO CAPITAL MANAGEMENT
PLAN PROTECT PROSPER

CFO 2023 Economic & Financial Market Outlook

When future historians write about landmark years in economics and financial markets, 2022 will make the top-ten list. Driven by the highest inflation and most aggressive tightening cycle in 40 years, the uneven reopening from COVID, and the Russian/Ukrainian war, both stocks and bonds fell by more than **-10%** for the first time on record. In the end, the S&P 500 fell -19.4%, its seventh-worst year since 1926; and the Bloomberg Barclays U.S. Aggregate Bond Index fell -13.0% making 2022 the worst year on record for bonds. Our chart below and our Morningstar report attached herewith confirm the widespread sell-off in the global financial markets: A majority of double digit "red" figures! Despite a strong Q4 rebound for most all the broad asset categories and financial market indices that we follow, only U.S. Treasury Bills [+1.4%], the U.S. Dollar [+9.5%] and the S&P GSCI Commodity Index [+8.7%] provided positive returns for the total 2022 year. There were simply very few places to hide from the carnage of 2022. For 2023, we believe there will be a recovery, but it will start slowly, and in the bond markets, before equities will rebound.

Index Returns for Asset Classes & Broad Market Index Averages (1)	4TH Quarter 2022	2022 Total Year
30-Day US Treasury Bills	0.86%	1.43%
Barclays Long-Term US Treasury Bond	-0.59%	-29.26%
Barclays US Aggregate Bond Index	1.87%	-13.01%
S & P 500 Composite Price Index	7.08%	-19.44%
Dow Jones Industrials Price Index	15.39%	-8.78%
Wilshire 5000 Total US Stock Mkt Index	6.62%	-20.35%
MSCI EAFE Index of Foreign Markets	17.34%	-14.45%
MSCI Emerging Markets Index	9.79%	-19.74%
MSCI Europe Index	19.35%	-15.06%
MSCI Japan Index	13.23%	-16.65%
MSCI China Index	13.52%	-21.93%
SPDR GOLD Shares ETF [GLD]	8.30%	-0.82%
US Dollar ETF [UUP]	-6.93%	9.51%
S & P GSCI Commodity Index [Spot]	0.38%	8.71%
(1) Source: MORNINGSTAR [In USD$]		

Despite the general outlook for a slowing U.S. economy and a possible recession, the driving force for the financial markets in 2023 remains inflation and the Federal Reserve's monetary policies to control it. As inflation surged to the highest levels in 40 years, the Fed launched its most hawkish campaign to fight it since the early 1980s. Rates were raised an unprecedented 75-basis points four consecutive times with a lower 50-basis point increase at its last meeting in December. The current federal funds rate is 4.25% to 4.50%. Many analysts expect that to be raised to between 5.0% and 5.25% by the end of Q1 2023. Recent economic data shows a moderate easing of inflationary pressures. According to the December Consumer Price Index (CPI), inflation climbed +6.5% in 2022 through last month, down from +7.1% in November. This marked the sixth consecutive decline since mid-June 2022. Core CPI, excluding the more volatile sectors of food and energy, rose at a +5.7% annual rate matching estimates but below November's +6.0% gain. Ned Davis Research [NDR], along with many analysts, believes that inflation has peaked both globally, and in the U.S. The current rally in the U.S. stock markets is based on the ***hope*** that the Federal Reserve **might** raise the Fed Funds rate only 25 basis points [0.25%] **but** then go on hold, leaving the Fed Funds rate capped at under 5.0%. For market strategists [including both investors and analysts!] who watch the Fed and try to anticipate its behavior, they often mistakenly merge what they believe the Fed should do with what the Fed will do. That thinking ignores that inflation may have peaked but could remain "sticky" and resilient at far above the Fed's stated targeted rate of 2%. The Fed will do what it believes needs to be done to bring inflation down!

Starting with the Fed's monetary policy actions, the U.S. financial markets need to see real evidence that the economy is cooling enough to bring down inflation, but not so much that it will increase the risks of a serious recession that could lead to a sharp drop in corporate earnings. In short, a recession would prolong 2022's bear market in stocks, since the stock market has never bottomed before the start of a recession. Conversely, a soft landing would mean an earlier equity rebound, since the 2022 bear market was close to the average, non-recession bear market in time and price. Many of the 2023 analyst predictions depend on a recession outcome, and the direction of earnings revisions is likely to be down regardless of whether Powell can find some of Greenspan's 1994 "soft-landing magic". If the economy avoids a recession, revisions could be small and easier for the stock market to digest. If not, earnings preannouncements and misses could dominate headlines and result in a repeat of 2022 where every time the stock market rallied throughout the year, it was a bear trap resulting in the cumulative 2022 decline of almost -20% for the S&P 500. So far for 2023, the recent U.S. economic data has increased the hopes for a "soft landing"—where inflation is tamed without sparking a recession. The S&P 500 has risen about +6% through January 31, 2023, but corporate earnings are a real risk and may decline well over -10%, making the 2023 rise in stock prices just another bear market rally. In summary, the investment landscape will remain very challenging in the first half of 2023 until the outlook for inflation and economic growth become clearer. This current economic backdrop argues for a cautious investment strategy in the near term. We are currently at 50% target allocations for global equities and overweight cash equivalents. Our allocations to fixed income are higher quality with shorter durations, although we have been adding both credit risk and some duration to our fixed income positions to take advantage of opportunities for increased yield. As always, we remain very data-dependent and will alter investment and allocation policies as economic conditions warrant.

The CFO Capital Management Team, January 31, 2023