



2023 U.S. Economic & Financial Market Outlook

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Part 1: U.S. Economic Outlook

Inflation

- Headline inflation peaked, rolling over.
- Declines driven by Goods & Energy.
- Services (roughly 60% of CPI) & Food still elevated.
- Wage inflation elevated as well.
- Services inflation sticky around level of wages.
- Fed shifting focus from headline inflation to wage & services inflation.

Consumer Health

- The most important variable in consumer spending is a job.
- Upper income cohorts still have a cash cushion, lower income cohorts have spent savings.
- Goods spending still above trend, services spending climbing back to trend.
- Fed needs to bring goods & services demand into balance with supply.

2023 Recession

- Strategas odds are 50% in 2023 & in 2024.
- 75% odds over 2 years.
- U.S. labor market remains tight.
- Notable weakness in housing & mfg.
- Interest rate hikes will hit economy with a lag.
- Inverted yield curve also signaling recession.
- China re open may boost U.S. in 2nd half of 2023.



Part 1: Economic Outlook

	<u>2023</u>			
	<u>1QE</u>	<u>2QE</u>	<u>3QE</u>	<u>4QE</u>
Real GDP Q/Q % AR	-1.50%	0.00%	1.00%	0.30%
Core CPI Q/Q % AR	3.50%	2.80%	3.50%	2.50%
Fed Funds EOP	5.00%	5.25%	5.25%	5.25%

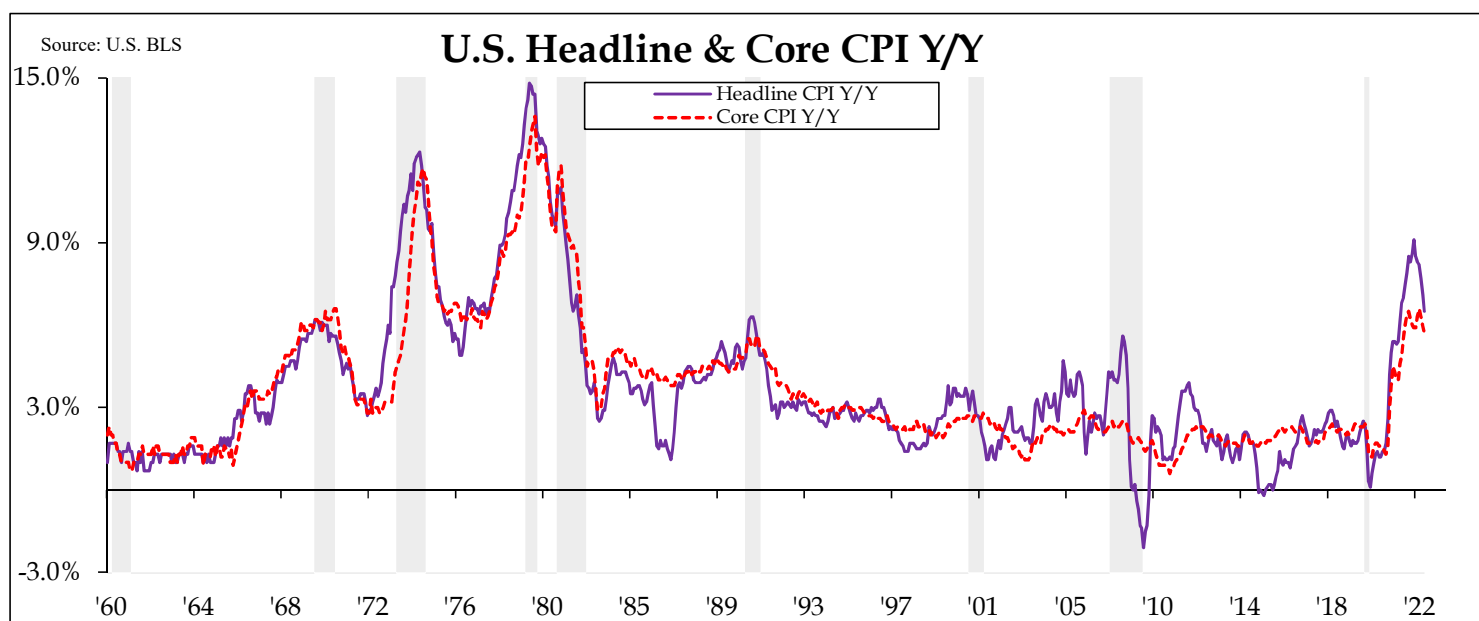
E = End of Period Expected Value

	<u>2024</u>			
	<u>1QE</u>	<u>2QE</u>	<u>3QE</u>	<u>4QE</u>
Real GDP Q/Q % AR	-0.50%	1.00%	1.80%	1.50%
Core CPI Q/Q % AR	2.50%	2.50%	2.30%	2.20%
Fed Funds EOP	4.75%	4.25%	3.75%	3.50%

E = End of Period Expected Value

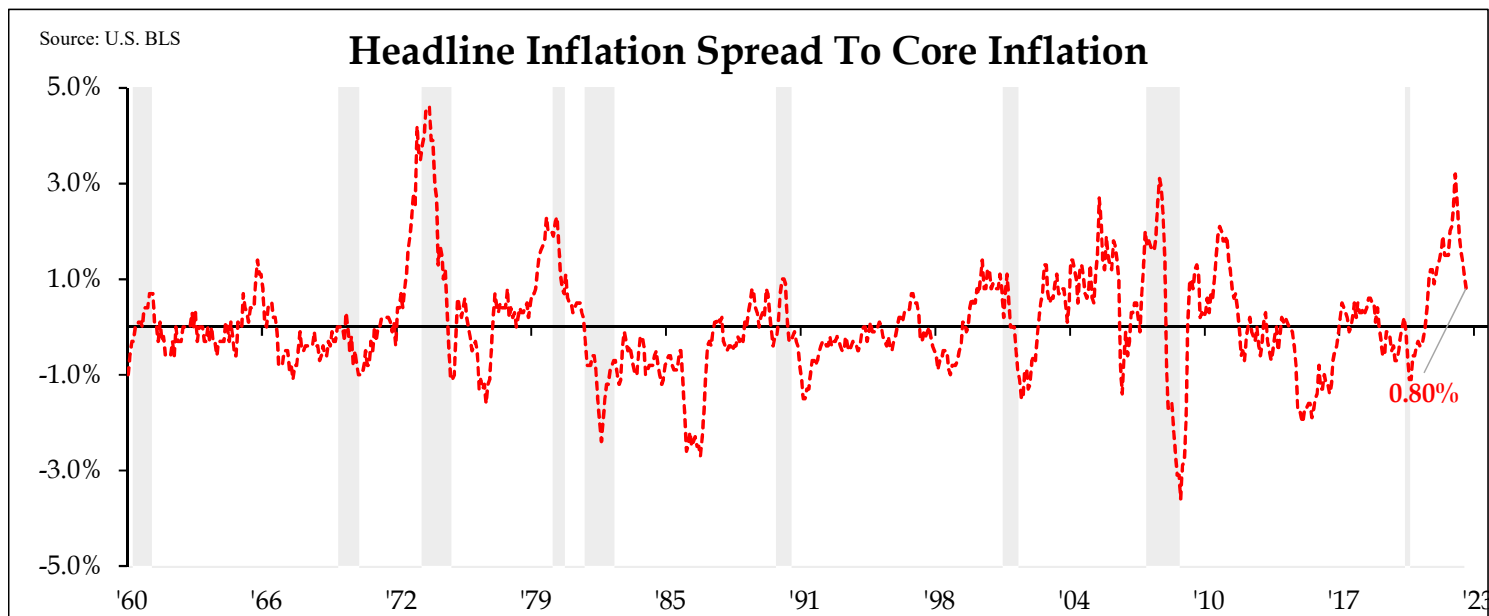


U.S. Inflation Rolling Over



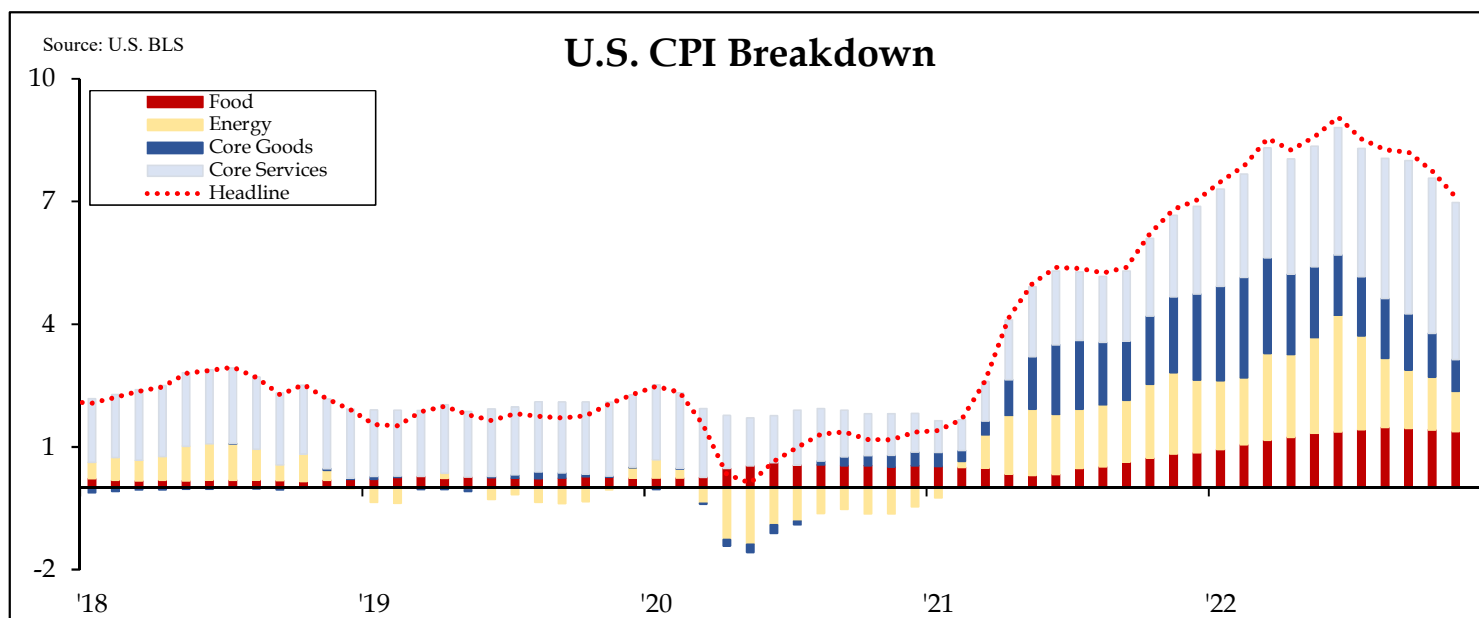


Headline & Core CPI Converging



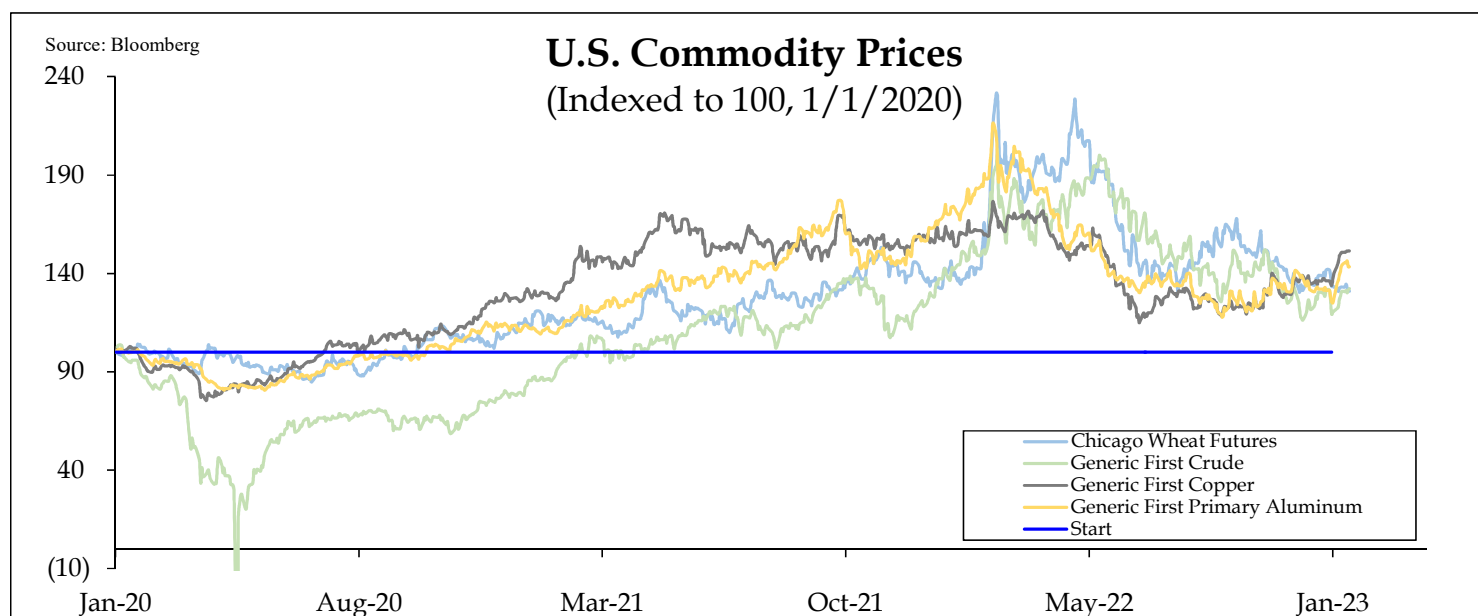


Sticky Core Svcs. & Food Driving U.S. Infl.



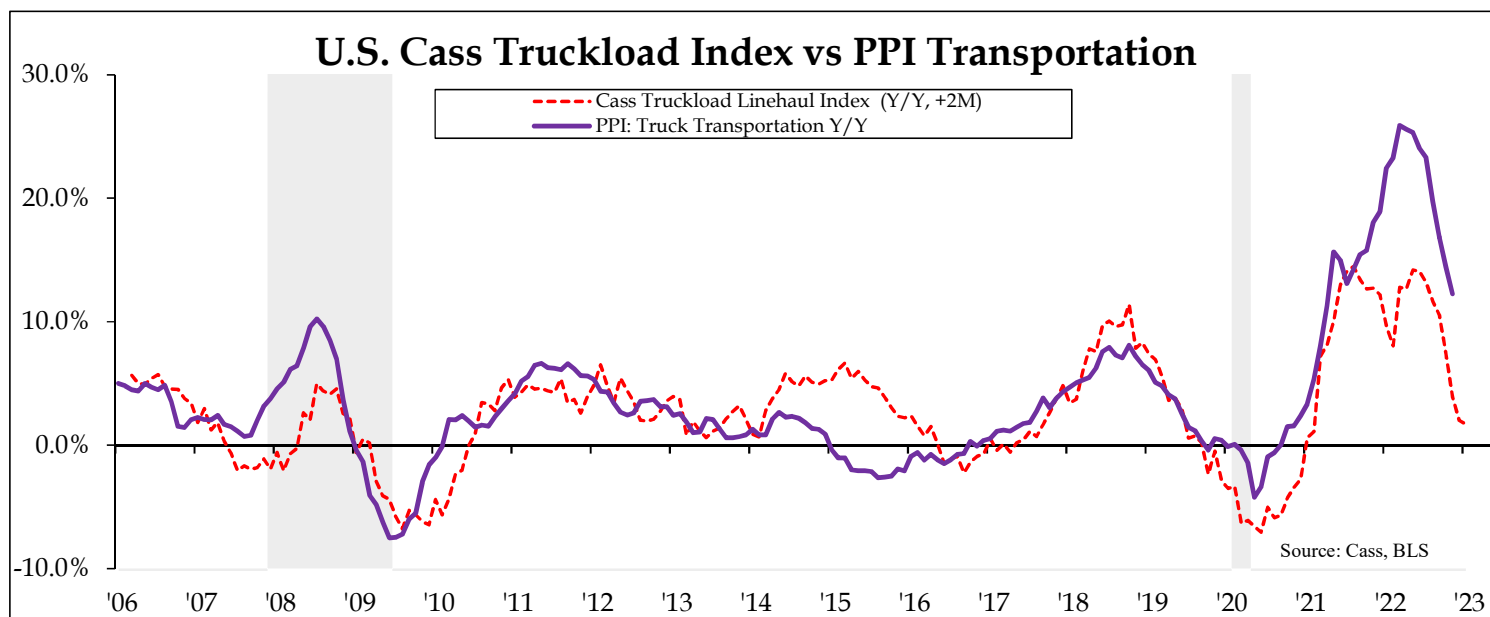


Commodities No Longer the Story in 2023



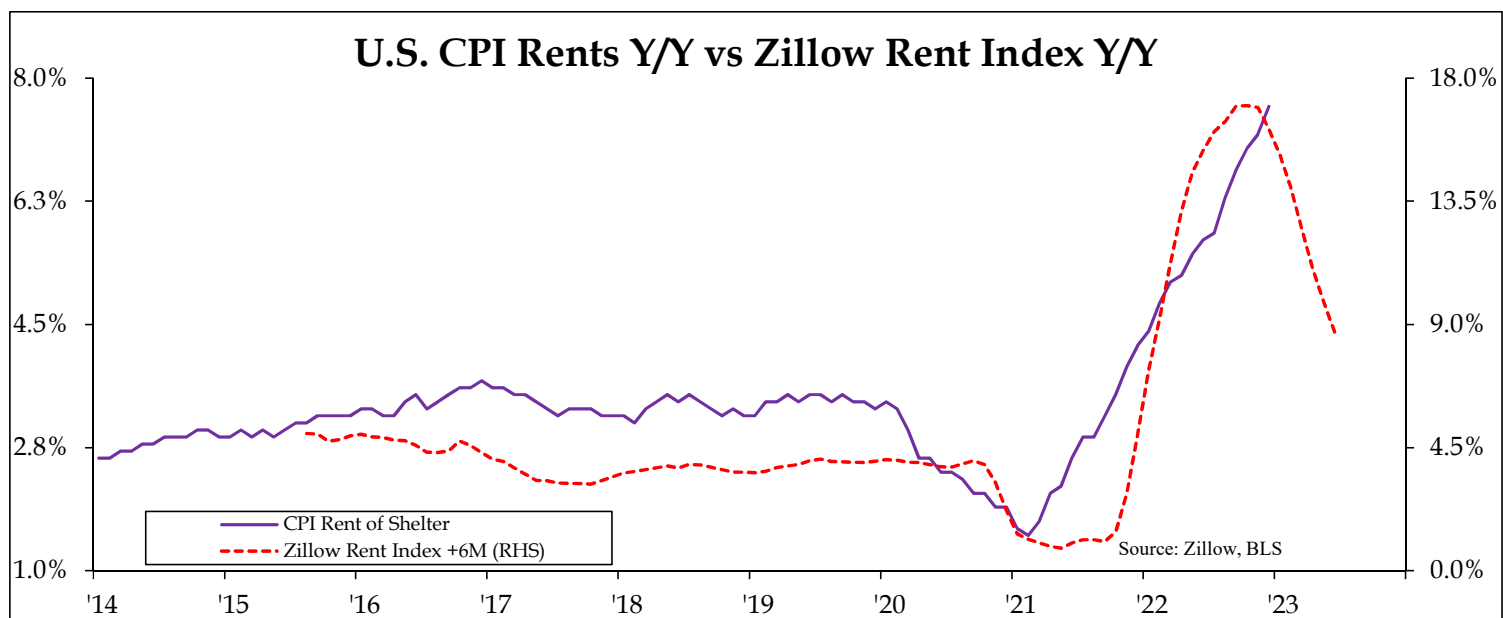


Trucking Inflation Looks to Move Lower



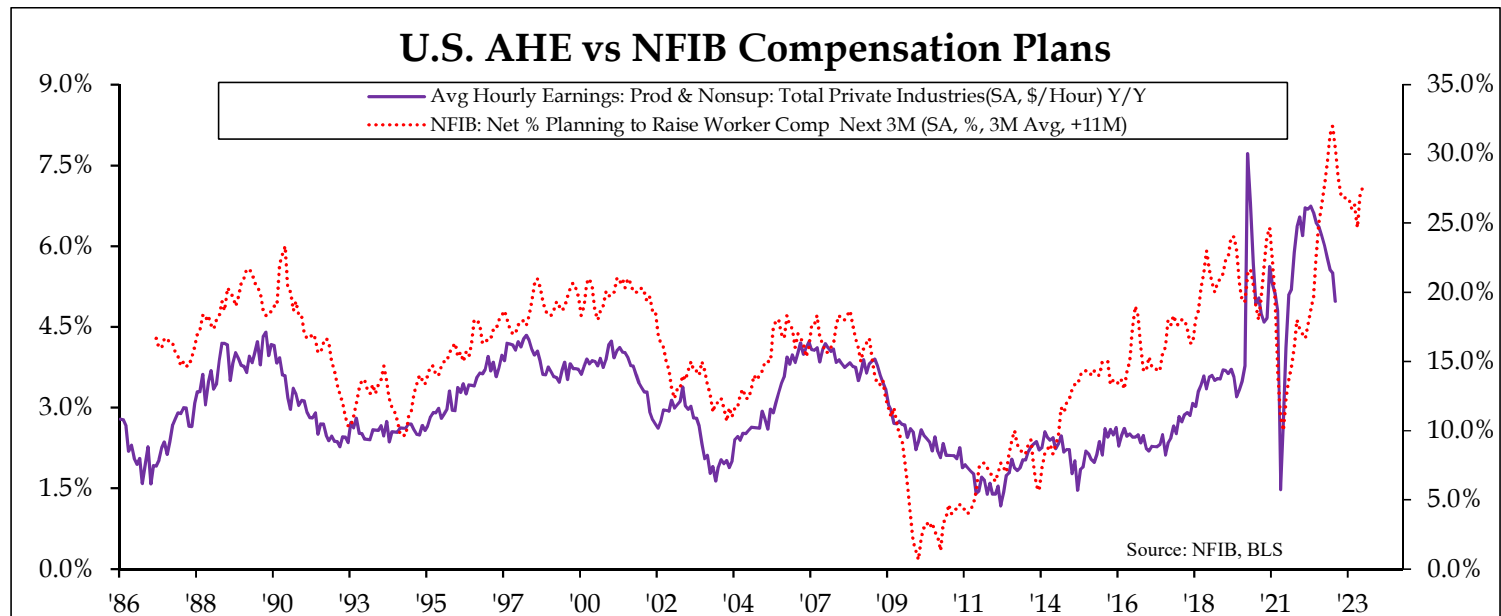


Zillow Rent Prices Lead U.S. CPI of Rent



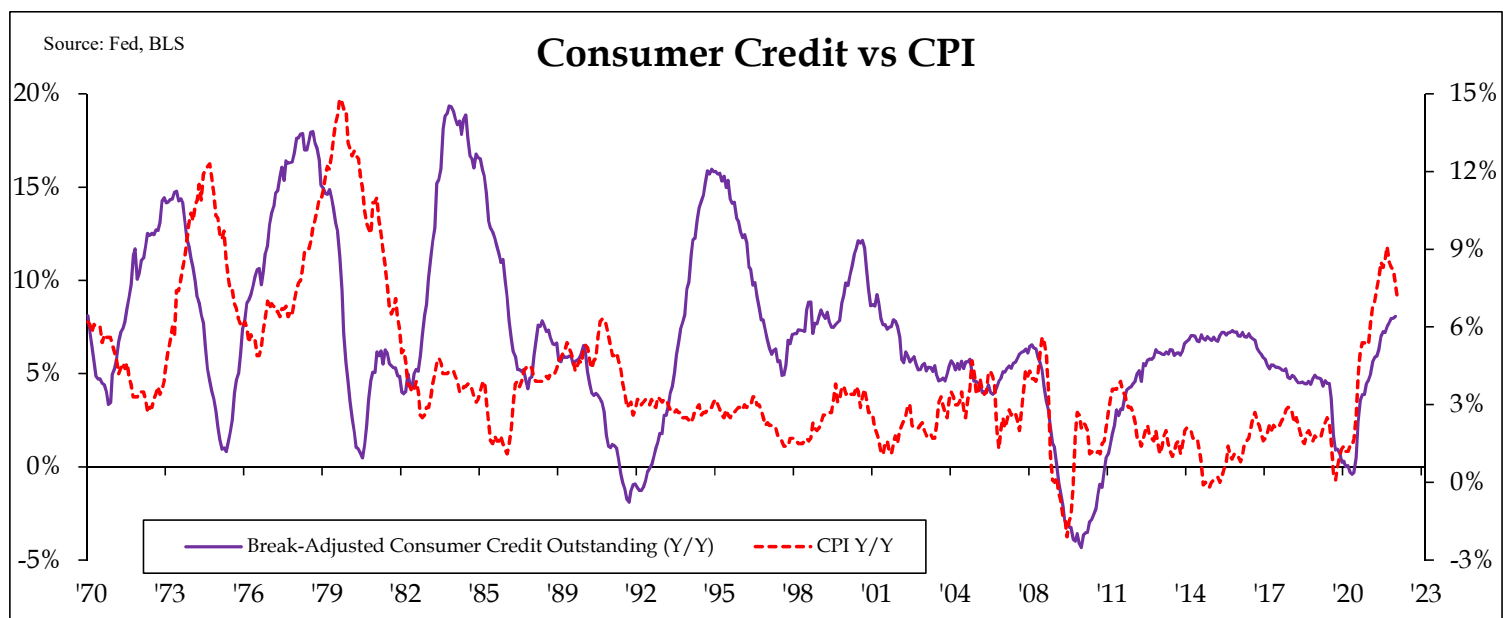


Concern is Stickier Components Like Wages



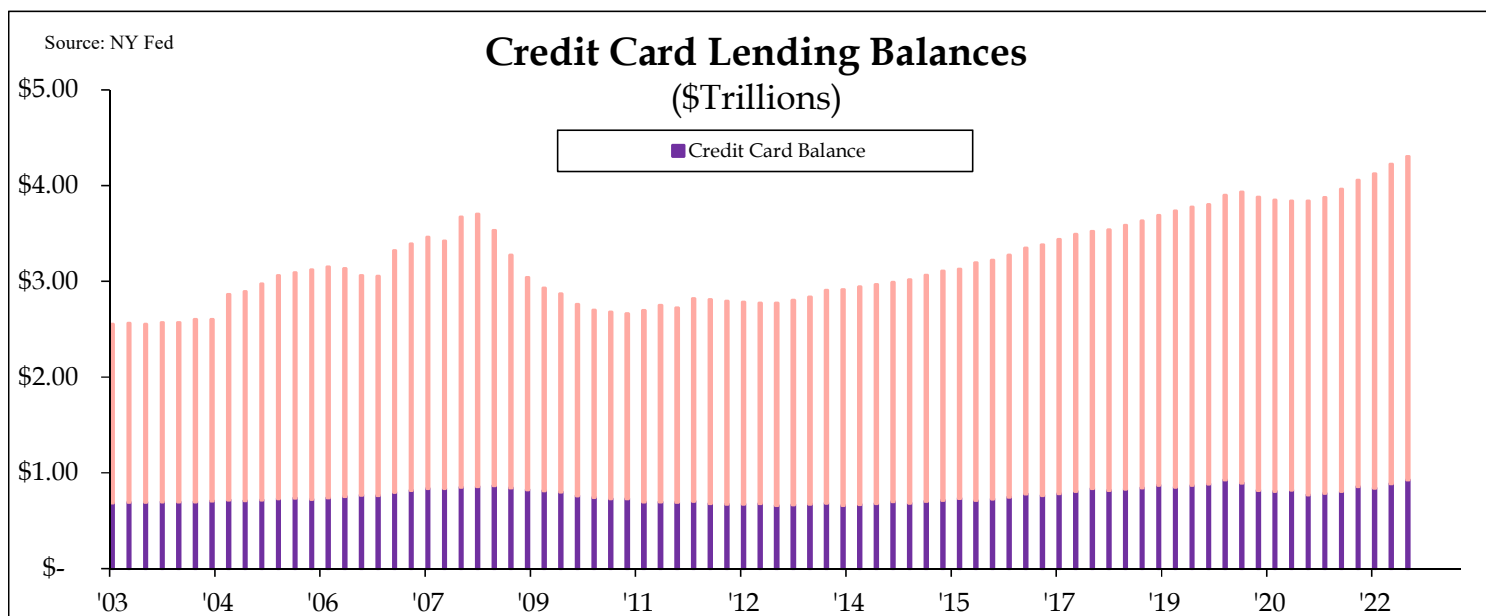


Inflation Causing Consumers to Add Debt



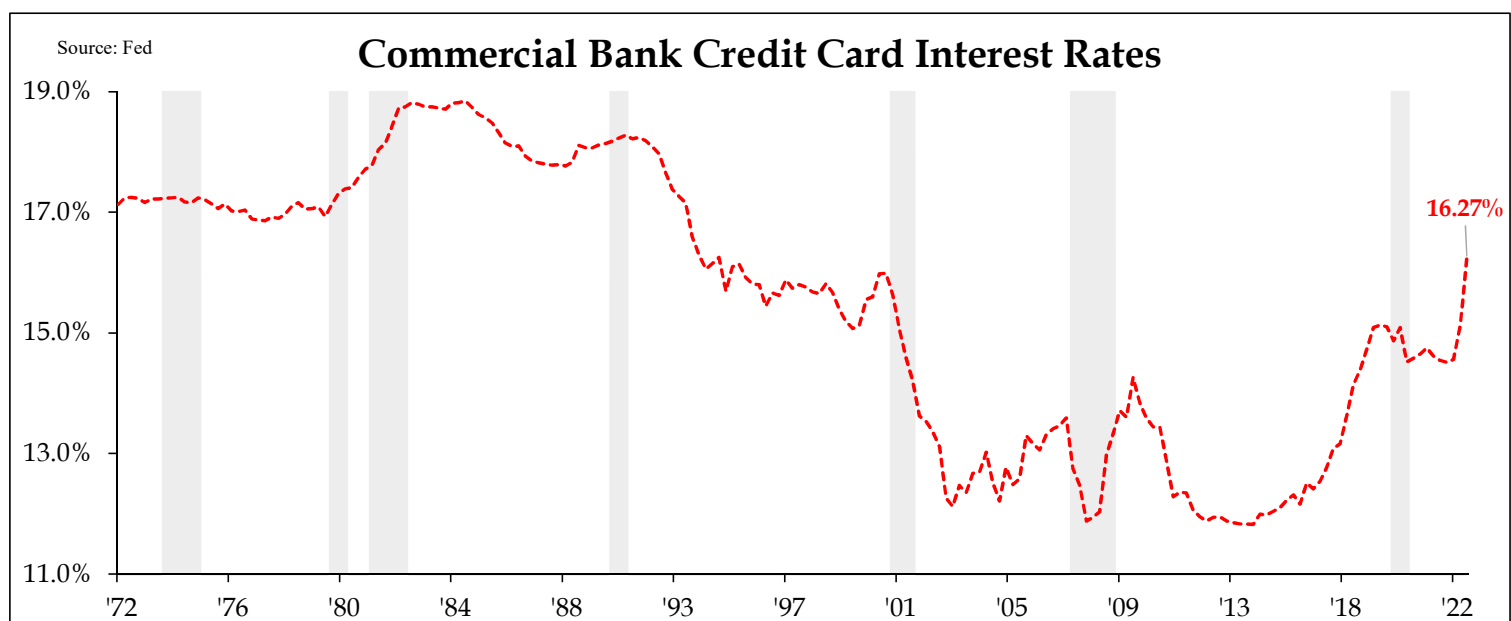


U.S. Consumers Adding Credit Card Debt



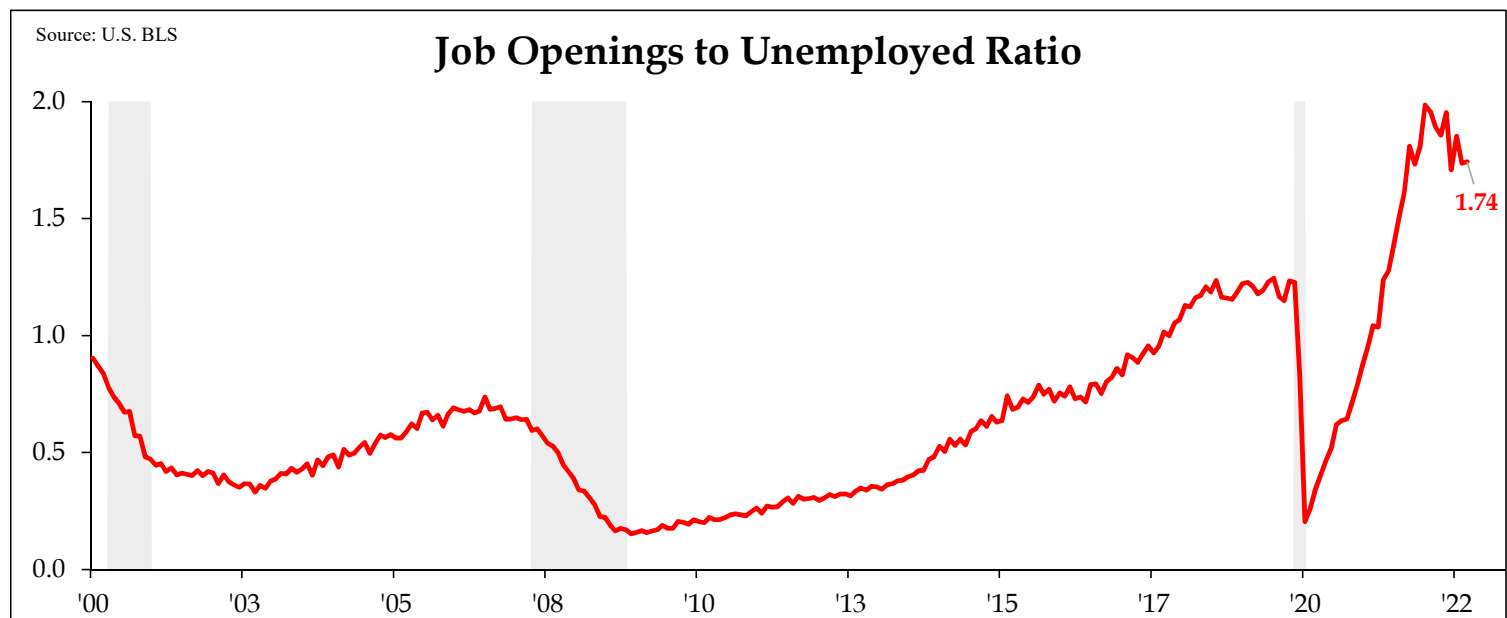


Credit Card Interest Rates Surging



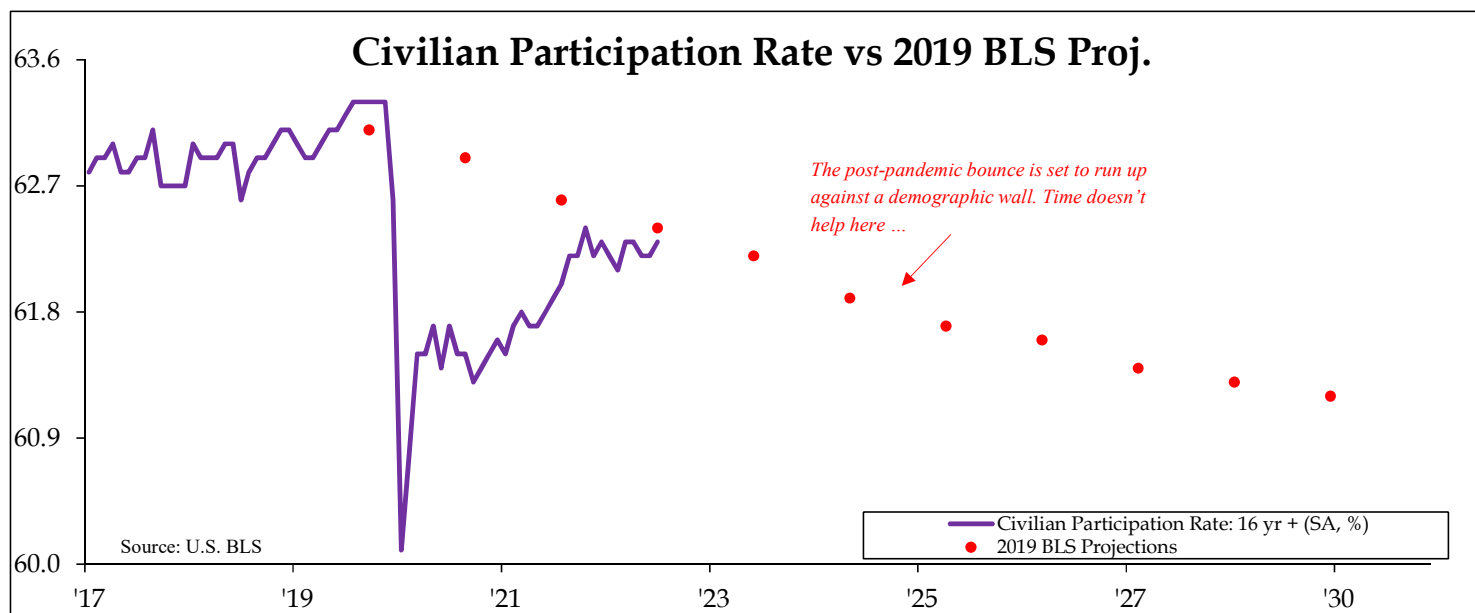


Most Important Variable In Consumer Spending Is a Job



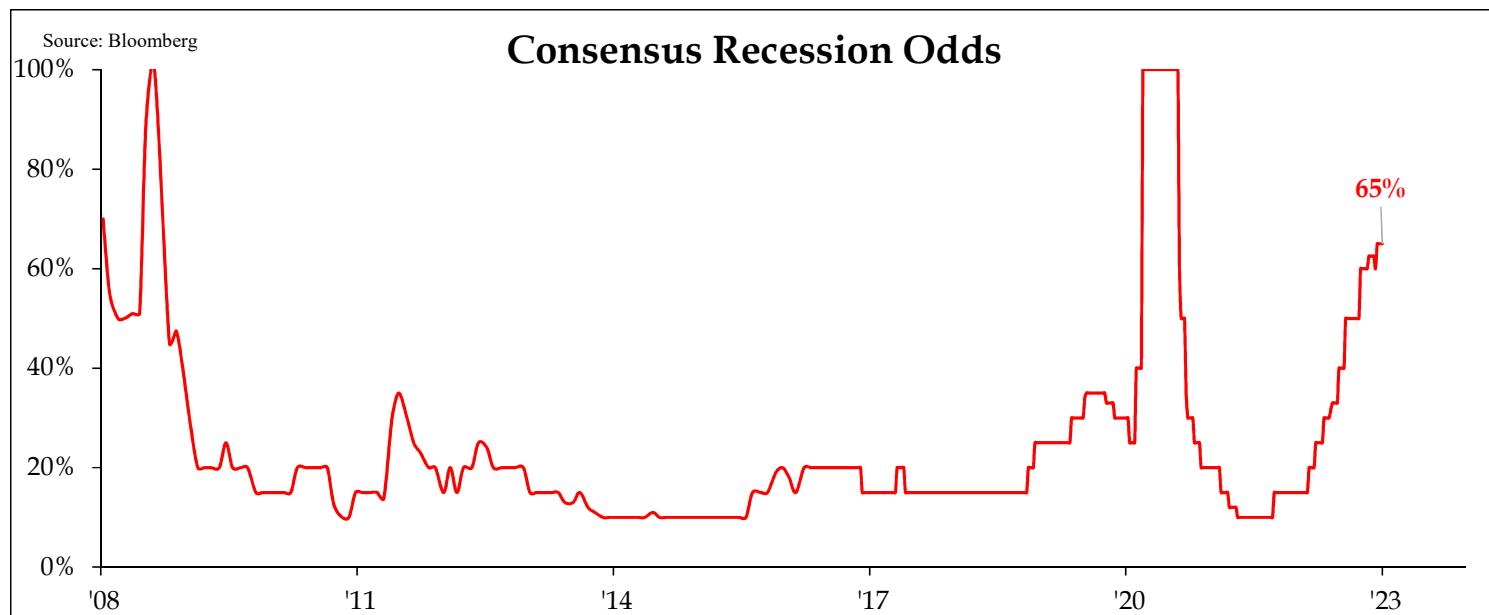


U.S. Labor Market Running into Demographic Wall



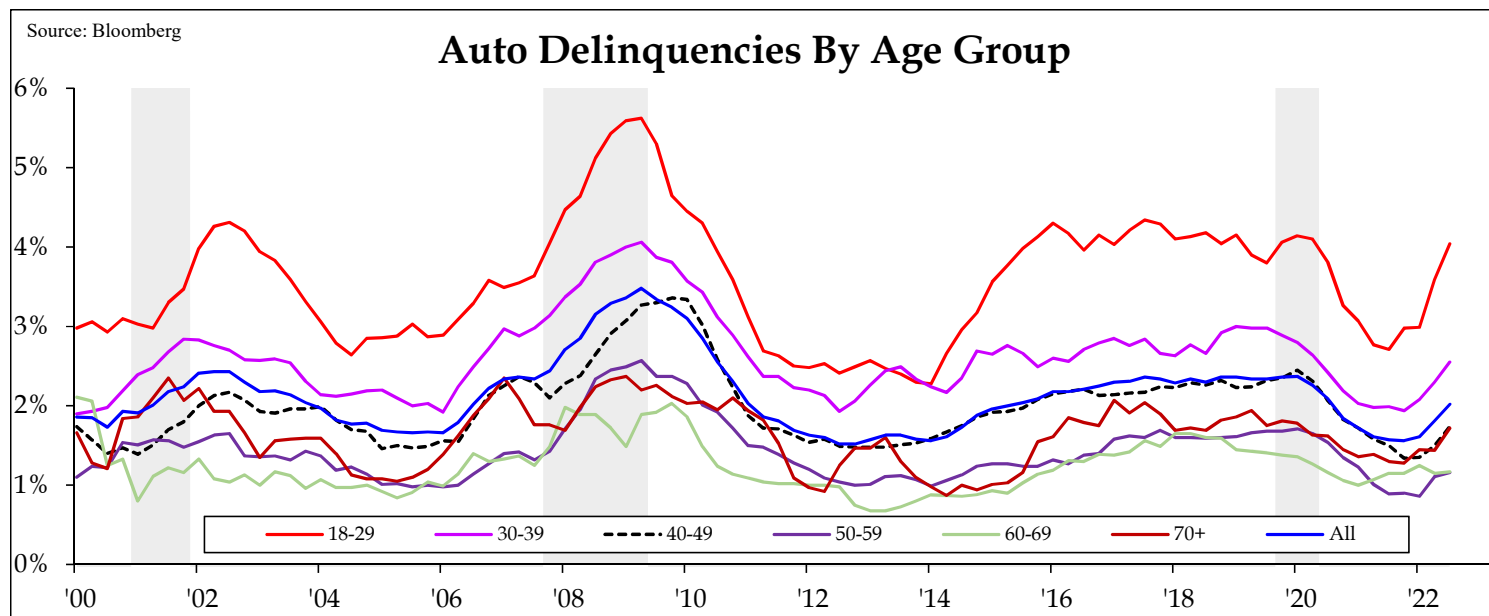


2023 Recession? Consensus Odds Near 65%. Why?



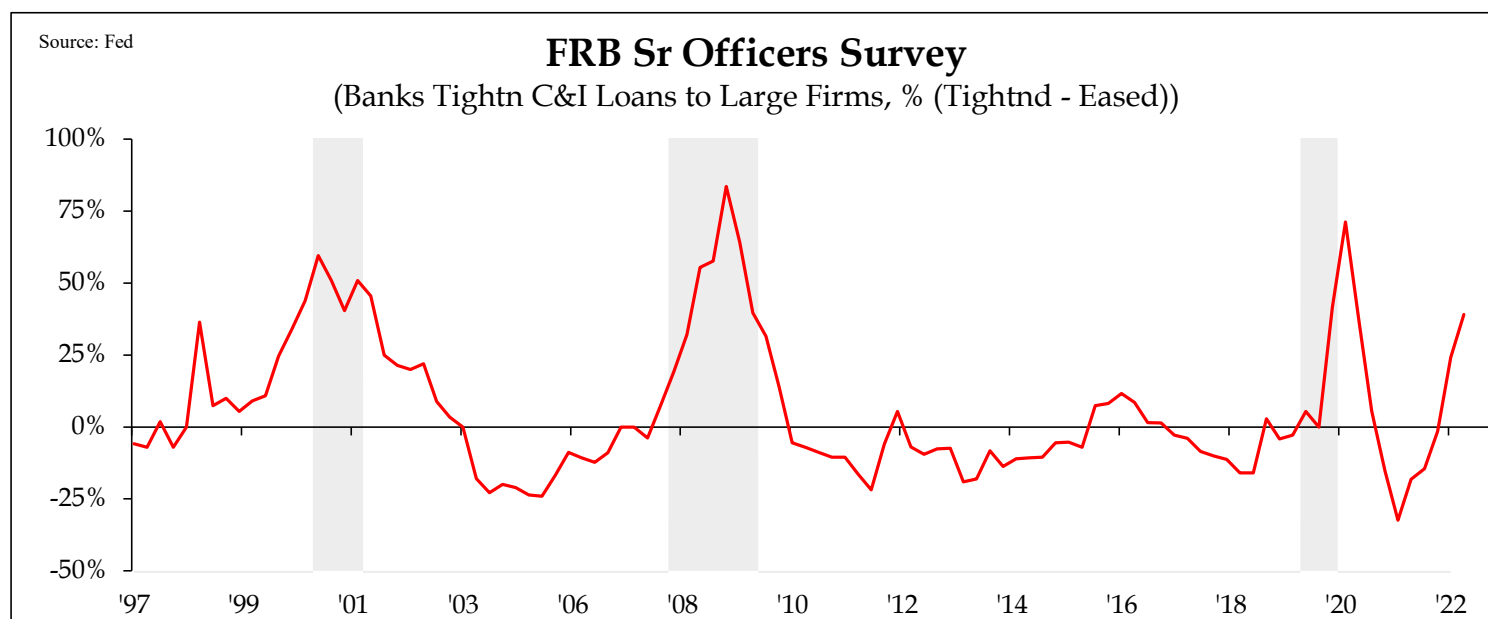


1) Auto Delinquencies Rising



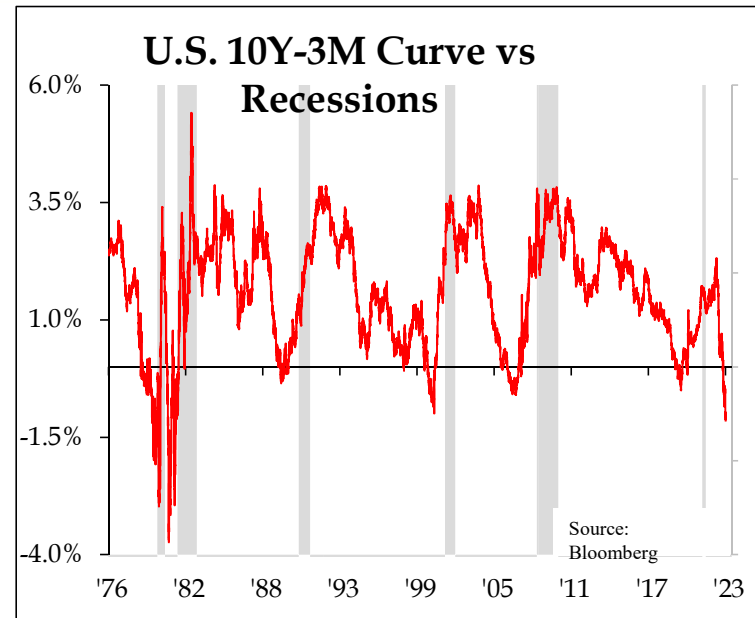
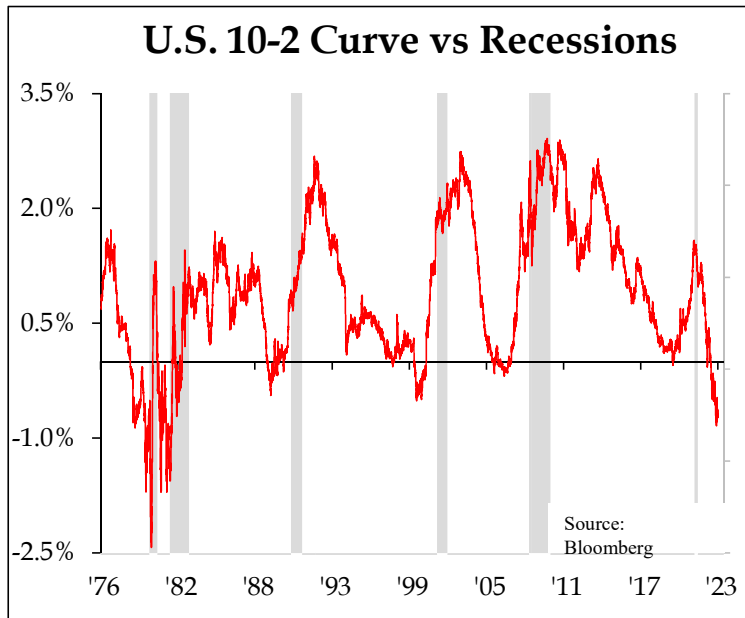


2) Banks Tightening Lending Standards





3) Inverted Curves Lead Recessions





3) Inverted Curves Lead Recessions

U.S. 10 Year - 2 Year Spread			U.S. 10 Year - 3 Month Spread		
Inversion Date	Days to Recession	Inversion Length	Inversion Date	Days to Recession	Inversion Length
8/17/1978	342	431	11/8/1978	280	372
9/12/1980	203	284	10/27/1980	171	219
1/5/1989	355	213	10/30/1989	148	42
3/8/1990	59	16	9/11/1998	622	9
6/10/1998	687	32	2/2/2000	271	230
2/2/2000	271	230	2/22/2006	449	6
1/31/2006	464	40	7/17/2006	349	217
6/8/2006	375	250	3/25/2019	217	4
8/27/2019	109	4	5/15/2019	181	103
3/31/2022	TBD	3	10/26/2022	TBD	55
7/5/2022	TBD	135			
Average	318	167	Average	299	134
Avg Ex Green Cells	214	179	Avg Ex Green Cells	231	170

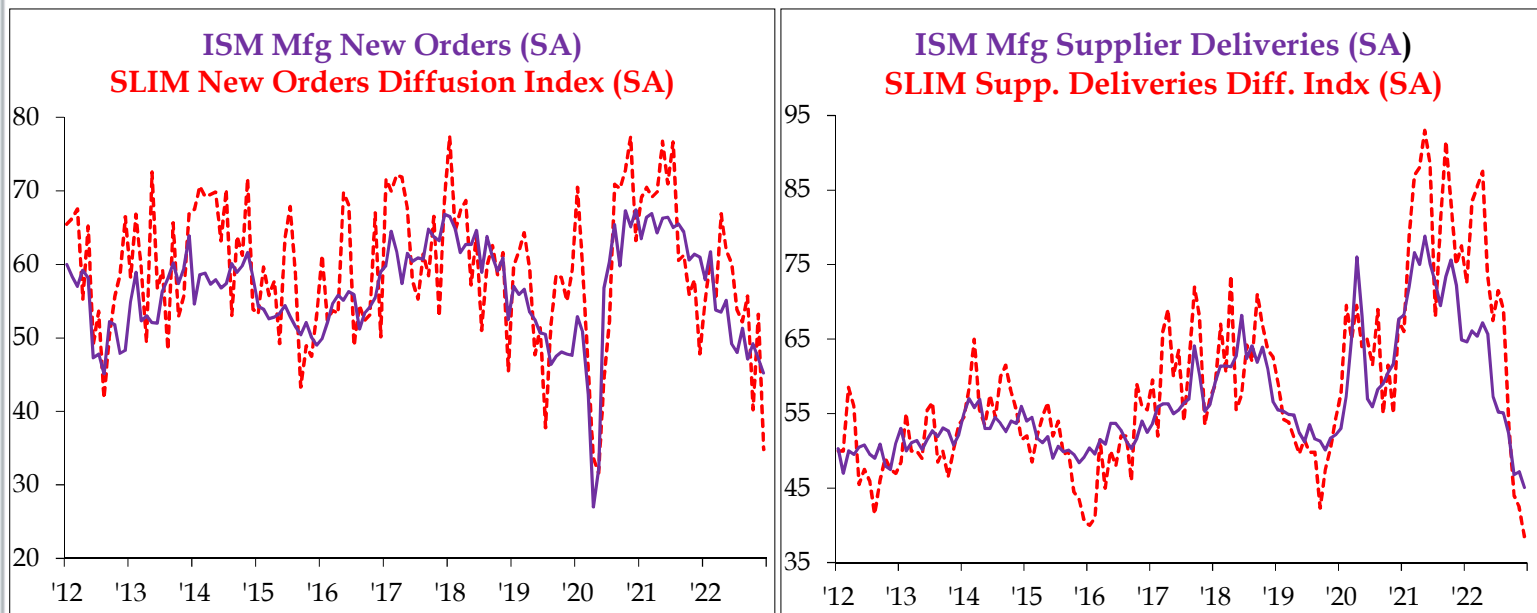


4) ISM Manufacturing in Contraction

Contraction Month	Reading	Trough Month	Reading	Months to Trough	Recession (Y or N)
Jun-51	45.5	Apr-52	36.7	10	N
May-53	48.9	Dec-53	35.6	7	Y
Mar-57	47.5	Jan-58	33.4	10	Y
Mar-60	47.8	May-60	42.6	2	Y
Jan-67	49.1	Apr-67	42.8	3	N
Jan-70	48.7	Nov-70	39.7	10	Y
Sep-74	46.2	Jan-75	30.7	4	Y
Aug-79	49.5	May-80	29.4	9	Y
Jan-81	49.2	May-82	35.5	16	Y
Feb-85	49.9	May-85	47.1	3	N
May-89	49.3	Jan-91	39.2	20	Y
May-95	46.7	Jan-96	45.5	8	N
Jun-98	48.9	Dec-98	46.8	6	N
Aug-00	49.9	Oct-01	40.8	14	Y
Feb-08	48.8	Dec-08	34.5	10	Y
Jun-12	49.5	Nov-12	48.0	5	N
Oct-15	49.1	Jan-16	47.6	3	N
Aug-19	48.5	Apr-20	41.6	8	Y
Nov-22	49.0	TBD	TBD	TBD	TBD
Recession Average			36.6	10	Source: ISM
Non Recession Average			44.9	6	
Total Average			39.9	8	



Strategas SLIM Survey Also Showing Weakness





Part 2 Policy Outlook

Fed Comes Under Political Pressure

- Decline in M2 & rapid tightening helping to bring inflation down.
- If employment data starts to falter & the Fed holds policy restrictive, they may become a political target.
- Fed has historically been most accommodative in 3rd year of presidency.
- Powell previously faced political pressure from Trump when hiking rates.

Return of Deficit Politics

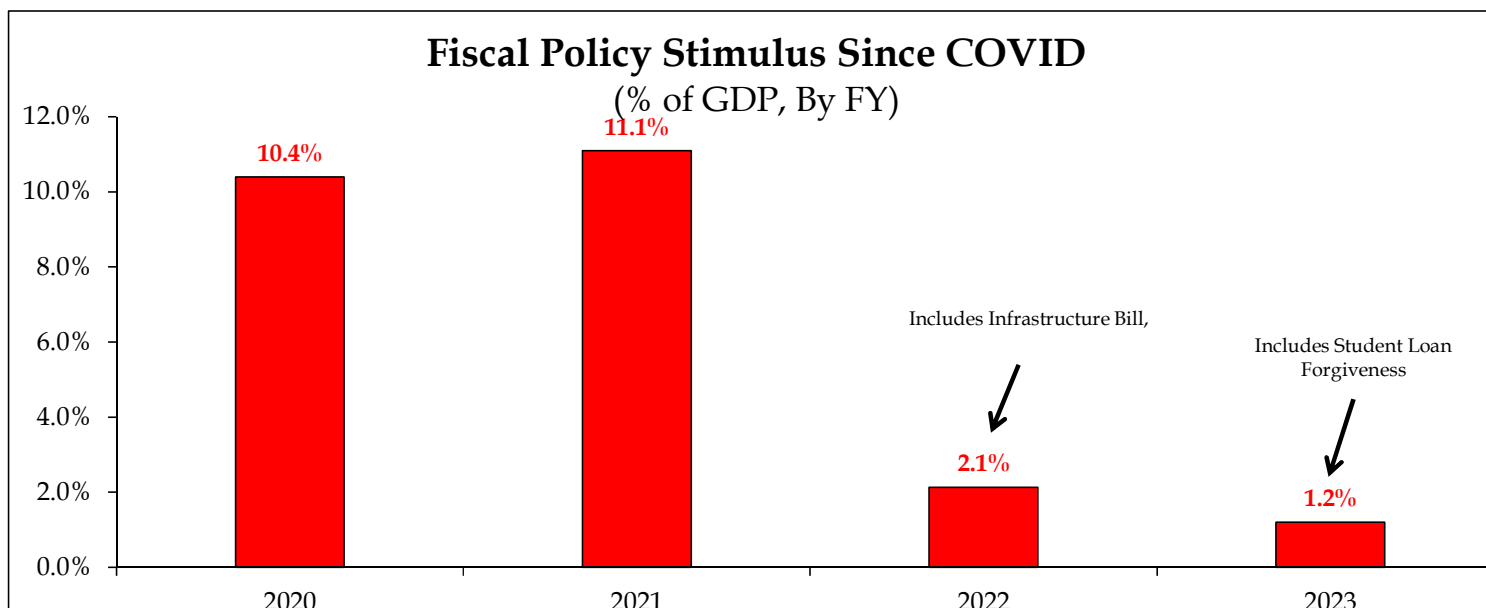
- Deficit politics look to return for the first time in 30 years.
- Congress must raise the debt ceiling by mid 2023.
- The process will be toxic, but it will be lifted.
- A 0.1% underestimation of the FFR in the budget means \$10 billion more of interest costs.
- Current estimate is <1%.
- Lower tax revenues + higher interest costs.

State Fiscal Party Over

- State aggregate budget surpluses falling.
- As surpluses fell, governments cut taxes and raised spending.
- Potential for 5%-10% decline in tax revenues with spending increasing.
- High income states may announce mid year budget cuts & lower FY '24 expectations.

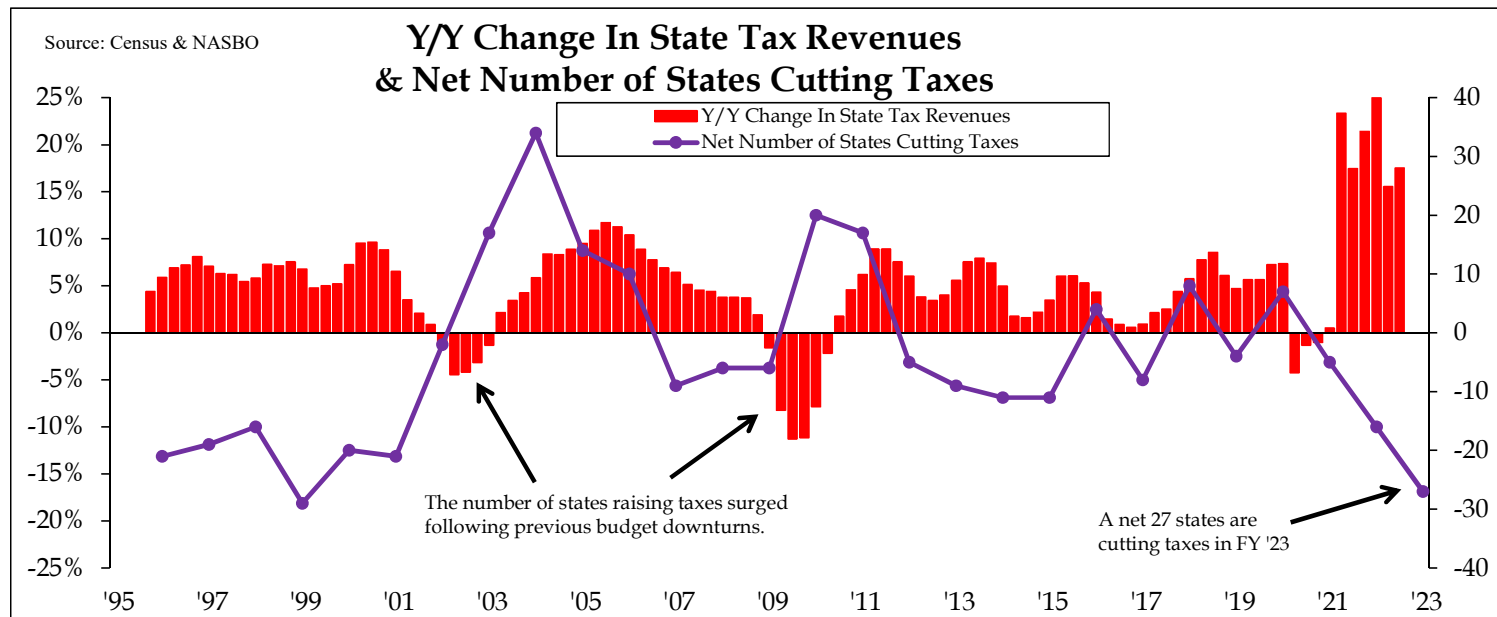


Federal Picture: More Fiscal Drag in 2023



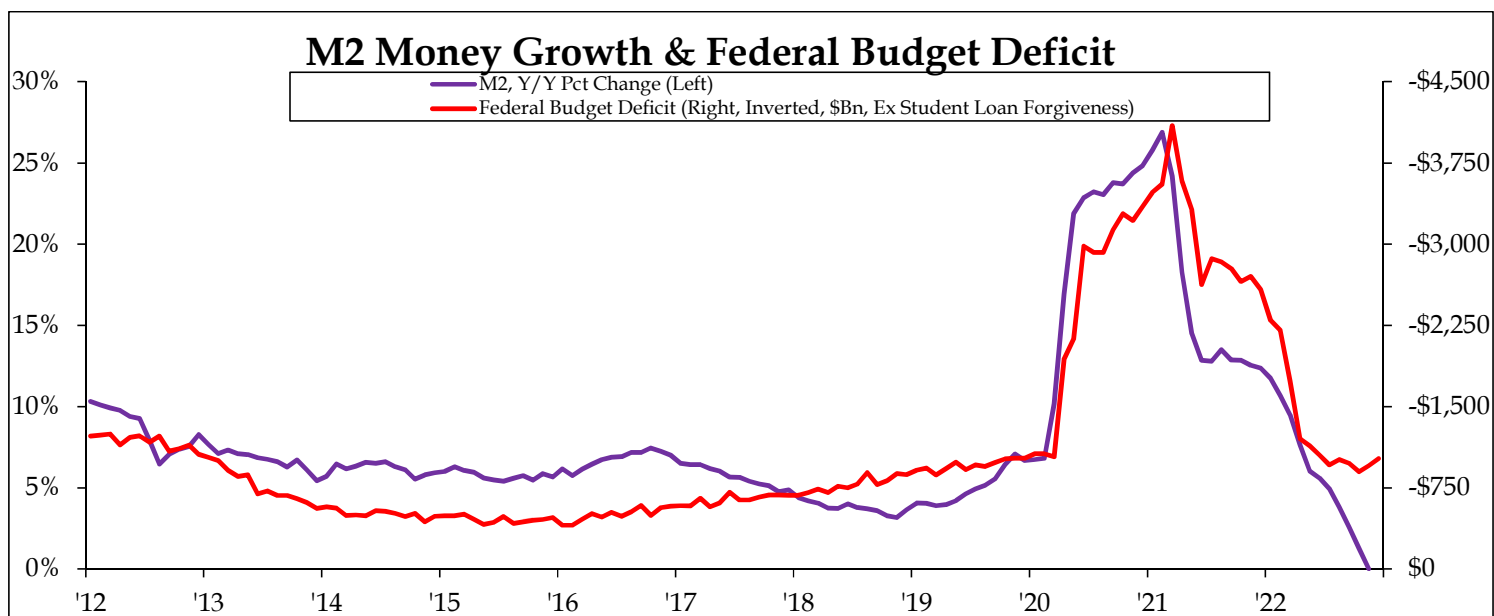


State Revenues Still Strong



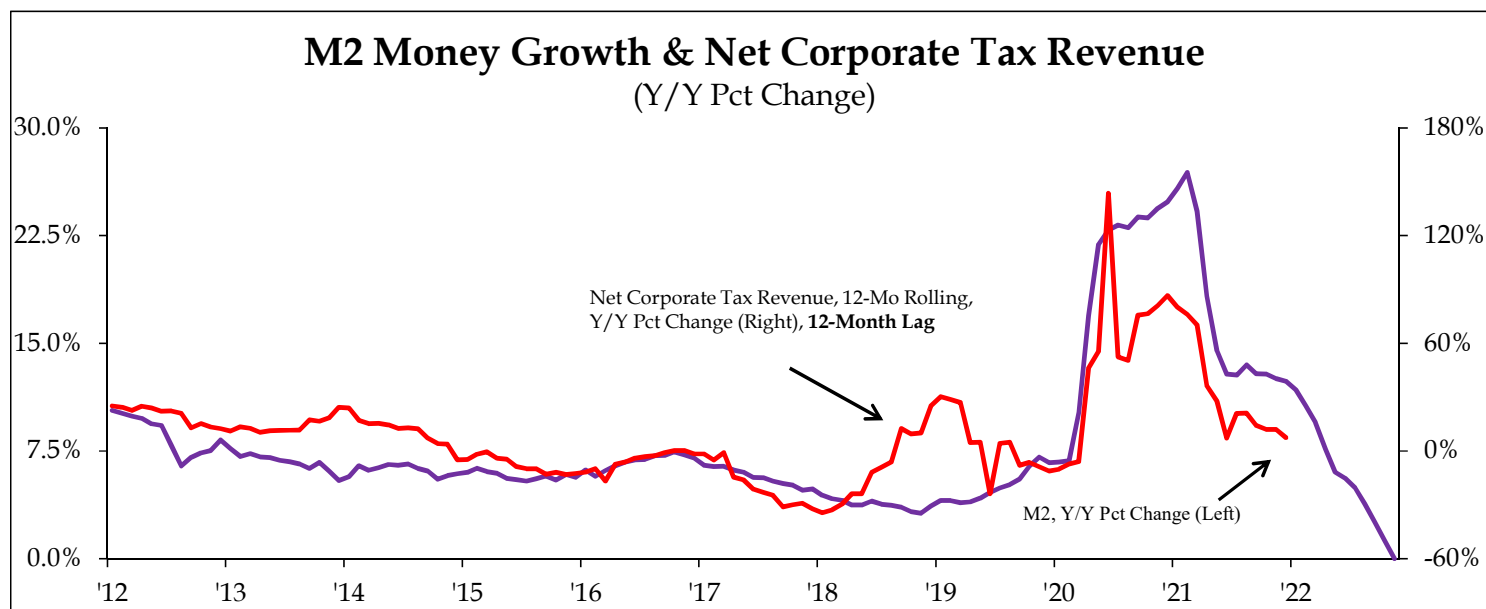


Budget Deficit Matters For M2 Growth



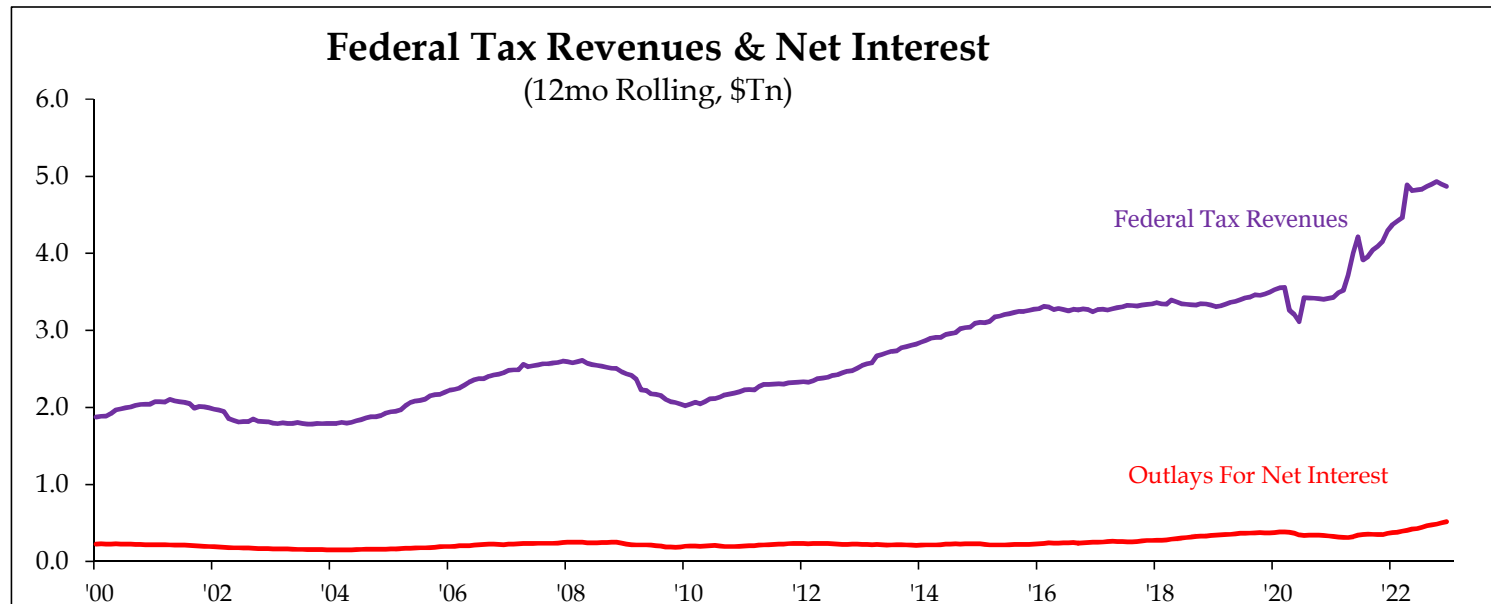


And M2 Matters for Corp Tax Revenues



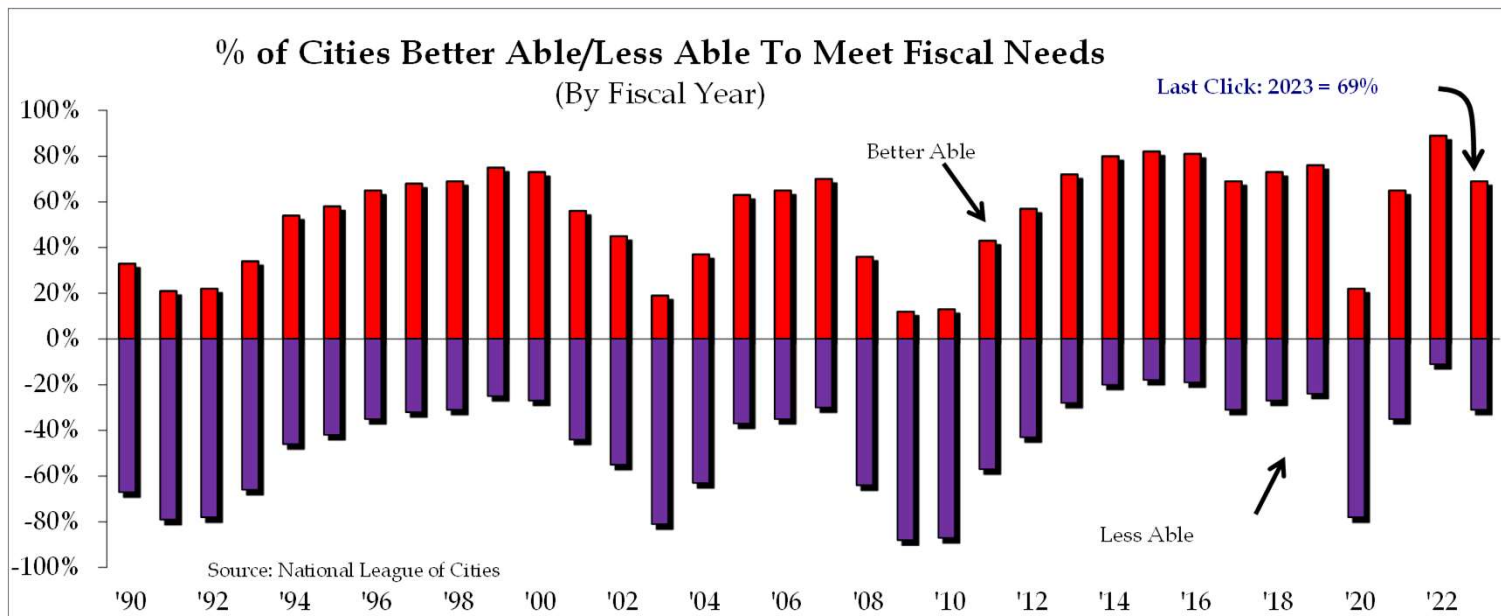


Net Interest Costs Rising For U.S.





Muni: Cities and Towns Doing Better in 2023





Part 3: Interest Rate Outlook

Terminal FFR

- We expect the FFR to terminate at 5.25% this cycle, in line with Fed expectations.
- Our clients, per our Fed Funds Rate survey, expect a terminal rate around 5%.
- Market futures imply a rate just below 5%.
- We expect to hit the terminal rate in 1H 2023, and do not expect hikes this year.
- Cuts = something broke!!!

Tightening Conditions

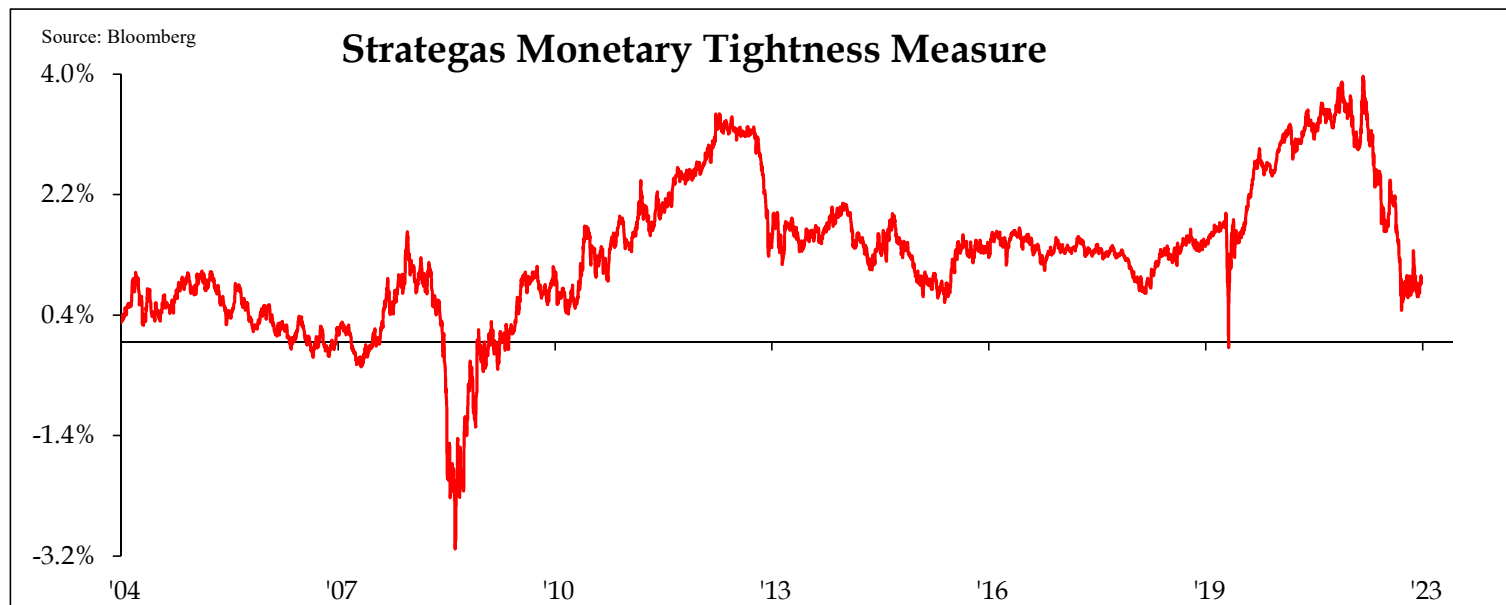
- This is the third fastest tightening cycle since 1970.
- Cumulative impact of hikes starting to be felt.
- Fed estimates 1-to-2-year lag for hike impacts.
- Some interest rate sensitive sectors (housing) are adjusting, and yields surged higher through '22.

Global Central Banks

- G20 central banks have been hawkish as inflation has soared globally.
- Many now are or are preparing to downshift to smaller hikes.
- OECD is urging central banks to “keep at it” until the job is done.
- Big 2023 stories include:
 - 1) BOJ capitulation/hikes
 - 2) Fed terminal rate & does the Fed cut.

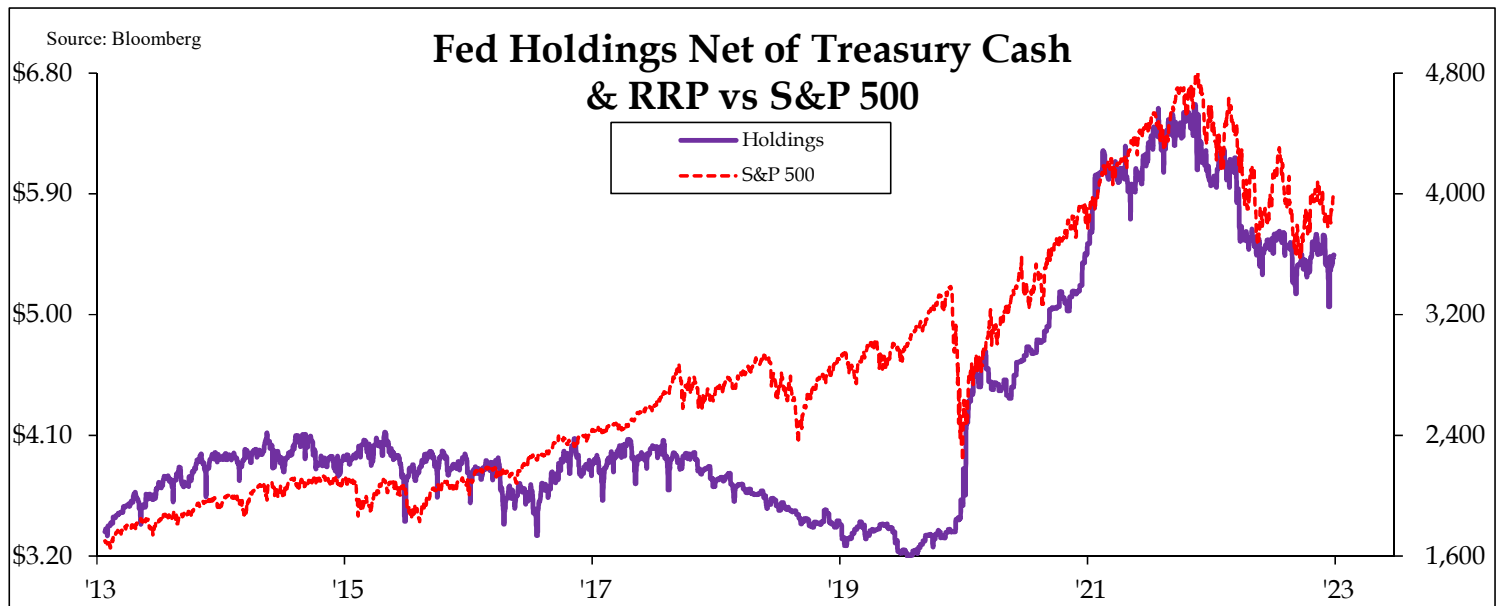


Monetary Conditions Tightened In 2022, But Eased In Latter Portion Of Year



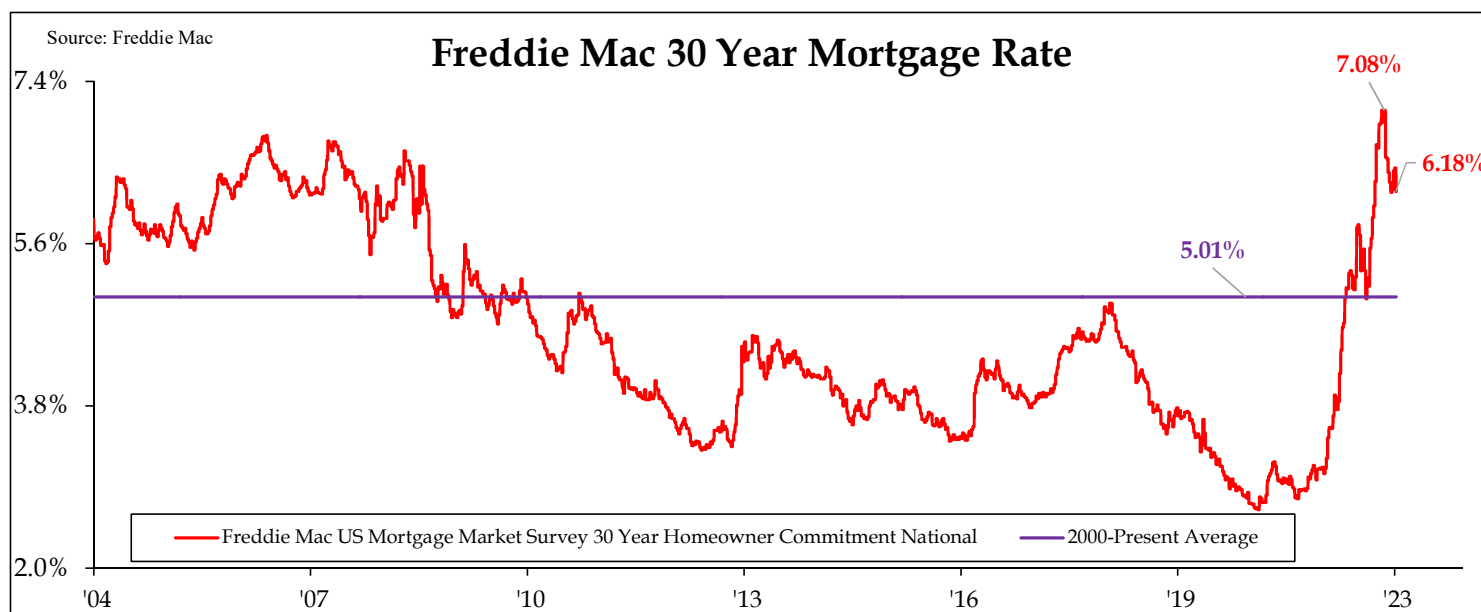


Market Liquidity Important to S&P Performance



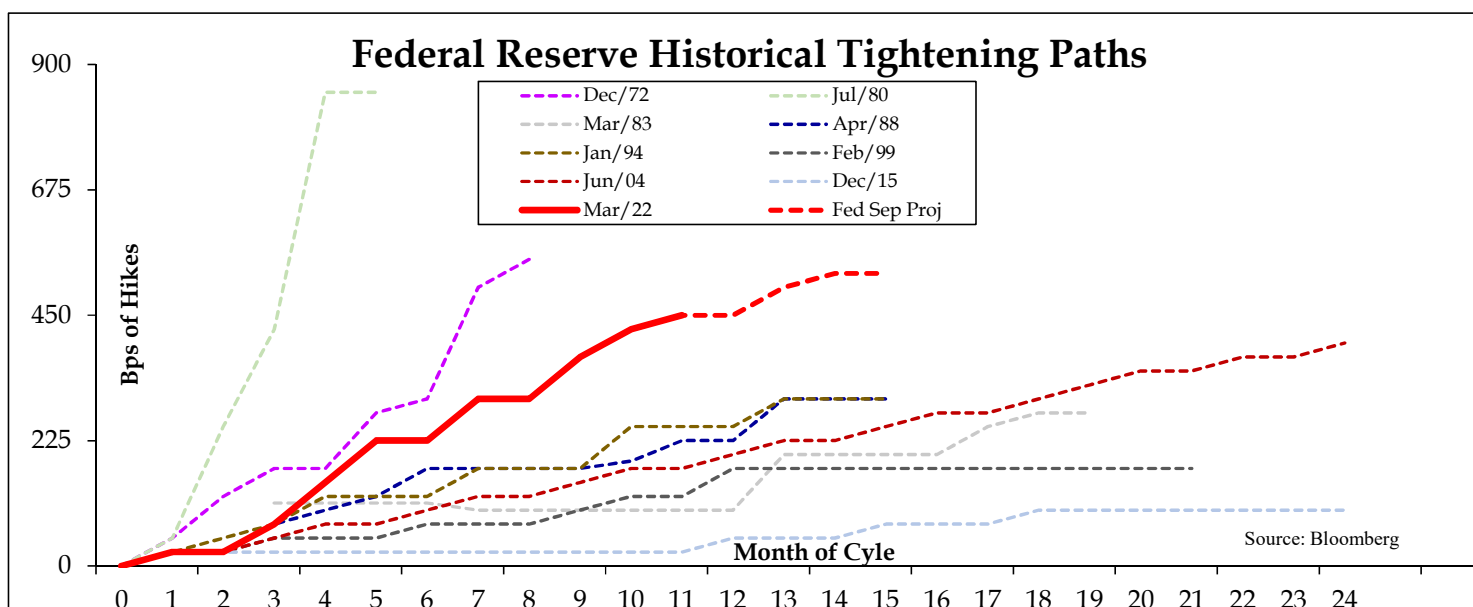


Mortgage Rates Still Elevated



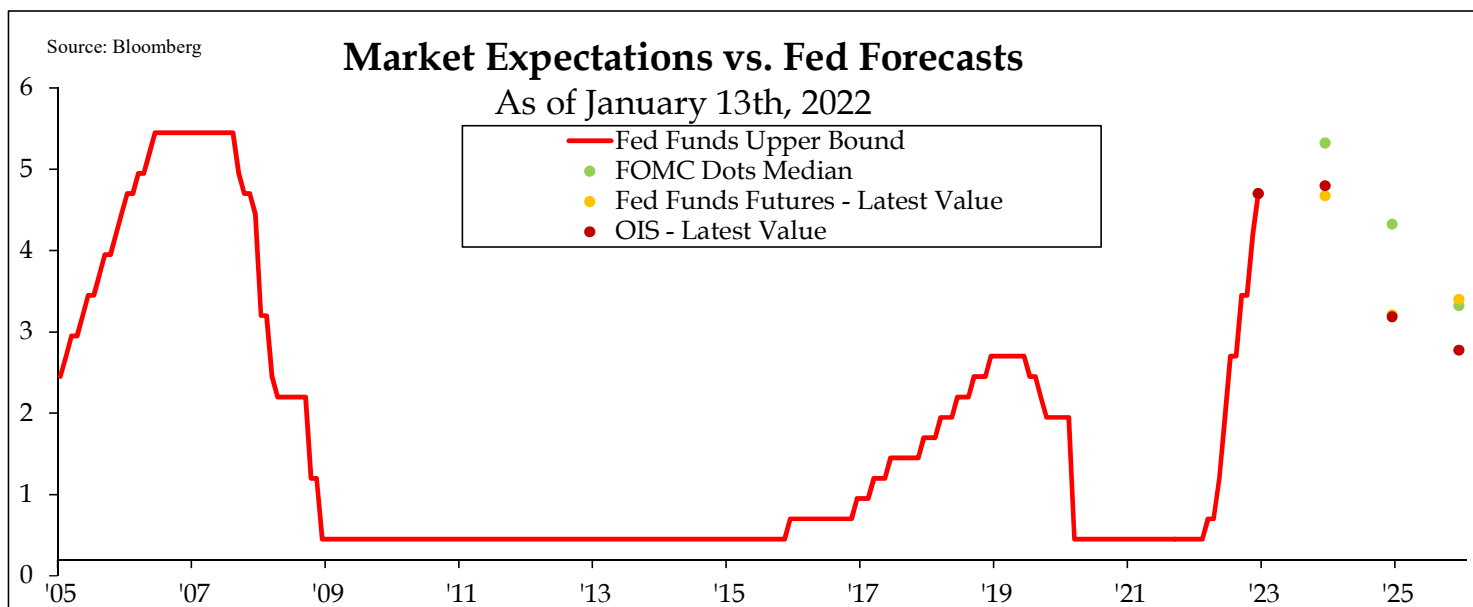


2022 Cycle Has Been 3rd Fastest Cycle Since 1970



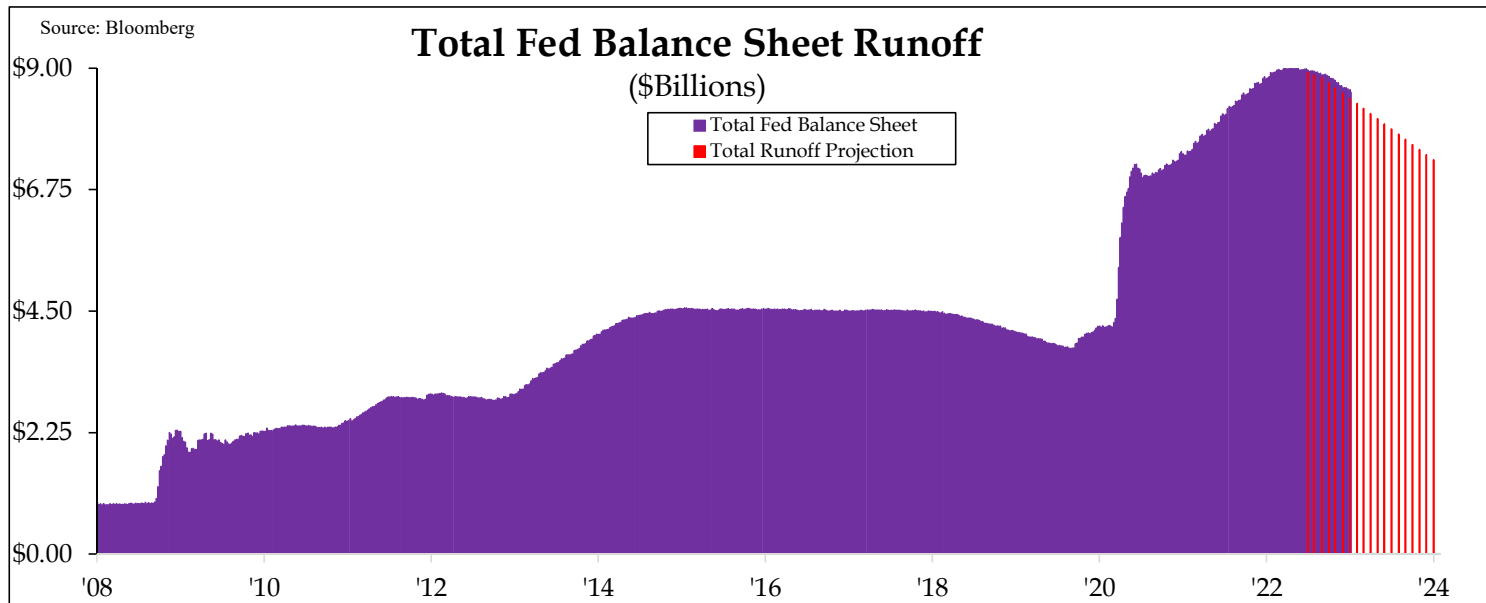


Fed Says 5.25% Terminal Rate, Market Does Not Buy It



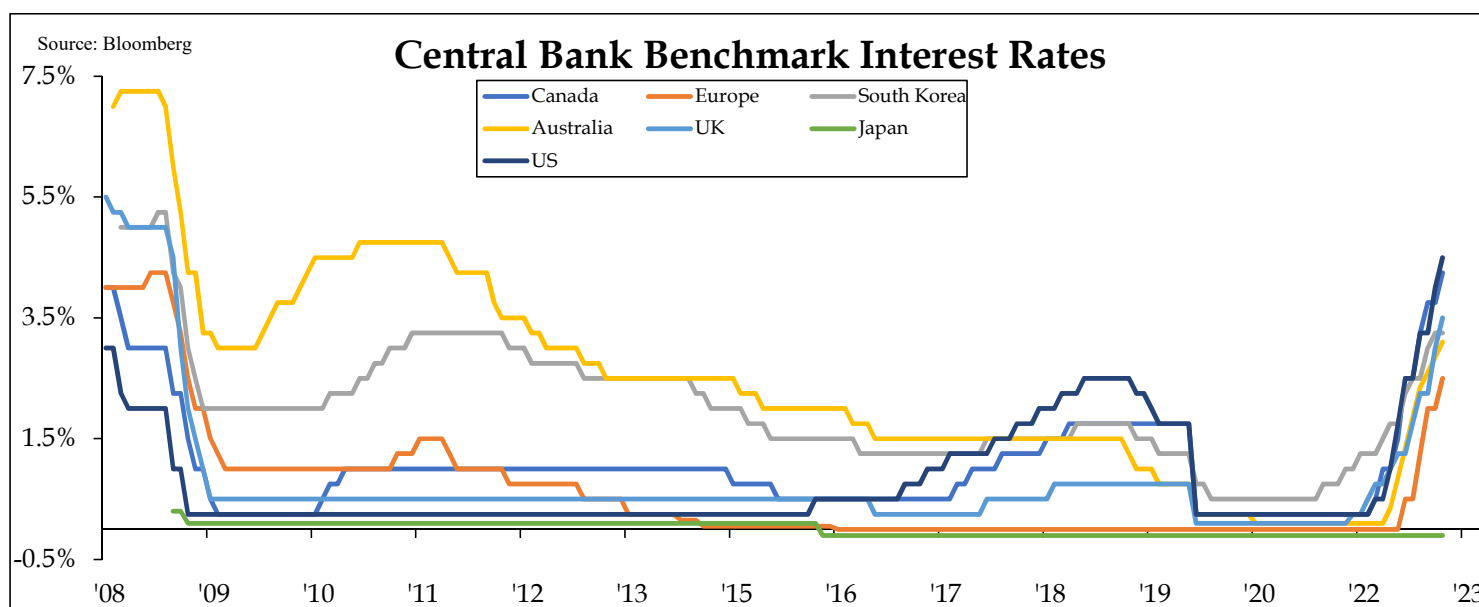


Balance Sheet Runoff has Been Negligible





Regime Change in Interest Rates Evident





Strategas Yield Forecast

<u>Maturity</u>	<u>2023</u>			
	<u>1QE</u>	<u>2QE</u>	<u>3QE</u>	<u>4QE</u>
1 Year	4.50%	4.05%	3.50%	3.30%
2 Year	4.00%	3.70%	3.45%	3.40%
5 Year	3.60%	3.40%	3.25%	3.40%
10 Year	3.35%	3.20%	3.20%	3.40%
30 Year	3.55%	3.40%	3.50%	3.60%

E = End of Period Expected Value



What's the Wildcard in 2023???

Labor Market

Labor Market

Labor Market





Conclusion: What Does This Mean?

- Labor market has kept consumer and manufacturing sector out of contraction for 2022 and early 2023, but time is running out.
- Fed rate hikes will continue until labor market finally rolls over. Then it's a question of how fast does unemployment rise relative to the drop in inflation. If inflation falls slowly, Fed will let recession prevail.



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