CLEARPOINT

clearstead

JANUARY 2023

CLEARSTEAD'S INVESTMENT OFFICE

2023 OUTLOOK

BY CLEARSTEAD'S INVESTMENT OFFICE

ECONOMY

Despite challenges investors faced in 2022, the economy remained resilient, supported by a strong labor market. For 2023, the economy, with the likely exception of inflation, is expected to get a little worse before getting better—yet financial markets tend to be leading indicators of future expected economic activity, so we understand that markets may have already discounted a wide range of downside economic outcomes.

2023 probably will be characterized by traditional late cycle themes for the US economy:

- *GDP growth moderating, a possible recession and at best lackluster economic growth with downward revision risks to corporate profit forecasts*
- *Monetary policy tightening; long lags mean the economy has yet to feel the full brunt of monetary policy tightening; lending conditions will be tightened further*
- *Inflation remains high, but starts to show signs of relief*
- *Employment remains high but begins to soften*

Labor markets were resilient, and surprisingly tight, throughout 2022 despite the economic uncertainty related to inflation and higher interest rates. After

FIRM UPDATE

Since its founding in 1989, Clearstead has grown to become a prominent private client and institutional wealth advisory firm. Today, we have over 130 employees, and most of our senior leadership professionals are shareholders. Clearstead's private client group provides comprehensive wealth management services to hundreds of clients and advises approximately $6 billion in assets. Clearstead's institutional consulting group advises approximately $20 billion in assets for more than 190 endowments and foundations, higher educational institutions, hospitals, and corporate retirement plans.

Read more about our growth and initiatives over the past year in our Annual Firm Update on our website.

Sustainable Clearstead

This year we produced our second Sustainable Clearstead Impact Report, which summarizes our activities through our Diversity, Equity, & Inclusion Council; EmpowHER, our women's initiative; the Clearstead Closet, a new charitable effort; the Clearstead Scholarship; the Clearstead Foundation; and several others.

More about Sustainable Clearstead can be found on our website at clearstead.com/sustainable averaging over 391,000 jobs over the course of the year, with unemployment ending 2022 near multi-decade lows of 3.7%, we are expecting to see job gains turn to job losses during 2023 with unemployment ticking higher by year end. In the Federal Reserve's most recent Summary of Economic Projections (December 2022), it forecasts unemployment to rise to 4.6% by year end 2023. *(Side note—the Fed is being optimistic—there is no historic precedent for the unemployment rate rising only 1 percentage-point and holding there. Every previous economic downturn has been marked by a multi-percentage point rise in unemployment.)*

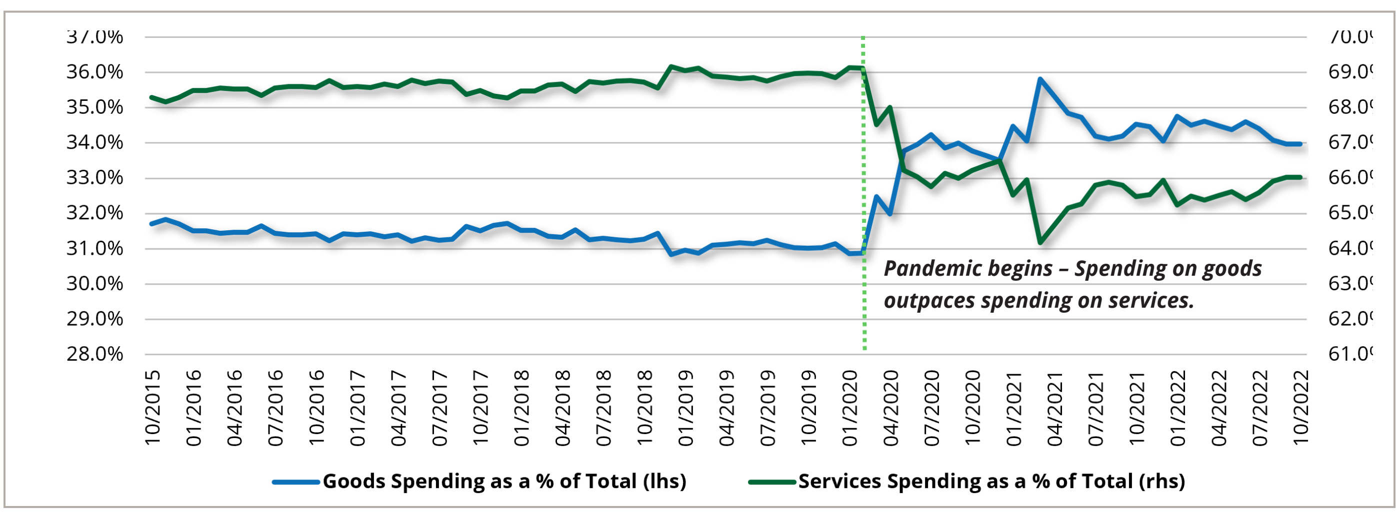
2023 INVESTMENT THEMES

PUBLIC EQUITY	**Value Over Growth**	After a decade of underperforming growth, value has staged a come-back of sorts. Whether we are in the early stages of a value cycle is less clear, but momentum favors value and dividend-oriented strategies.
	Small Cap over Large Cap	Small cap could find itself in a better relative position than large cap by mid-year.
	Emerging Markets, a Coin Toss	Emerging market success largely hinges on the US Dollar and a reversal in its strong momentum. We think there is a case to be made for a dollar reversal and EM outperformance.

PUBLIC FIXED INCOME	**Still Short Duration**	We think it is too early to move to long duration bonds, as such we continue to favor a duration position less than benchmarks.
	Credit Remains Attractive	Credit looks more attractive; defaults should remain contained should the economy enter recession in 2023.
	Focus on Income	2022 was relatively easy to perform well vs core bond benchmarks by simply focusing on duration. We do not think 2023 is likely to be as easy and "Carry" will be critically important in 2023 for bond investors.

Normalization in spending between goods and services continues to be a key theme after a post-COVID stretch that has seen spending in the goods side of the economy significantly outpace services related spending by a wide margin. Pre-COVID, goods-related expenditures accounted for about 31% of total spending, and in the months that followed lock-downs, goods related spending climbed to 36% of overall spending. The consumption side of the economy appears to be in the process of normalizing back to trend with more services-related spending vs. goods-related spending on the horizon—see Figure 1 below.

FIGURE 1: PERSONAL CONSUMPTION: GOODS VS SERVICES



Source: Clearstead, Bloomberg LP, as of December 19, 2022, monthly data.

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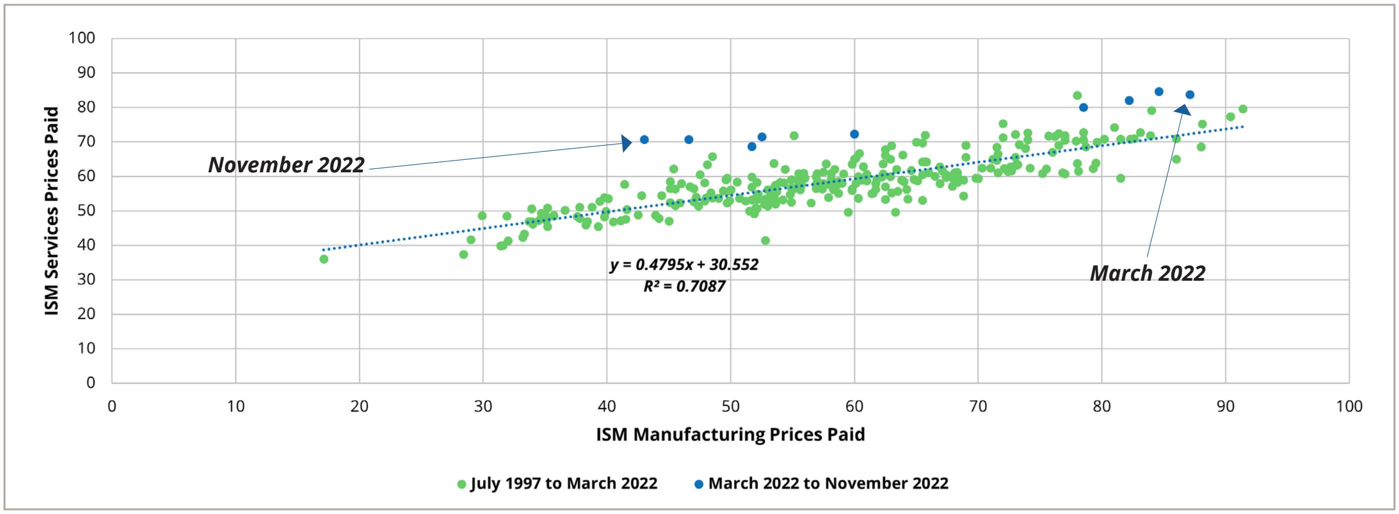
This is a transition that is likely to have inflation implications as we already are observing signs of manufacturing-related inflation softening while services-related inflation remains high—whereas both were high in March of 2022 (Figure 2). With most of the economy tied to services, the progression of inflation here will be one of the more relevant macroeconomic data points watched in the first few months of 2023.

FIGURE 2: PRICES PAID: SERVICES AND MANUFACTURING

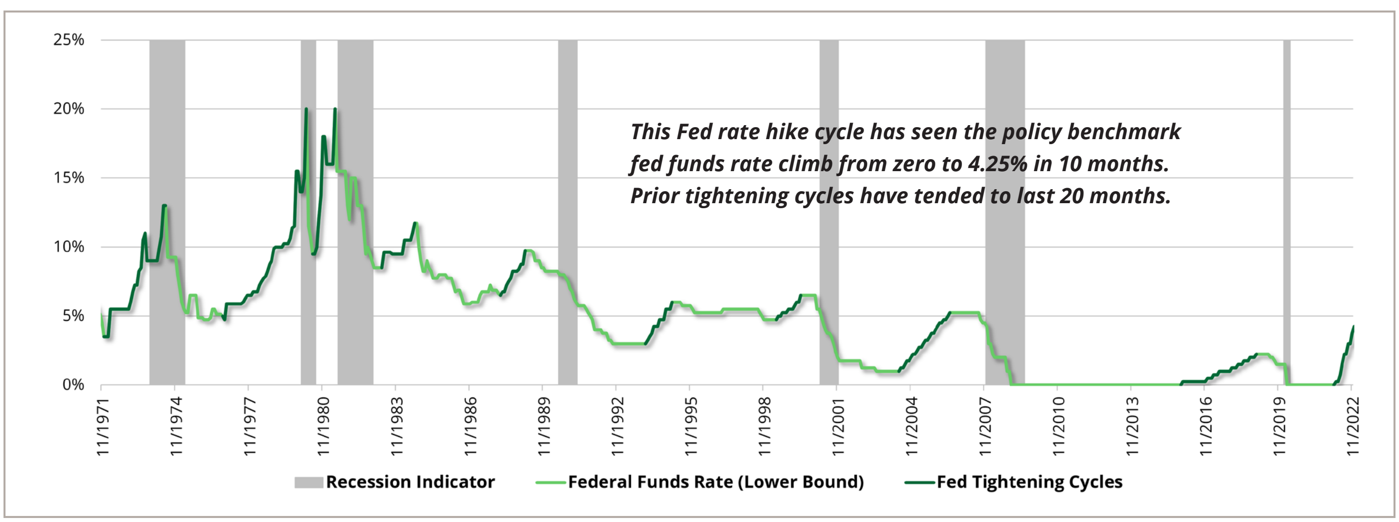


Source: Clearstead, Bloomberg LP, as of December 19, 2022, monthly data.

INFLATION AND THE FED

Arguably the most significant drivers of capital markets in 2022, inflation and interest rates enter the year at levels not seen in years. After raising the Fed's policy rate by 4.25% in 2022 alone (Figure 3), markets are priced for another couple of quarter point rate hikes with an eventual terminal rate of 5.00% (a terminal rate near here would be consistent with prior Fed Fund peaks in the last thirty years). Further, futures markets are looking for the Fed to begin easing interest rates at some point near the middle of 2023. We believe markets may simply have gotten this wrong. Markets are pricing a terminal rate (5.00%) which is below what the Fed has communicated as their best estimate of the terminal rate (5.25%). The Fed has further communicated its expectation to keep rates at that level for the remainder of 2023, while the markets have priced declines in interest rates given the consensus view of an impending recession.

FIGURE 3: FEDERAL RESERVE POLICY: AN AGGRESSIVE STANCE



Source: Clearstead, Bloomberg LP, WSJ, as of December 19, 2022.

We are less confident in that market view given the propensity for markets to misjudge policy—the market might be ahead of itself, either in the timing or magnitude of a change in policy. The Fed has repeated that rates will remain higher for longer. Until sufficient slack is witnessed in the labor market and until financial conditions tighten further (neither of which are anywhere near forthcoming or where the Fed would like them to be), we do not see why the Fed would reverse course from the current policy stance. So, we think it is better to assume a longer drawn-out monetary policy process, that which includes 50-75bps of additional tightening and then holding at a near 5.25% policy interest rate for part of the first half of the year, followed by increasing use of forward guidance to begin to convey to markets the likely forward path of rates for the final portion of 2023 and into 2024. Bear in mind that the Fed plans to continue to shrink its balance sheet—so called quantitative tightening—that will tighten monetary conditions in 2023, likely keeping upward pressure on the 10-Year U.S. Treasury yield.

Geopolitics – 2023 Wildcards

Russo-Ukrainian War – the war in Ukraine will probably persist throughout this Winter, and Spring, and could grind on throughout 2023. Russian President Vladimir Putin has prepared Russian society for a long, drawn-out war, largely pushing a narrative that NATO, in its efforts to expand to Russia's doorstep, was the aggressor and forced Moscow's hand to blunt NATO's neo-imperialism and protect Russian minorities living in Ukraine. New Russian recruits are being readied and a late Winter/early-Spring offensive is likely in the works. Ukraine is being supplied by the West with technology, basic supplies and munitions, and training support. The Ukrainian Army has been effective in reversing Russian gains in large portions of the country, but what remains in Russia's hands is more fortified and will likely be harder to regain—barring significant Russian missteps. Meanwhile, Russia is hoping the European and American solidarity with Ukraine will erode over the course of a cold 2022-2023 winter.

- While the probability of a lasting ceasefire and peace talks seems low at the outset of 2023, such a development would ease energy and grain prices and provide a tailwind to European economic prospects.

China-Taiwanese Situation – tension around Chinese efforts to re-assert its sovereignty over Taiwan have simmered for years, but many see the coming years as particularly difficult for Taiwan as Chinese President Xi Jinping—elected to an unprecedented third, five-year term—has vowed to make Taiwan's reunification with China a key priority. However, China seems willing to play a long-game here and to gradually pressure—or incentivize—Taiwan to seek a two-systems, one-country arrangement that will recognize Beijing's ultimate authority over the island. In that vein, Beijing has sought US assurance it will not encourage Taipei to seek an independence vote, but rather reiterate and re-affirm its one-China policy.

- A near-term military move by China on Taiwan seems unlikely, but such an outcome would tank global markets, disrupt global supply chains, and potentially bring the US and China into direct conflict.

North-South Korea Conflict – talks to denuclearize the Koran peninsula are dead and North Korea's economy has continued to deteriorate in the face of sporadic COVID outbreaks and slowing global growth. As a result, the North Korean regime has heightened the tension by testing new, and more powerful ballistic missiles. Furthermore, there are subtle shifts suggesting Pyongyang's emphasis is increasingly on aligning itself with China and Russia and refusing to engage or negotiate with Seoul or Western nations about a lasting peace in the region.

- North Korea may conduct its first nuclear weapons test since 2017 this year that will likely garner widespread condemnation in the West. But Pyongyang has refused to condemn Russia's attack on Ukraine and will likely receive diplomatic support from Moscow. The prospect of more brinkmanship by North Korea is likely in the cards for 2023.

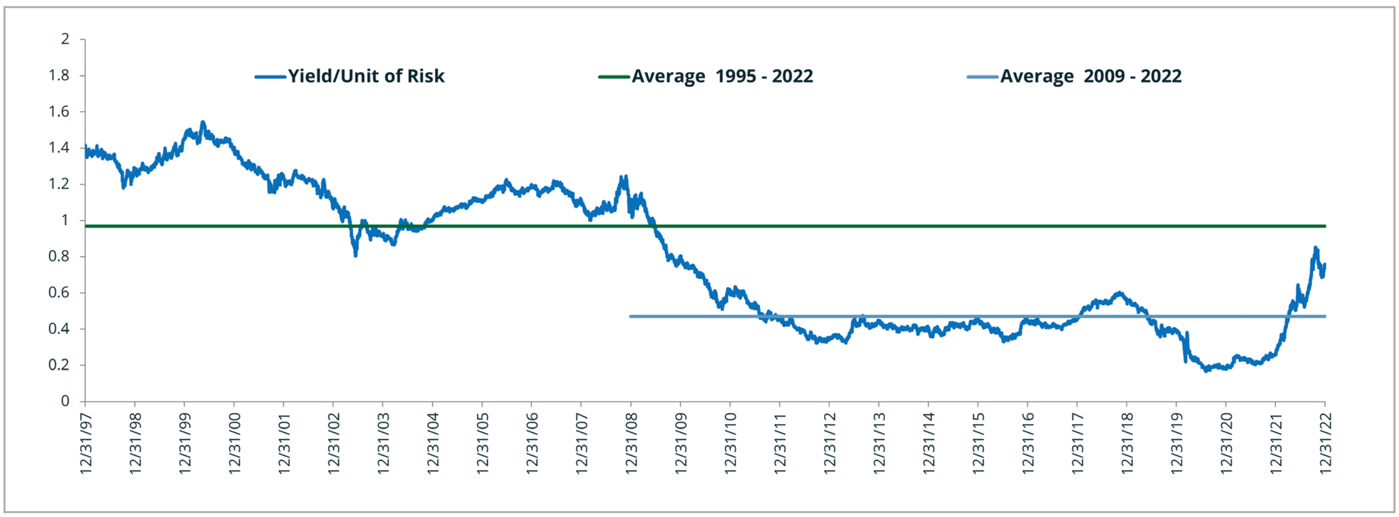
Iranian Anti-Regime Protests – widespread protests encompassing Iranian society—workers, students, Iranian youth, minority groups, and women of all ages—have been protesting across large and small cities for months. The protests were sparked by Iranian authority's detention of a young woman for violating the dress code who subsequently died in police custody. Her death prompted protests, and Iranian authorities, after initially waiting to see if the protests would fizzle out, have chosen to crack-down on instigators and instigating further anti-regime protests. Countless arrests have been made in recent weeks, and several executions have taken place. As the regime stifles dissent at home, it has abandoned attempts to revive its nuclear deal with the West, which paves the way for it to further enrich uranium and take the final necessary steps towards building a nuclear weapon.

- The traditional Iranian playbook would call for changing the narrative from attempts to quash domestic protests towards a crisis or conflict—real or manufactured—with its Arab or Israeli neighbors. Meanwhile a push by Tehran towards nuclear weapons could well spur Israel to confront Iran in 2023.

FIXED INCOME MARKETS

The Bloomberg Aggregate Bond Index experienced its second consecutive negative year in 2022 (Bloomberg Aggregate Index -13%), the first back-to-back yearly losses for the index.[1] But as a result, we are finally presented with a better starting point for bond market investors. However, before getting too comfortable, we would caution that risks remain. Some negative risk/reward asymmetry has been removed given the ascent of interest rates since reaching near zero in 2020. That said, the interest rate sensitivity (modified duration) of bonds remains high. This is particularly relevant when interest rate sensitivity is related to the yield of the bond index. This ratio (Yield-to-Worst versus Modified Duration—see Figure 4) offers reasonable return per unit of risk perspective that, while better, is tough to call a screaming buy.

FIGURE 4: YIELD-TO-WORST VERSUS MODIFIED DURATION



Source: Clearstead, Bloomberg LP, Data as 9/30/2022. Past performance is not an indicator of future results.

Bond markets are no longer relegated to the sort of bad math that plagued them during 2021 and 2022, where negative returns were all but assured—thanks to low beginning yields and long durations. But investors should not hold out for the bond bull market years of two decades ago. What seems more reasonable is very low single digit type positive returns from investment grade bond markets, understanding that even a modest rise in rates—the 10-Yr U.S. treasury rising an additional 1.0%—will likely lead to a third negative year for the Aggregate Bond Index. So, bond markets have a better starting point, but the risk-return dynamic remains modest at best.

As a result, we continue to favor a lower relative duration position in fixed income with a relative overweight to credit. We are still inclined to favor credit, particularly high yield credit, as we do not view looming recession as posing an outsized risk for high yield issuers. The quality of high yield has changed substantively from a decade ago and we believe should keep default rates lower than otherwise expected by history.

Top 5 Potential Market Surprises

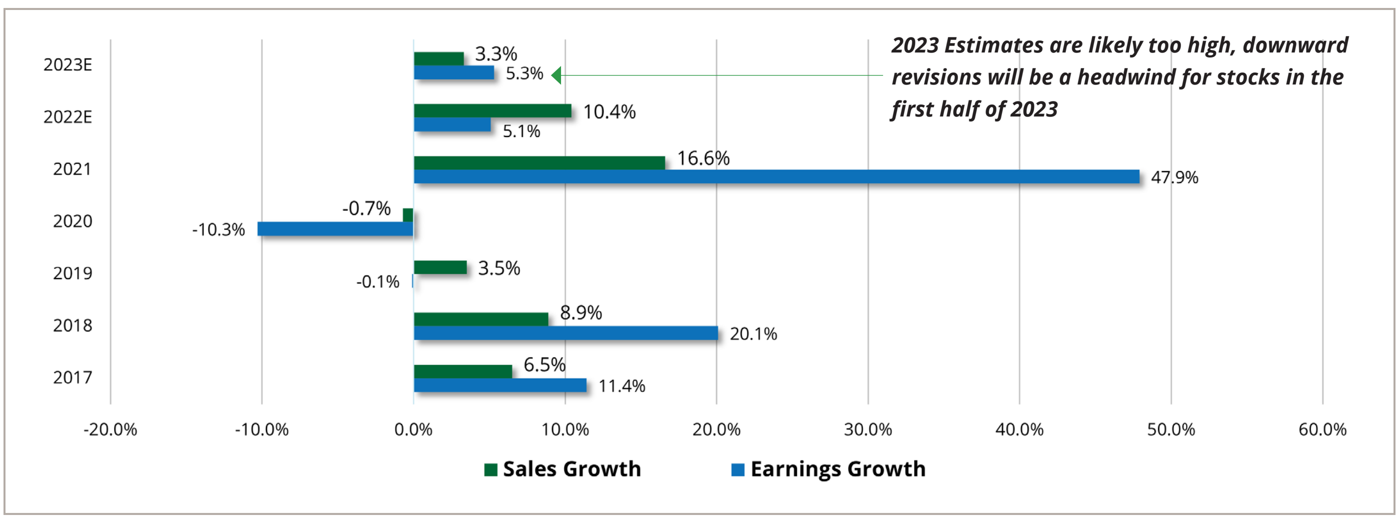
We asked our colleague and industry veteran Jim Awad for his top five surprises that may shake or shape, 2023. Jim's over 50 years of market experience are called upon frequently in our research of markets and economics. He frequents television and radio as a guest and is a long-standing member of an investors group now hosted by private equity giant Blackstone.

1. The Fed raises rates 25bps but then stops to study the cumulative effects of rate increases
2. The economy powers through with growth, remaining marginally positive due to resilient consumer spending
3. Defying expectations for a decline, profits grow over five percent and stocks appreciate 10% for the year
4. Russia grows tired of the war, which costs Putin his job (life)
5. Both Biden and Trump decide not to run in 2024, allowing a reset in both parties

EQUITY MARKETS

Stocks begin 2023 on better valuation footing than prior years given that most of the declines in broad based stock markets in 2022 were based on P/E valuation contraction. That is good news for long-term investors (for whom valuations tend to matter more). Unfortunately, in the near term we are observing converging risk factors for stock market investors, centered on lofty earnings expectations combined with 'at-risk' near peak profit margins. Wall Street expectations for earnings for calendar year 2023 still appear lofty with a +5.3% year-over-year earnings growth rate expectation. That number (Figure 5) is almost assuredly too high as margin pressures are likely to weigh on corporate earnings in the first half of the year.

FIGURE 5: S&P 500 EARNINGS AND SALES GROWTH (YEAR-OVER-YEAR)



Source: Clearstead, Factset Earnings Insight, December 15, 2022.

We are left with a baseline expectation for equity investors where, absent P/E multiple expansion, returns are likely to be less than stellar—a zero return (plus or minus 5%) and accompanied by more than usual volatility by year end 2023 would be a win.

That said, pockets of opportunity are availing themselves. Value-oriented strategies (specifically dividend strategies) look poised to perform well again, given the uncertain economic backdrop. Otherwise, 2023 is likely to be a year where income as a percent of total return is expected to be higher than usual.

Additionally, the US dollar's breakneck rally is likely to end as the Fed closes in on pausing, while other central banks are likely to keep policy in tightening mode. The net effect of a policy regime change like this could lead to a reversal in the dollar's recent momentum, boosting developed international and emerging market stock markets. This is not a highly convicted statement, though we do think there is some non-trivial likelihood of this happening. Clearly, China's reopening process and general progression away from its zero-COVID policies are likely to contribute to emerging markets in 2023 as well.

PRIVATE MARKETS

Overall, private assets played a stabilizing role in investment portfolios in 2022, providing a much-needed diversification. It will take a couple of quarters to tally up the numbers, but as of 6/30/2022, Cambridge Associates US Private Equity Index was down 5.3% YTD.[1] Sheltered from daily volatility of public markets, private companies are facing the same challenges as their public cousins: shrinking profit margins caused by increased material, energy, and labor costs, weakening consumer demand, supply chain disruptions, and rapidly growing interest rates. Despite these challenges, we believe companies backed by the best private equity and venture capital firms should continue to benefit from quick and decisive active ownership and additional resources that public shareholders cannot provide.

As valuations are coming down from the peaks and more restructuring transactions become available, we expect the next couple of years to be a great buying opportunity for private investors and encourage our clients to maintain allocations to private markets. We also believe the pace of realizations to remain subdued, highlighting the importance of maintaining sufficient liquidity in portfolios.

CONCLUDING THOUGHTS

2022 was a year where assets geared to cash flow certainty and less to rising interest rates fared best. In bonds, that would have been short duration strategies while, in stocks, that would have been dividend-based strategies. There is a good chance that 2023 will reward the same asset classes given the continued economic uncertainty, at least in the first half of the year. In the scheme of things, investors should be pleased at no longer having to contemplate the Fed's zero interest rate bound as financial market normalization away from zero interest rates continues. The distortions created by zero interest rate policies, and the now subsequent unwinding, are likely to lead to increased volatility in most publicly traded markets. If you can look through the calendar year's noise, the long-term set up is much more attractive today than it has been in some time—that is exciting. It goes without saying, during times like this, it is critical to make sure your assets are appropriately allocated versus the liabilities and objectives they are meant to fund.

Lastly, we continue to work with clients in educating and presenting private market investing opportunities and employ those strategies across client portfolios, where appropriate, given our long-standing position that private markets may offer potentially better overall outcomes than public markets.

Source:
(1) Bloomberg.

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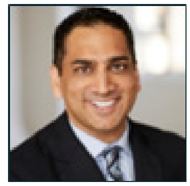

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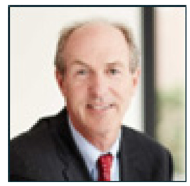

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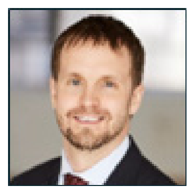

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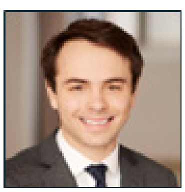

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MARKET BENCHMARK RETURNS

December 31, 2022		1M	3M	12M	YTD
US Large Cap	S&P 500	-5.8%	7.6%	-18.1%	-18.1%
US Small Cap	Russell 2000	-6.5%	6.2%	-20.4%	-20.4%
Developed Intl	MSCI EAFE	0.1%	17.3%	-14.5%	-14.5%
Emerging Intl	MSCI Em Mkt	-1.4%	9.7%	-20.1%	-20.1%
Real Estate	NAREIT	-5.1%	4.5%	-25.1%	-25.1%
Core Fixed	BarCap Agg	-0.5%	1.9%	-13.0%	-13.0%
Short Fixed	BarCap 1-3Yr	0.2%	0.9%	-3.7%	-3.7%
Long Fixed	BarCap LT G/C	-1.4%	2.6%	-27.1%	-27.1%
Corp Debt	BarCap Corp	-0.4%	3.4%	-15.3%	-15.3%

Source: Bloomberg

The performance data shown represents past performance. Past performance is not an indicator of future results. Current performance data may be lower or higher than the performance data presented.