

# Economic & Markets Overview

January 2023



Partnering with:



# ECONOMIC AND MARKETS OVERVIEW: EXECUTIVE SUMMARY

## Inflation

- Surprisingly strong and stubborn inflation was the key factor in 2022
- Year began at 7%, peaked in June at 9.1%, finished at 6.5%
- Path of inflation and its ripple effects will drive the markets again in 2023

## Fed Policy

- Got behind the curve and took aggressive action in 2022 with 7 hikes totaling 4.25%
- Powell has stated clearly Fed's determination, will err on side of overtightening
- Unwinding of Fed balance sheet (Quantitative Tightening) adds risk

## Economic Outlook

- Base case scenario is at least a mild recession
- Macro variables including supply chain issues, Ukraine war complicate matters

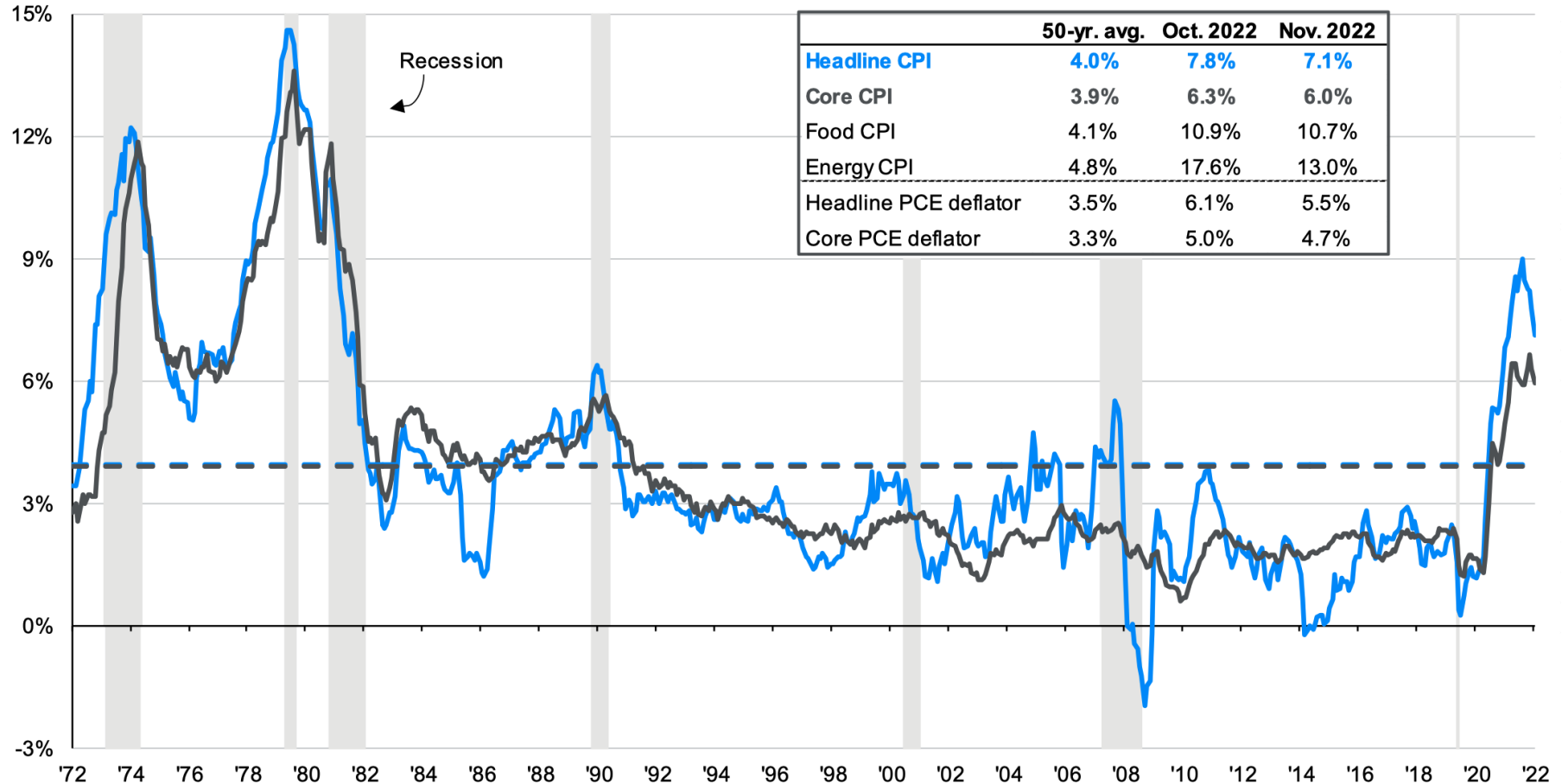
## Market Outlook

- Stock valuations not cheap but more reasonable
- Sector rotation into value, small cap and non-U.S. may be underway
- Bond yields offer compelling low-risk returns

# INFLATION IS KEY VARIABLE | DID NOT PROVE TRANSITORY

## CPI and core CPI

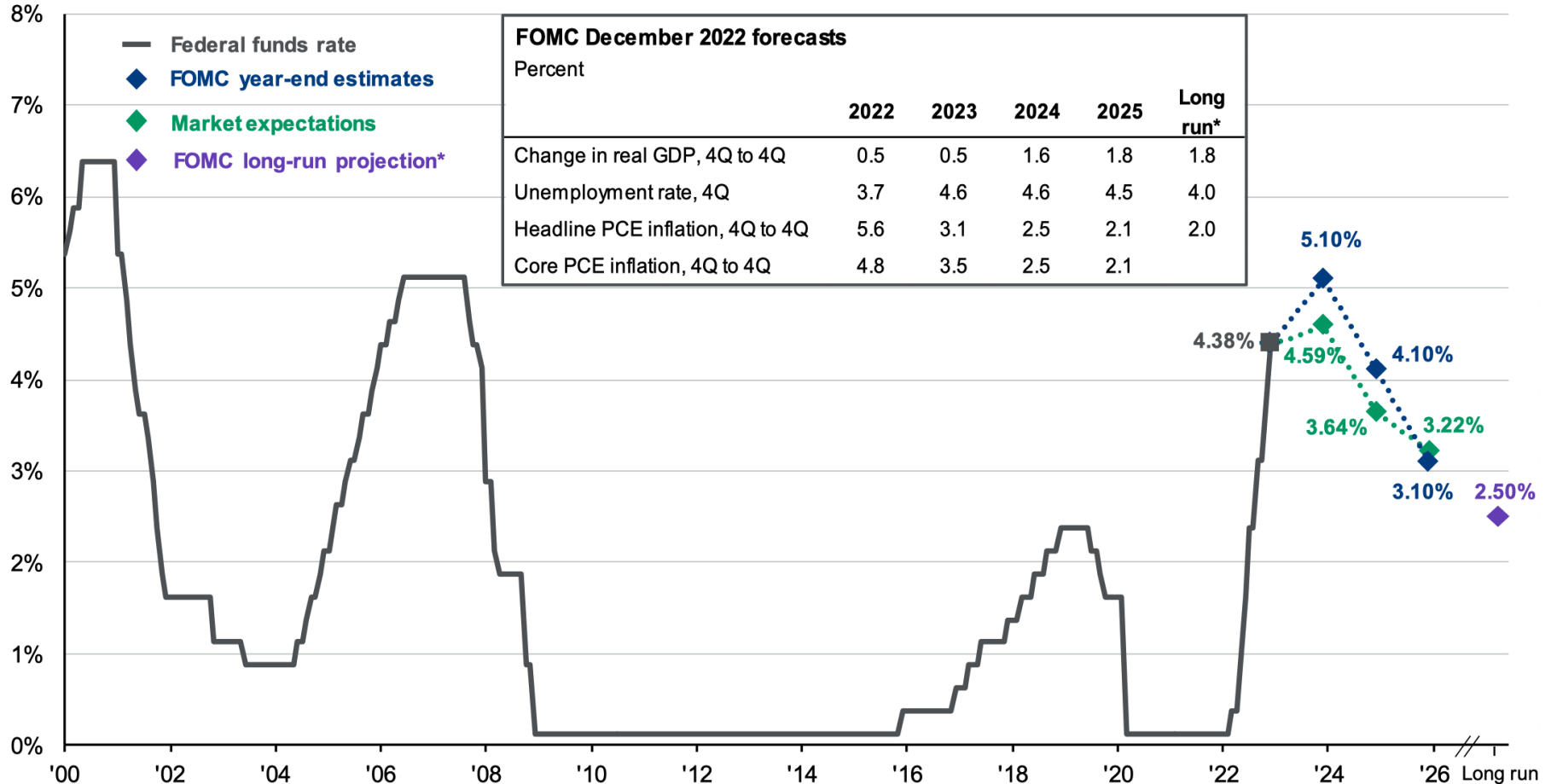
% change vs. prior year, seasonally adjusted



# FED NEEDS TO THREAD THE NEEDLE ON PACE OF TIGHTENING

## Federal funds rate expectations

FOMC and market expectations for the federal funds rate

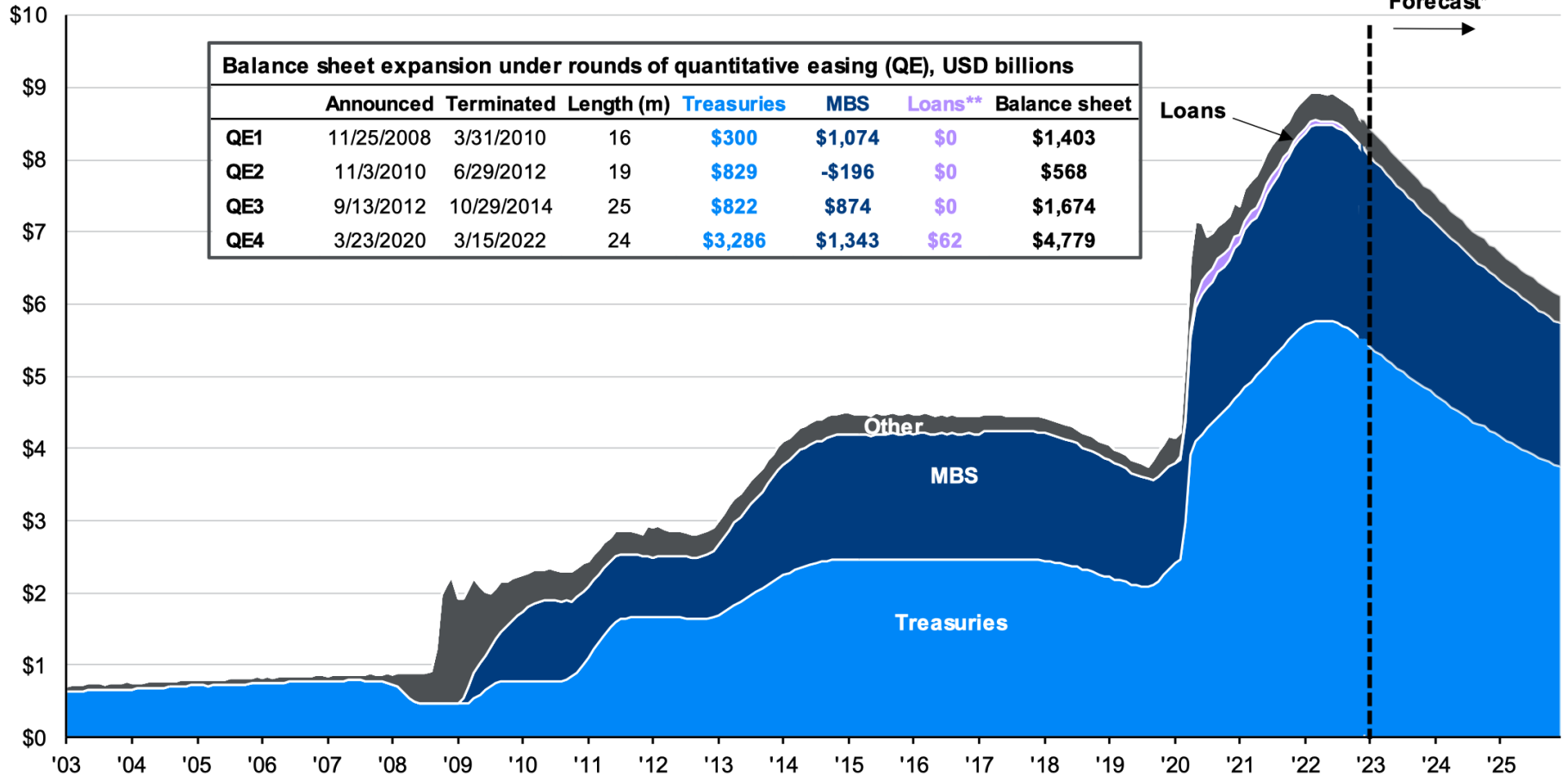


Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management. Market expectations are based off of the USD Overnight Index Forward Swap rates. \*Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated. Guide to the Markets – U.S. Data are as of December 31, 2022.

# THE UNWINDING OF QUANTITATIVE EASING ADDS RISK

## The Federal Reserve balance sheet

USD trillions



Source: FactSet, Federal Reserve, J.P. Morgan Investment Bank, J.P. Morgan Asset Management.

At its peak, the balance sheet contained \$5.8t in Treasuries and \$2.7tn in MBS. "Per the most recent Federal Reserve policy meeting, the forecast assumes the Federal serve began balance sheet runoff in June 2022. 4 From June to August, the committee allowed up to \$30bn in U.S. Treasury securities and \$17.5b in agency mortgage-backed securities to mature per month, with that pace doubling to \$60bn and \$35b, respectively, in September. Quide to the Markets - U.S. Data are as of December 31, 2022.

# THIS WILL BE THE MOST WIDELY EXPECTED RECESSION EVER!

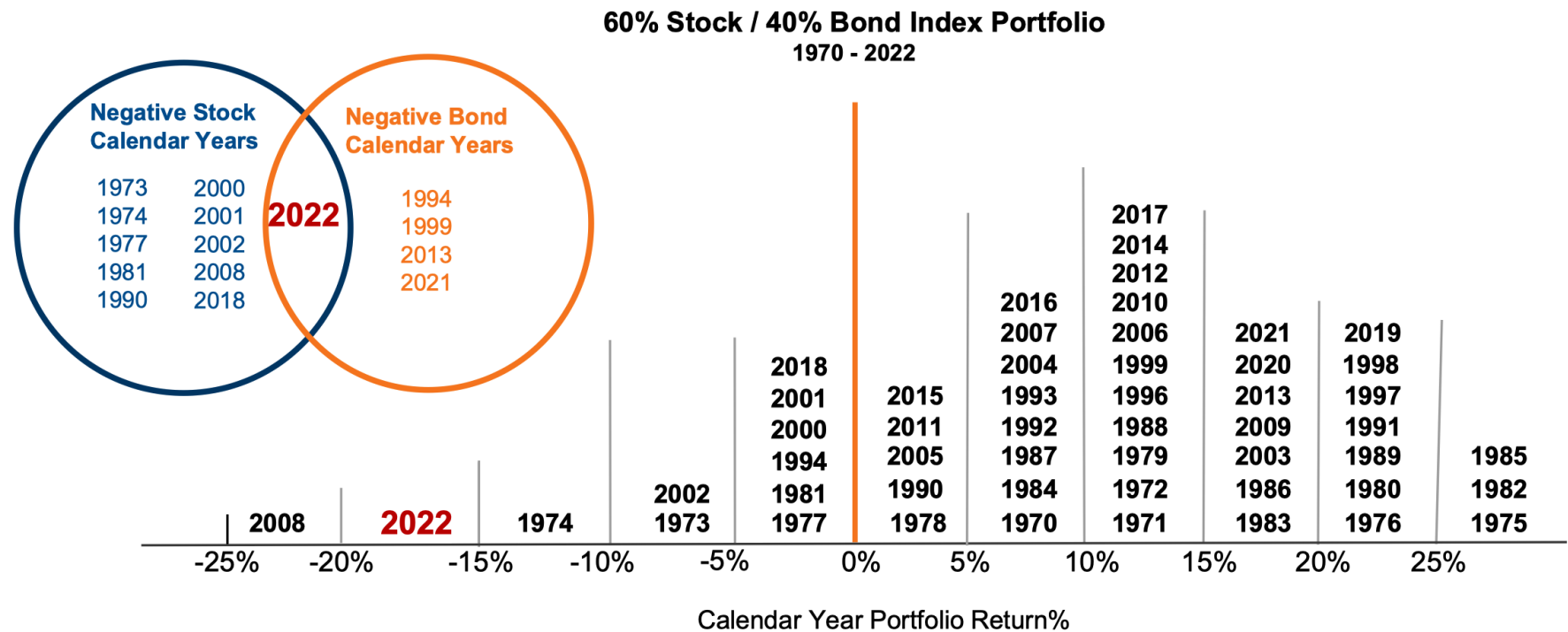
Survey of Professional Forecasters shows Elevated Risk of Recession



## MARKET RETURNS SUMMARY – DECEMBER 31, 2022

Equity Index	1 Week	MTD	1 Month	QTD	YTD	1 Year	3 Year	5 Year
Dow Jones Industrial Average	-0.2	-4.1	-4.1	16.0	-6.9	-6.9	7.3	8.3
S&P 500 Index	-0.1	-5.8	-5.8	7.6	-18.1	-18.1	7.6	9.4
Large Cap Stocks (Russell 1000)	-0.1	-5.8	-5.8	7.2	-19.1	-19.1	7.3	9.1
Growth	-0.3	-7.7	-7.7	2.2	-29.1	-29.1	7.8	10.9
Value	0.2	-4.0	-4.0	12.4	-7.5	-7.5	5.9	6.6
Small Cap Stocks (Russell 2000)	0.1	-6.5	-6.5	6.2	-20.4	-20.4	3.1	4.1
Growth	0.1	-6.4	-6.4	4.1	-26.4	-26.4	0.6	3.5
Value	0.0	-6.6	-6.6	8.4	-14.5	-14.5	4.7	4.1
MSCI All Country World Index	0.0	-3.9	-3.9	9.9	-18.0	-18.0	4.5	5.7
International Stocks (MSCI EAFE)	0.1	0.1	0.1	17.4	-14.0	-14.0	1.3	2.0
Growth	0.2	-1.1	-1.1	15.1	-22.7	-22.7	0.8	2.8
Value	0.0	1.3	1.3	19.7	-4.9	-4.9	1.3	0.8
Emerging Markets Stocks (MSCI EM)	0.3	-1.4	-1.4	9.8	-19.7	-19.7	-2.3	-1.0
Fixed Income Index/ETF	1 Week	MTD	1 Month	QTD	YTD	1 Year	3 Year	5 Year
Barclays U.S. Aggregate Bond Index	-0.7	-0.5	-0.5	1.9	-13.0	-13.0	-2.7	0.0
iShares 1-3 Year Treasury Bond ETF	-0.2	0.1	0.1	0.7	-3.9	-3.9	-0.6	0.6
iShares 3-7 Year Treasury Bond ETF	-0.6	-0.6	-0.6	1.2	-9.5	-9.5	-1.9	0.2
iShares 20+ Year Treasury Bond ETF	-2.5	-2.6	-2.6	-1.9	-31.2	-31.2	-8.1	-2.7
iShares TIPS Bond ETF	-0.5	-1.3	-1.3	1.9	-12.2	-12.2	0.9	1.9
iShares National AMT-Free Municipal Bond ETF	-0.2	-0.3	-0.3	3.7	-7.3	-7.3	-0.5	1.2
SPDR Barclays Intermediate Term Corporate Bond ETF	-0.7	-0.3	-0.3	2.7	-9.7	-9.7	-1.3	1.0
SPDR Barclays High Yield Bond ETF	-1.1	-1.9	-1.9	4.8	-12.2	-12.2	-1.4	1.3
PowerShares Senior Loan ETF	-1.3	-0.4	-0.4	3.8	-2.5	-2.5	0.4	1.9
SPDR Barclays International Treasury Bond ETF	-0.1	-0.2	-0.2	8.2	-19.7	-19.7	-7.0	-3.6
iShares JPM USD Emerging Market Bond ETF	-0.7	-1.4	-1.4	8.4	-18.6	-18.6	-5.7	-1.7

## 2022 WAS AN HISTORICALLY BAD YEAR FOR DIVERSIFIED PORTFOLIOS

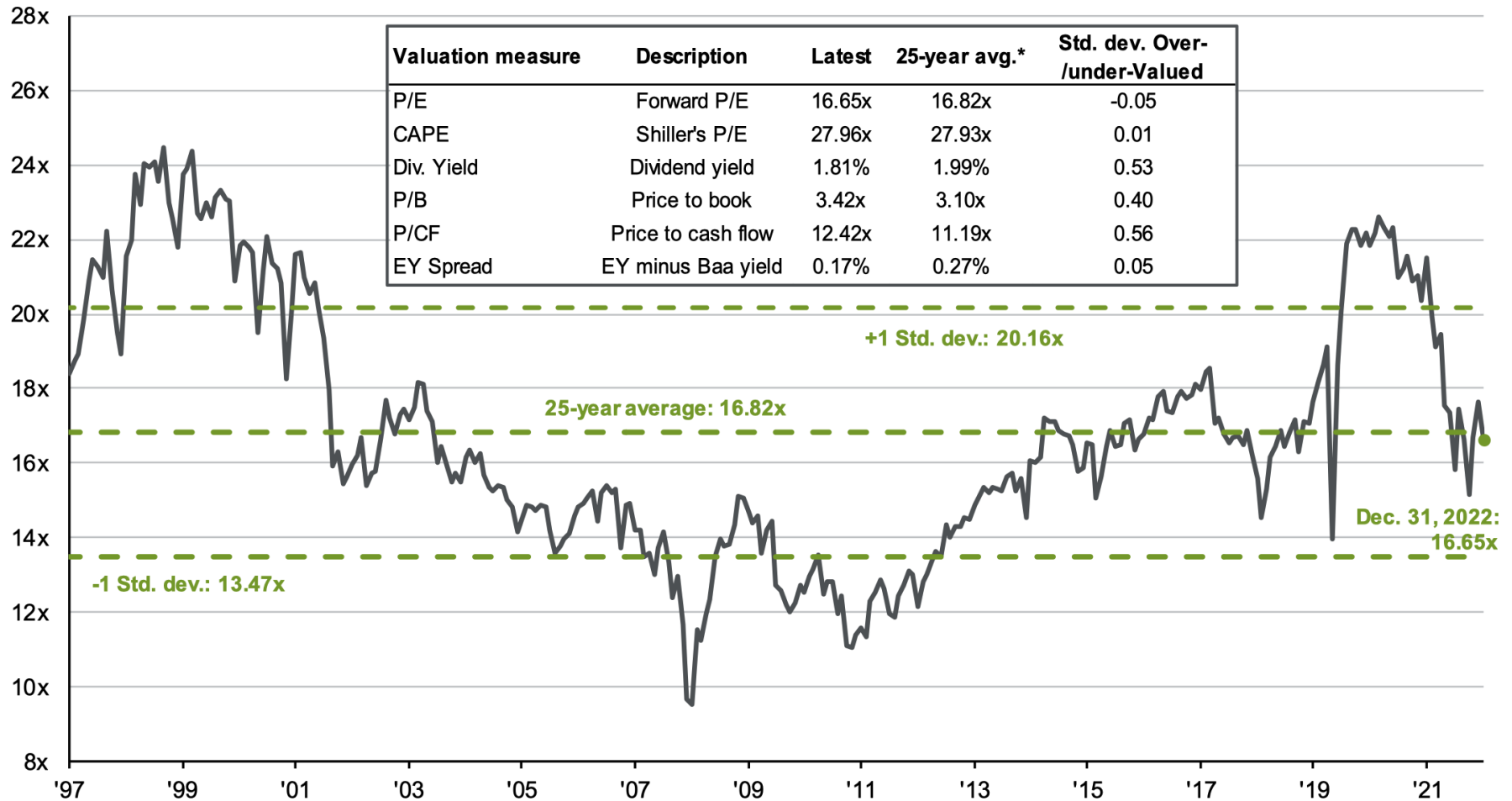


- Second worst year since 1970
- Both stocks and bonds posted negative returns



# STOCK VALUATIONS ARE REASONABLE, IF EARNINGS HOLD UP

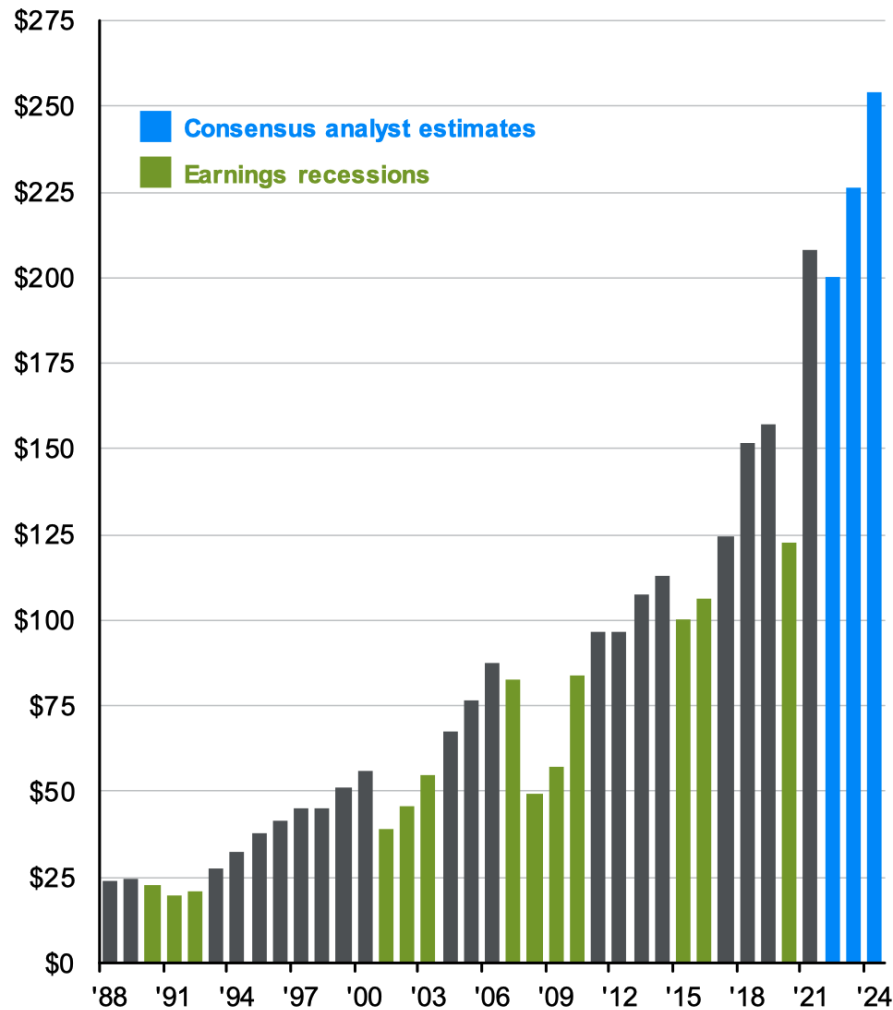
## S&P 500 Index: Forward P/E ratio



## EARNINGS ESTIMATES REMAIN UPBEAT, BUT RISK OF MISS IS HIGH

### S&P 500 earnings per share

Index annual operating earnings

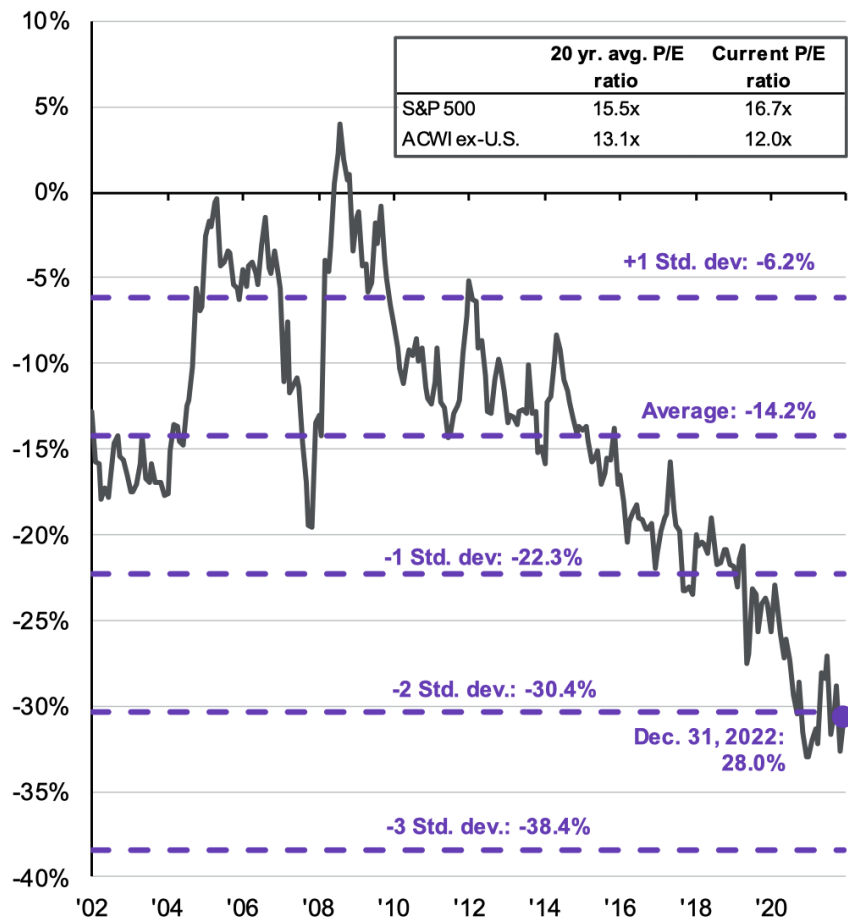


- 2023 Consensus Estimate is \$225
- Dispersion of estimates is almost 20% vs. non-recession norm of 3-4%

# INTERNATIONAL STOCKS REMAIN CHEAP DESPITE 4Q RALLY ON DOLLAR WEAKNESS

## International: Price-to-earnings discount vs. U.S.

MSCI AC World ex-U.S. vs. S&P 500 Indices, next 12 months



## International: Difference in dividend yields vs. U.S.

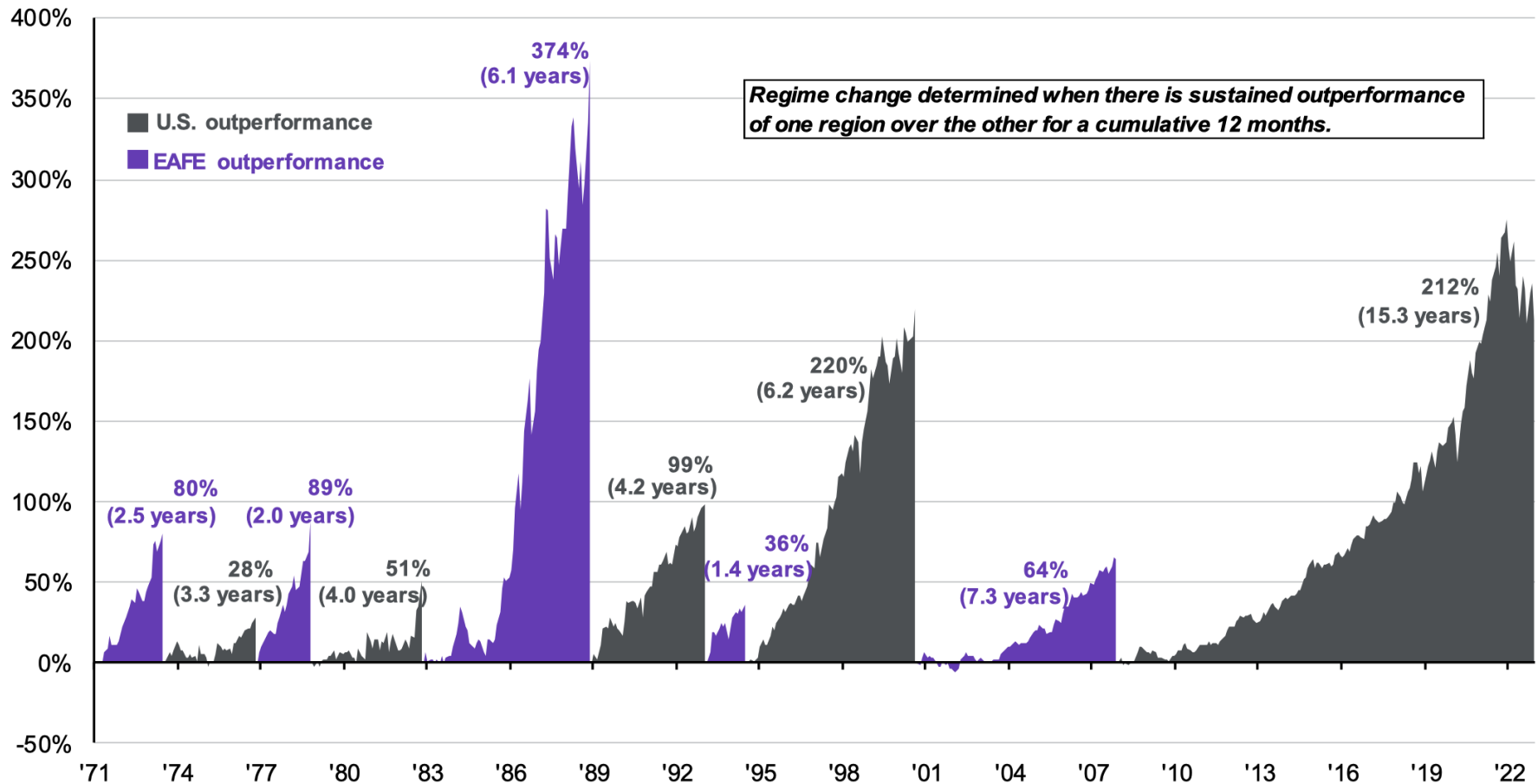
MSCI AC World ex-U.S. minus S&P 500 Indices, next 12 months



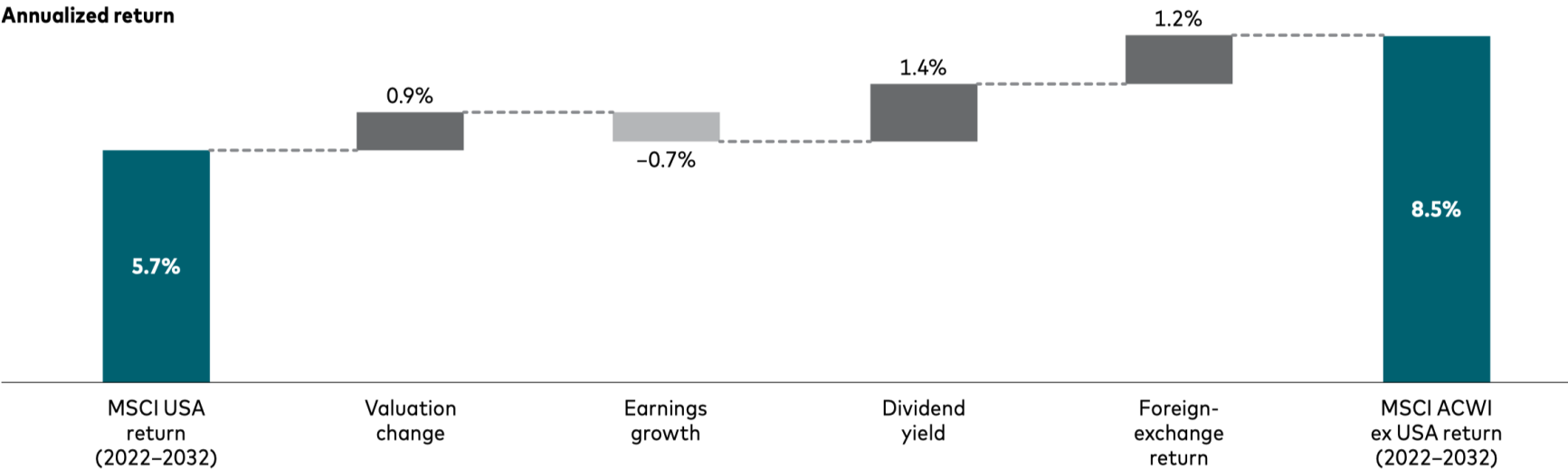
## CYCLES OF OUTPERFORMANCE BY GEOGRAPHY ARE LONG AND PRONOUNCED

### MSCI EAFE and MSCI USA relative performance

U.S. dollar, total return, cumulative outperformance\*

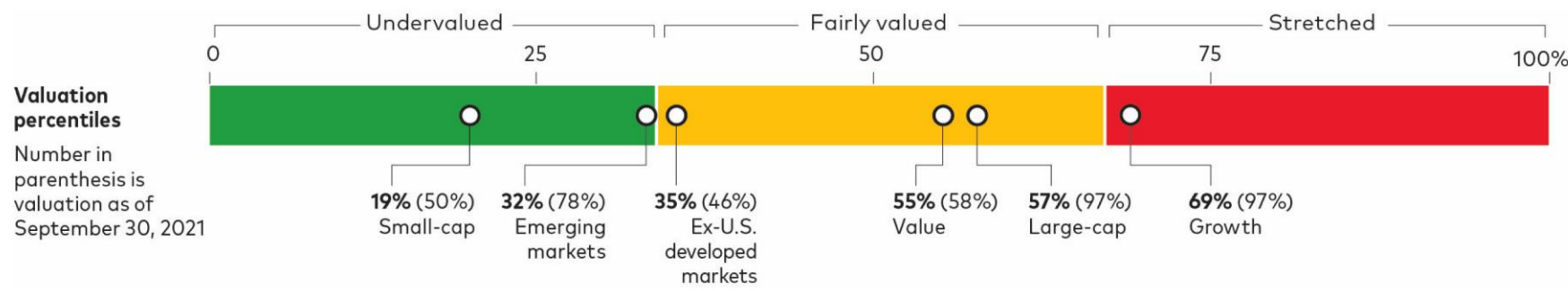


VALUATIONS, YIELD, AND LIKELIHOOD OF WEAKER DOLLAR SUPPORT INTERNATIONAL STOCK OUTLOOK



	Valuation change	Earnings growth	Dividend yield	Foreign-exchange return	Total return
MSCI USA Index	-1.18%	5.0%	1.9%	—	5.7%
MSCI ACWI ex USA Index	-0.27%	4.3%	3.3%	1.2%	8.5%

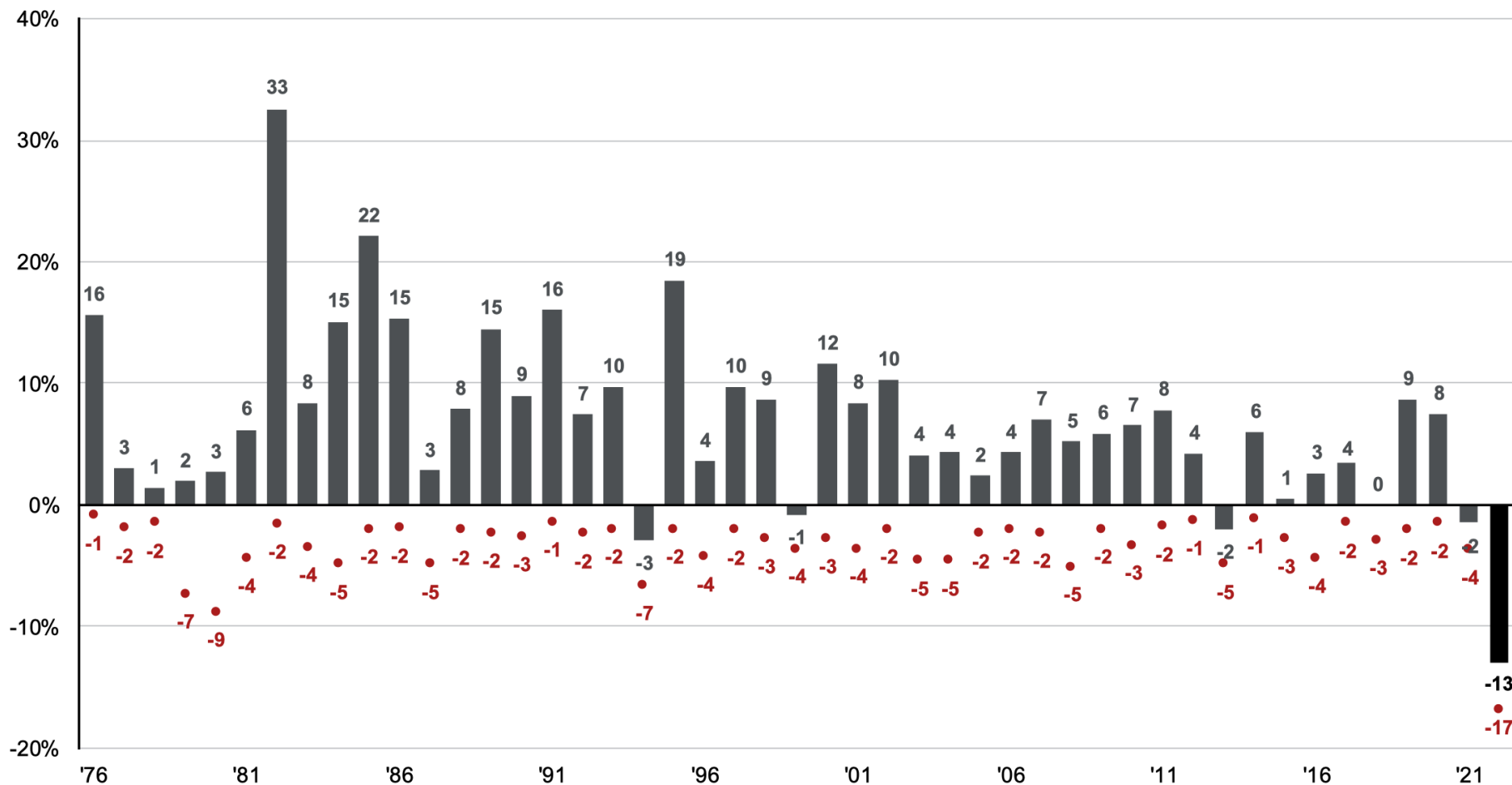
# ANOTHER LOOK AT RELATIVE VALUATIONS



## BONDS BROKE LONG STRING OF POSITIVE RETURNS IN 2022

### Bloomberg U.S. Aggregate intra-year declines vs. calendar year returns

Despite average intra-year drops of 3.3%, annual returns positive in 42 of 47 years



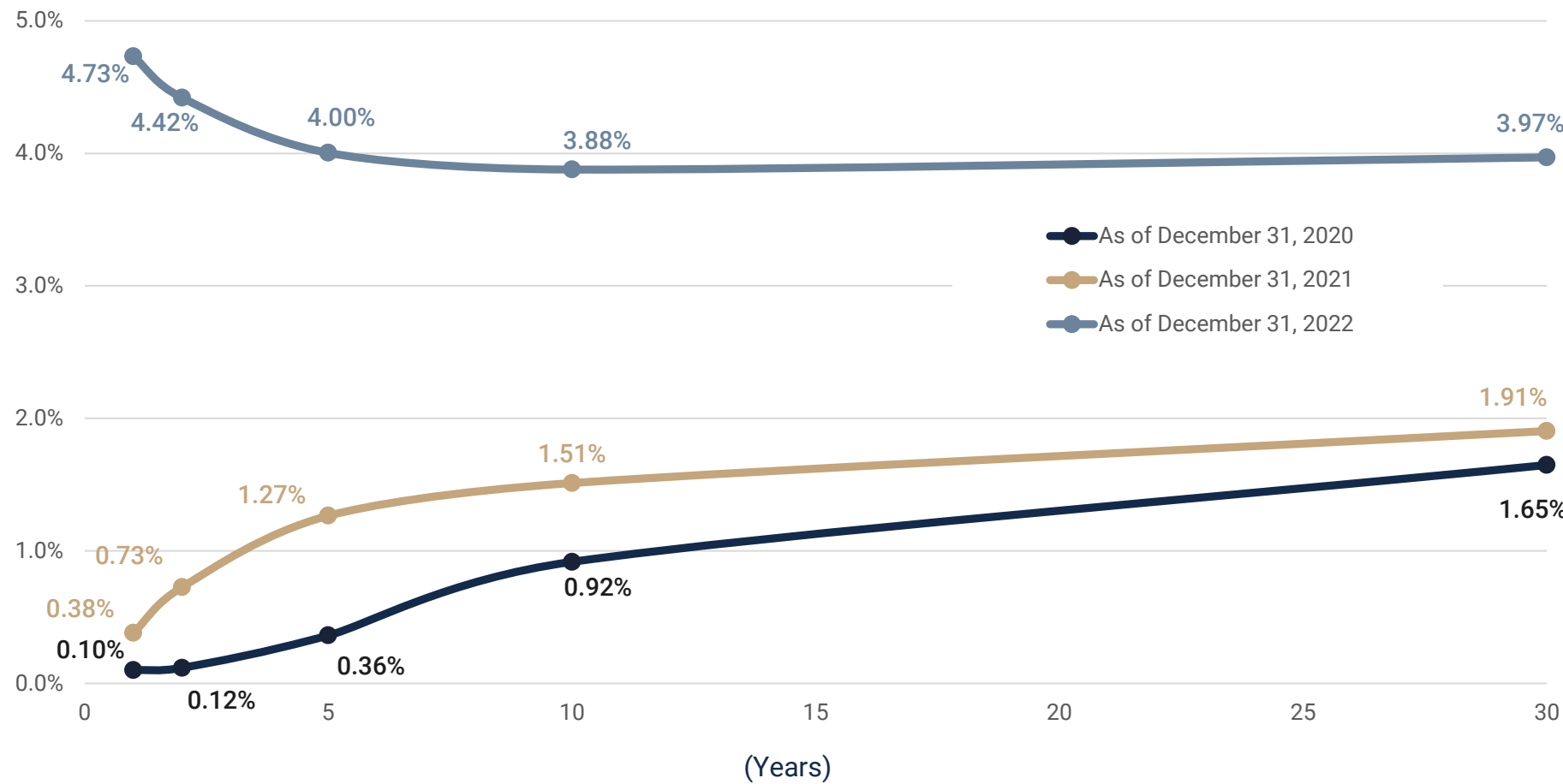
Source: Bloomberg, FactSet, J.P. Morgan Asset Management.

Returns are based on total return. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1976 to 2022, over which time period the average annual return was 6.6%. Returns from 1976 to 1989 are calculated on a monthly basis; daily data are used afterwards.

Guide to the Markets – U.S. Data are as of December 31, 2022.

# YIELD CURVE REVEALS GAP BETWEEN FED PERSPECTIVE AND MARKET VIEW OF ECONOMIC OUTLOOK

## U.S. Treasury Yield Curves

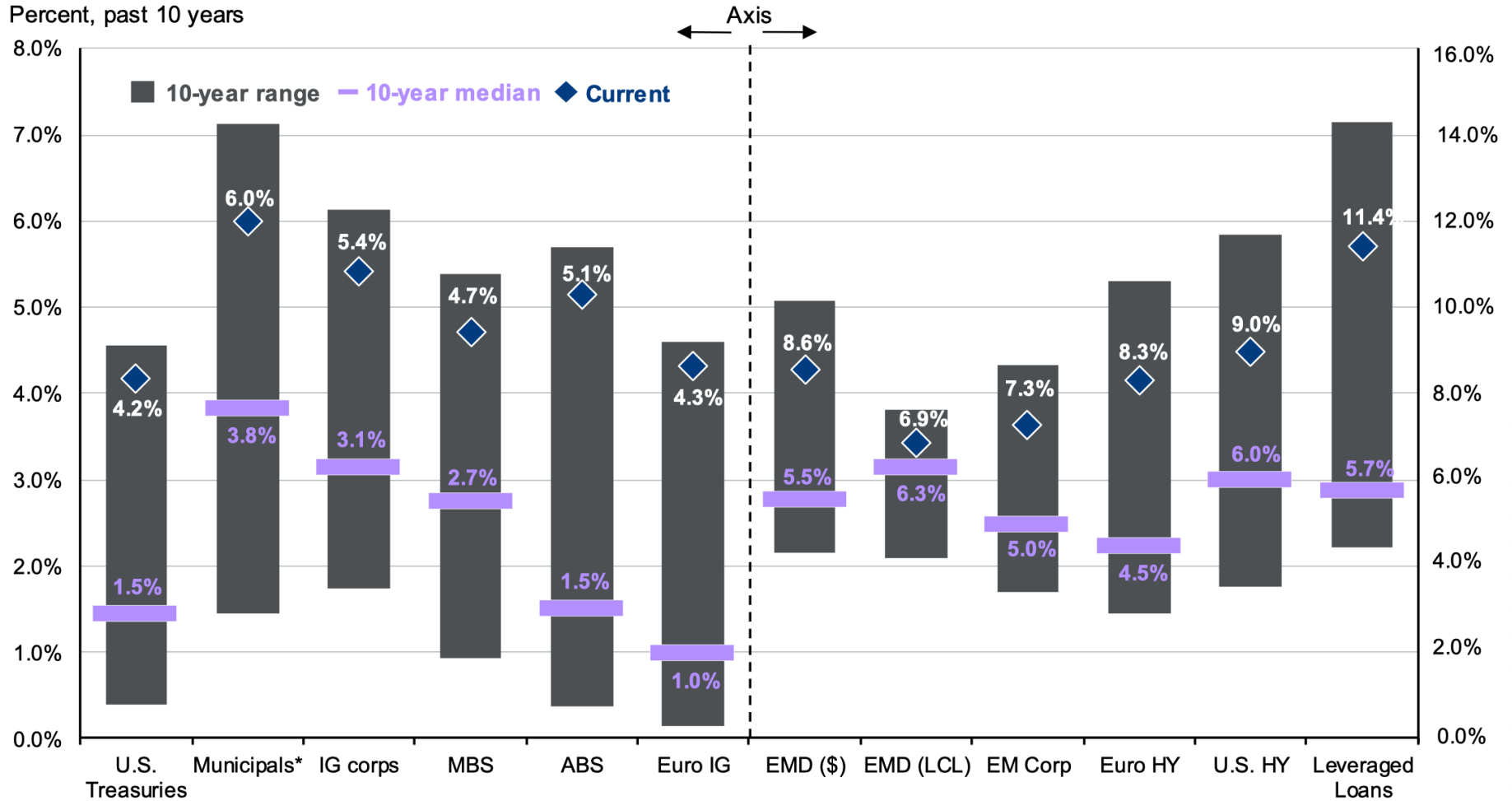




# IT'S A WHOLE NEW GAME IN FIXED INCOME

## Yield-to-worst across fixed income sectors

Percent, past 10 years



## SUMMARY – OUTLOOK IS STRAIGHTFORWARD BUT NOT SIMPLE

### **Markets will be unusually data dependent in 2023**

- Inflation
- Fed policy
- Economic growth
- Corporate Earnings

### **Maintaining neutral allocation weights**

- Both stocks and bonds are more attractive than a year ago
- Short-term bonds are particularly compelling
- Sector/factor tilts favor international, value, small cap

### **Keeping focus on the long run!**

# Notes & Disclosures

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Barclays US Aggregate Bond Index: Benchmark covering the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The index includes bonds from the Treasury, Government-Related, Corporate, MBS, ABS, and CMBS sectors.

Yield to Call is the yield of a bond or note if you were to buy and hold the security until the call date. This yield is valid only if the security is called prior to maturity.

Yield to Maturity is the rate of return anticipated on a bond if it is held until the maturity date.

During the period(s) shown, there were no material market or economic conditions which affected the results portrayed. With the exception of several market corrections during the period(s), the overall market as measured by the S&P 500 was generally rising. If such trends are broken, the clients may experience real capital losses in their managed accounts.

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Small company issues can be subject to increased volatility and considerable price fluctuations.

Commodities and futures generally are volatile and are not suitable for all investors. The value of commodity funds relate directly to the value of the futures contracts and other assets held within the fund and any fluctuation in the value of these assets could adversely affect an investment in commodities.

High yield bonds are rated in the lower rating categories by the various credit rating agencies, investors must take into account the special nature of such securities and certain special considerations in assessing the risk associated with such investments. Securities in the lower rating categories are subject to greater risk of loss of principal and interest than higher-rated securities and are generally considered to be predominantly speculative with respect to the issuer's capacity to pay interest and repay principal.

MSCI EAFE Index: A free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Index consists of the following 22 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

MSCI Emerging Markets Index: A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of the following 21 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

S&P 500 Index: The S&P 500 Index is a market capitalization-weighted index, including reinvestment of dividends and capital gains distributions that is generally considered representative of the U.S. stock market.

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