MONTH IN REVIEW

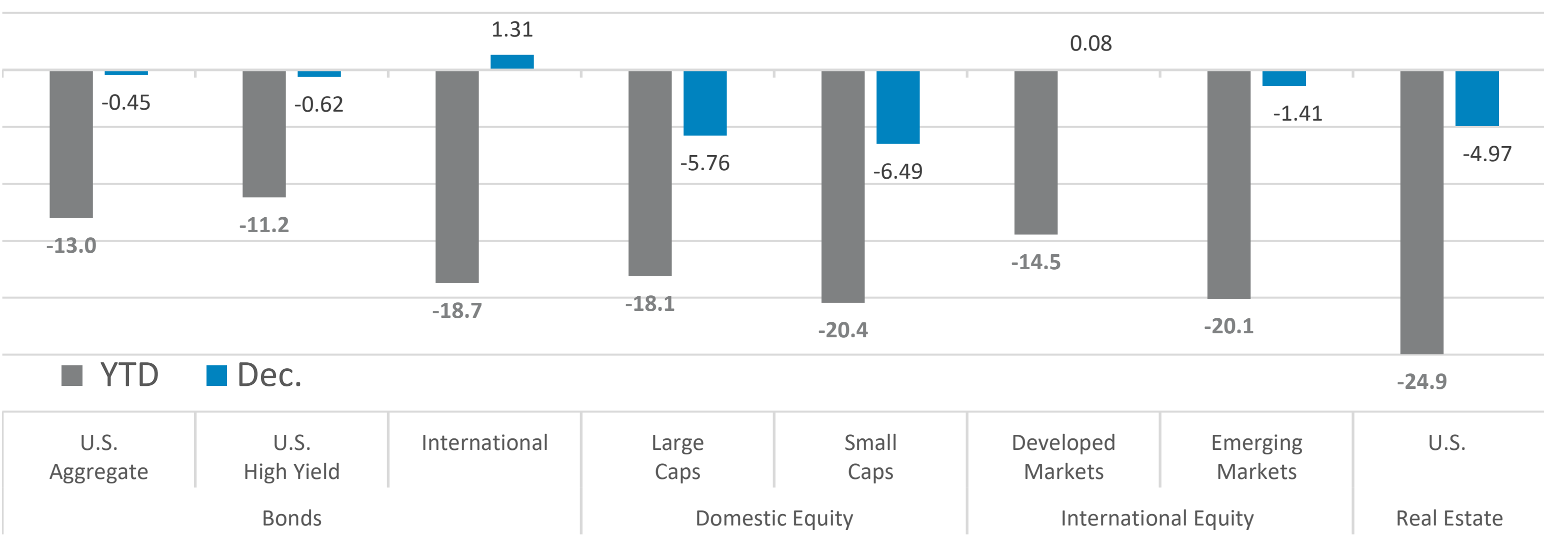
December 2022

Quick Takes

- **Risk Assets Stumble Into Year End.** Most risk assets declined for the final month of the year on the back of hawkish Fed speak, which locked in an abysmal double-digit decline for almost every asset class on the year to date returns for 2022.
- **Fed Moderates Rate Hike.** While the Fed still increased the upper bound of interest rates during their December meeting, the increase was 50bps as compared to the previous hikes of 75bps. Despite this moderation in hike, the language during the press conference and interviews afterwards was decisively hawkish.
- **Greenback Retreats for December.** The dollar ebbed and flowed against other major currencies for the month of December but overall retreated from its high for the month, which was achieved during the first half of the month. While
- **GDP, Labor Markets, and Inflation.** GDP for the third quarter of the year came in hotter than expected but most inflation metrics came in softer than expected despite labor markets maintaining their tightness. It appears that the Fed's tightening of financial conditions has started to affect the US economy as intended but the concerns surrounding a hard landing, i.e., a recession, is still top of mind.

Asset Class Performance

Most major asset classes declined for the month of December, except for Developed International Equities and International Bonds posting a modestly positive month, which locked in double-digit declines for most major asset classes. With 2022 ending, market participants have already shifted their focus to the new year.



Source: Bloomberg, as of December 31, 2021. Asset-class performance is presented by using total returns for an index proxy that best represents the respective broad asset class. U.S. Bonds (Barclays U.S. Aggregate Bond TR), U.S. High Yield (Barclays U.S. HY 2% Issuer-Capped TR), International Bonds (Barclays Global Aggregate ex USD TR), Large Caps (S&P 500 TR), Small Caps (Russell 2000 TR), Developed Markets (MSCI EAFE NR USD), Emerging Markets (MSCI EM NR USD), Real Estate (FTSE NAREIT All Equity REITS TR).

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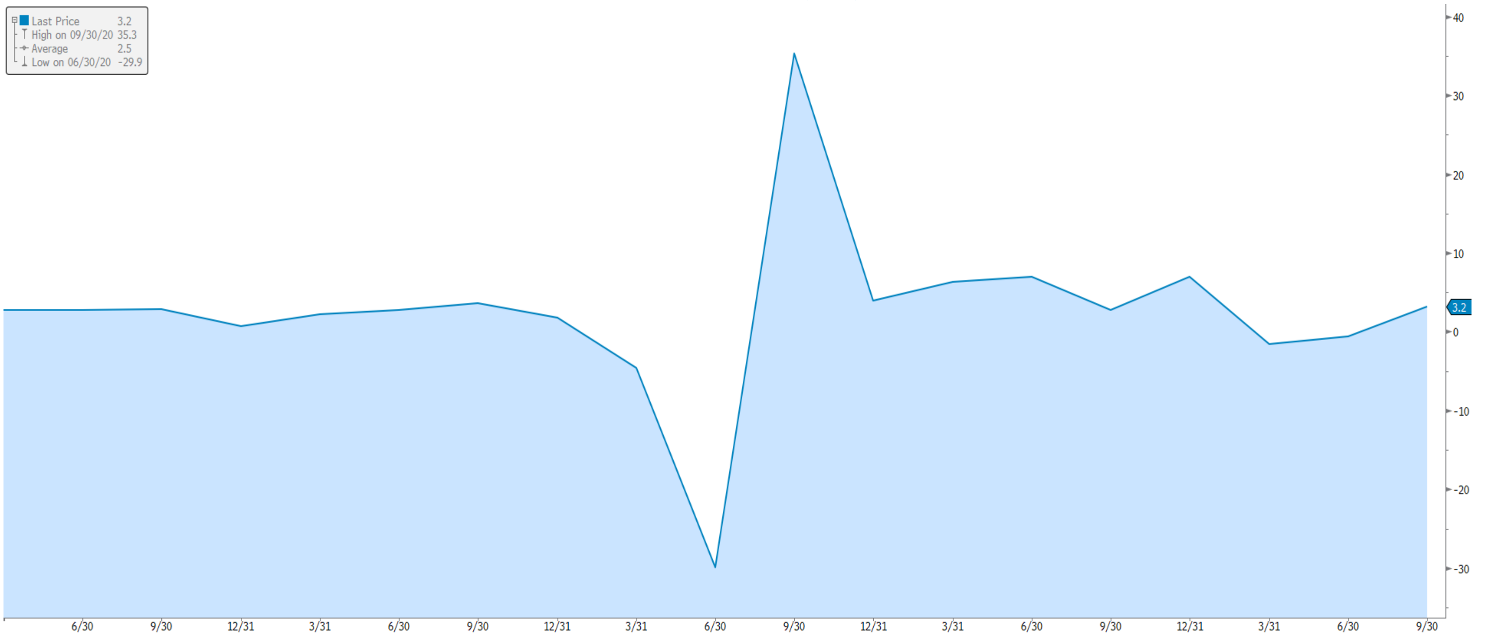
Markets & Macroeconomics

GDP Beats Expectations for the Third Quarter of the Year

GDP Lands Hotter Than Expected for the Third Quarter of 2022

US GDP QoQ



Source: Bureau of Economic Analysis, Bloomberg

Much to market participants' surprise, US GDP for the third quarter of 2022 come in above consensus expectations of +2.9%, landing at +3.2%. Additionally, Personal consumption, a component in GDP calculations, was revised quite a bit higher from the first reading estimate of +1.7% to +2.3%. This revision in consumer spending was mostly due to an upward revision on service spending. Despite the Fed's tightening actions during the year of 2022, consumers have not only weathered the storm relatively well but have also maintained a solid level of spending. This has helped to prop up the US Economy overall throughout the year. While consumers spending more on services may lead to some concerns on its impact to overall inflation levels, overall Personal Spending levels for November came in below expectations of +0.2%, at +0.1% on the month over month metric. Digging into the underlying components of Personal Spending, while service spending has remained robust, goods spending is starting to show some downward pressure. This is further illustrated with manufactures reporting contracting new orders over the past several months and thus has led to manufactures ordering less inventory/raw materials. Another area of soften demand as a result of the Fed's tightening actions has been the housing market. With mortgage rates skyrocketing over the year, this has led to a slackening housing market over the past several months. Putting everything together, it appears that the Fed is on the right track to successfully slow the economy, which should in turn help to exert downward pressure on inflation levels. As we have mentioned in previous editions, the Fed is attempting to thread the needle by slowing the economy, with the main goal of stifling runaway inflation, while keeping overall economic growth positive. The biggest obstacle for the Fed to overcome will be taking their foot off the gas of their tightening at the correct point in time to ensure that their policy does not become overly restrictive to businesses and consumers alike and send the US economy into a recession.

<u>Bottom Line</u>: GDP for the third quarter came in hotter than expected on the back of robust consumer spending, mostly attributable to consumer spending on services. Goods spending, manufacturing production and new orders have also been moderating as the Fed's tighter monetary policy has worked its way through the US economy, and this has begun to affect the housing market as well. It remains to be seen if the Fed will be able to thread the needle of taming inflation without sending the economy into a recession in the coming months.

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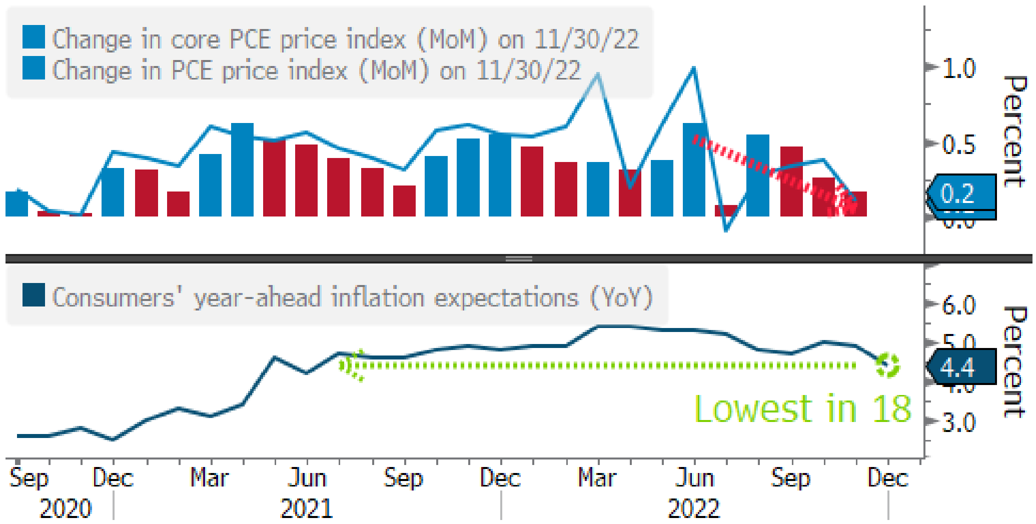
What's Ahead

Will the Fed Send the US Into a Recession in 2023?

Inflation Metric and Inflation Expectations Moderate

Change in PCE Price Index (Top) Consumers' Inflation Expectations (Bottom)



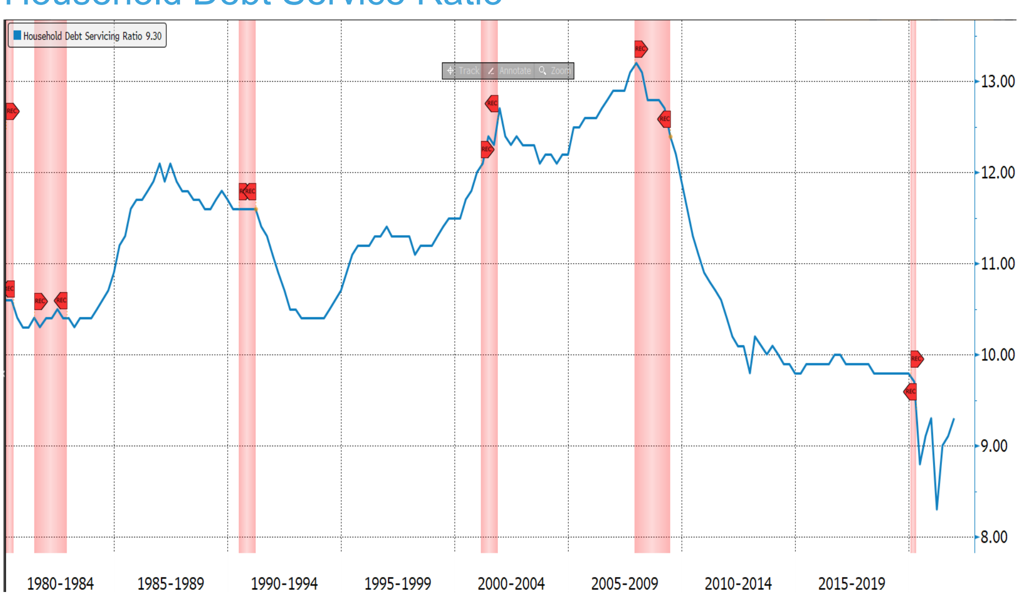
Source: Bureau of Economic Analysis, U. of Mich., Bloomberg

While the Fed spent the majority of 2022 tightening financial conditions in the United States via interest rate hikes and quantitative tightening, consumers' financial balance sheets remained in robust condition. As illustrated in the chart below, Household Debt Service Ratio increased for the year but remains at a four-decade low. The Fed's extremely accommodative actions during the initial onslaught of the global pandemic enabled consumers to strengthen their balance sheet via the direct stimulus payments as well as obtaining or refinancing debt obligations at rock bottom rates. This cushion created by the Fed has limited the impact of increasingly tighter financial conditions faced by the consumer and ultimately was a major driver for keeping the US economy afloat for the year. While the Fed has maintained that it will continue to tighten financial conditions into the new year, the relatively low impact that tighter financial conditions has had on consumers may help to soften the blow and achieve the "soft landing" that the Fed is so desperately chasing currently. While the consumer balance sheet should help to soften the blow of tighter financial conditions, employment and wage growth have been an area of concern for the Fed. With wage growth continuing to expand through the end of the year, Personal Income was up +0.4% for the month of November (source: Bureau of Economic Analysis), and labor markets remaining extremely tight, Unemployment Rate for the month of November was steady at 3.7% (source: Bureau of Labor Statistics), this concern will likely spill over into the new year. Despite these concerns, as illustrated in the chart above, it appears that the Fed's tighten actions have begun to exert downward pressure on inflation, as measured by the PCE price index, and maybe more importantly, Consumers' inflation expectations. These datapoints could reinforce that the consumer will prop up the US economy through the new year, especially since many public companies have announced cost cutting plans and labor force reductions. With wage expense becoming more expensive for these companies, it's possible that corporations may spend on capital expenditure to increase productivity rather than increase/maintain their labor force.

<u>Bottom Line</u>: Inflation metrics are showing signs of downward pressure as the Fed's tightening actions are working their way through the US economic system. The main concern is that the Fed will overtighten and send the US into a recession sometime in the new year, but the robust consumers' balance sheet combined with moderating inflation expectations may cushion the blow of tighter financial conditions despite corporations announcing cost cutting measures and labor force reduction plans.

Household Debt Service Ratio at Lowest in 40 Years

Household Debt Service Ratio



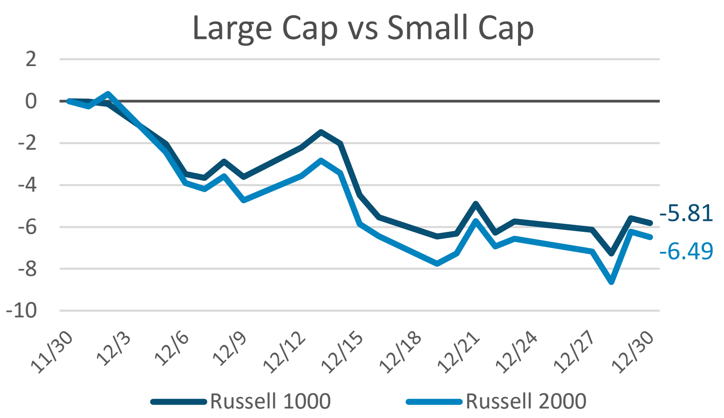
Source: Bureau of Economic Analysis, Bloomberg

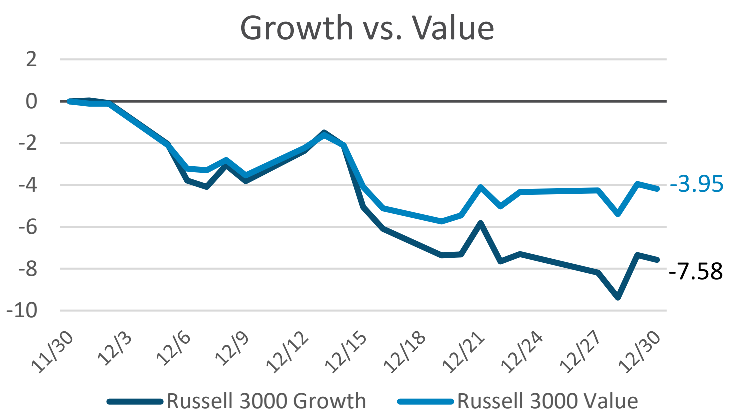
December 2022

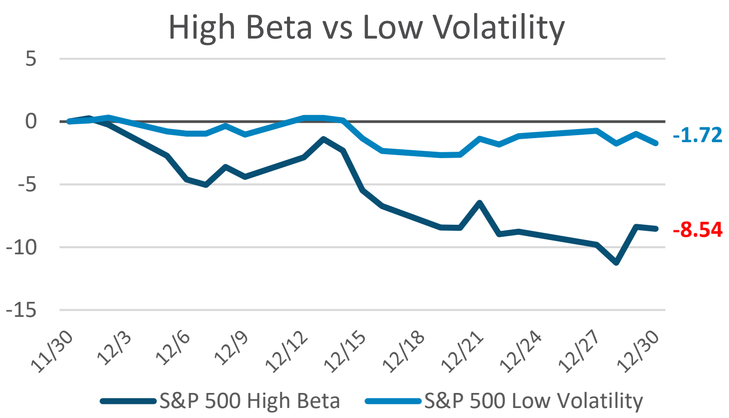
Equity Themes

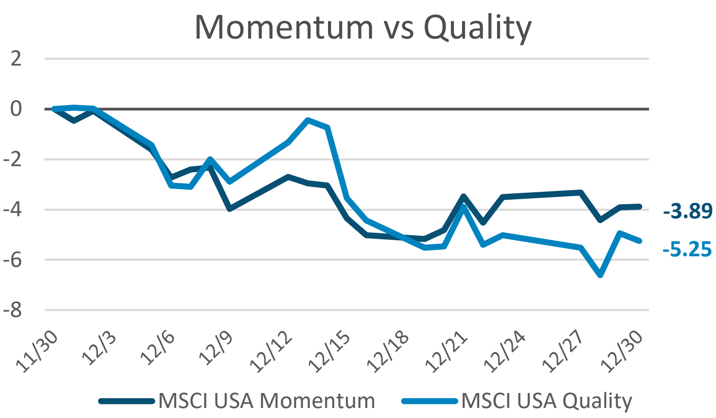
What Worked, What Didn't

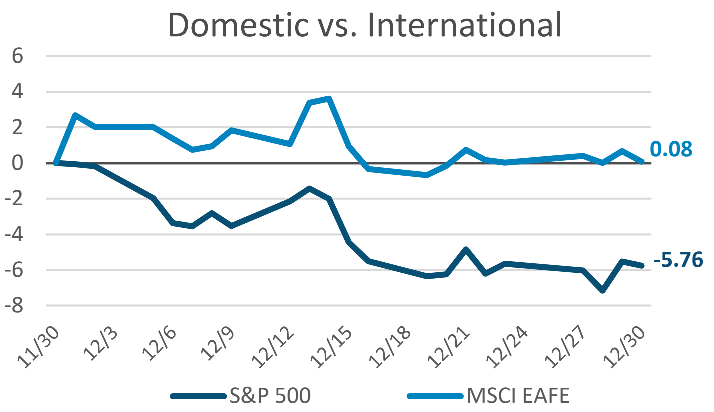
- **Large Over Small, Value Over Growth.** Large Cap Equities posted a decent margin of outperformance versus Small Cap Equities, but Value Style Equities candidly outperformed Growth Style Equities for the month of December.
- **Low Vol and Momentum Provide Downside Protection.** Low Vol Equities and Momentum Equities provided downside versus their respective High Beta and Quality Factor Equities for the final month of the year.
- **International Over Domestic, Developed Over Emerging.** Domestic equities underperformed International Developed markets by a relatively wide margin for the month of December and Emerging Markets faired better than Domestic Equities but lagged their Developed Markets peers.

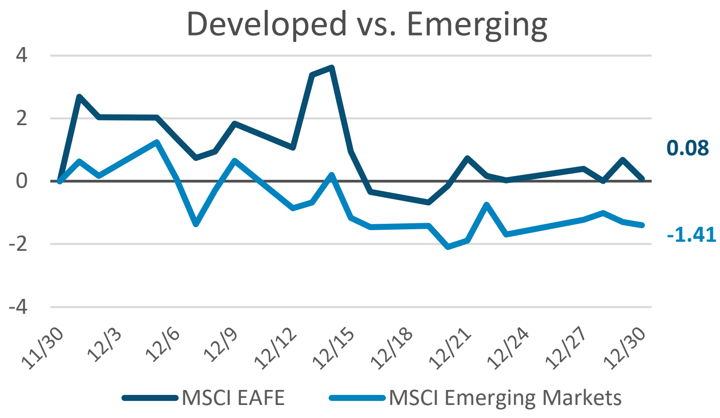












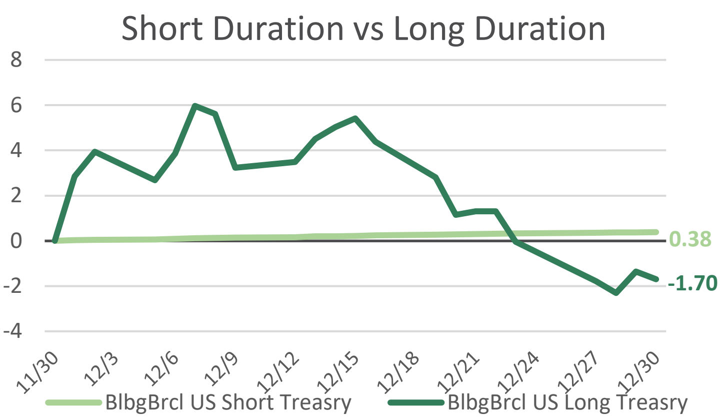
Source: Bloomberg.

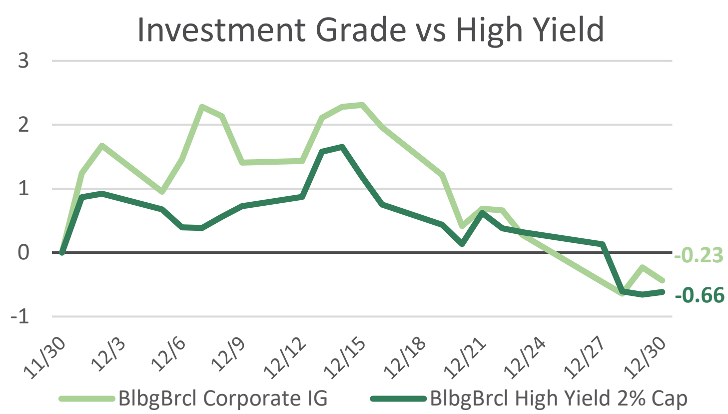
December 2022

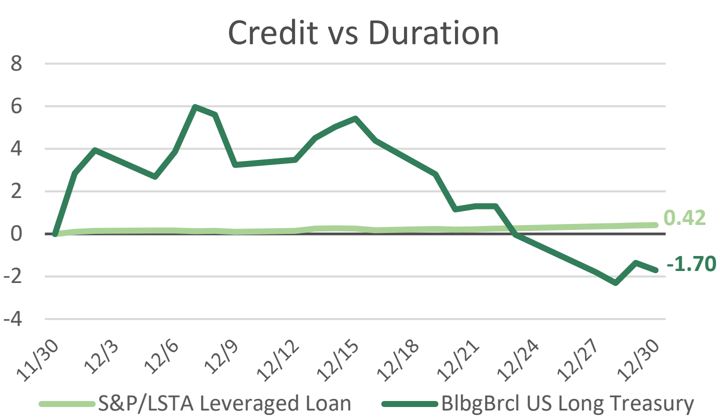
Bond Themes

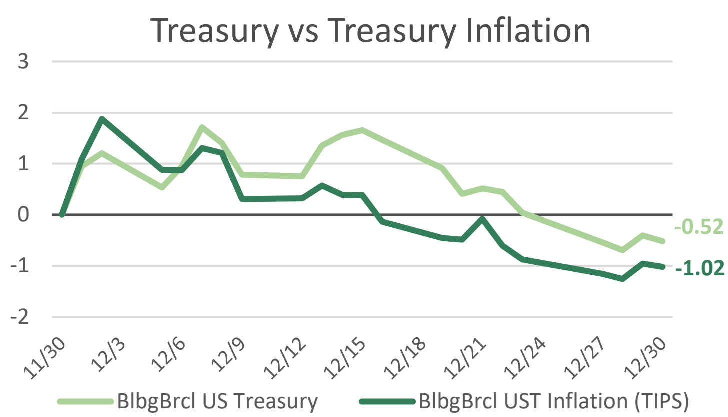
What Worked, What Didn't

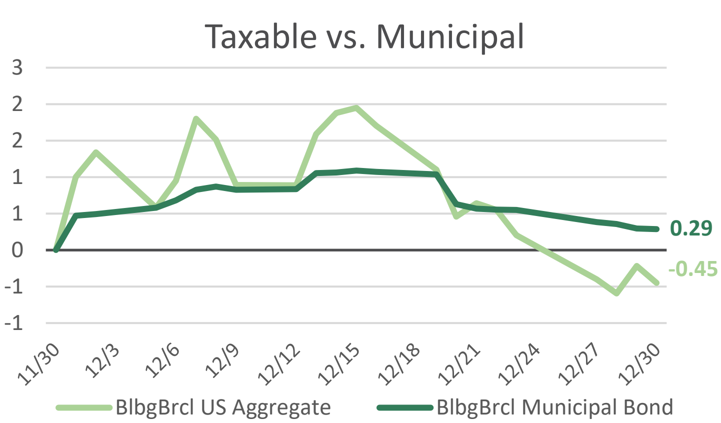
- **Short Duration and High Quality Outperform.** Shorter Duration bonds outperformed their Long Duration peers for the month of December, as did Investment Grade versus lower quality High Yield.
- **Credit Beats Duration and TIPS Stumble.** With the Fed raising interest rates yet again, Credit outperformed Long Duration Treasuries and TIPS modestly underperformed nominal Treasuries.
- **Munis Outperform Taxables and International Outperforms Domestic.** Munis posted a decent margin of outperformance versus their Corporate peers and International bonds posted a modest margin of outperformance against Domestic bonds.

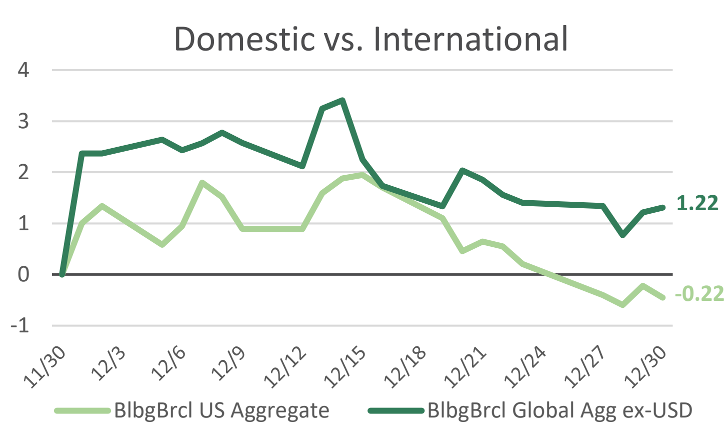












Source: Bloomberg.

December 2022

Asset Class Performance

The Importance of Diversification. From period to period there is no certainty what investment will be the best, or worst, performer. Diversification mitigates the risk of relying on any single investment and offers a host of long-term benefits, such as less portfolio volatility, improved risk-adjusted returns, and more effective compounding.

	Dec-01	Dec-02	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23	Dec-27	Dec-28	Dec-29	Dec-30	Dec	YTD	
High	IBD 1.51	SCG 0.68	IBD -0.57	USB 0.29	USB 0.89	MCG 1.28	IEQ 0.06	MCG 1.72	RE 1.85	IBD 0.41	USB 0.15	EM 0.29	EM 0.08	SCG 0.74	SCG 1.79	USB -0.03	RE 0.86	EM 1.48	USB -0.17	SCG 2.80	HYB 0.08	EM -0.96	LCV -7.74	High
	IEQ 0.97	SCV 0.54	USB -0.79	IBD 0.10	HYB 0.55	EM 1.21	HYB 0.00	SCG 1.56	IEQ 1.41	USB 0.22	HYB -0.37	USB -0.26	IBD 0.06	IEQ 0.40	MCG 1.73	IBD -0.25	MCV 0.84	IBD 0.18	IBD -0.36	SCV 2.34	IBD -0.11	IBD -1.16	HYB -10.99	
	USB 0.83	USB 0.41	HYB -0.95	EM -0.13	IBD 0.43	LCG 1.14	RE -0.13	LCG 1.49	SCG 1.22	EM 0.05	RE -1.43	HYB -0.53	IEQ -0.24	SCV 0.34	LCG 1.59	RE -0.40	LCV 0.71	IEQ 0.15	60/40 -0.90	MCG 2.29	SCG -0.20	USB -1.22	MCV -12.28	
	MCG 0.76	EM 0.38	EM -1.14	HYB -0.36	60/40 0.21	SCG 0.78	60/40 -0.52	MCV 1.41	IBD 1.18	IEQ -0.09	60/40 -1.52	IBD -0.55	HYB -0.51	LCV 0.32	MCV 1.49	HYB -0.62	SCV 0.62	LCV 0.13	IEQ -1.06	RE 2.23	LCV -0.23	IEQ -1.75	USB -13.02	
	60/40 0.53	60/40 0.10	IEQ -1.31	IEQ -0.45	RE 0.20	RE 0.76	IBD -0.58	LCV 1.38	MCG 1.17	60/40 -0.16	IBD -1.57	SCG -0.60	USB -0.61	MCG 0.29	SCV 1.48	60/40 -0.71	LCG 0.36	MCV 0.06	LCV -1.14	LCG 2.17	LCG -0.28	HYB -2.20	IEQ -14.35	
	HYB 0.37	IBD -0.07	60/40 -1.35	60/40 -0.52	MCG 0.00	SCV 0.62	USB -0.59	SCV 0.90	HYB 1.04	LCG -0.47	LCV -2.01	60/40 -0.70	60/40 -0.62	MCV 0.29	LCV 1.42	IEQ -0.82	IEQ 0.35	RE -0.07	MCG -1.29	MCV 1.71	MCV -0.39	60/40 -2.85	SCV -14.75	
	LCG 0.12	IEQ -0.07	RE -1.79	RE -0.94	IEQ 0.00	MCV 0.58	EM -0.66	RE 0.73	60/40 0.93	HYB -0.57	MCV -2.02	SCV -0.82	LCV -0.66	LCG -0.01	IEQ 1.04	EM -0.89	MCG 0.34	60/40 -0.26	LCG -1.31	EM 1.67	SCV -0.40	LCV -3.79	60/40 -16.31	
	MCV 0.08	LCV -0.08	LCG -1.82	SCV -1.03	LCV -0.05	LCV 0.53	MCV -0.73	60/40 0.54	LCG 0.92	SCG -0.58	SCV -2.26	IEQ -0.88	MCV -0.93	EM -0.03	RE 1.03	LCV -0.93	HYB 0.26	SCV -0.39	HYB -1.34	IEQ 1.58	MCG -0.43	RE -3.84	IBD -19.44	
	SCG 0.00	HYB -0.08	LCV -1.94	MCV -1.10	SCG -0.06	IEQ 0.51	LCG -0.75	HYB 0.39	EM 0.71	MCG -0.60	EM -2.31	MCG -1.05	SCV -1.00	60/40 -0.10	60/40 0.90	MCV -1.02	SCG 0.23	MCG -0.55	EM -1.46	LCV 1.43	USB -0.47	MCV -4.81	EM -20.56	
	LCV -0.01	MCV -0.08	MCV -2.16	LCV -1.16	MCV -0.29	60/40 0.38	LCV -0.75	IEQ 0.30	USB 0.67	SCV -0.62	IEQ -2.55	LCV -1.13	RE -1.18	HYB -0.26	EM 0.90	SCV -1.06	60/40 0.15	USB -0.72	SCG -1.47	60/40 1.31	60/40 -0.54	SCV -5.84	RE -25.50	
	RE -0.12	MCG -0.17	MCG -2.49	LCG -1.80	LCG -0.38	HYB 0.08	SCV -1.08	IBD 0.07	LCV 0.65	LCG -0.64	SCG -2.82	LCG -1.21	LCG -1.29	RE -0.28	HYB 0.85	SCG -1.50	EM -0.13	SCG -0.92	MCV -1.52	HYB 1.29	RE -0.82	SCG -6.11	SCG -26.26	
	EM -0.33	LCG -0.24	SCV -2.69	MCG -1.91	SCV -0.49	IBD 0.04	MCG -1.12	USB 0.02	MCV 0.56	MCV -0.65	MCG -2.88	MCV -1.24	MCG -1.46	IBD -0.40	USB 0.28	MCG -1.65	IBD -0.25	LCG -0.96	SCV -1.59	IBD 0.95	IEQ -1.03	MCG -6.34	MCG -26.90	
Low	SCV -0.41	RE -0.31	SCG -2.76	SCG -2.04	EM -0.59	USB -0.30	SCG -1.43	EM -0.31	SCV 0.34	RE -0.68	LCG -3.01	RE -2.53	SCG -1.68	USB -0.68	IBD 0.04	LCG -1.90	USB -0.35	HYB -1.04	RE -1.69	USB 0.37	EM -1.38	LCG -7.52	LCG -29.31	Low

Legend

- 60/40 Allocation (60/40)
- Large Growth (LCG)
- Large Value (LCV)
- Mid Growth (MCG)
- Mid Value (MCV)
- Small Growth (SCG)
- Small Value (SCV)
- Intl Equity (IEQ)
- Emg Markets (EM)
- U.S. Bonds (USB)
- High Yield Bond (HYB)
- Intl Bonds (IBD)
- Real Estate (RE)

Source: Bloomberg. Asset-class performance is presented by using market returns from an exchange-traded fund (ETF) proxy that best represents its respective broad asset class. Returns shown are net of fund fees for and do not necessarily represent performance of specific mutual funds and/or exchange-traded funds recommended by the Prime Capital Investment Advisors. The performance of those funds June be substantially different than the performance of the broad asset classes and to proxy ETFs represented here. U.S. Bonds (iShares Core U.S. Aggregate Bond ETF); High-Yield Bond (iShares iBoxx $ High Yield Corporate Bond ETF); Intl Bonds (SPDR® Bloomberg Barclays International Corporate Bond ETF); Large Growth (iShares Russell 1000 Growth ETF); Large Value (iShares Russell 1000 Value ETF); Mid Growth (iShares Russell Mid-Cap Growth ETF); Mid Value (iShares Russell Mid-Cap Value ETF); Small Growth (iShares Russell 2000 Growth ETF); Small Value (iShares Russell 2000 Value ETF); Intl Equity (iShares MSCI EAFE ETF); Emg Markets (iShares MSCI Emerging Markets ETF); and Real Estate (iShares U.S. Real Estate ETF). The return displayed as "Allocation" is a weighted average of the ETF proxies shown as represented by: 30% U.S. Bonds, 5% International Bonds, 5% High Yield Bonds, 10% Large Growth, 10% Large Value, 4% Mid Growth, 4% Mid Value, 2% Small Growth, 2% Small Value, 18% International Stock, 7% Emerging Markets, 3% Real Estate.

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