



# *2023 U.S. Economic & Financial Market Outlook*

PCBE  
January 2023

Tom Tzitzouris  
Head of Fixed Income Research

---

- Investment Strategy
- Economics
- Policy Research
- Equity Sector Strategy
- Fixed Income Strategy
- Technical Analysis
- Industry Surveys
- Bespoke Research
- Corporate Services
- Institutional Sales & Trading
- Commission Management



## Part 1: U.S. Economic Outlook

Inflation	Consumer Health	2023 Recession
<ul style="list-style-type: none"><li>Headline inflation peaked, rolling over.</li><li>Declines driven by Goods &amp; Energy.</li><li>Services (roughly 60% of CPI) &amp; Food still elevated.</li><li>Wage inflation elevated as well.</li><li>Services inflation sticky around level of wages.</li><li>Fed shifting focus from headline inflation to wage &amp; services inflation.</li></ul>	<ul style="list-style-type: none"><li>The most important variable in consumer spending is a job.</li><li>Upper income cohorts still have a cash cushion, lower income cohorts have spent savings.</li><li>Goods spending still above trend, services spending climbing back to trend.</li><li>Fed needs to bring goods &amp; services demand into balance with supply.</li></ul>	<ul style="list-style-type: none"><li>Strategas odds are 50% in 2023 &amp; in 2024.</li><li>75% odds over 2 years.</li><li>U.S. labor market remains tight.</li><li>Notable weakness in housing &amp; mfg.</li><li>Interest rate hikes will hit economy with a lag.</li><li>Inverted yield curve also signaling recession.</li><li>China re open may boost U.S. in 2<sup>nd</sup> half of 2023.</li></ul>



## Part 1: Economic Outlook

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

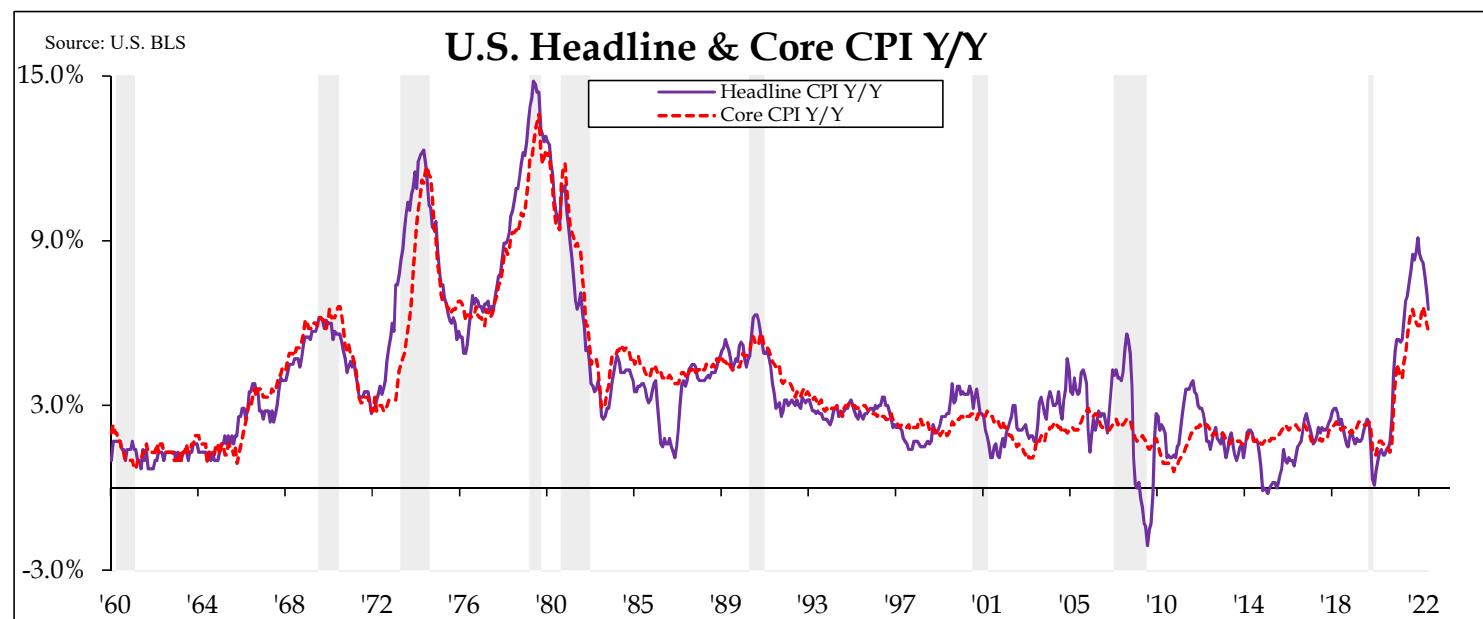
E = End of Period Expected Value

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

E = End of Period Expected Value

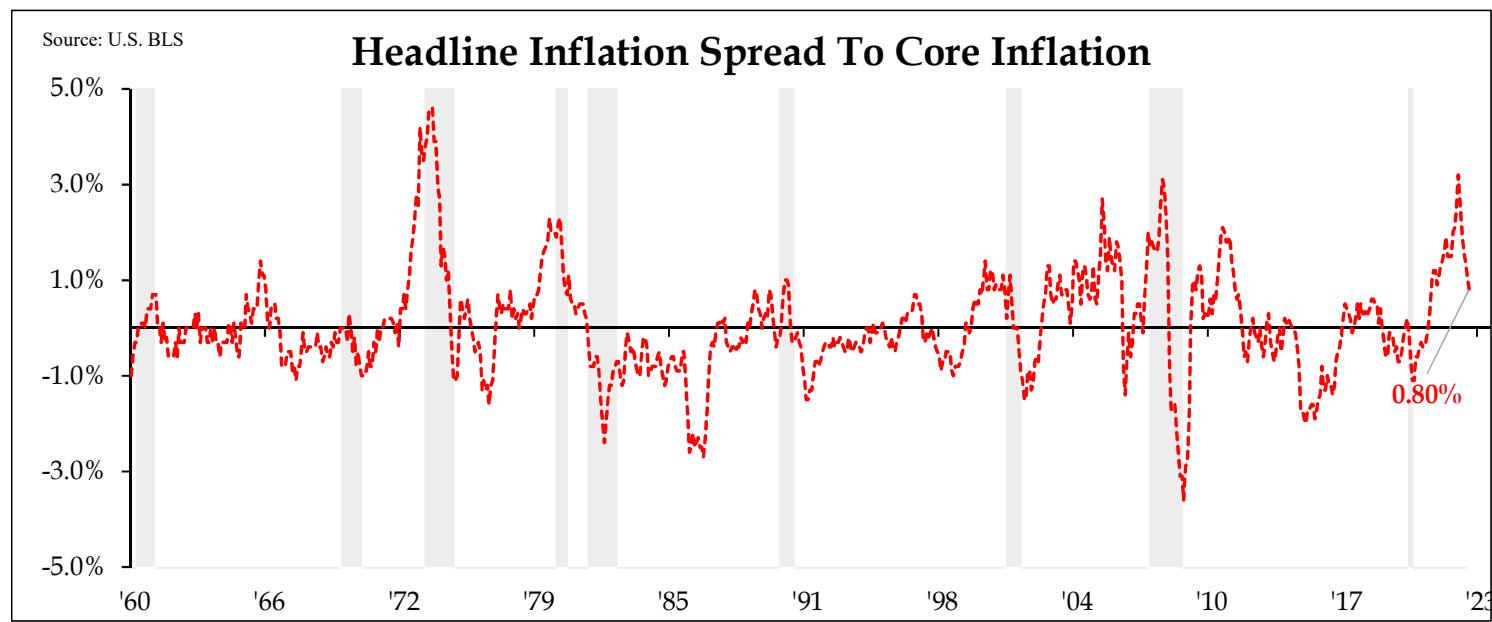


## U.S. Inflation Rolling Over



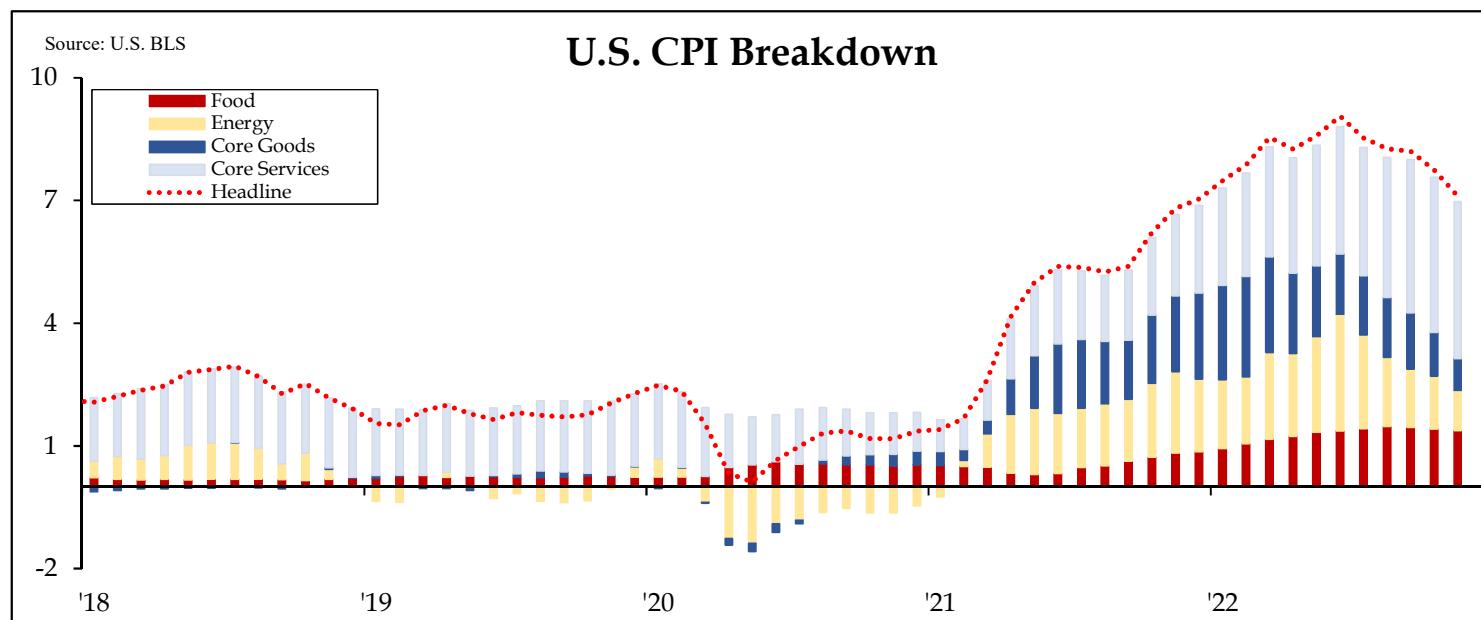


## Headline & Core CPI Converging



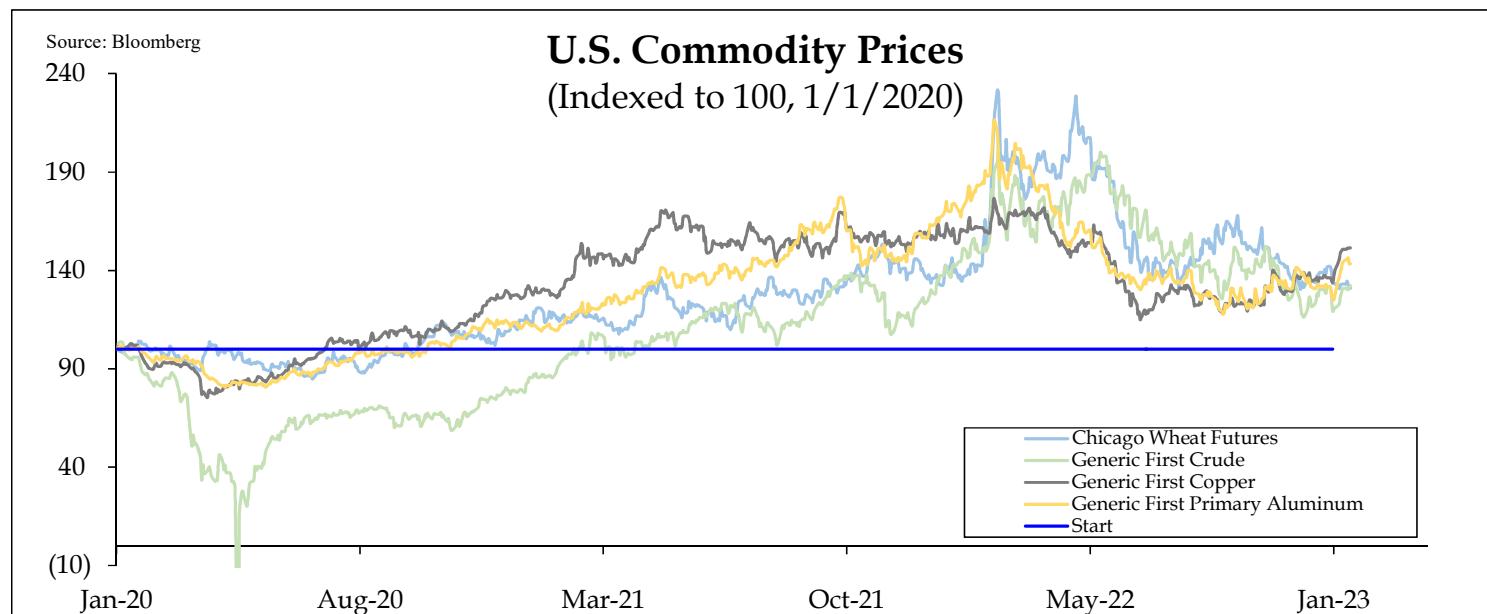


## Sticky Core Svcs. & Food Driving U.S. Infl.



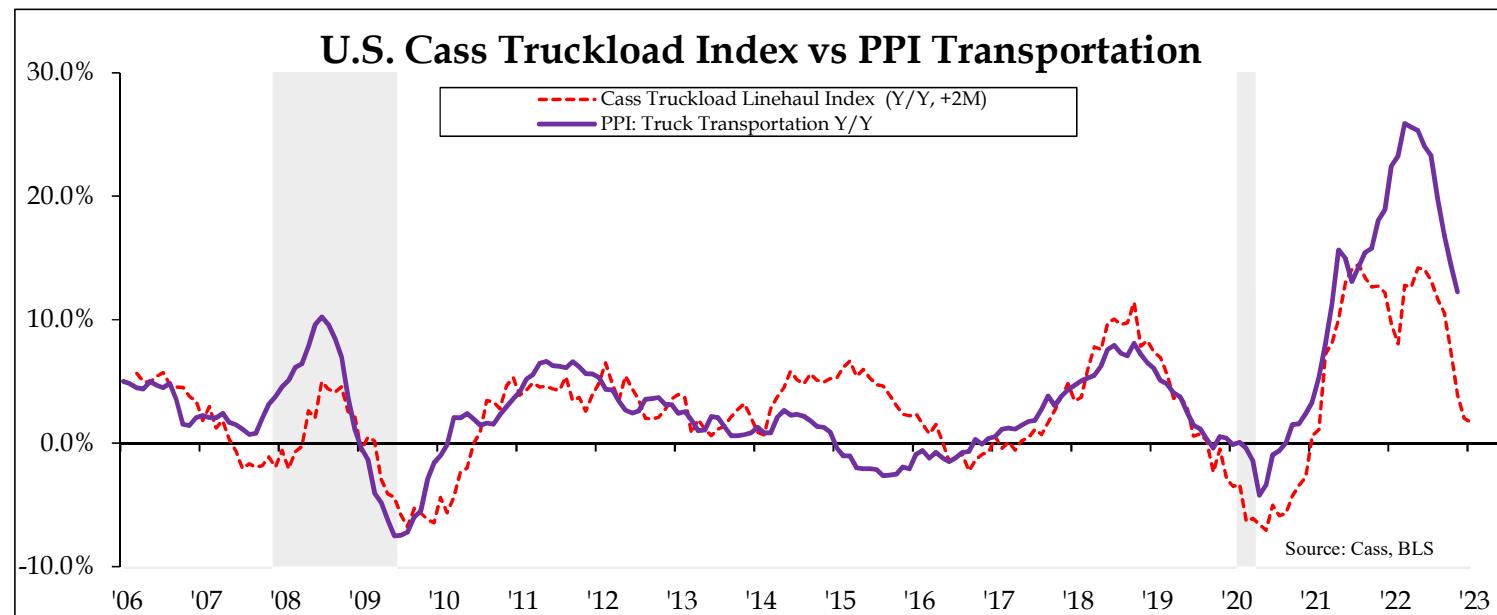


## Commodities No Longer the Story in 2023



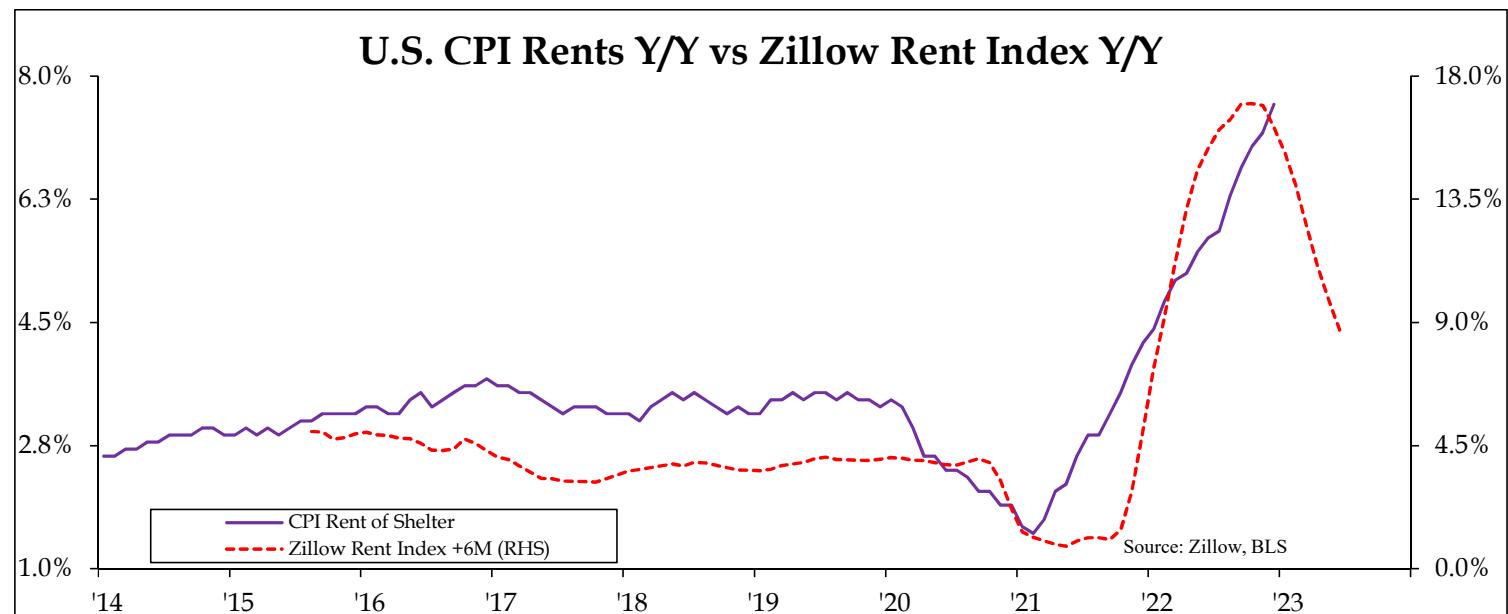


## Trucking Inflation Looks to Move Lower



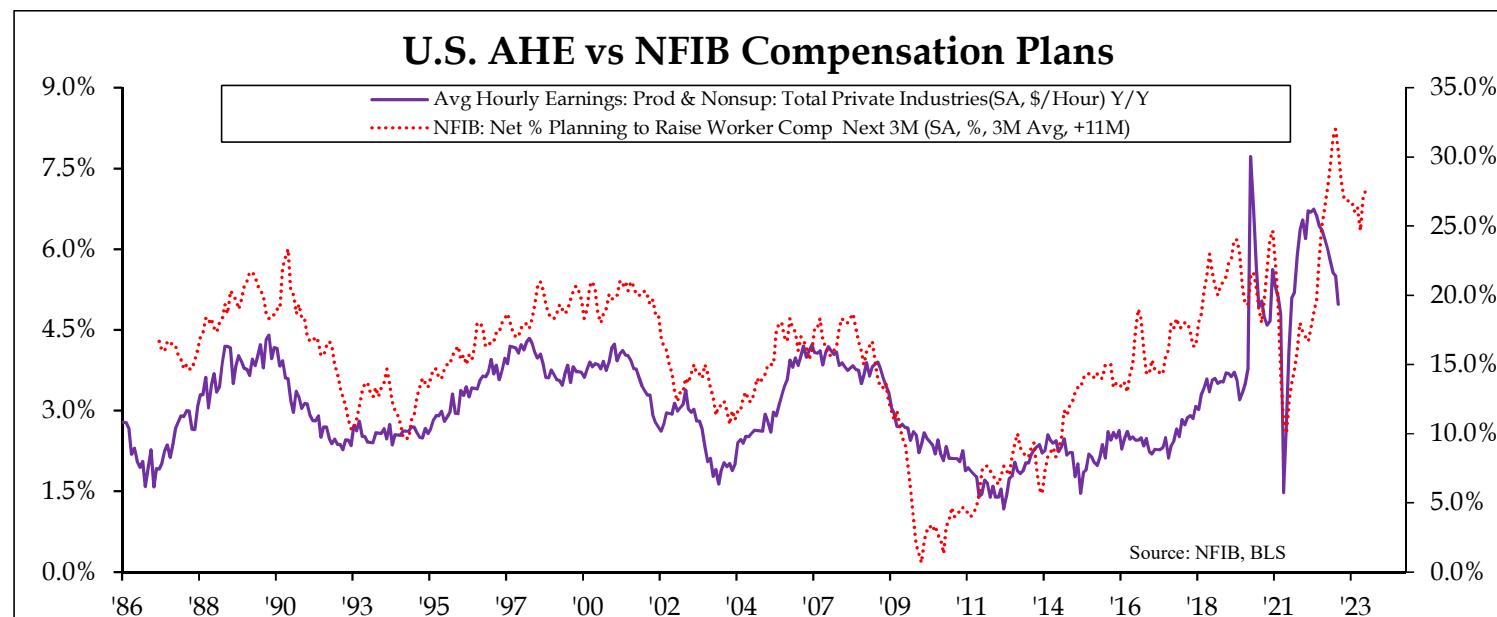


## Zillow Rent Prices Lead U.S. CPI of Rent



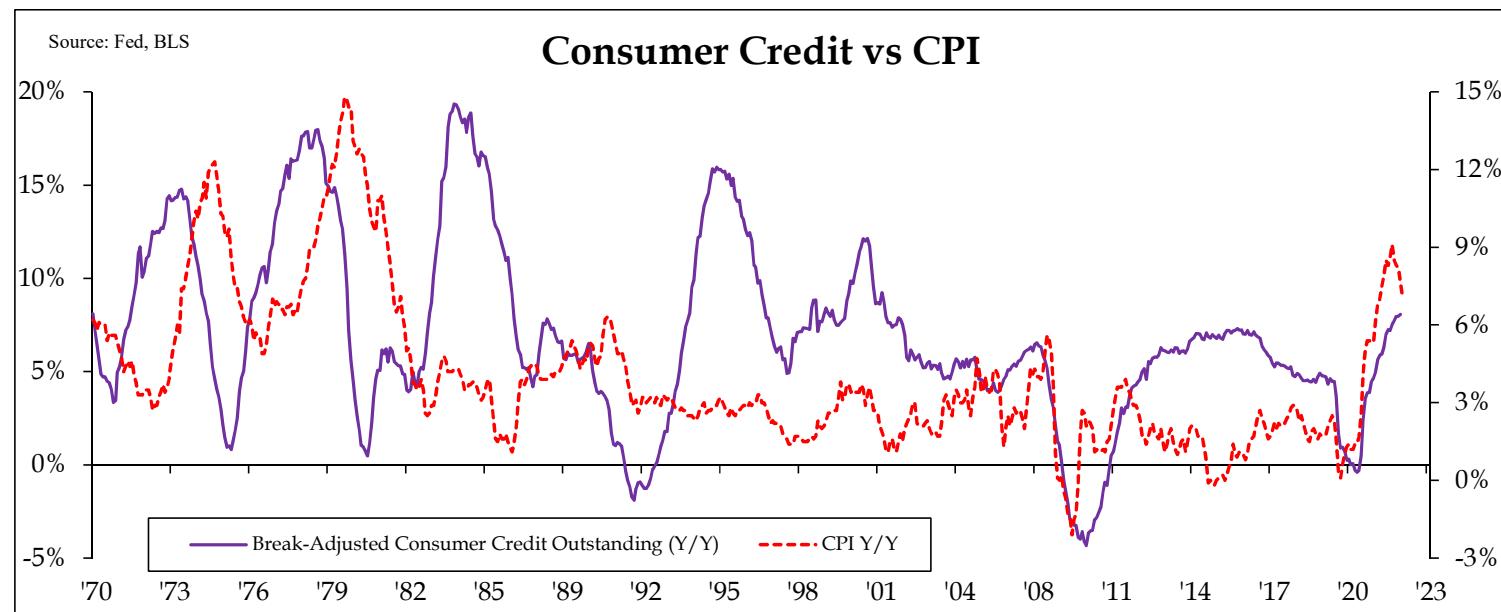


## Concern is Stickier Components Like Wages



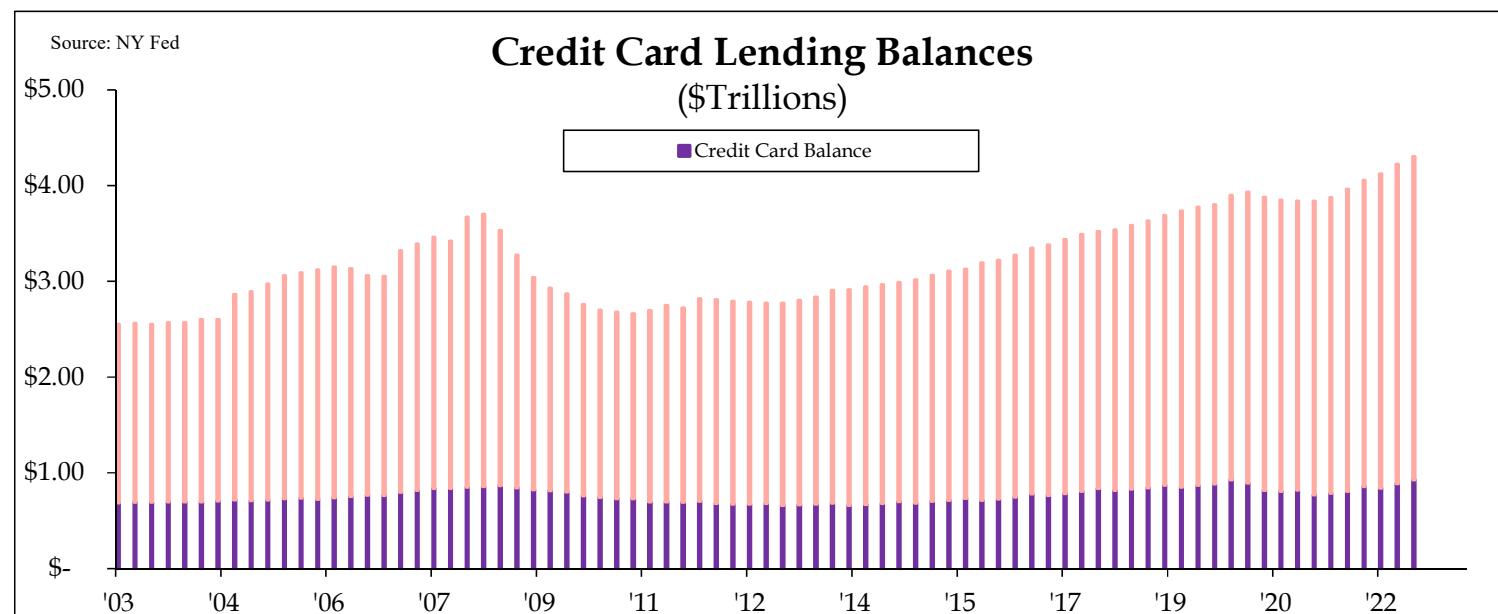


## Inflation Causing Consumers to Add Debt



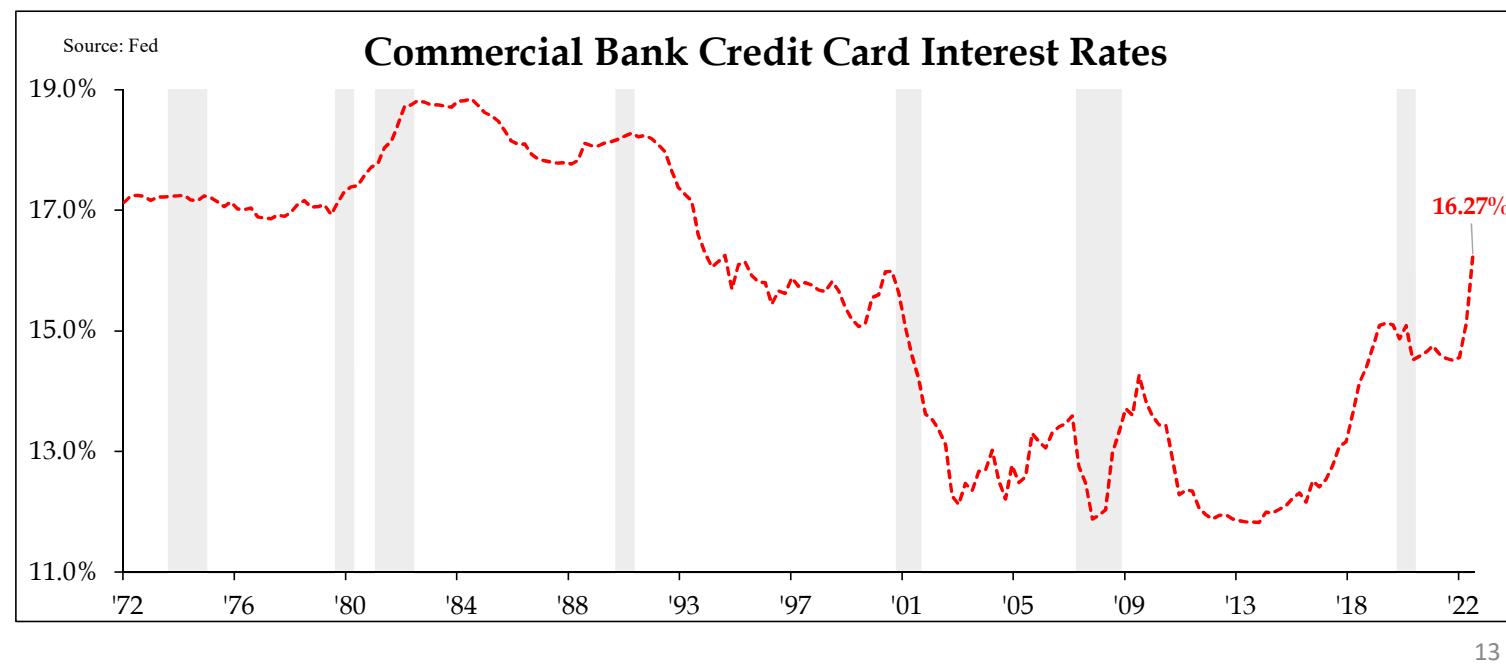


## U.S. Consumers Adding Credit Card Debt



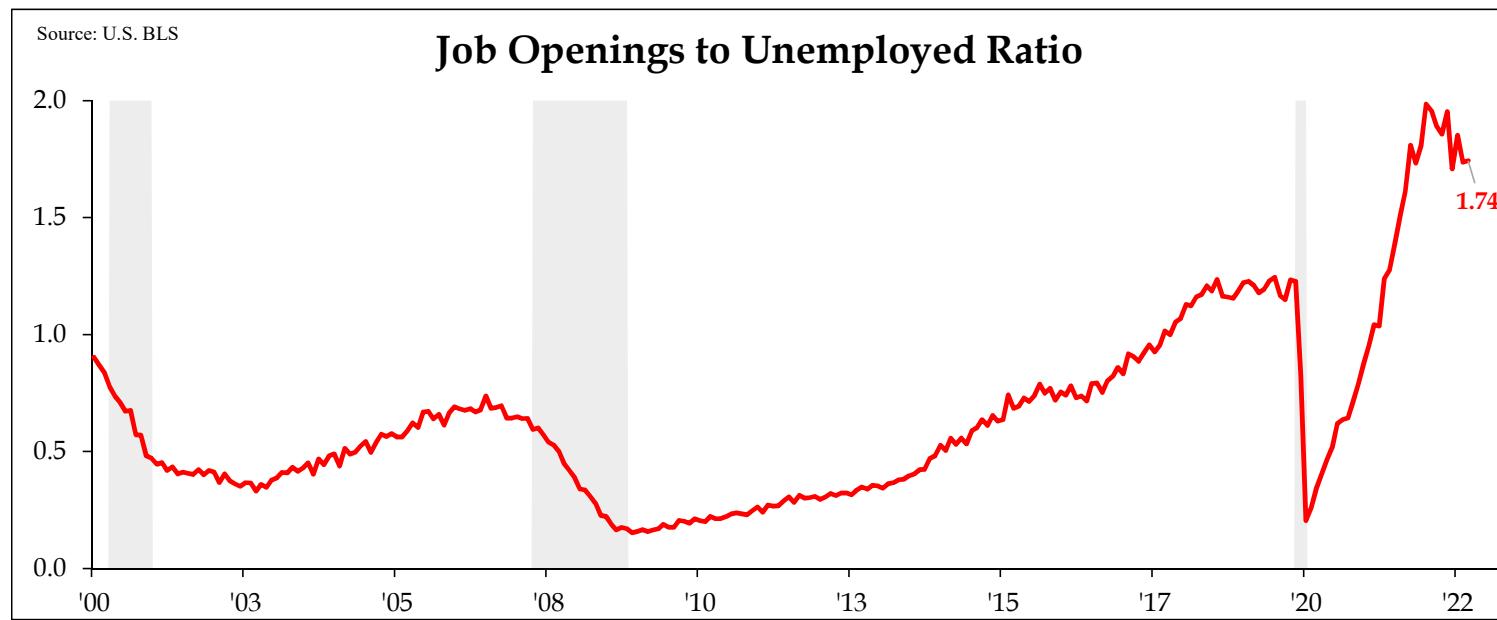


## Credit Card Interest Rates Surging



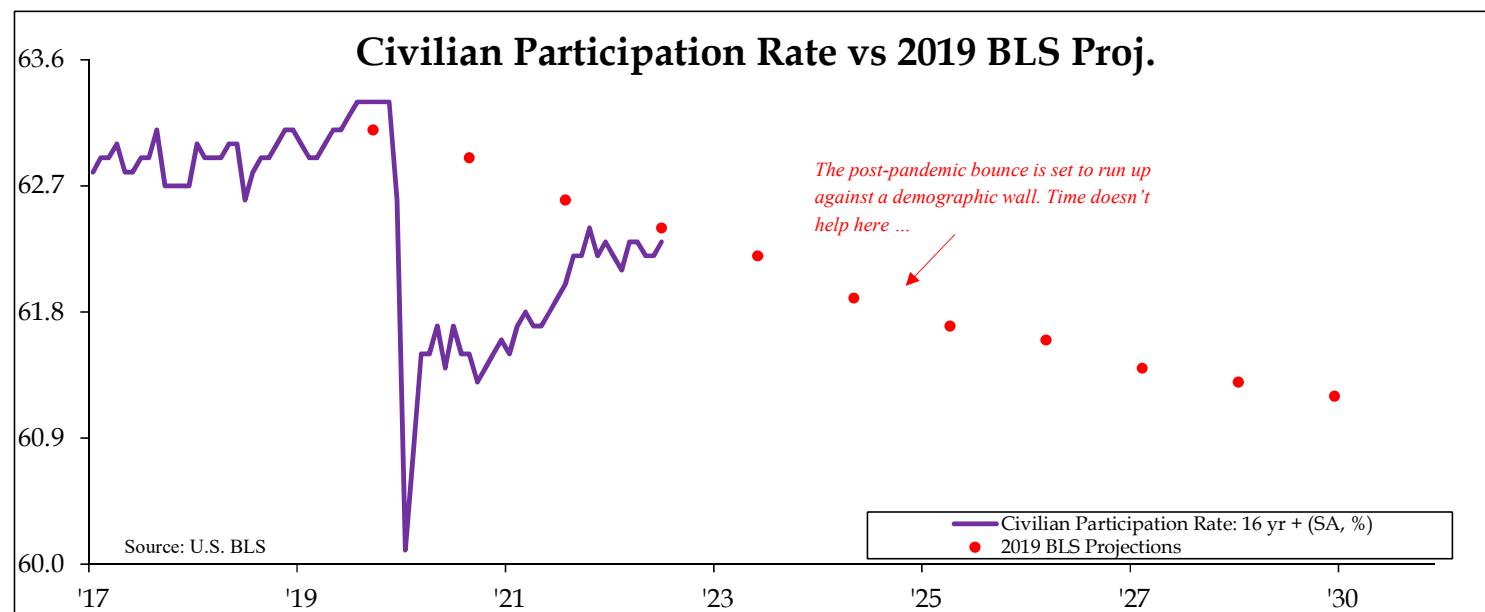


## Most Important Variable In Consumer Spending Is a Job



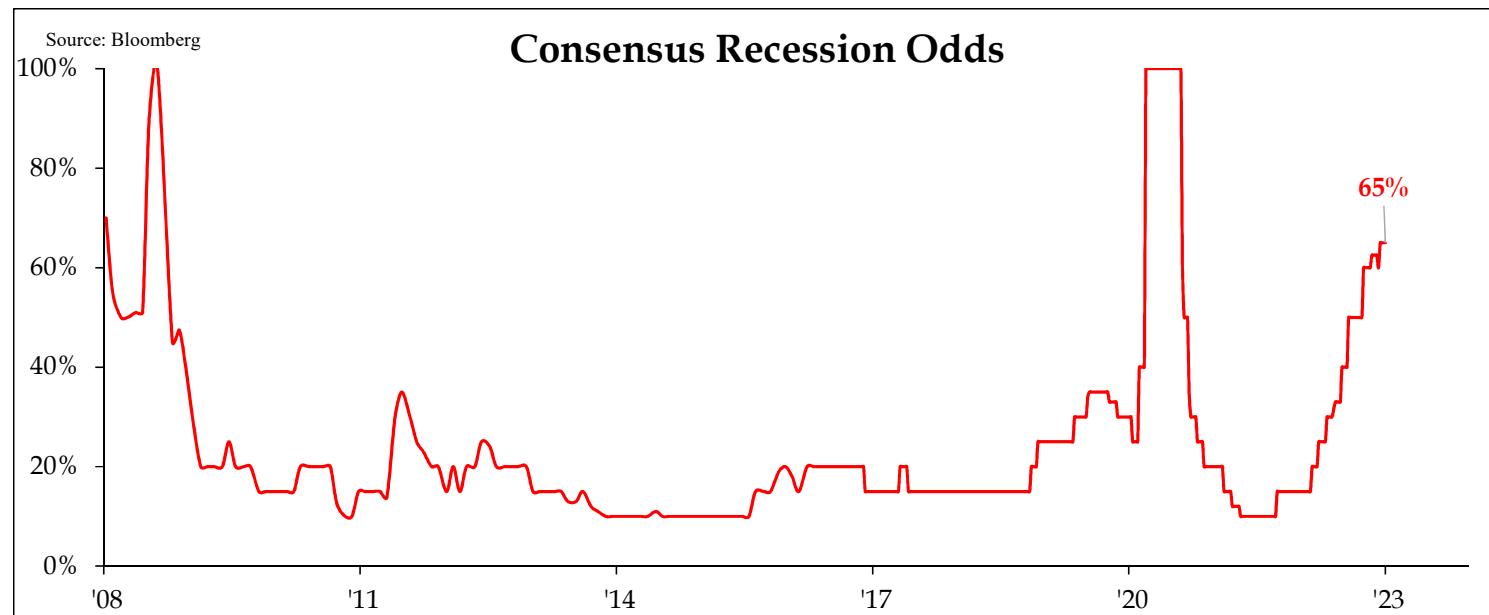


## U.S. Labor Market Running into Demographic Wall



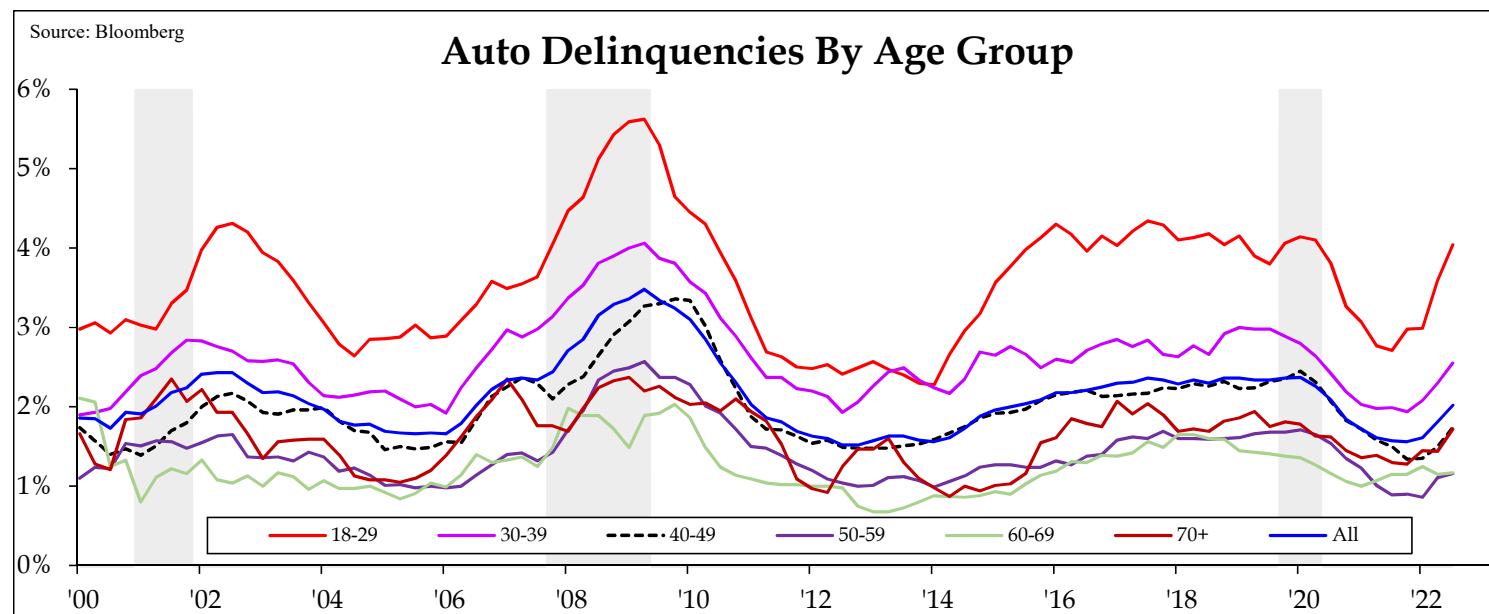


## 2023 Recession? Consensus Odds Near 65%. Why?



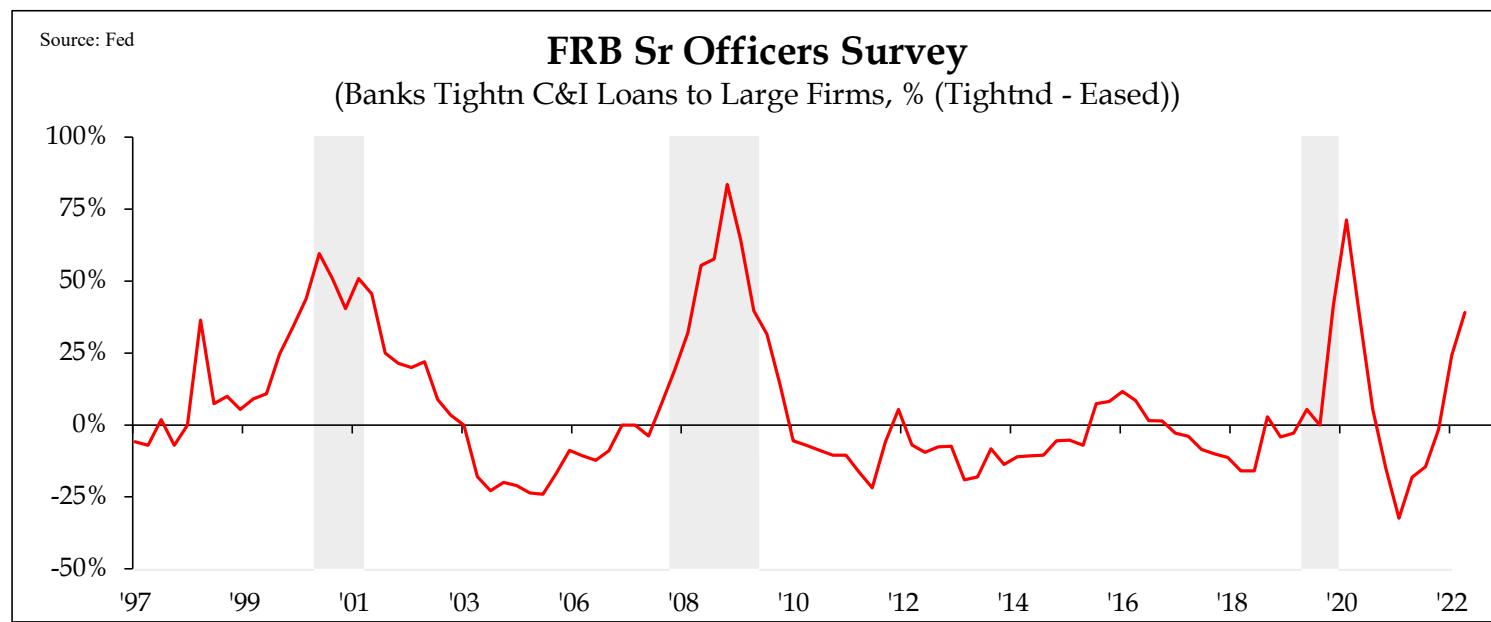


## 1) Auto Delinquencies Rising



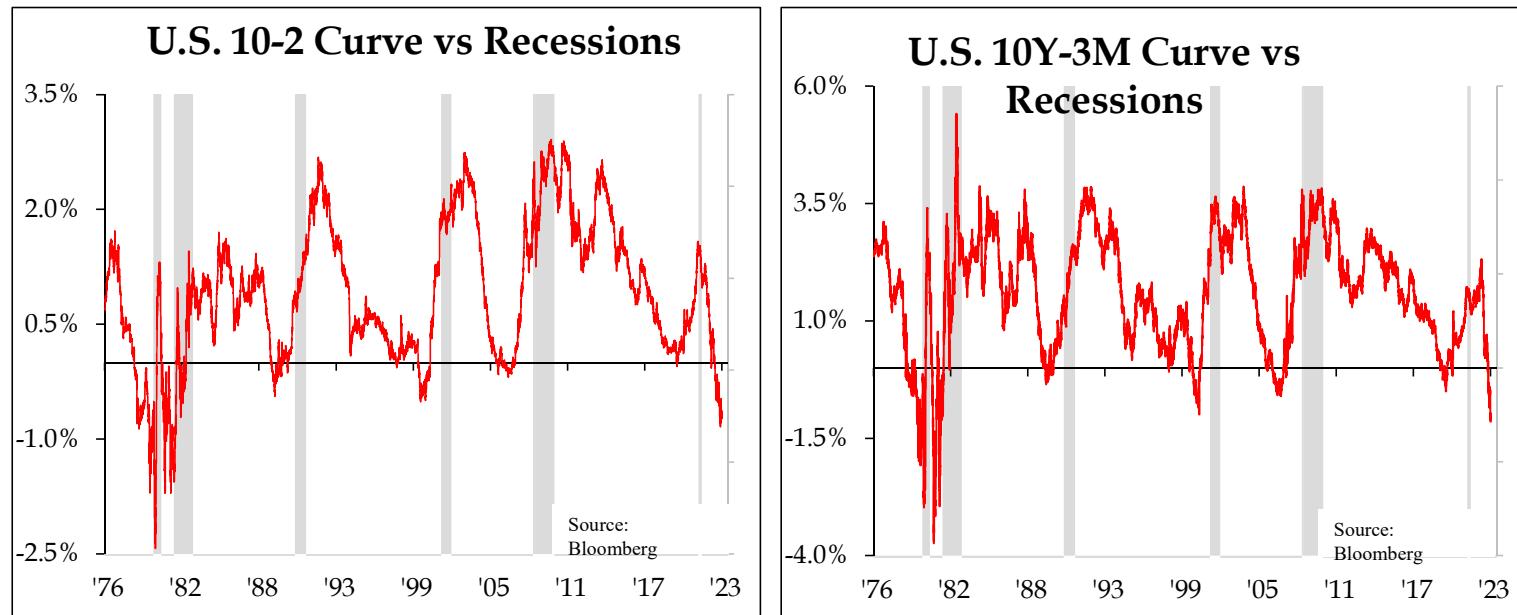


## 2) Banks Tightening Lending Standards





### 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			
<b>Average</b>	<b>318</b>	<b>167</b>	<b>Average</b>	<b>299</b>	<b>134</b>
Avg Ex Green Cells	214	179	Avg Ex Green Cells	231	170

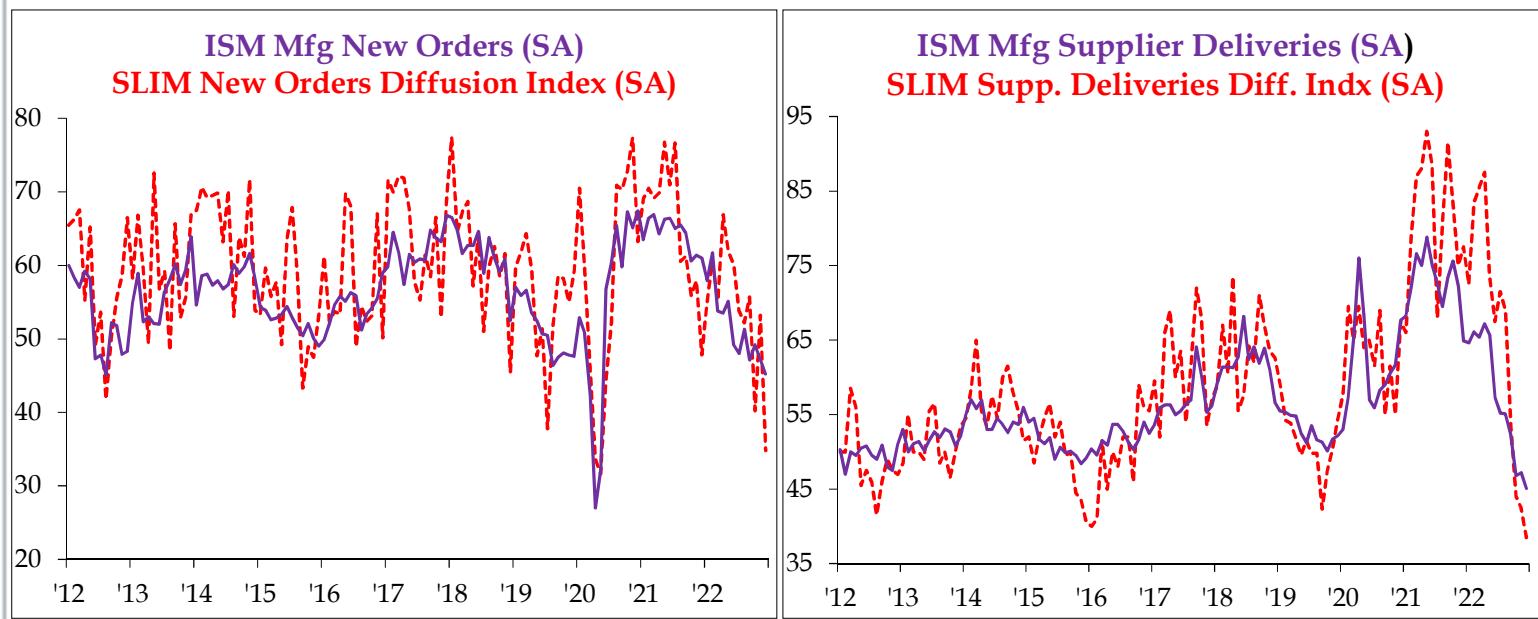


## 4) ISM Manufacturing in Contraction

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 3<sup>rd</sup> year of presidency.
- Powell previously faced political pressure from Trump when hiking rates.

### Return of Deficit Politics

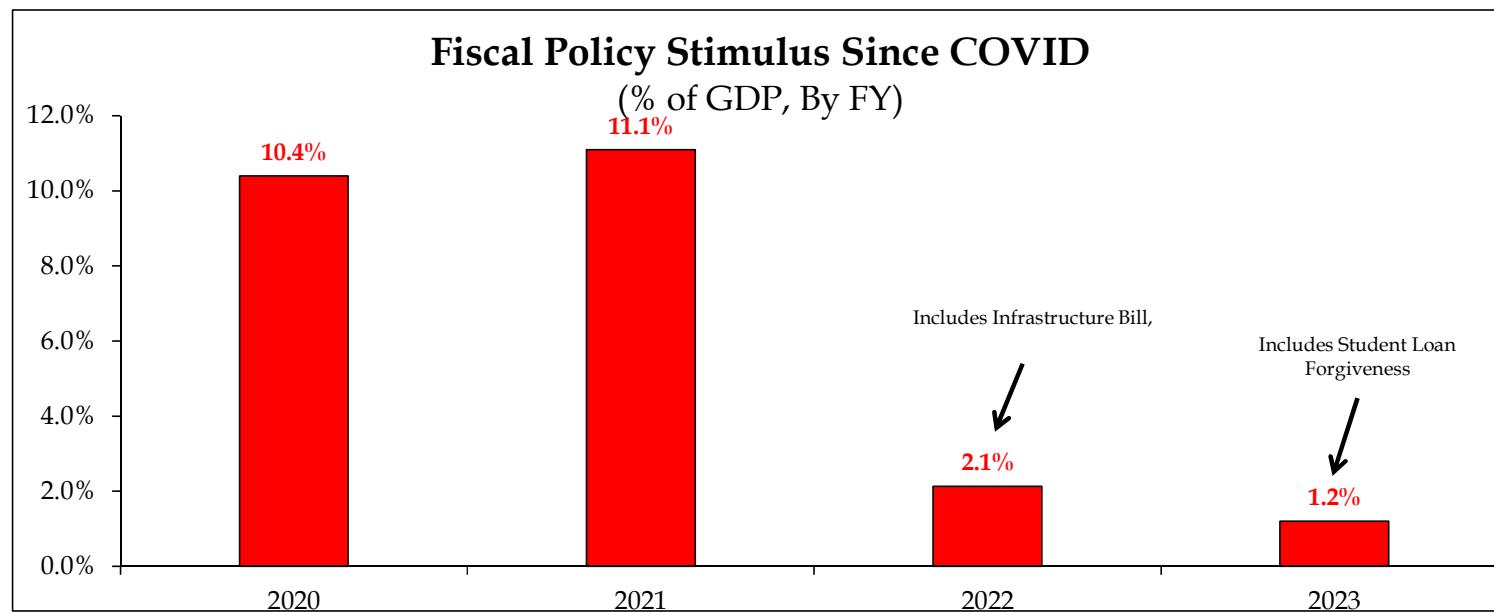
- Deficit politics look to return for the first time in 30 years.
- Congress must raise the debt ceiling by mid 2023.
- The process will be toxic, but it will be lifted.
- A 0.1% underestimation of the FFR in the budget means \$10 billion more of interest costs.
- Current estimate is <1%.
- Lower tax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

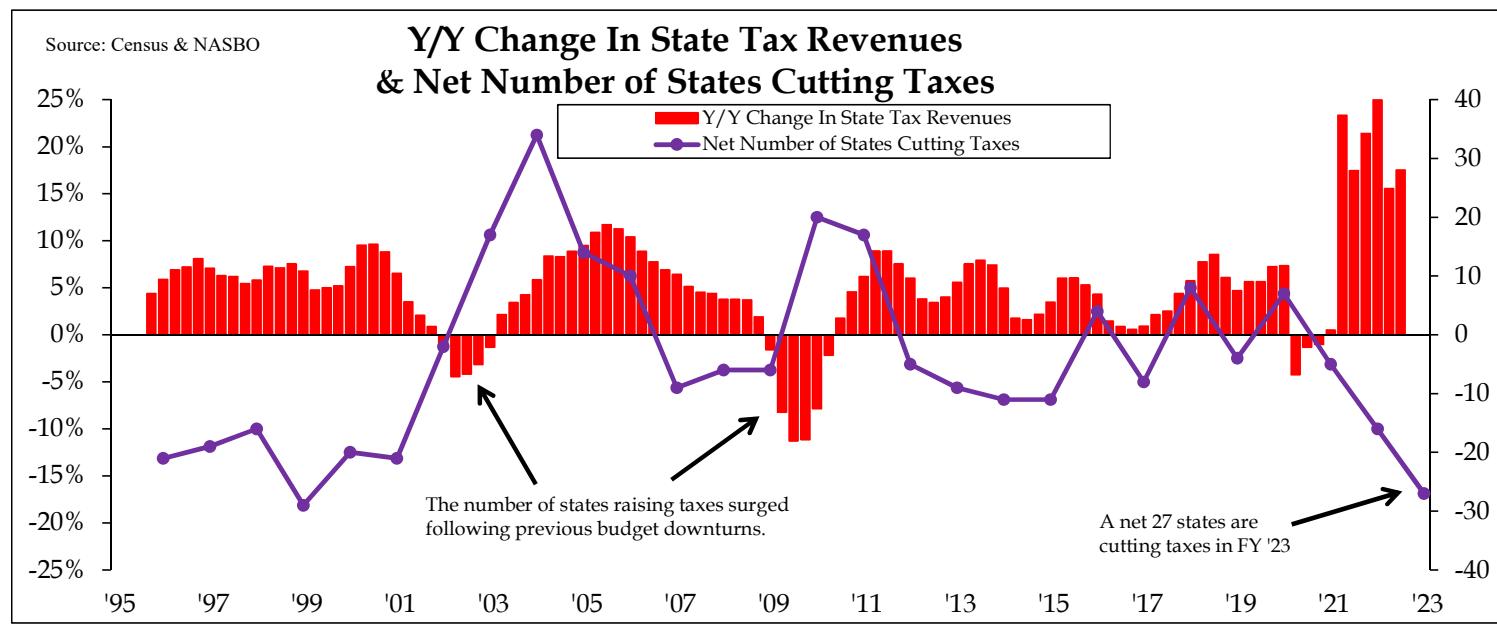


## Federal Picture: More Fiscal Drag in 2023



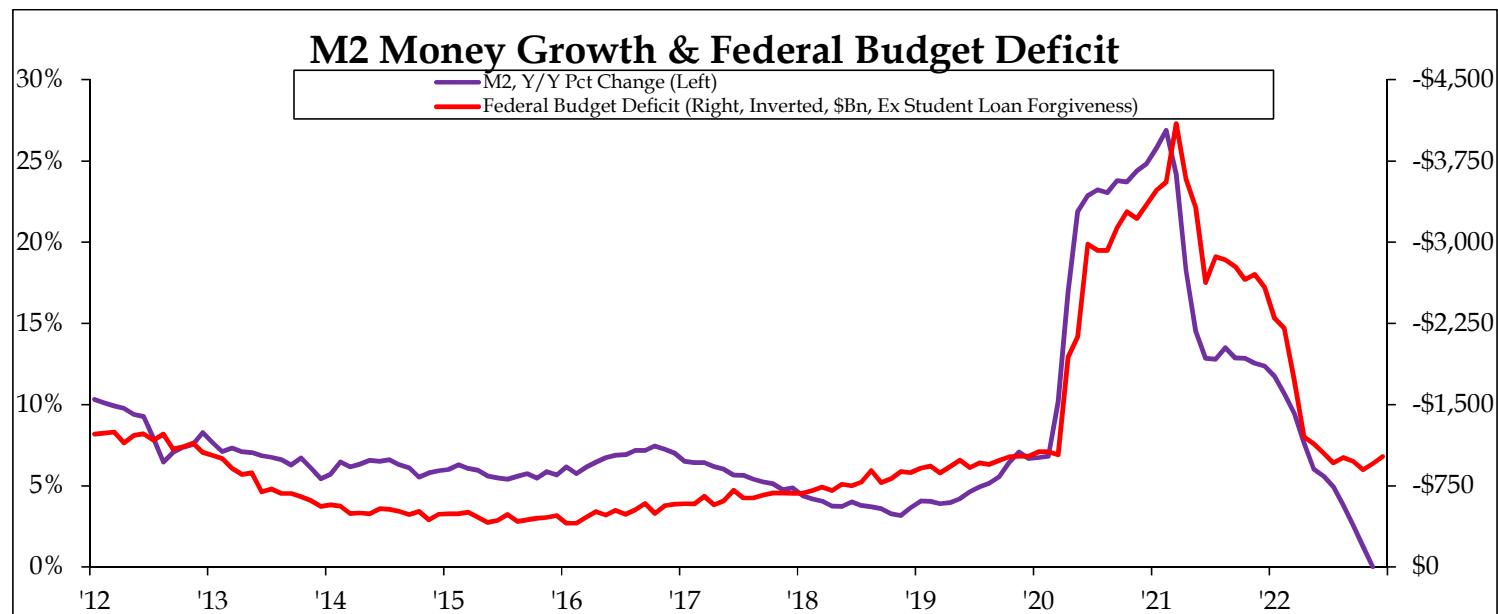


## State Revenues Still Strong



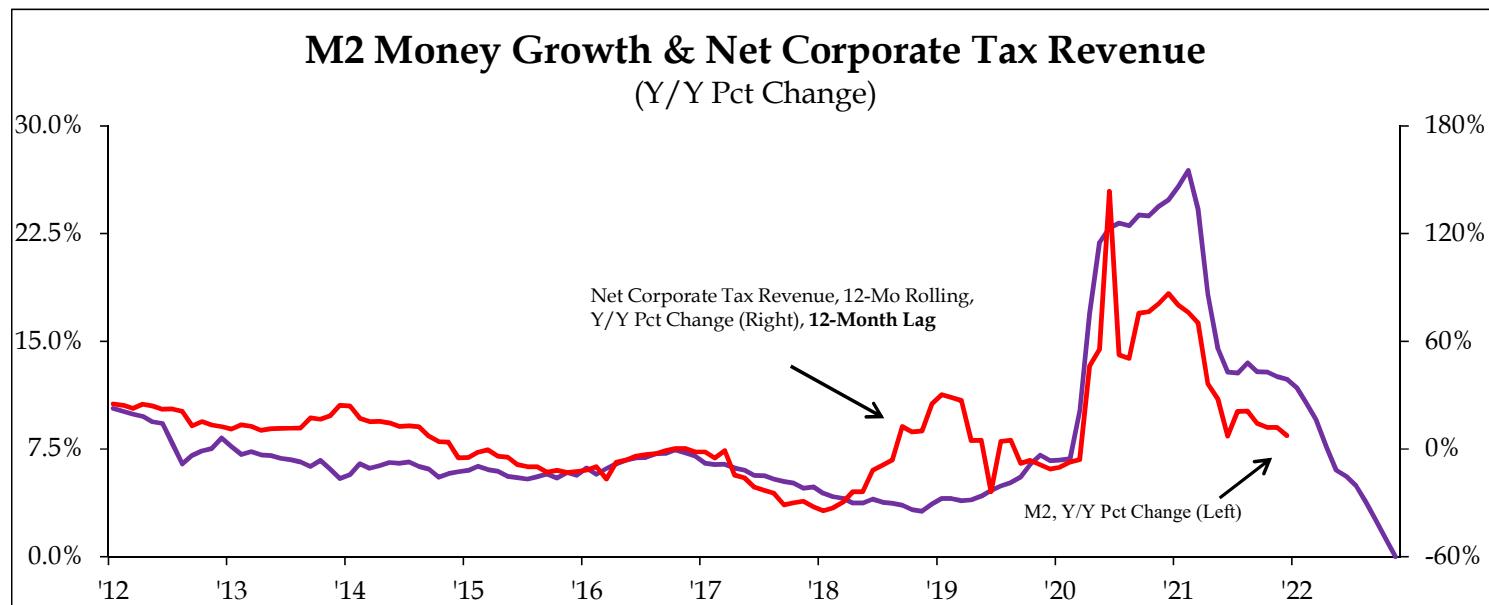


## Budget Deficit Matters For M2 Growth



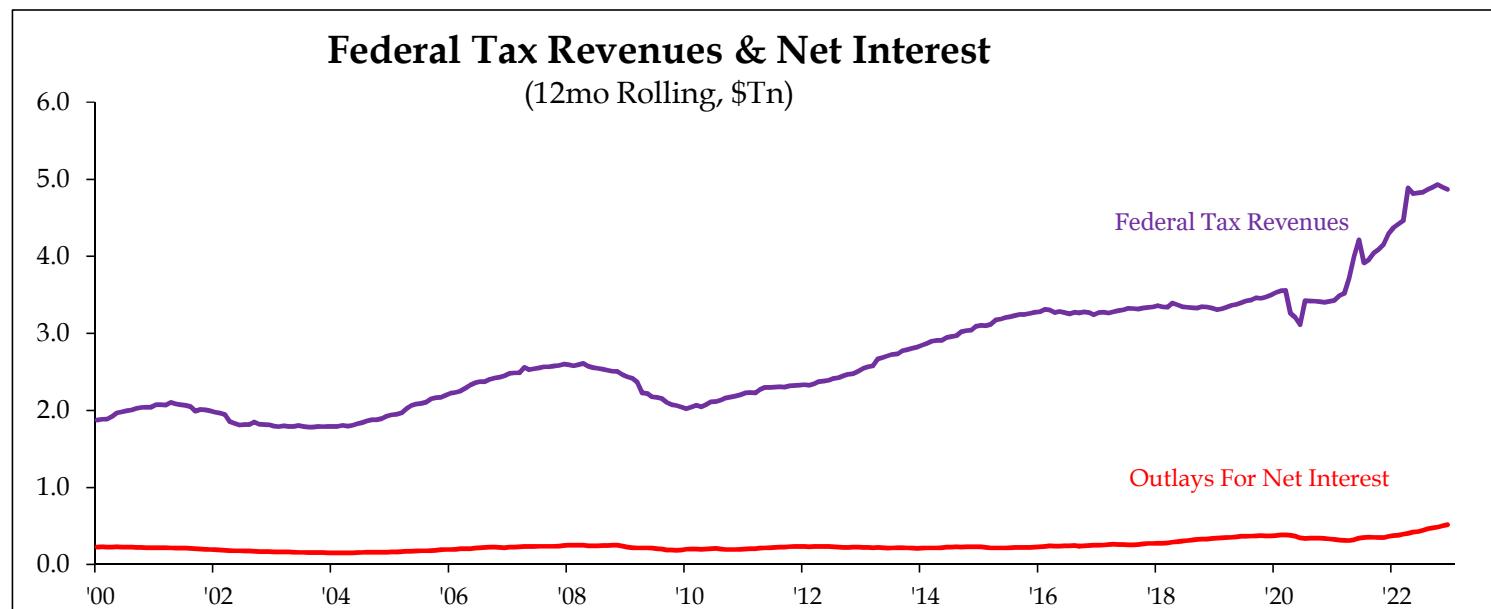


## And M2 Matters for Corp Tax Revenues



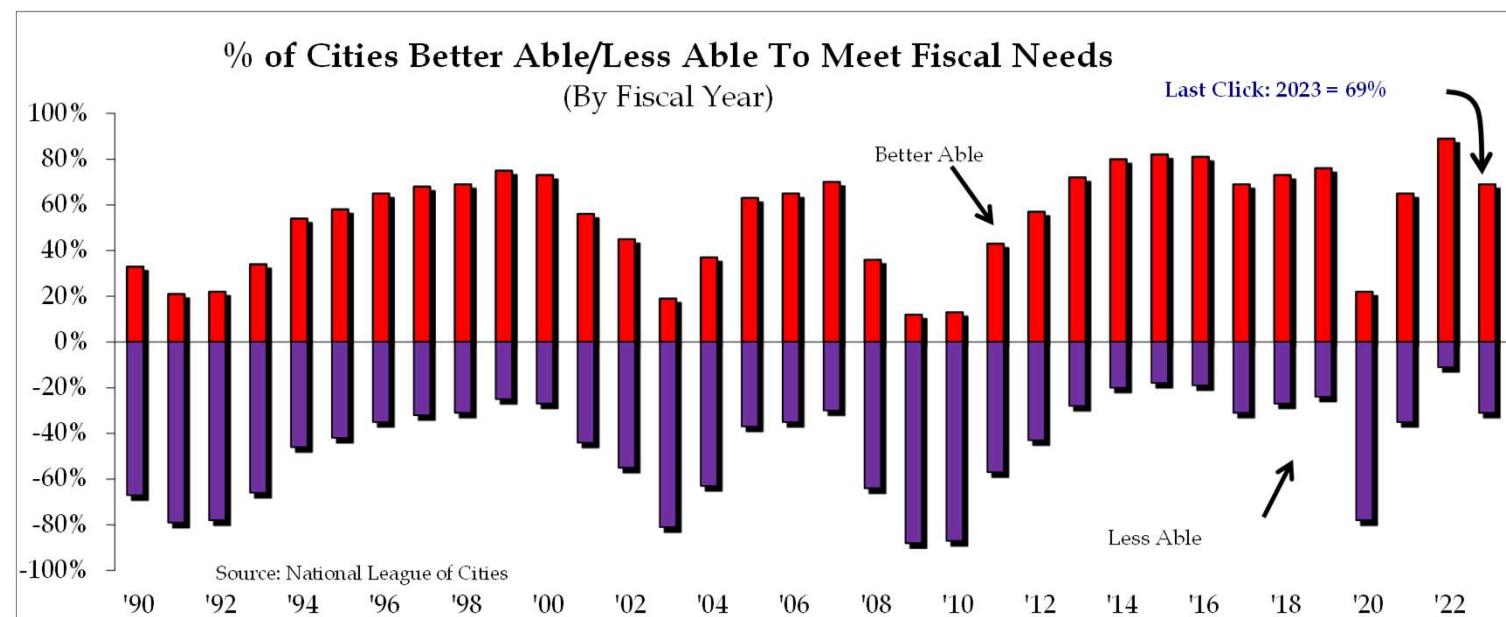


## Net Interest Costs Rising For U.S.





## Muni: Cities and Towns Doing Better in 2023



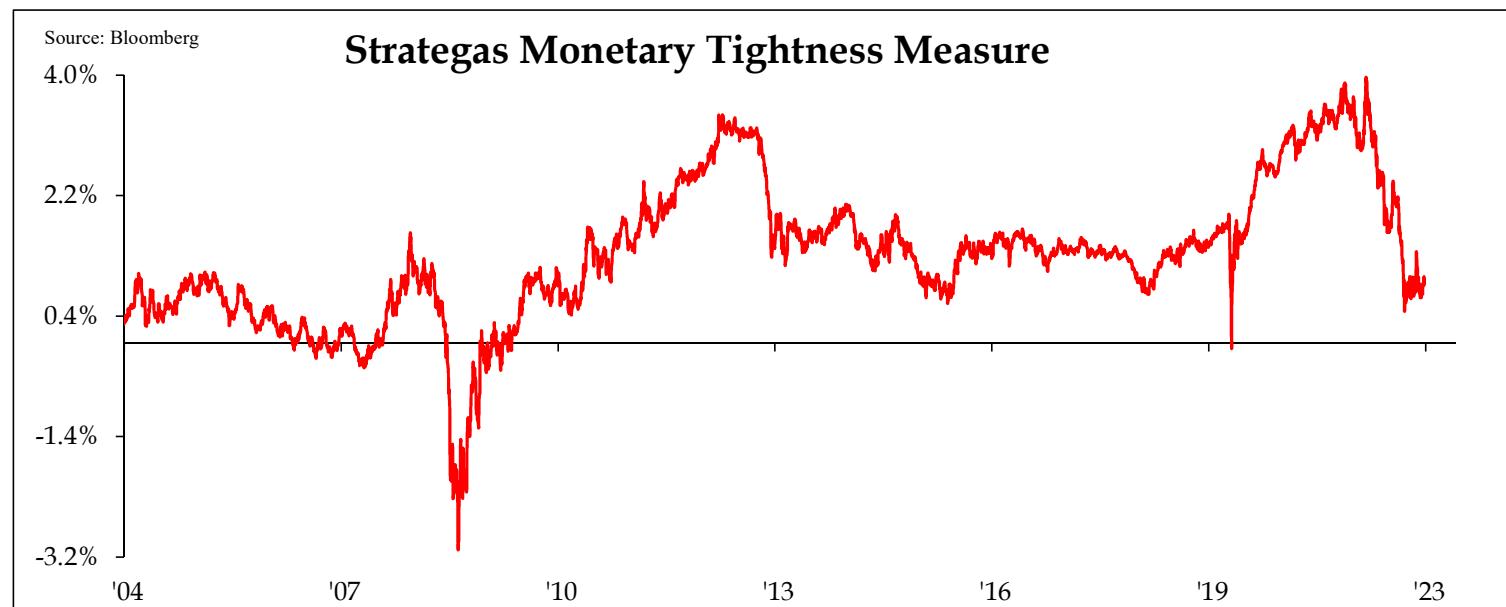


## Part 3: Interest Rate Outlook

Terminal FFR	Tightening Conditions	Global Central Banks
<ul style="list-style-type: none"><li>• We expect the FFR to terminate at 5.25% this cycle, in line with Fed expectations.</li><li>• Our clients, per our Fed Funds Rate survey, expect a terminal rate around 5%.</li><li>• Market futures imply a rate just below 5%.</li><li>• We expect to hit the terminal rate in 1H 2023, and do not expect hikes this year.</li><li>• Cuts = something broke!!!</li></ul>	<ul style="list-style-type: none"><li>• This is the third fastest tightening cycle since 1970.</li><li>• Cumulative impact of hikes starting to be felt.</li><li>• Fed estimates 1-to-2-year lag for hike impacts.</li><li>• Some interest rate sensitive sectors (housing) are adjusting, and yields surged higher through '22.</li></ul>	<ul style="list-style-type: none"><li>• G20 central banks have been hawkish as inflation has soared globally.</li><li>• Many now are or are preparing to downshift to smaller hikes.</li><li>• OECD is urging central banks to “keep at it” until the job is done.</li><li>• Big 2023 stories include:<ol style="list-style-type: none"><li>1) BOJ capitulation/hikes</li><li>2) Fed terminal rate &amp; does the Fed cut.</li></ol></li></ul>

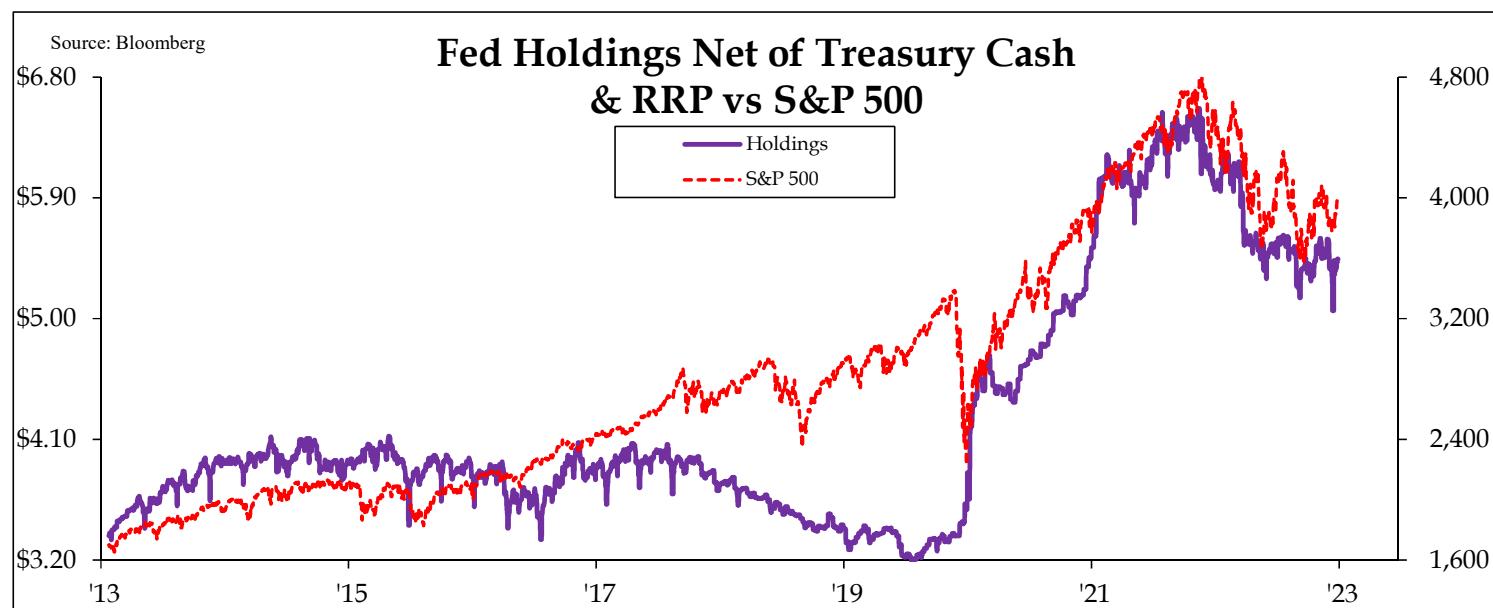


## Monetary Conditions Tightened In 2022, But Eased In Latter Portion Of Year



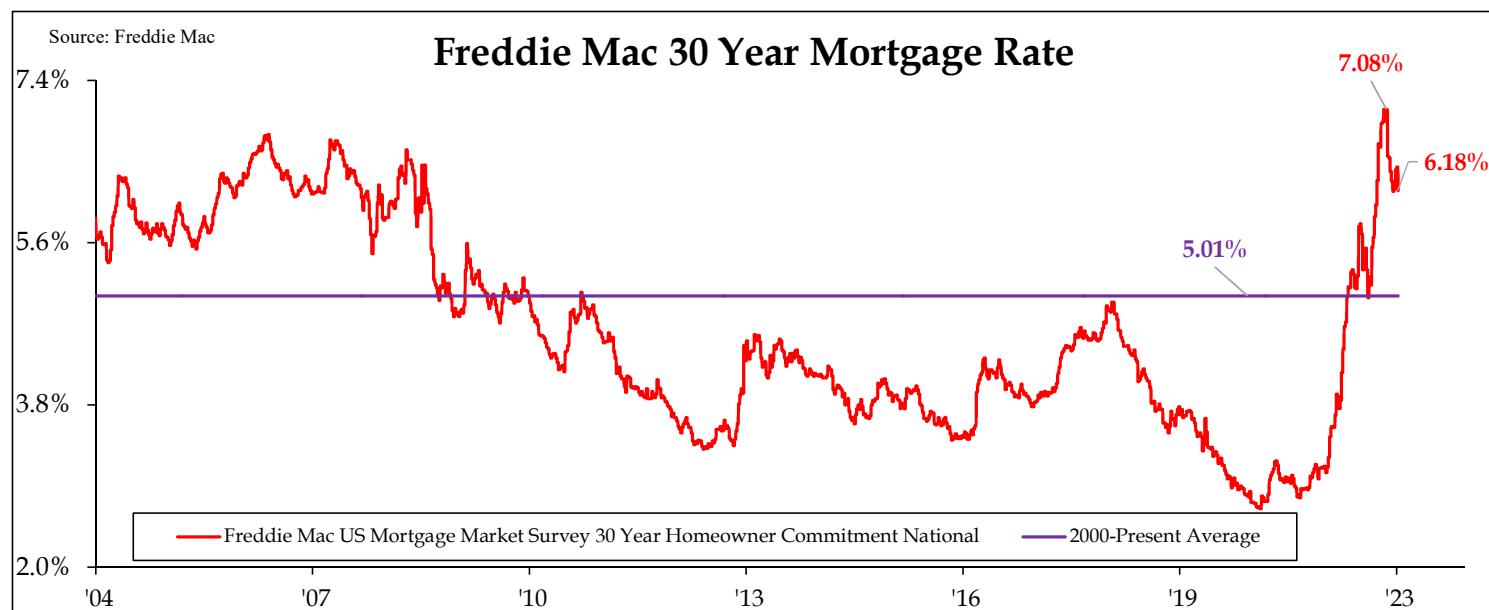


## Market Liquidity Important to S&P Performance



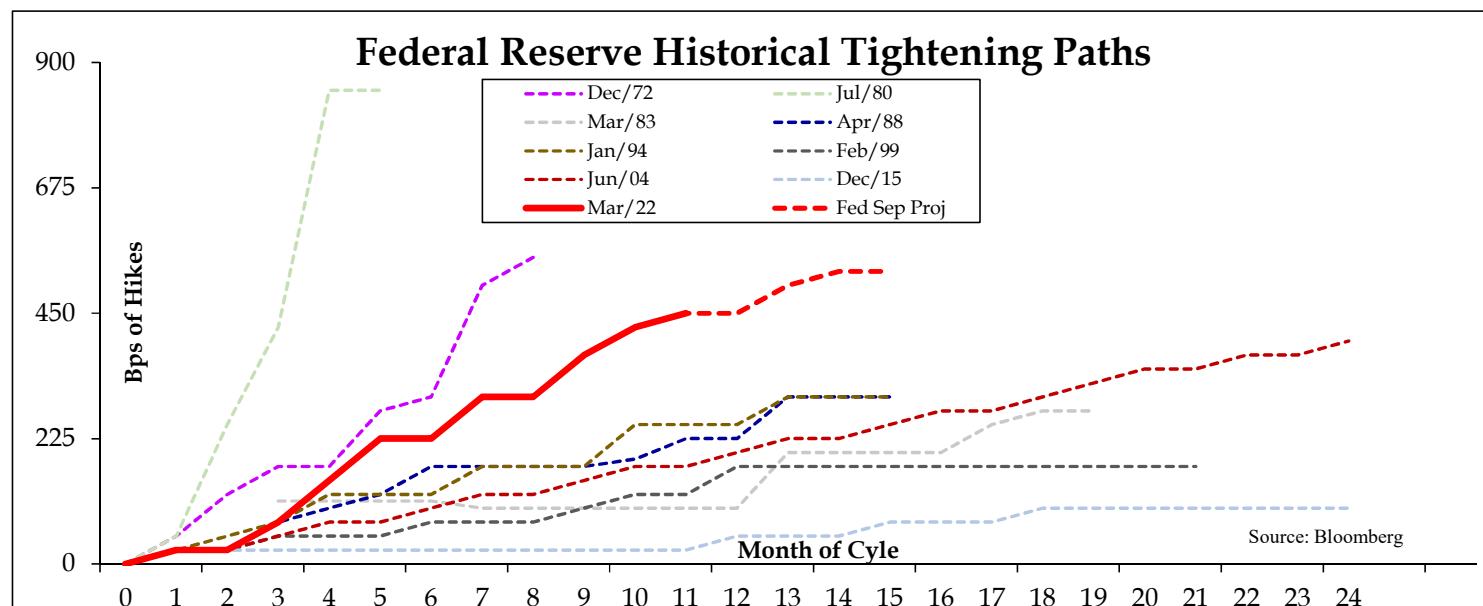


## Mortgage Rates Still Elevated



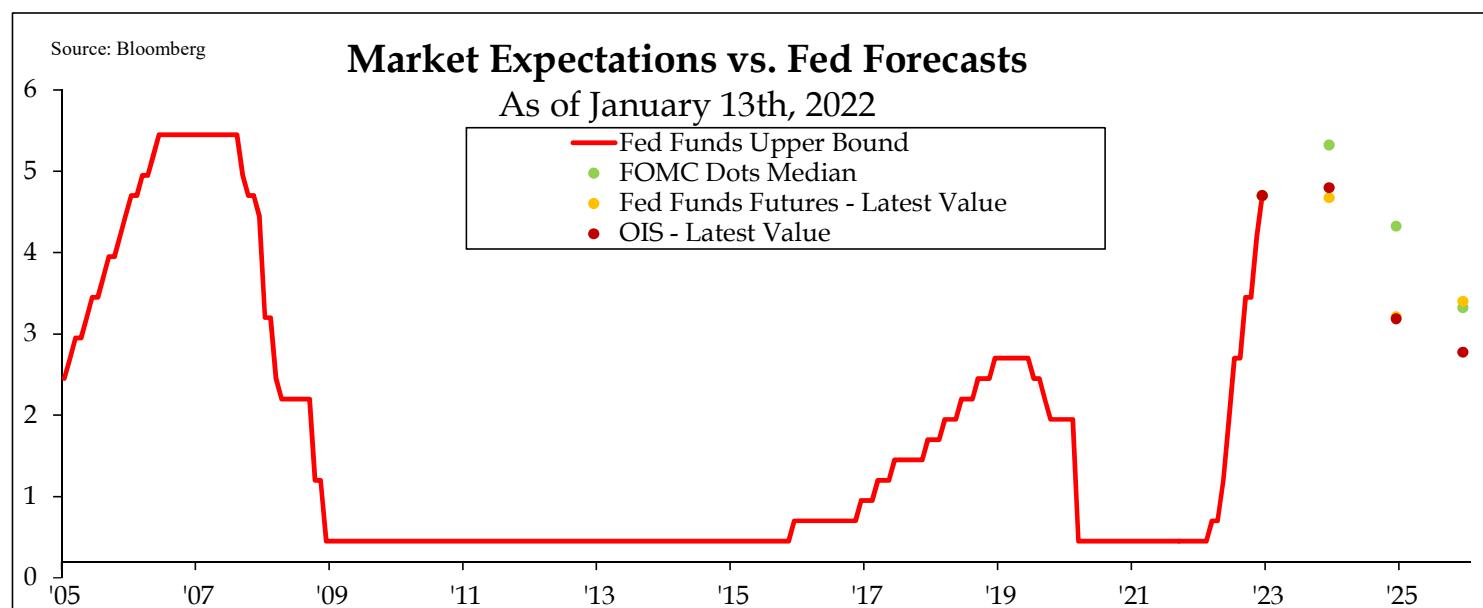


## 2022 Cycle Has Been 3<sup>rd</sup> Fastest Cycle Since 1970



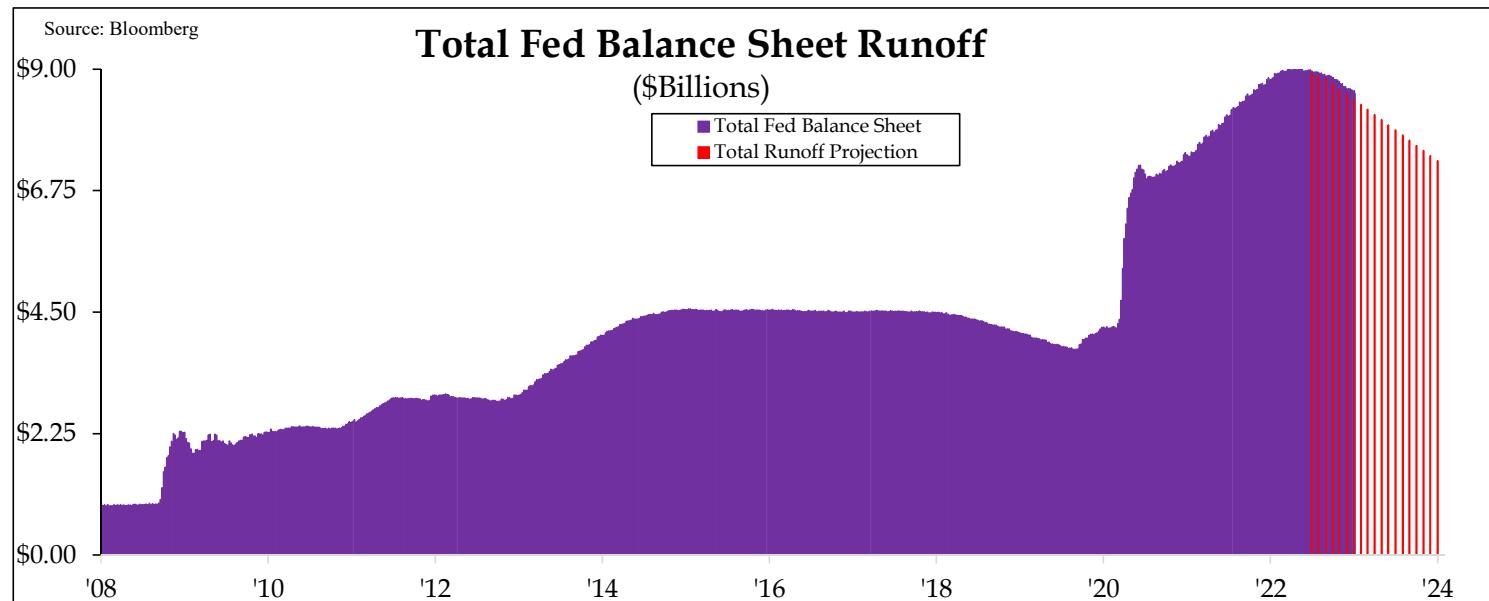


## Fed Says 5.25% Terminal Rate, Market Does Not Buy It



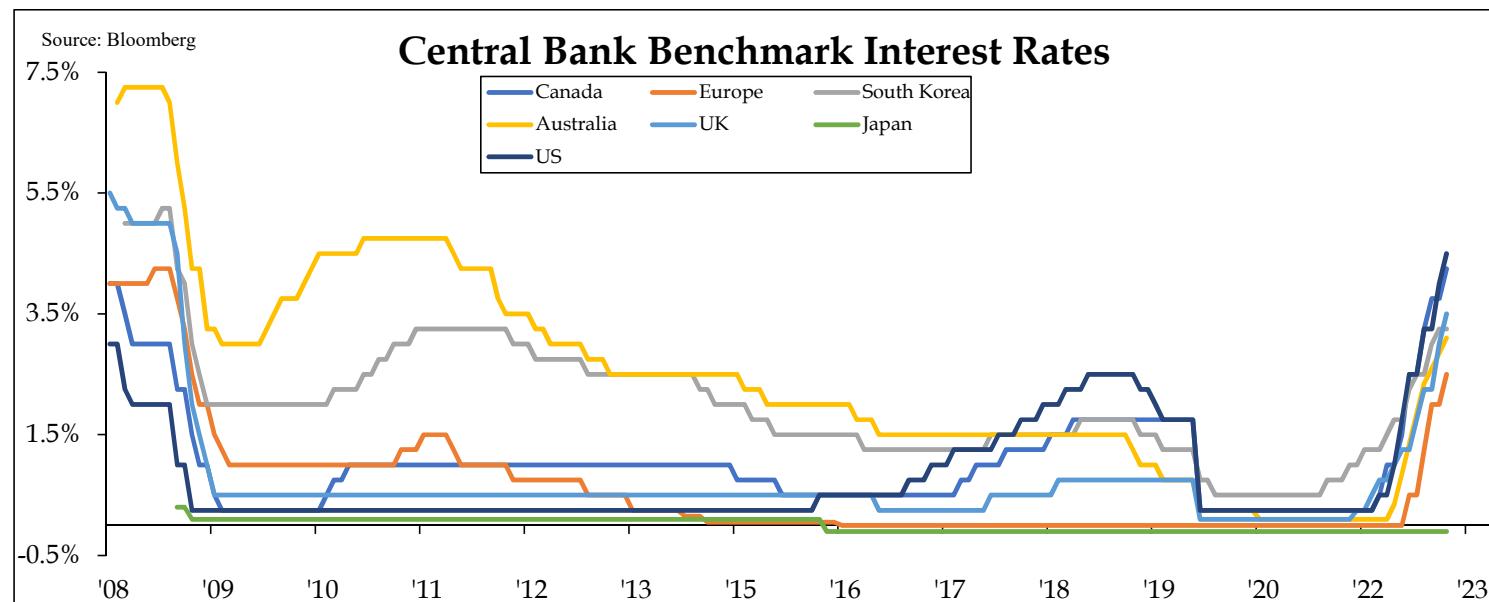


## Balance Sheet Runoff has Been Negligible





## Regime Change in Interest Rates Evident





## Strategas Yield Forecast

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



## APPENDIX – IMPORTANT DISCLOSURES

This communication was prepared by Strategas Securities, LLC (“we” or “us”) and is intended for institutional investors only. Recipients of this communication may not distribute it to others without our express prior consent. This communication is provided for informational purposes only and is not an offer, recommendation or solicitation to buy or sell any security. This communication does not constitute, nor should it be regarded as, investment research or a research report or securities recommendation and it does not provide information reasonably sufficient upon which to base an investment decision. This is not a complete analysis of every material fact regarding any company, industry or security. Additional analysis would be required to make an investment decision. This communication is not based on the investment objectives, strategies, goals, financial circumstances, needs or risk tolerance of any particular client and is not presented as suitable to any other particular client. The intended recipients of this communication are presumed to be capable of conducting their own analysis, risk evaluation, and decision-making regarding their investments.

For investors subject to MiFID II (European Directive 2014/65/EU and related Delegated Directives): We classify the intended recipients of this communication as “professional clients” or “eligible counterparties” with the meaning of MiFID II and the rules of the UK Financial Conduct Authority. The contents of this report are not provided on an independent basis and are not “investment advice” or “personal recommendations” within the meaning of MiFID II and the rules of the UK Financial Conduct Authority.

The information in this communication has been obtained from sources we consider to be reliable, but we cannot guarantee its accuracy. The information is current only as of the date of this communication and we do not undertake to update or revise such information following such date. To the extent that any securities or their issuers are included in this communication, we do not undertake to provide any information about such securities or their issuers in the future. We do not follow, cover or provide any fundamental or technical analyses, investment ratings, price targets, financial models or other guidance on any particular securities or companies. Further, to the extent that any securities or their issuers are included in this communication, each person responsible for the content included in this communication certifies that any views expressed with respect to such securities or their issuers accurately reflect his or her personal views about the same and that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this communication. This communication is provided on a “where is, as is” basis, and we expressly disclaim any liability for any losses or other consequences of any person’s use of or reliance on the information contained in this communication.

Strategas Securities, LLC is affiliated with Robert W. Baird & Co. Incorporated (“Baird”), a broker-dealer and FINRA member firm, although the two firms conduct separate and distinct businesses. A complete listing of all applicable disclosures pertaining to Baird with respect to any individual companies mentioned in this communication can be accessed at <http://www.rwbaird.com/research-insights/research/coverage/third-party-research-disclosures.aspx>. You can also call 1-800-792-2473 or write: Robert W. Baird & Co., PWM Research & Analytics, 777 E. Wisconsin Avenue, Milwaukee, WI 53202.