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# Capital Markets Outlook
# 3Q 2023


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## Summary

*Outlook*

- The global economy proved resilient to recession in the second quarter. However, the US is likely to see slower growth and lower inflation for the remainder of 2023 and into 2024.
- There is evidence that inflation will fall in the coming months. With goods prices already back to the pre-pandemic norm, the key variable will be services inflation.
- The Fed paused interest rate hikes in June but indicated that there will be additional interest rate increases in 2023.

*Key Risks*

- If the labor market doesn't weaken, interest rates could continue to move higher.
- Higher interest rates could theoretically disrupt the economy in an unforeseen way.

### Review

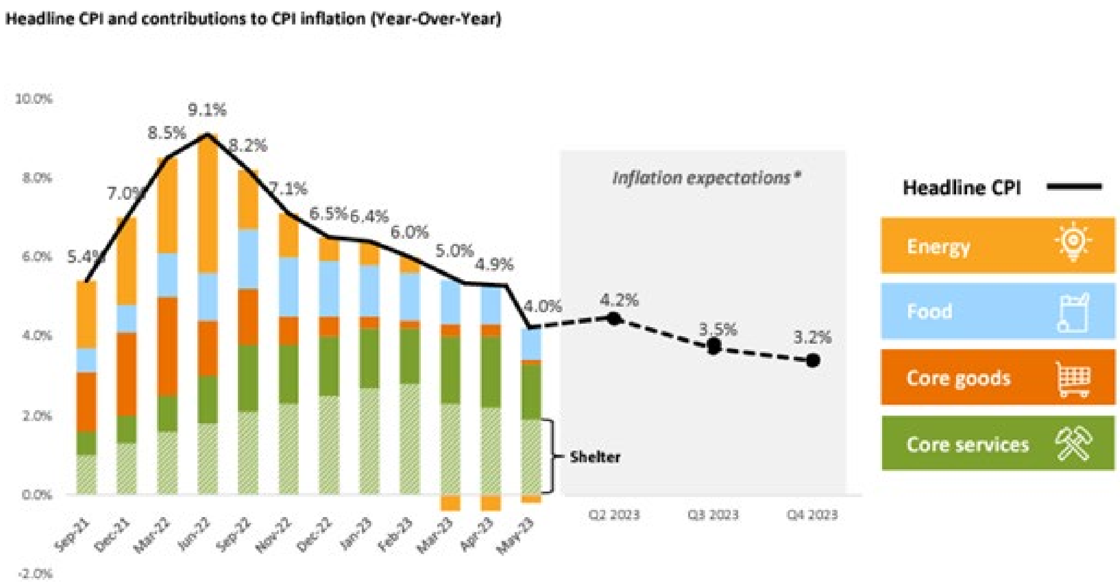
The economy proved more resilient than many expected in the first half of 2023. Stronger-than-expected economic data and steady corporate earnings have supported markets as they recover from the downturn in 2022. Positives have included low unemployment, real wage growth, strong consumer spending, and solid corporate fundamentals. As a result, many major asset classes have posted positive returns in the first half of 2023.

| | YTD | 1 Year |
|---|---|---|
| **Large Cap** | 16.8% | 19.4% |
| **Mid Cap** | 8.9% | 17.6% |
| **Small Cap** | 6.0% | 9.6% |
| **International** | 12.5% | 18.6% |
| **Emerging Markets** | 5.2% | 0.9% |
| **1-3 Year Treasuries** | 1.0% | 0.0% |
| **7-10 Year Treasuries** | 2.0% | -3.3% |
| **20+ Year Treasuries** | 4.7% | -7.8% |
| **Aggregate Bond** | 2.3% | -1.0% |
| **TIPS** | 2.1% | -1.6% |

*Source: YCharts. S&P 500 Index, S&P MidCap 400 Inde[2], S&P SmallCap 600 Index, MSCI EAFE Index, MSCI Emerging Markets Inde[x], ICE Us Treasury 1-3 Year Bond Index, ICE US Treasury 7-10 Year Bond Index, ICE US Treasury 20+ Year Bond Index, Bloomberg US Aggregate Bond Index, Bloomberg US Treasury Inflation-Linked Bond Index[1]*

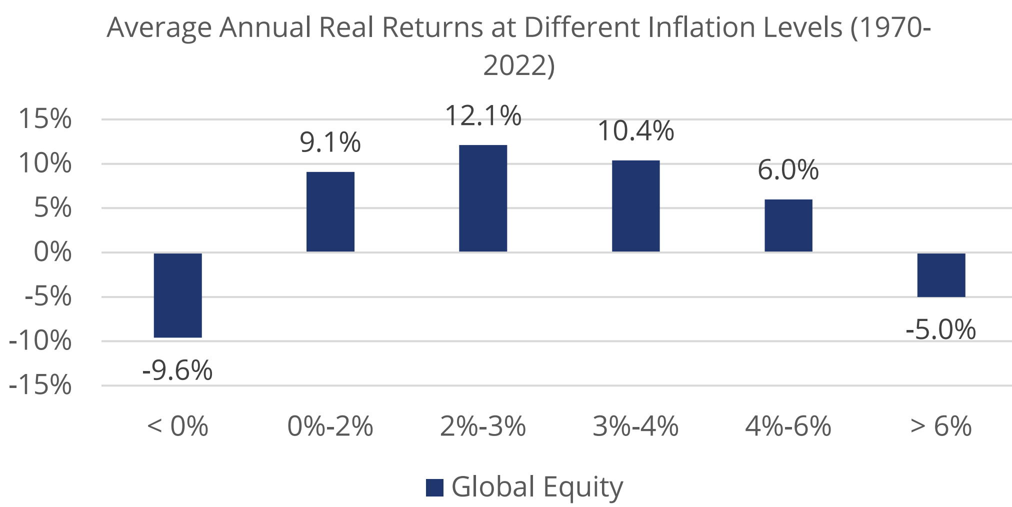
**Outlook**

Inflation has been a major focus since it peaked dramatically in the summer of 2022. Price increases have eased steadily since June 2022 and current expectations are for CPI to fall to 3.2% by the end of the year.



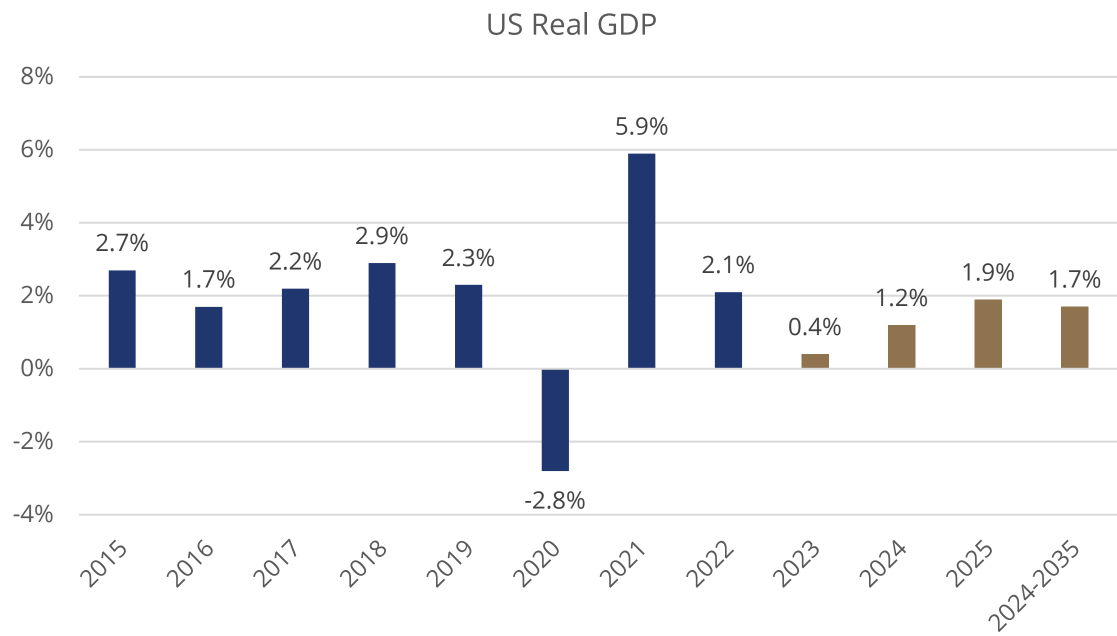

*Source: Lincoln Financial Market Intel Exchange, U.S. Bureau of Labor Statistics. Inflation projections for 2023 represent median analyst expectations compiled by Bloomberg as of 6/30/2023.*

Moving to less extreme level of inflation could be positive for risky assets. Historically, exceptionally high or low inflation have been the least desirable inflationary environments.



*Source: Capital Group "Equity investing in an inflationary environment." All returns are inflation-adjusted real returns. Global equity returns represented by MSCI World (broad global index of large and mid cap companies across 23 developed countries) to 30 September 2011 and thereafter MSCI ACWI (broad global index of large and mid cap companies across 23 developed countries and 24 emerging market countries). Inflation rates are defined by the rolling 12-month returns of the Ibbotson Associates SBBI US Inflation Index.*

While the economy has avoided recession as the Fed combats inflation, tighter monetary policy is expected the impact growth. The Fed has projected economic growth in 2023 and 2024 to be below what we have typically seen in recent years.




*Source: Federal Reserve Bank of St Louis, Federal Open Market Committee, The Conference Board. Future projections as of March 2023.*

If a slowing economy does fall into recession, it is important to remember that equity returns do not always have extreme downturns. The Great Financial Crisis caused significant losses and often comes to mind because it was so recent. However, history shows that returns during a recession can follow many different paths and that returns following a recession are almost always strong. There have been multiple recession that featured positive returns and only one case where returns were negative the year following a recession.

| Recession Start Date | Duration (months) | Return During Recession | Return 1 Year After | Return 3 Years After | Return 5 Years After |
|---|---|---|---|---|---|
| July 1953 | 10 | 18% | 30% | 62% | 101% |
| August 1957 | 8 | -4% | 33% | 50% | 61% |
| April 1960 | 10 | 17% | 10% | 23% | 44% |
| December 1969 | 11 | -5% | 8% | 10% | 5% |
| November 1973 | 16 | -13% | 23% | 7% | 22% |
| January 1980 | 6 | 7% | 8% | 34% | 57% |
| July 1981 | 16 | 6% | 20% | 46% | 66% |
| July 1990 | 8 | 5% | 8% | 19% | 72% |
| March 2001 | 8 | -2% | -18% | 3% | 23% |
| December 2007 | 18 | -38% | 12% | 48% | 113% |
| February 2020 | 2 | -1% | 44% | 4% | n/a |
| Average Return | | -1% | 16% | 31% | 56% |
| Number of positive periods | | 45% | 91% | 100% | 100% |

*Source: Lincoln Financial Market Intel. Morningstar, NBER. Cumulative price return of the S&P 500 index. Past performance is not indicative of future returns. Recession duration is measured from the first day of the month following the peak month, to the end of the trough month.*

**Conclusion**

There are economic risks ahead as growth is expected to slow. However, there remain opportunities in equities and fixed income due to attractive valuations, strong corporate balance sheets, and a resilient economy.

We will continue to monitor trends that we believe could impact your portfolios, such as the pace of the recovery, earnings growth, valuation, and inflation. Our goal is always to be efficient and selective in portfolio construction to best position clients for success.

If you have any questions, please don’t hesitate to reach out to your Academy Financial advisor.

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*[1]The S&P 500 index covers the 500 largest companies that are in the United States. These companies can vary across various sectors. The S&P MidCap 400 Index, more commonly known as the S&P 400, is a stock market index from S&P Dow Jones Indices. The index serves as a barometer for the U.S. mid-cap equities sector and is the most widely followed mid-cap index in existence. The S&P SmallCap 600 Index is a stock market index established by Standard & Poor's. It covers roughly the small-cap range of US stocks, using a capitalization-weighted index. The MSCI EAFE Index tracks large cap and mid cap companies in developed countries around the world. The index primarily covers the Europe, Australasia, and the Far East regions. The MSCI Emerging Markets Index represents securities that are headquarted in emerging markets. An emerging market is considered a country that has not yet become developed because of economic characteristics. The ICE U.S. Treasury 1-3 Year Bond Index is part of a series of indices intended to assess the U.S. Treasury market. The Index is market value weighted and is designed to measure the performance of U.S. dollar-denominated, fixed rate securities with minimum term to maturity greater than one year and less than or equal to three years. The ICE U.S. Treasury 7-10 Year Bond Index is part of a series of indices intended to assess the U.S. Treasury market. The Index is market value weighted and is designed to measure the performance of U.S. dollar-denominated, fixed rate securities with minimum term to maturity greater than seven years and less than or equal to ten years. The ICE U.S. Treasury 20+ Year Bond Index is part of a series of indices intended to the assess U.S. Treasury market. The Index is market value weighted and is designed to measure the performance of U.S. dollar-denominated, fixed rate securities with minimum term to maturity greater than twenty years. The Bloomberg USAgg Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency). The Bloomberg US Treasury Inflation-Linked Bond Index measures the performance of the US Treasury Inflation Protected Securities (TIPS) market.*