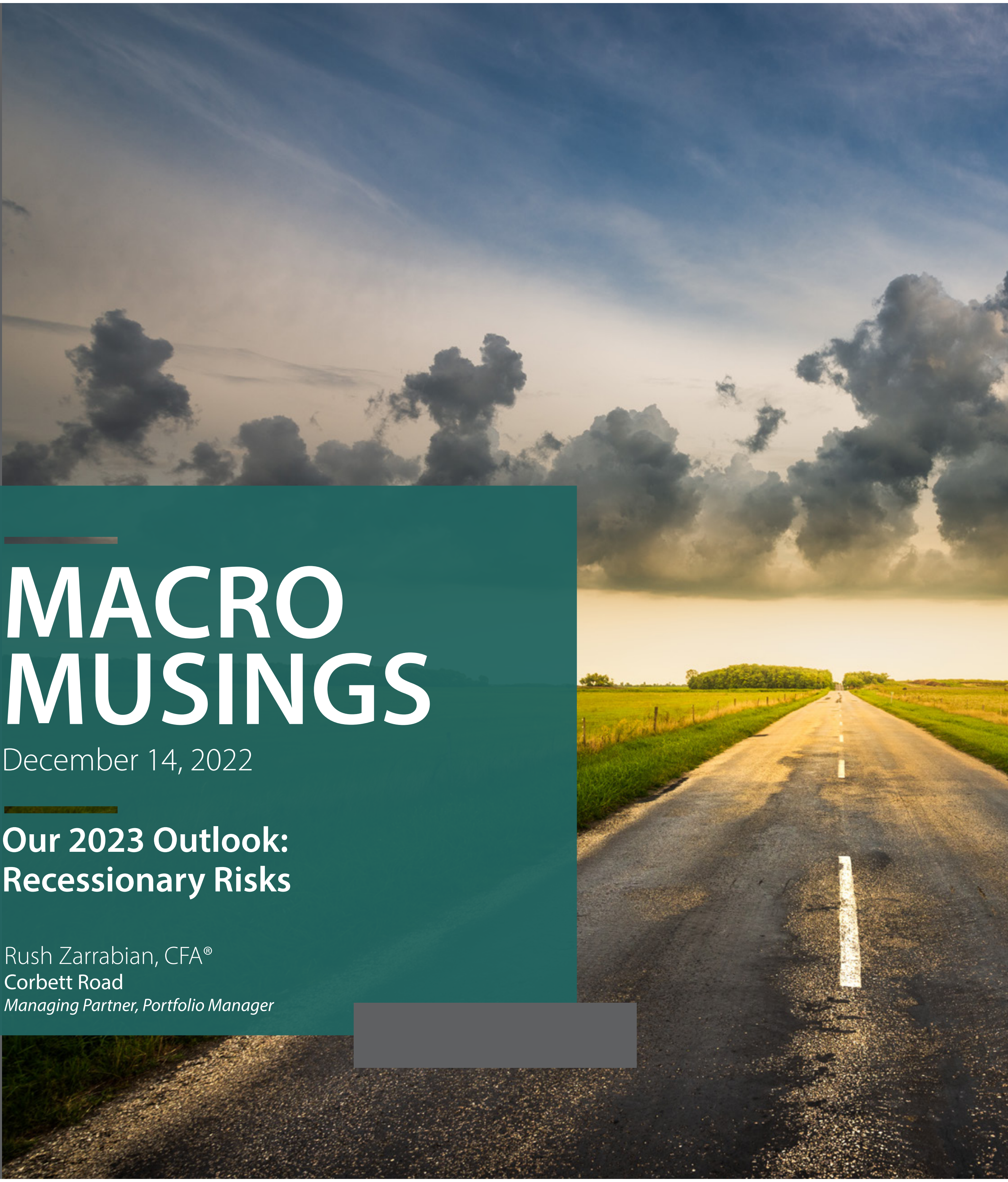

MACRO MUSINGS

December 14, 2022

Our 2023 Outlook: Recessionary Risks

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SUMMARY

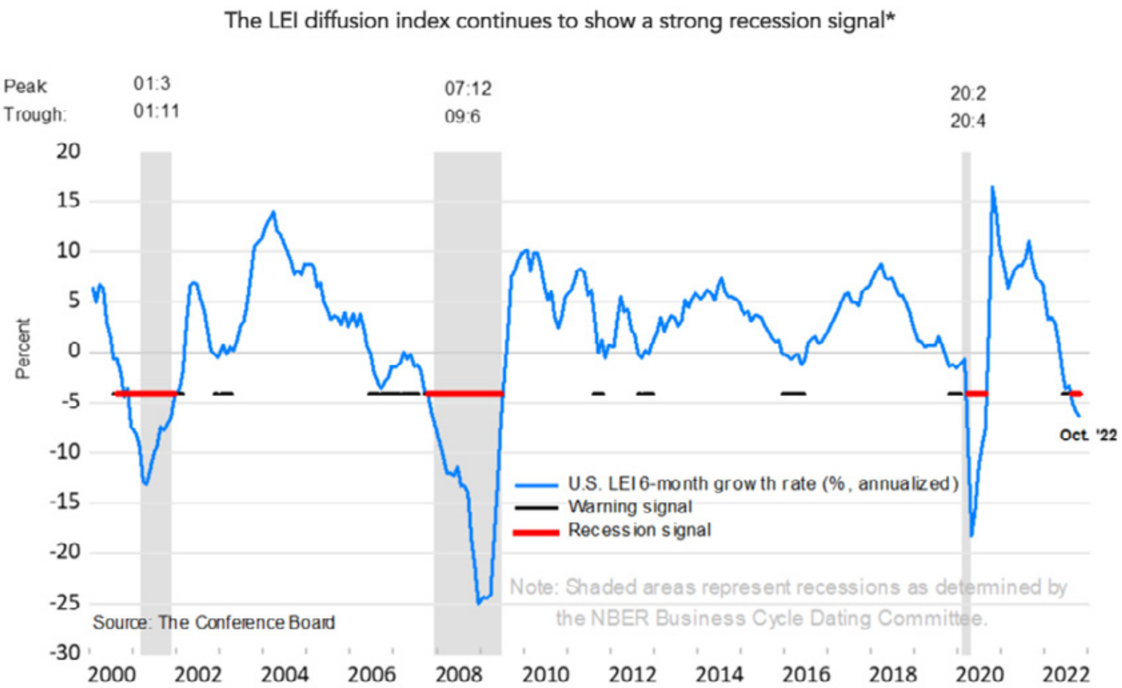
- The **macro**cast™ score suggests the probability of a recessionary bear market remains elevated, and the defensive position of **micro**cast™ reflects the volatile market conditions. The combination of both risk models suggests we remain in a challenging market environment, which we expect to persist into 2023.
- Most leading economic indicators are at levels consistent with past recessions, signaling a recession is likely sometime in 2023.
- In each recession since 1957, S&P 500 earnings have contracted. With analysts projecting mid-single-digit earnings growth next year, we do not believe a recession is adequately "priced in" to stock prices.
- As inflation continues to decline from its peak, we expect the focus to shift toward the weakening economic outlook in the year ahead.

CORBETT ROAD
WEALTH MANAGEMENT

THE BASE CASE FOR
THE US ECONOMY IS RECESSION

As outlined in the summary, our **macro**cast™ model indicates an increasing risk of a recessionary bear market while, the defensive posture of **micro**cast™ reflects the weakness and volatility in market internals. The current readings from both models suggest caution heading into the new year.

Along with our own proprietary indicators, we often refer to the Conference Board's Leading Economic Index (LEI) as a confirming data point for our economic outlook. The latest signal from this series points to a high probability of recession:



Note: The chart illustrates the so-called 3D's rule which is a reliable rule of thumb to interpret the duration, depth, and diffusion - of a downward movement in the LEI. Duration refers to how long-lasting a decline in the index is, and depth denotes how large the decline is. Duration and depth are measured by the rate of change of the index over the last six months. Diffusion is a measure of how widespread the decline is (i.e., the diffusion index of the LEI ranges from 0 to 100 and numbers below 50 indicate most of the components are weakening). The 3D's rule provides signals of impending recessions 1) when the diffusion index falls below the threshold of 50 (denoted by the black dotted line in the chart), and simultaneously 2) when the index over the most recent six months falls below the threshold of -4.0 percent. The red dotted line is drawn at the threshold value (measured by the median, -4.0 percent) on the months when both criteria are met simultaneously. Thus, the red dots signal a recession.

The chart(s)/graph(s) shown is(are) for informational purposes only and should not be considered as an offer to buy, solicitation to sell, or recommendation to engage in any transaction or strategy. Past performance may not be indicative of future results. While the sources of information, including any forward-looking statements and estimates, included in this (these) chart(s)/graph(s) was deemed reliable, Corbett Road Wealth Management, Spire Wealth Management LLC, Spire Securities LLC and its affiliates do not guarantee its accuracy.

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The sharp decline in leading indicators has exceeded levels typically seen in a mid-cycle slowdown, and the current rate of contraction is consistent with signals that have preceded economic recessions over the past twenty years. Leading economic data suggests the soft landing scenario is less likely.

RECESSION LEADS TO **NEGATIVE EARNINGS GROWTH**

An economic recession most notably impacts equity markets by reducing corporate earnings. On a year-over-year basis, earnings have contracted between 10% and 30% during recessions since 1957 (table from Cresset Capital):

Recession	YoY Earnings Drawdown	S&P
2020	-20.1%	-19.6%
2009	-29.5%	-45.8%
2001	-23.1%	-43.8%
1990	-26.9%	-13.8%
1982	-16.3%	-13.6%
1974	-17.5%	-42.6%
1970	-10.2%	-26.2%
1960	-14.6%	-22.2%
1957	-17.0%	-13.7%

Source: Standard & Poor's; Cresset Capital.
Chart #1380

Equity markets reflect future expectations, so the performance of the S&P 500 does not always correlate perfectly with the changes in earnings growth, but in each of the cases shown above, stocks fell at some point during the decline in corporate profits.

Even though the S&P 500 has produced negative returns in 2022, we believe the stock market has not yet "priced in" a recession. Earnings growth was positive this year, and analysts on Wall Street expect earnings to grow an additional 5.5% in 2023, according to FactSet. These expectations are inconsistent with prior recessions, which saw earnings decline each time. With leading economic indicators pointing towards a recession, it is likely that current earnings estimates are too optimistic and will be revised lower next year, creating a headwind for stocks.

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MARKET PERFORMANCE IS USUALLY WORSE **EARLY IN A RECESSION**

The following table from Schroders highlights the average S&P 500 returns during a recession:

Chart 3: Average S&P returns are typically higher towards the end of recessions Schroders

Note: Performance statistics based on daily S&P 500 price returns. For recessions less than 12 months, they are excluded from the first 6 months and last 6 months calculation.
Source: Refinitiv, Yahoo Finance, Schroders Economics Group, 5 December 2022. 606693

Recessions often see negative equity market returns, but on average, the drawdowns typically occur in the early stages of the economic downturn. This is consistent with the view that the stock market is a forward-looking indicator that usually leads GDP by 2-3 quarters. In the back half of a recession, stocks will often rally as the economic outlook improves.

WHAT ABOUT **INFLATION AND THE FED?**

In our view, inflation will be less of an issue next year. While higher inflation and interest rates were the key themes driving markets this year, we expect the focus in 2023 to shift to the deteriorating economic outlook and the challenges weaker growth may pose for equity markets. The Fed may continue raising rates in 2023, but we do not expect to see the same degree of tightening that we've experienced over the past twelve months as inflation continues to decline from its peak in June.

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In summary, leading economic indicators continue to weaken and are at levels that have historically suggested a recession is likely. Economic recessions tend to see corporate earnings decline, which creates a headwind to potential equity market upside. In our opinion, analyst estimates do not seem to be incorporating the probability of a recession into their forecasts, with the consensus expecting S&P 500 earnings to continue growing next year. While the S&P 500 usually declines during a recession, on average, it recovers before the recession is over.

This is the final Macro Musings of the year. We will publish our 2022 Year in Review next month.

We at Corbett Road would like to thank all our clients and partners for your continued trust and business during a very challenging year for equity and fixed-income markets. We wish you a happy and safe holiday season and a successful New Year.

IMPORTANT DISCLOSURES

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