

# Allocation Insights



## MACROECONOMIC OVERVIEW

- The paths for inflation, monetary policy, and the economy remain uncertain, but we expect to find balance with these issues as the year progresses, initiating a transition to a new cycle of positive but lower economic growth and the next bull market.
- We expect core PCE inflation to fall to 3.50%–3.75% by the end of 2023, modestly above the Federal Reserve (Fed’s) latest projections and consensus estimates. Wage pressures should gradually ease as the economy slows and unemployment rises, but not yet to a level to support 2% inflation.
- We expect economic growth to be muted in 2023. We see a reasonable chance of a soft landing (0.0% to 0.5% GDP growth), but a roughly equal chance of a mild recession (-0.1% to -0.5% GDP growth). The consumer will be a deciding factor.
- The Fed is likely to pause after an additional 50 basis points (0.50%) of tightening as policy reaches a sufficiently restrictive level, and the full effects of cumulative tightening have yet to show up in the economy.



## PORTFOLIO CONSTRUCTION IMPLICATIONS

- For the better part of six months, we’ve maintained a neutral stance in our dynamic asset allocation (DAA) versus our longer-term strategic asset allocation (SAA). As we begin 2023, uncertainty persists, so our DAA guidance continues to reflect caution.
- This somewhat unusual circumstance gives us the opportunity to reinforce two elements of our investment philosophy. 1) Our investment approach is anchored in a long-term view, and we believe a portfolio aligned with our SAA guidance is well positioned for that investment horizon. 1) Our choice to be neutral on any DAA leaning is an active decision, informed by our macroeconomic and market analysis, whereby we choose to be neutral.
- We’re anticipating modestly positive calendar year returns for stocks in 2023, but with continued volatility and market weakness in the near term.
- We expect investment opportunities to emerge as we find balance on these and other issues and are prepared to take advantage of such possible dislocations.

## ALLOCATION INSIGHTS

Taking our portfolio implications into consideration, our key allocation insights as we start the year include:









- **Embrace Quality.** Focus on companies that exhibit quality fundamentals like healthy balance sheets, strong margins, stable earnings, and/or stable and growing dividends. We believe the market decline has presented compelling investment opportunities for long-term investors across market capitalization, sector, and style.
- **Celebrate Yield.** A higher level of predictable portfolio income helps in a volatile and uncertain environment. The reset in fixed income yields has created opportunities in bonds. Our focus on quality inspires in fixed income a focus on the investment-grade market, which is offering better yields today than has been the case for more than a decade prior to 2022.
- **Trust 60/40.** Both stocks and bonds were down last year. With yields now much higher and the global economy slowing, investors should have confidence that stocks and bonds, as reflected in the traditional 60/40 portfolio, will provide diversification for one another over the long term. We also guide investors to diversify both across and within asset classes. And the more sophisticated, qualified investor can look beyond “traditional” asset classes to what the industry has defined as “alternative investments.”

# STIFEL

## INVESTMENT THEMES

The following table summarizes our thinking across various asset classes and regions.

 Underweight
  Neutral
  Overweight







|        |  | ASSET CLASS  | CURRENT   | COMMENTS  |
|--------|--|--|---|---|
| EQUITY |  |  |    |   |
|        |  | <b>U.S. Equity vs. Non-U.S. Equity</b>                 |    | While non-U.S. equity relative valuations remain attractive for longer-term investors, we remain neutral given the global economic and geopolitical headwinds. The strength of the U.S. consumer and corporate balance sheets put the U.S. on a stronger footing, but richer valuations mean near-term weakness is possible.                                    |
|        |  | <b>U.S. Large Cap vs. U.S. Small Cap</b>               |    | Small cap company valuations are providing an attractive entry point for skilled investors. Falling prices reflect, to a good degree, the concerns about higher interest rates and an economic slowdown. But lower valuations create opportunities. We guide investors to implement an overweight with active management.                                       |
|        |  | <b>U.S. Large Value vs. U.S. Large Growth</b>          |   | In this environment, we believe investors should diversify across both value and growth styles. Within U.S. large cap, we have a modest overweight to dividend growth and quality companies, regardless of style.   |
|        |  | <b>Non-U.S. Developed Markets vs. Emerging Markets</b> |    | Risks stemming from China and the war in Ukraine are each binary, meaning one or both could quickly dissipate, or get worse. Our team is closely following the developments in China and Europe, and we are prepared to act swiftly as we receive further clarity on the macroeconomic outlook.   |
|        |  | Europe vs. Japan                                       |    | We see investment opportunities across regions of the world. Japan's corporate governance reform is a positive and likely to enhance shareholder value in the medium to long term. Risks from the war in Ukraine are largely reflected in European stock valuations, and there is meaningful upside potential if and when we see a diplomatic resolution there. |

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## INVESTMENT THEMES (CONTINUED)

The following table summarizes our thinking across various asset classes and regions.

 Underweight    
  Neutral    
  Overweight

|              | ASSET CLASS                               | CURRENT   | COMMENTS   |
|--------------|---|---|--|
| FIXED INCOME | U.S. Investment Grade vs. U.S. High Yield |    | Bond yields are the most attractive they have been in the last 10–15 years, despite coming off of recent highs. Near-term volatility and an economic slowdown may exacerbate near-term price losses in high yield.   |
|              | Corporates/<br>Government/Agency<br>MBS   |    | While our base case is for Treasury yields and corporate spreads to remain range bound, we remain neutral and diversified across fixed income supersectors given the fat tail risks of our bear and bull scenarios.  |
|              | Duration                                  |    | We view duration as a diversifier in a multi-asset class portfolio given the near-term uncertainty and remain neutral to the overall market.   |
| ALTERNATIVES | Private Assets                            |    | For investors interested in alternative investments and able to handle illiquidity, exposure to some combination of private equity, private debt, and/or private real estate can be considered as part of a diversified portfolio.                                     |
|              | Hedge Funds                               |    | For investors interested in alternative investments and able to handle less liquidity who have conviction about manager skill, exposure to hedge funds can be a helpful part of a diversified portfolio. This is especially true in volatile, low-return environments. |

## DISCLOSURE

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation, or needs of individual investors. There is no guarantee that the figures or opinions forecasted in this report will be realized or achieved. Employees of Stifel, Nicolaus & Company, Incorporated or its affiliates may, at times, release written or oral commentary, technical analysis, or trading strategies that differ from the opinions expressed within.

Diversification and asset allocation do not ensure a profit or protect against loss. Investing involves risk, including the possible loss of principal. Any data on past performance contained herein is no indication as to future performance. The value of any investment may fluctuate as a result of market changes. The information in this document is not intended to predict actual results, and no assurances are given with respect thereto. The products mentioned in this document may not be suitable for all types of investors.

Led by Stifel Chief Investment Officer Michael O'Keeffe, the Stifel CIO Office is comprised of several investment professionals. The team works collaboratively with other Stifel professionals to develop macroeconomic analysis, market analysis, strategic and tactical asset allocation guidance, applied behavioral finance, and specific investment solutions for advisors and clients.

## ASSET CLASS RISK

**Bonds** – Bonds are subject to market, interest rate, and credit risk. Prices on bonds and other interest rate-sensitive securities will decline as interest rates rise. Municipal bonds may be subject to state and alternative minimum taxes, and capital gains taxes may apply. High yield bonds have greater credit risk than higher quality bonds. Yields and market values will fluctuate, and if sold prior to maturity, bonds may be worth more or less than the original investment.

**Equities** – Portfolios that emphasize stocks may involve price fluctuations as stock market conditions change. Small and mid capitalization stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies.

**International/Global/Emerging Markets** – There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries.

**Alternative Investments** – Alternative investments involve a high degree of risk, often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing tax information, are not subject to the same regulatory requirements as more traditional investments, and often charge high fees, which may erode performance. An investment is appropriate only for investors who have the capacity to absorb a loss of some or all of their investment. Alternative investments may include, but are not limited to: Real Estate Investment Trusts (REITs), Commodities, Futures, and Hedge Funds. **Real Estate** – When investing in real estate companies, property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance. **Commodities and Futures** – The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains. **Hedge Funds** – Investors should be aware that hedge funds often engage in leverage, short-selling, arbitrage, hedging, derivatives, and other speculative investment practices that may increase investment loss. Hedge funds can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, and often charge high fees that can erode performance. Additionally, they may involve complex tax structures and delays in distributing tax information. While hedge funds may appear similar to mutual funds, they are not necessarily subject to the same regulatory requirements as mutual funds.

## INDEX DESCRIPTIONS

The Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market. The average market capitalization is approximately \$4 billion, and the median market capitalization is approximately \$700 million.

The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.

The Standard & Poor's/TSX Composite Index is the benchmark Canadian index, representing roughly 70% of the total market capitalization on the Toronto Stock Exchange with about 250 companies included in it.

The Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 Index, which measures the performance of the 3,000 largest U.S. companies based on total market capitalization. The average market capitalization is approximately \$11 billion, and the median market capitalization is approximately \$3.5 billion.

The Russell 1000 Growth Index measures the performance of those Russell 1000 index companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 1000 Value Index measures the performance of those Russell 1000 index companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the broader Russell 3000 Index, which measures the performance of the 3,000 largest U.S. companies based on total market capitalization. The average market capitalization is approximately \$490 million, and the median market capitalization is approximately \$395 million.

The Russell 2000 Growth Index measures the performance of those Russell 2000 index companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 2000 Value Index measures the performance of those Russell 2000 index companies with lower price-to-book ratios and lower forecasted growth values.

The Russell Microcap Index is a capitalization-weighted index of 2,000 small cap and micro cap stocks, including the smallest 1,000 companies in the Russell 2000 plus 1,000 smaller U.S. based listed stocks. Over-the-counter stocks and pink sheet securities are excluded.

The MSCI World ex USA All Cap Index captures large, mid, small, and micro cap representation across 22 of 23 Developed Markets (DM) countries (excluding the United States). With 8,138 constituents, the index covers approximately 99% of the free float-adjusted market capitalization in each country.

The MSCI EAFE Index (Europe, Australasia, and the Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.

The MSCI Europe Index is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of the developed markets in Europe.

The MSCI Pacific Index captures large and mid cap representation across five Developed Markets (DM) countries in the Pacific region. With 470 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market. With 322 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

The MSCI EM (Emerging Markets) Europe, Middle East and Africa Index is a free float-adjusted market

capitalization weighted index that is designed to measure the equity market performance of the emerging market countries of Europe, the Middle East, and Africa.

The Bloomberg U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related, and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and nonagency). Provided the necessary inclusion rules are met, U.S. Aggregate-eligible securities also contribute to the multicurrency Global Aggregate Index and the U.S. Universal Index, which includes high yield and emerging markets debt.

The Bloomberg U.S. Government/Credit Bond Index is a broad-based flagship benchmark that measures the non-securitized component of the U.S. Aggregate Index. It includes investment-grade, U.S. dollar-denominated, fixed-rate Treasuries, government-related, and corporate securities.

The Bloomberg U.S. Treasury Index measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. Treasury bills are excluded by the maturity constraint, but are part of a separate Short Treasury Index. STRIPS are excluded from the index because their inclusion would result in double-counting. The U.S. Treasury Index is a component of the U.S. Aggregate, U.S. Universal, Global Aggregate, and Global Treasury Indices.

The Bloomberg U.S. Treasury U.S. TIPS index includes all publicly issued, U.S. Treasury inflation-protected securities that have at least one year remaining to maturity, are rated investment grade, and have \$250 million or more of outstanding face value.

The Bloomberg U.S. Municipal Index covers the U.S. dollar-denominated, long-term, tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds.

The Bloomberg U.S. Credit Index measures the investment-grade, U.S. dollar-denominated, fixed-rate, taxable corporate and government-related bond markets. It is composed of the U.S. Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals, and local authorities.

The Bloomberg U.S. Corporate High Yield Bond Index measures the U.S. dollar-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded.

The Bloomberg Global Aggregate Bond Index is a flagship measure of global investment-grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate, and securitized fixed-rate bonds from both developed and emerging markets issuers.

The Bloomberg Emerging Markets Hard Currency Aggregate Index is a flagship hard currency Emerging Markets debt benchmark that includes U.S. dollar-denominated debt from sovereign, quasi-sovereign, and corporate EM issuers.

The Wilshire U.S. REIT Index is a float-adjusted market capitalization-weighted index that measures U.S. publicly traded real estate investment trusts (REITs), excluding mortgage REITs, net-lease REITs, real estate finance companies, home builders, large landowners and sub-dividers, hybrid REITs, and companies that have more than 25% of their assets in direct mortgage investments.

The Wilshire ex U.S. Real Estate Investment Trust Index<sup>SM</sup> (Wilshire ex U.S. REIT) measures global publicly traded real estate investment trusts, less all U.S. securities. The Wilshire ex U.S. REIT is a subset of the Wilshire ex U.S. Real Estate Securities Index<sup>SM</sup> (Wilshire ex U.S. RESI).

The Wilshire Global REIT Index is a float-adjusted, market capitalization-weighted index that measures global publicly traded real estate investment trusts (REITs), excluding mortgage REITs, net-lease REITs, real estate finance companies, home builders, large landowners and sub-dividers, hybrid REITs, and companies that have more than 25% of their assets in direct mortgage investments.

Bloomberg Commodity Index (BCOM) is calculated on an excess return basis and reflects commodity futures price movements. The index rebalances annually weighted two-thirds by trading volume and one-third by world production, and weight-caps are applied at the commodity, sector, and group level for diversification. Roll period typically occurs from the sixth to the tenth business day based on the roll schedule.

The S&P GSCI Crude Oil Index is a sub-index of the S&P GSCI Commodity Index. The production-weighted index reflects the returns that are potentially available through an unleveraged investment in the West Texas Intermediate (WTI) crude oil futures contract.

The Wilshire Liquid Alternative Index<sup>SM</sup> measures the collective performance of the five Wilshire Liquid Alternative strategies that make up the Wilshire Liquid Alternative Universe. The Wilshire Liquid Alternative Index (WLIQA) is designed to provide a broad measure of the liquid alternative market by combining the performance of the Wilshire Liquid Alternative Equity Hedge Index<sup>SM</sup> (WLIQAEH), Wilshire Liquid Alternative Global Macro Index<sup>SM</sup> (WLIQAGM), Wilshire Liquid Alternative Relative Value Index<sup>SM</sup> (WLIQARV), Wilshire Liquid Alternative Multi-Strategy Index<sup>SM</sup> (WLIQAMS), and Wilshire Liquid Alternative Event Driven Index<sup>SM</sup> (WLIQAED).

Indices are unmanaged, do not reflect fees or expenses, and you cannot invest directly in an index.