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Economic INSIGHT

2023 Outlook — The Inflation Clock Keeps Ticking: Stubbornly Elevated Prices Push Rates Higher for Longer With a Modest Recession

The unevenness in the data, not to mention the uncertainty in the outlook for the economy and policy, has left a number of questions unanswered as the new year approaches. Investors and consumers alike continue to wonder is the U.S. in recession? How deep and prolonged will the downturn be? Has inflation peaked, and if so, will price pressures continue to retreat from here? What are the upside risks to sustained inflation in the U.S. and globally? And of course, can monetary policy offer a solution to the country's elevated level of prices with so many inflationary variables stemming from outside the Federal Reserve (Fed)'s control? Will the Fed have the resolve to stay the course as policy intentionally forces the economy into or further into recession?

Looking out to 2023, the Fed will continue to face an uphill battle to slay the inflation dragon, as the longer price pressures remain above the preferred target range, the more they become embedded into the economy. Furthermore, given the challenging composition of inflation, including lingering supply-side constraints, traditional monetary policy actions may prove less effective in combating price growth, resulting in a higher-for-longer rates scenario. Although, while the Fed will expectedly tighten more than previously expected, forcing a return of negative activity in 2023, near-term pain will no doubt offset a larger, longer-term struggle should inflation be left unchecked. For the consumer, higher borrowing costs, a lingering low level of labor market participation, and depleted savings will increasingly weigh on spending activity. However, as shoppers reduce or shift spending behaviors, businesses will presumably continue a growing trend of investment, particularly in technology to replace costly labor and grow productivity, a missing component of domestic activity for more than a decade. International uncertainty will exacerbate market unease, consistently resulting in sizable volatility and threatening dysfunction.

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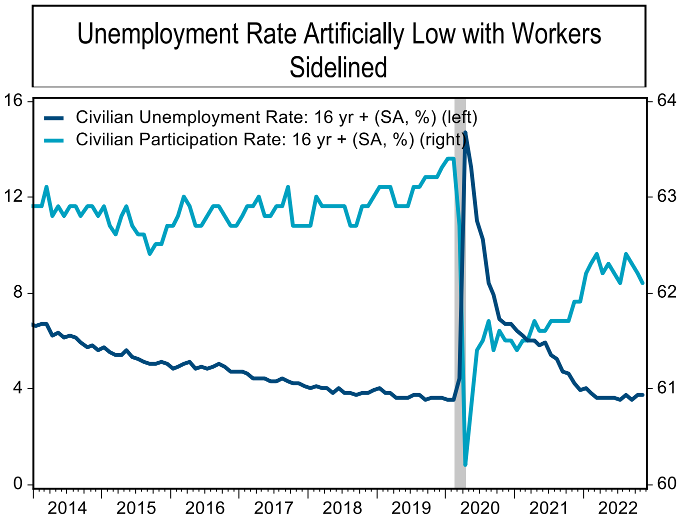
THE LABOR MARKET AND THE CONSUMER

Tight labor market conditions carry into 2023 with some reprieve, while consumer spending declines further amid still-elevated prices.

While arguably the recessionary box can be checked for nearly every sector of the economy, that is not the case for the U.S. labor market, at least for the time being. The pace of hiring has slowed and will expectedly continue to slow into 2023. However, with labor demand severely outpacing labor supply, conditions remain tight, seemingly satisfying the Fed's mandate of full employment and allowing officials to remain hyper-focused on stable prices.



Source: Bureau of Labor Statistics/Haver Analytic

Of course, much of the employment gains over the past 31 months have simply been job replacement as opposed to job creation, with the labor market only returning the 22 million jobs lost during the pandemic as of July. Assuming a more normal pathway of improvement, the U.S. labor market still remains six million shy of where job creation arguably should be without the COVID disruption, a gap that will presumably widen near term.

Nevertheless, a five-decade low in the unemployment rate has not and does not signal weak labor market conditions, despite the artificially low nature of the jobless rate due to a lingering low level of labor force participation. Driven to the sidelines by ongoing fears of contracting or spreading COVID, attempting to strike a work-life balance, struggles to establish reliable child care or eldercare services, or continuing to draw down earlier COVID-era savings, barriers will remain for a return to a more traditional level of participation. While seemingly counterintuitive, a rise in the unemployment rate going into next year could be a sign of improved labor market conditions if such an increase reflects previously sidelined workers returning to the labor market and seeking employment.

Near-term supports stemming from drawing down savings, adjusting monthly purchases, and ramping up credit card and other forms of debt have and will continue to support modest, but positive, spending activity. Such factors, however, will not support would-be workers indefinitely. Without further fiscal initiatives or a massive taming of inflation, consumers will continue to slow the pace of expenditures, as household balance sheets become increasingly fragile under the weight of rising price pressures and modest income gains. While businesses remain desperate for workers, driving higher average hourly earnings against the backdrop of elevated inflation, real income growth will continue to trend negative into 2023 until the Fed has slain the inflation beast.

The notion of a reduced or evaporated wealth cushion is already causing an outright shift or reduction in spending habits. For some, this means curtailing purchases. For others, this means downgrading the quality or brand of their purchases. And for others – particularly the younger generation – this has resulted in binge spending, or a scenario where consumers pull back as much as possible one month in order to purchase a more expensive or higher ticket item the next. However, regardless of the form it is taking, it has become increasingly evident that consumers are dramatically shifting the goods and services in their basket from one month to the next, a reflection of growing unease regarding household financials.

Given the likely extended timeline for price stability to be achieved, businesses, meanwhile, will struggle to shoulder an increased burden of costs from parts, materials, and rents, as well as labor. Some corporations have already announced sizable layoffs or hiring freezes. Others, particularly small businesses, have slowed or stalled investment. This growing trend will presumably lead to a rising number of closures or bankruptcies into next year, particularly as reduced profits – and profit expectations – for 2023 lead to credit quality problems. Larger businesses, or those with a heavier access to capital, will likely seek to offset the rising cost of labor as an input and increasingly turn to technology, potentially displacing – permanently – at least some job positions, particularly on the lower end of the skills spectrum. For now, however, elevated labor costs are likely to continue for at least as long as workers remain scarce.

THE HOUSING MARKET

Higher borrowing costs continue to slow activity, but a lingering supply shortfall provides welcome support.

The pandemic disproportionately impacted the housing market, and now inflation is having a similar outsized increase on activity. In the immediate aftermath of the COVID crisis, Americans were looking at their homes very differently than they had before: as a workplace, a school, and in many cases, a refuge. For example, some fled the cities for safety, sought less expensive alternatives outside cities, or additional space to accommodate a home office. Others sought to take advantage of low interest rates or the new "*work from anywhere*" environment. There were a plethora of variables resulting in a surge of housing market activity during and in the immediate aftermath of the pandemic. More recently, rising interest rates, heightened materials costs, limited access to labor, particularly specialized labor, and declining real income growth continue to undermine affordability.

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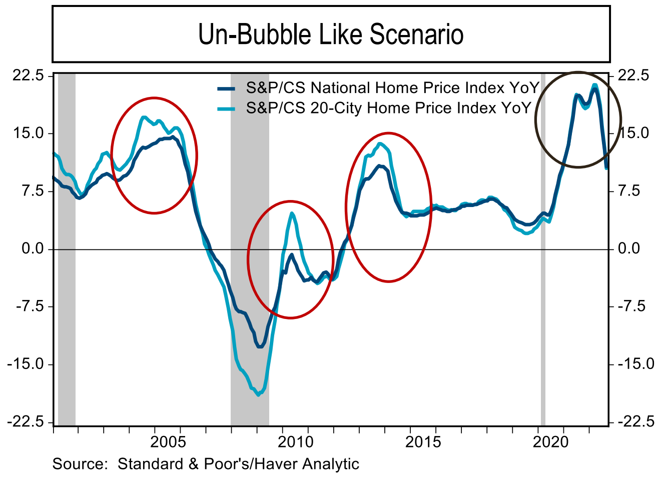


That being said, even with demand off peak levels and supply rising from lows, there remains a sizable shortage of housing stock. Facing a multi-year deficit, demand continued to outpace supply, leaving prices still firmly in positive territory, although markedly below peak growth rates. Looking out to 2023, there remains additional downside momentum to prices as activity continues to recede. However, unlike earlier housing market cycles that began from a point of equilibrium, natural growth in demand for shelter stemming from immigration, population growth, and traditional household formation will seemingly provide welcome support to the current market even as borrowing costs remain elevated or push higher still.

Much of the double-digit housing price growth in the last two years has been in secondary or even tertiary housing markets, as opposed to the traditional "*hot*" downtown urban centers that have historically outpaced the national market during housing market booms. Thus, rather than a reflection of a housing market bubble, price growth appears more structural – and sustainable – in nature as individuals relocated themselves and their families from one location to another.

PRODUCTION AND SUPPLY CHAIN DISRUPTIONS

With incremental signs of improvement, ongoing limitations to global trade hinge on international policy adjustments.

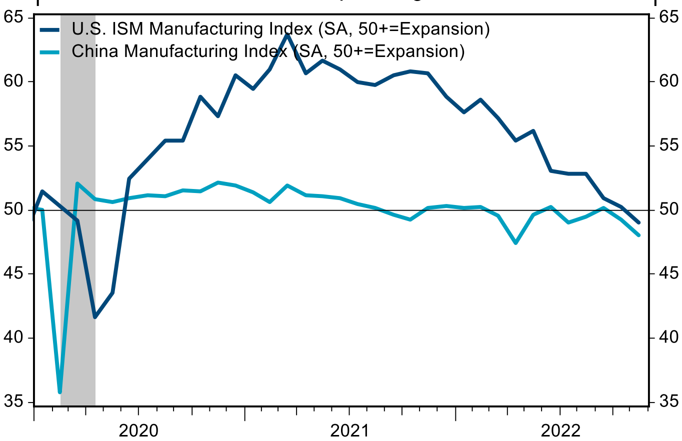
With a *relative* decline in spending on a nominal basis, consumers nevertheless have and will continue to keep pressure on producers to increase output, or at least maintain sufficient production to meet the reduced but still positive level of orders. However, even if businesses can find the workers they need, which remains a big if with more than 10 million current job vacancies, there are ongoing supply limitations, supply chain bottlenecks, and disruptions that continue and, in some cases, may intensify in the near term. While supply chain disconnects have improved broadly by roughly 50% from the peak disruptions, supply chain pressures remain at historically high levels.

As a result, heading into the new year, industry insiders will presumably continue to report – as they have now for years – shortages of production inputs from copper wire, tires, and the chips used in the auto industry, to transformers, lumber, pallets, and even shipping containers themselves. Without a return to a fully functional global marketplace, producers will struggle to obtain the parts and materials needed for production, resulting in ongoing extended wait times, further price pressures, and additional complications from an inventory management standpoint. As consumers reduce or shift their spending habits, many businesses inclined to hoard parts and materials when they become available will be left sitting on only partially producible or undesirable goods.

When will supply chain issues be addressed or when will dislocations dissipate? First, there have already been marked improvements from peak levels of distortions in the immediate aftermath of the pandemic. Second, more broadly, the answer will depend on global policy, particularly China's Zero-COVID policy, limiting a return to a free flow of goods and services. Even with a recent reduction in international safety protocols, attempts to fully restore structural fluidity to the global exchange of goods and services likely remains several years out.

Recent protests overseas have increased expectations for a more accelerated timeline of improvement. Going forward, demonstrations should continue to have a meaningful impact on adjusting China's COVID protocols, likely resulting in a further reduction or lessening of safety restrictions into 2023. Beijing, however, does have a threshold for such "*unruly behavior*" and a history of cracking down on protestors. If pressed too hard or too far, the Chinese government will not hesitate to flex its muscles.

Domestic Output Faces Lingering Supply Chain Restraints and Reduced Spending



Sources: ISM, CFLP/NBS/Haver

From an economic standpoint, China's Zero-COVID policy has already had serious implications for the country's growth, evoking calls for adjustments. With China's GDP falling well short of expectations, reigniting domestic production and consumption – particularly luxury consumption – could add several percentage points to current topline growth both in China and globally. Of course, an expedited reopening and surge in demand, particularly demand for high-end or luxury items, will pose an upward threat to inflation. Assuming the recovery time from a one-day shutdown in operations is loosely two weeks, extrapolating out to nearly two years of disruptions, it stands to take a prolonged period of time to return Chinese production and capacity utilization rates back to pre-COVID levels even as COVID-policy becomes more accommodative.

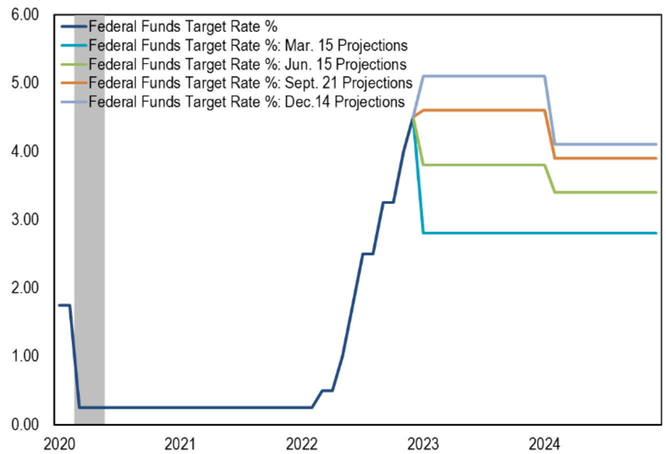
The evolution of global trade relations and geopolitical tensions will shape the timeline for supply chain relief in the U.S. and around the world. Any erosion of trade lines, additional sanctions, and further international conflict in regions like the Middle East, Eastern Europe, or Asia Pacific will only serve to exacerbate complications and dislocations in global supply networks. Incremental progress is likely to continue throughout 2023; however, returning to the free-flow of goods and services of the pre-pandemic era and entirely easing product and price pressures is likely years out.

MONETARY POLICY, INFLATION, AND GROWTH

A slower ascent in policy results in ultimately higher rates as inflation remains elevated amid a modest technical recession.

As Federal Reserve Chairman Jerome Powell noted most recently at the final December Federal Open Market Committee (FOMC) meeting of the year, while the Fed has *taken "forceful actions to tighten the stance of monetary policy,"* and the *"full effects"* of earlier tightening has not yet been felt, there is more work to be done. *"Price stability,"* Powell said, *"is the responsibility of the Federal Reserve and serves as the bedrock of our economy."* While inflation has made meaningful improvement, falling from peak levels, price pressures remain well above the Committee's earlier expectations for year-end levels and even further above the Fed's 2% target range. With already 425 basis points (bps) in tightening having a clearly minimal impact on taming inflation, ongoing rate increases are presumably necessary. The Fed has said higher, the question remains how much higher? The answer will dpend on inflation.

Federal Reserve Projects Higher Rates for Longer



Source: Federal Reserve Board/Bloomberg

There are multiple components that go into the inflation equation, and unfortunately, all are pushing on the aggregate inflation rate at present. Such pressures will expectedly remain well into 2023 and beyond, albeit it at a potentially waning pace over the next 12-36 months. On the supply side, domestic and global supply chain issues, China's Zero COVID policy, commodity price shocks, energy market uncertainty, and pressures will all continue to pose upside risks to inflation, variables that are largely outside of the Fed's control.

While significant improvements have been made in clearing global supply chains, distortions still remain. Parts and materials are still limited in number and availability. Of course, domestic consumption is slowing – as intended by tighter monetary policy – alleviating some pressure on producers to meet a previously elevated level of demand in the marketplace. And internationally, mainland China may be on the verge – or least heading towards – a (full) reopening, a scenario that would vastly assist in easing global supply limitations and, by extension, global price pressures. Of course, when it comes to the outlook for the energy market, stabilization or maintaining balance largely hinges on the potential for reduced geopolitical tensions or international struggles, particularly between Russia and Ukraine. As Powell noted at the December FOMC meeting, the risks to inflation are largely to the "*upside*."

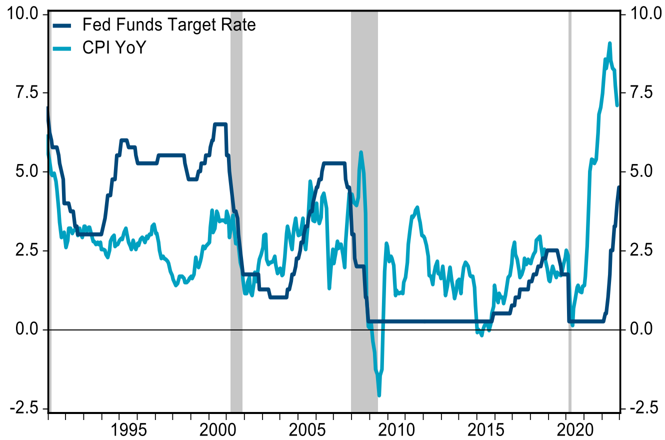
The longer the conflict persists, the more measures Western nations will undertake in an attempt to rob Moscow of key revenues, interference that could further destabilize markets. Russia remains the world's third largest oil producer and second largest oil exporter, thus the impact of the price caps, sanctions, or other policy measures will have global ramifications. Moscow may be able to skirt regulations in any form at least to some degree, keeping prices at current levels or even under, adding additional downward pressure. If not, a meaningful decline in Russian output could lead to upward pressure on global energy prices, particularly if Chinese demand picks up quickly amid a recent lessening of COVID protocols and restrictions.

On the demand side of the inflation equation, the primary driver – or scapegoat – remains earlier fiscal policy initiatives. While much of the world was – and is – contending with supply-side pressures of inflation, demand-side pressures in the U.S. were ignited with unprecedented monetary and fiscal support totaling nearly $6 trillion, with much of the spending in the form of direct payments to households and businesses, fueling a surge in consumption. Of course, much of the developed world also increased fiscal outlays, but Washington spent more than double the next highest spender, resulting in not only massive levels of additional debt, but also the highest levels of domestic inflation in the aftermath of COVID than most anywhere else in the world.

Inflation expectations, meanwhile, remain well anchored reflecting optimism that inflation will remain in check and continue its more recent decent. Furthermore, expectations are widely expected to remain well anchored amid clear policy intentions repeatedly vocalized by monetary policy officials rendering a reinstatement of price stability, the bedrock of the economy, the number one priority. Inflation expectations, of course, can drive realized levels of inflation. If consumers begin to expect higher levels of costs, they will change their behavior from a timing standpoint, adding to the near-term disconnect between supply and demand, and resulting in further upward pressure on prices. Essentially, that which is feared becomes a self-fulfilling prophecy.

Above all else, the Fed is intent on taming inflation and keeping price pressures from becoming entrenched. If inflation were entrenched, it would mean that cost pressures

Inflation Remains the Primary Driver of the Fed's Policy Directive



Sources: FRB, BLS/Haver

would remain elevated, and the more accelerated pace of price appreciation we see in the market today would be a more permanent fixture in the economic life of all Americans.

Approaching year-end, the market was fully anticipating a Fed pivot in December to a smaller size rate hike of just 50 bps after four supersized rate hikes of 75 bps, taking the upper bound of the federal funds range to 4.50% as of December 14. While conditions have displayed far from robust improvement, with policy makers raising rates at the fastest pace in nearly three decades, many are anxious to allow earlier policy initiatives to work their way through the system. After all, historically, the lag between monetary policy decisions and the impact on the real economy comes with a sizable lag of 6-12 months. However, new literature suggests that with increased transparency from Fed communication, including a press conference at every meeting, a quarterly Summary of Economic Projections (SEP), not to mention countless commentary and speeches delivered from Fed officials throughout most days of the year (with the exception of the Fed-speak blackout period), the lag has been significantly reduced given the anticipatory nature of financial market conditions. In other words, the need for a pause or a look-back to assess earlier rate adjustments may not be necessary. Powell has acknowledged the potential for a lag but remains focused on the need for further policy action, looking forwards not backwards.

Looking into 2023, the pathway for rates is much less certain. As the Fed seeks to achieve a *"sufficiently restrictive"* level of policy to reinstate the Committee's desired condition of stable prices, the still-elevated level of inflation is not yet convincing that policy has moved into the proper range even under the most generous or optimistic assumptions. For the better part of the past two years, policy officials have predicted a meaningful pullback in prices that has failed to materialize, suggesting an under-appreciation for the complicated nature of supply-side pressures. Thus, while the Committee appears to be ushering in a new phase of reduced incremental increases, an ongoing reduction from 50 bps to 25 bps in the first quarter is far from a forgone conclusion as market metrics imply. The pathway for a further reduction in rate hikes will depend on the evolution of inflation pressures and should inflation fail to improve as expected, the size of ongoing rate hikes as well as the terminal rate is likely to be significantly higher than previously expected.

Several surveys show market players are increasingly betting on a higher terminal rate in the range of 5.0-5.5% sometime next year, yet, while markedly above earlier expectations, that may not be sufficiently restrictive to rein in inflation. In fact, even 100 bps or more beyond market forecasts may be understating the maximum rate needed, given the potential for more hawkish assumptions of inflation, growth, and r*, which designates the long run or equilibrium real rate of interest.

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Of course, the question remains will the Fed's plan work to rein in inflation? And what are the consequences of such a rapid and ultimately elevated level of policy if realized? After all, typically the Fed is raising rates at a point when the economy is overheating. As the Fed raises the cost of capital to cool an expanding economy, investment and demand presumably slow, resulting in weaker growth and inflation. This time around, however, the economy is not overheating, the economy has already slowed markedly with growth essentially flat (0.2%) across the first nine months of the year. While activity is likely to remain positive in the final quarter of 2022, although markedly below the near 3% pace in the third quarter, with the Fed continuing to raise rates and intensifying the pressure on the consumer and businesses, a return to negative growth is expected as the calendar turns to 2023.

Additionally complicating the equation for the Fed, as well as the outlook for the economy, is the source of inflation pressures stemming from both the supply and demand sides of the equation. The Fed can address demand-side inflation by raising the cost of capital and tamping down consumption, a destruction in demand already somewhat evident with a slower pace of expenditures. Raising the cost of capital, however, does little to alleviate price pressures resulting from supply chain disruptions in the aftermath of COVID-19 or international conflict. Raising the federal funds rate cannot accelerate a reopening of the Chinese economy or force resolution between Russia and Ukraine. As Powell himself has said, the Fed can't print more ships.

Thus, following through with such an aggressive rate path will almost assuredly result in a return to negative growth and an outright technical recession come 2023, conditions that Fed officials say they are willing to tolerate to achieve their goal of price stability. In fact, even as policy approaches the terminal level, with demand presumably slowing markedly from here should inflationary pressures remain elevated – likely because of lingering supply-side constraints – the Fed may not continue to hike, but will likely be forced to keep rates at that elevated level for some time, certainly beyond what the market is pricing in, which is a rate cut shortly after reaching a peak level in policy.

The depth and duration of the downturn will very much depend on the lingering elevation of inflation and the ultimate level of monetary policy needed to undermine price pressures, as well as the ability for consumers to shoulder the continued burden of rising prices eroding the value of the U.S. greenback. Given the peak in the federal funds rate is likely to be reached over the next 6-9 months, the downturn will expectedly be somewhat shallow, leaving annualized growth off roughly 1-2%. The risk, however, remains to the downside, particularly given the nontraditional nature of inflation potentially rendering more traditional monetary policy actions less effective in fighting price pressures. In this instance, the Fed will be forced to raise rates higher than would typically be needed to reinstate price stability and by extension, causing a deeper and potentially longer period of pain in the domestic economy.

For the currency market, while the argument is broadly a further weakening in the U.S. dollar along with a further weakening of oil prices, such a conclusion is statistically limited. The broader support will stem from a relatively faster or milder downturn relative to developed counterparts.

From a rates standpoint, as the Fed continues to tighten, the short end will presumably move along with the Fed, the long end, however, will struggle to keep up with the Fed as policy intentionally moves the U.S. into or further into recession. As volatility expectedly persists with wild swings of over 100 bps as experienced earlier this year, movement in the long end will presumably fall short of overtaking the short end, leaving an ongoing inversion up and down the term structure throughout the year and well into 2023. Sustainable downward momentum will only return once the market anticipates the Fed is at or nearing the terminal rate *and* inflation has established a meaningful downward trajectory towards the Fed's 2% target.

While inflation does not need to reach the Committee's 2% target before the Fed backs off from more aggressive policy initiatives, the Committee is well aware that the risk of curtailing inflation-taming action too soon is sufficiently larger than overshooting. The former would potentially allow inflation to become permanently entrenched in the economy. In other words, not only are rates likely to be higher than previously expected, but also should inflation remain elevated as the Fed nears the terminal level, rates may need to remain at these elevated levels for longer than expected as well.

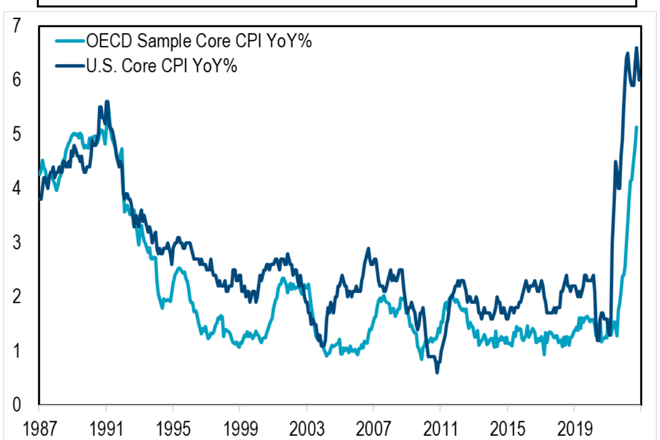
FISCAL POLICY AND MARKET DYSFUNCTION

A growing disconnect between monetary and fiscal policy compounds the challenge for the Fed to maintain orderly markets and tackle inflation.

Since March 2020, the Trump and Biden administrations have issued a whopping $5.7 trillion to combat the economic impact of the virus, or at least to counteract the policies aimed at stemming the spread of the virus. Such expansion of the government's balance sheet was not unique to the U.S. Developed nations in total spent $17 trillion on the pandemic, although the U.S. spent more than double the next highest spender, with much of the expenditures in the form of direct payments to individuals and households. While the debate continues over whether or not such policies were beneficial or even necessary, politics aside, there have been sizable consequences as a result of earlier fiscal initiatives, including a significant increase in debt and rapid inflation.

While, arguably, the U.S. has been on an unsustainable upward trajectory in terms of debt for some time, reaching 107% debt to GDP at the end of 2019, the slope of the increase shifted markedly higher at the onset of COVID and the COVID-related policies. In fiscal year 2022, the federal government ran a deficit of $1.38 trillion. The deficit for fiscal year 2023, of course, will be markedly less than the year prior given the significant reduction in outlays from the waning federal response to the pandemic. Still, the impact on the country's total outstanding debt level has been unprecedented, pushing the federal government's balance sheet to $31 trillion or relative to the size of the economy, up to 120%, and is furthermore forecasted to reach over $40 trillion by the end of the next decade. Debt servicing costs will also expectedly increase against the backdrop of a higher nominal level of debt as well as significantly higher interest rates. According to the CBO, interest payments will rise to $1 trillion by the end of the next decade and could total $66 trillion over the next 30 years.

Inflation Elevated in the U.S. and Across the Globe



*Sample includes: Canada, Denmark, Finland, France, Germany, Netherlands, Norway, Sweden, and the U.K.

Source: FRED

Additionally, while much of the world was and continues to reel from the impact of international disruptions resulting in significant supply-side constraints and price pressures, inflation in the U.S. has been exacerbated by fiscal policy initiatives fueling demand-side metrics and labor costs with trillions – upon trillions – of dollars flooding into the market. While inflation also jumped to historically peak levels elsewhere in the developed world, in the immediate aftermath of the COVID crisis, inflation in the U.S. was – significantly – above levels seen overseas. Of course, this sizable differential no longer holds true. While price pressures in the U.S. have receded, albeit minimally, from peak levels, inflation abroad continues to push higher amid ongoing supply-side constraints, particularly in the energy market. In the U.K., for example, annual November headline inflation remains near 11%, underscoring the need

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for policy makers to focus on reinstating price stability as opposed to coddling market participants or providing perpetual artificial support to economic activity. Such a reminder is equally welcome to domestic policy makers still encouraging additional fiscal – and monetary – policy intervention in the U.S.

Such initiatives including the Paycheck Protection Program, mortgage payment and student loan payment deferrals, as well as expanded unemployment benefits were initiated with the best of intentions, motives that carry to more recent policies including the Infrastructure Investment and Jobs Act and Inflation Reduction Act. These policies were – and are – aimed to increase American competitiveness, create jobs, and even tame inflation. The full reality of expansionary fiscal policies, however, while offering some benefits, also comes with sizable consequences, compounding debt and domestic inflationary pressures, as well as complicating the pathway for the Fed to achieve price stability. Of course, a divided government typically results in less policy action, favorable news for the central bank and markets alike. "*Gridlock*," however, may be an aggressive or simplistic characterization, as officials continue to negotiate an omnibus appropriations bill to fund the government through the remainder of fiscal year 2023 and the Biden administration seeks to push forward several additional initiatives, potentially under Executive Order.

Success in applying additional support for the economy, or more specifically for those still reporting a position of hardship or unemployment, will likely result in further permanent damage to public finances. Additionally, given the still-solid nature of the labor market and level of inflation in the U.S., market players may see such a disregard for monetary policy clearly pushing in the opposite direction as inappropriate and reckless, and working at opposing purposes of the central bank.

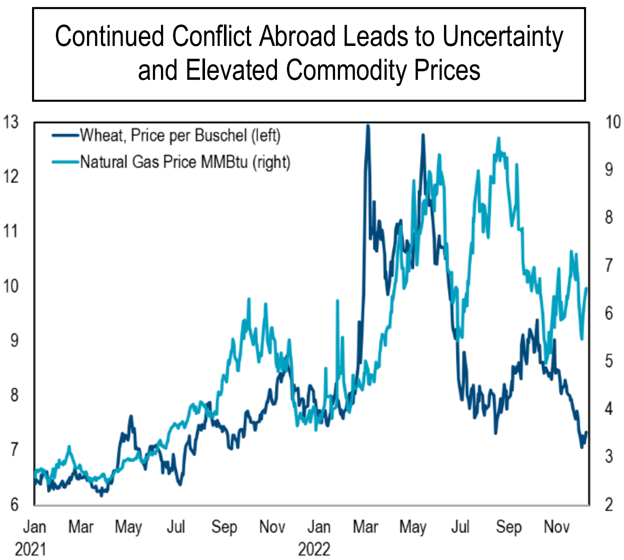
Such an assessment could result in market "*dysfunction*" if investors begin to react to increasingly accommodative fiscal policy against the backdrop of the latest Federal Reserve policy decisions already raising rates to a 15-year high. Volatility aside, if such sentiment resulted in a significant loss of liquidity or adequate flow of clearing action or credit to the real economy, similar to the September-October incident in England as investors responded to the massive tax cuts and spending initiatives of the short-lived Truss administration, then like the Bank of England that quickly announced plans to buy long-dated gilts and delay planned sales of debt in an effort to stabilize markets, Fed officials may also find it difficult to move forward with their proposed pathway of tighter policy until market action has been similarly smoothed. After all, a material risk to financial market stability would arguably warrant Fed intervention, however, any temporary pause or setback in policy will only exacerbate the tightening schedule ultimately needed to return price stability.

While fiscal conservatism or reduced government spending with sizable cuts in outlays is hardly a policy goal of either side of the aisle at this point, a lack of new momentum in action will be the most calming avenue to markets as the government faces an already uphill battle to contend with a rapidly growing deficit, immigration, as well as tenuous international relationships.

DARK HORSE

The U.S. economy will continue to face numerous risks including those not yet considered real-time threats as most seek to move beyond COVID and resolution to current conflicts.

While it's hard to imagine a more unprecedented or unexpected event than a global pandemic followed by a forced government economic shutdown, many risks to the outlook, and more broadly, the economy remain. First and foremost, while most have become complacent with COVID-19, returning to work and life as before the outbreak – at least as much as possible – caseloads are already increasing in China and the U.S. as well as elsewhere around the world. While Americans are increasingly less likely to tolerate a return to COVID safety protocols, quarantines, or lockdowns, economies overseas are monitoring virus loads and will respond in kind, particularly China, where many officials are reportedly "*anxious*" to return to more draconian measures. Furthermore, COVID-19 is unlikely to be the last global pandemic of our lifetimes. Will another virus emerge? When will it emerge? And will the government or the global economy respond in the same manner as it did to COVID-19?



Source: Bloomberg

As conflict persists overseas in Eastern Europe, a near-term solution appears increasingly unlikely or complicated. As such, Russian President Vladimir Putin has threatened the use of nuclear weapons, or at least insinuated the use of such warfare tactics is a possibility if Moscow is threatened as the battle ensues. Of course, there are those in the Putin regime that have less tolerance for such international posturing. If a more benign or clear-headed position becomes more widespread, the Kremlin may face a leadership change with the 70-year-old president "*permanently*" displaced from office. Russia is already under extreme pressure from its own populace to cease, or at the very least tamp down, military efforts in neighboring Ukraine. Sold as an easy victory, the ten-month conflict thus far has proven anything but. Aside from a significant loss of revenues as a result of Western sanctions, the mounting loss of life is tragic.

Russia could still secure the frontlines while gathering new waves of freshly trained recruits, a scenario more likely under a Republican blockage of additional spending or arms packages for Ukraine. However, even with thousands of new bodies, reports indicate Moscow is struggling to transition these young men into successful fighters, suggesting more is needed than just a military strategy. Putin will increasingly rely on time, prolonging conflict to undermine Ukraine's economy.

Additionally, a looming threat of conflict in the Mideast or the Far East as China tightens its grip on Taiwan could force U.S. involvement in a very costly and arguably avoidable conflict. President Biden has been somewhat unclear regarding the position of the U.S. with the One China policy, suggesting early on the U.S. military would intervene to defend Taiwan in any attack from China. As China increasingly enforces Beijing's policy control in Taiwan, civil clashes and demonstrations have been more frequent, escalating tensions and emotions. White House officials have walked back President Biden's comments, given the potential for a more conservative Republican takeover of the White House in 2024 – or potentially a Trump White House in 2024, should China wish to make a move to further ensure Taiwan remains under its thumb, the Biden administration may provide a more fortuitous opportunity given the less-than-robust perception of administration's current international policy agenda and ability.

Finally, conflict need not occur overseas to have a sizable impact on the American economy and psyche. As of November 15, former President Donald Trump announced plans to seek reelection in 2024. While early on in the bid for the White House, as the campaign ratchets up attention and exposure in 2023, a country already fiercely divided by politics is likely to feel salt poured on an open wound. Supporters and opponents alike will be freshly fueled to potentially reengage in the visceral reactions and commentary that have wreaked havoc on the ability for our political leaders to communicate effectively and civilly, as well as again wreak destruction on personal and work relationships and the mental well-being of all Americans.

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economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. Due to their narrow focus, sector-based investments typically exhibit greater volatility. Small company stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies. Property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance of real estate companies. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. The Standard & Poor's 500 index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market. The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ. The DJIA was invented by Charles Dow back in 1896. 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 NASDAQ Composite Index is a capitalization-weighted index that is comprised of all stocks listed on the National Association of Securities Dealers Automated Quotation System stock market, which includes both domestic and foreign companies.