December 28, 2023

Economic
INSIGHT

2024 Outlook: Don't Count Your Chickens Before They Hatch

Inflation Remains Elevated with Disappointing Pace of Improvement, Complicating the Fed's Policy Pathway Relative to Market Expectations

So much of the economy's momentum heading into 2024 is predicated on three main factors — the consumer, inflation, and monetary/fiscal policy. A more appreciable erosion of the consumer as temporary funding supports fade could result in a more precipitous decline in broad-based activity. Similarly, if recent *disinflationary* improvement slows or retreats, a fierce or unexpected response from the Federal Reserve (Fed) could undermine growth. Also, any fiscal efforts to artificially boost consumers and/or businesses to soften a near-term downturn could leave the U.S. economy vulnerable to a more sizable decline in the future.

In 2024, the Federal Reserve will expectedly continue to battle elevated inflation and be unsuccessful returning it to 2%. That battle has included 525bps in tightening over the past two years, and more recently holding policy steady for three consecutive meetings. While exercising patience allows the Committee to better assess earlier policy measures, the longer the Fed remains on the sidelines, 1) the more price pressures become embedded into the economy, which 2) could prompt policy makers to take an even firmer stance and slow the economy even more than would have been otherwise necessary under an expedited battle against inflation. The risk of the latter is undermining growth and sending the U.S. economy into negative territory for the first time since Q1 2022. The risk of the former, meanwhile, is that officials are compelled to simply give up on achieving their 2% goal. If left unchecked, this could allow the Fed to eventually achieve a soft landing amid sluggish but still positive activity, but the danger of prolonged elevated price pressures also raises the risk of stagflation.

For the consumer, despite improved labor market conditions, a rising level of debt coupled with higher borrowing costs and depleted savings will increasingly weigh on spending activity as well as business investment, save for technology which has the potential to counter rising labor input costs and subsequently grow productivity. Domestic dysfunction and bloated fiscal deficits will continue to reshape expectations for higher longer-term rates with international uncertainty and conflict exacerbating market unease

THE LABOR MARKET, THE CONSUMER AND INVESTMENT

Tight labor market conditions carry into 2024 with further improvement while consumer spending slows amid an increased reliance on debt accumulation and uncertainty keeps business investment at bay.

U.S. labor market conditions remain tight as gauged by a near five-decade low in the unemployment rate and still minimal level of growth in jobless claims. Additionally, while down from earlier peak levels, the current pace of job openings at 8.7M as of October suggests the need for further gains in hiring going forward at a pace (well)

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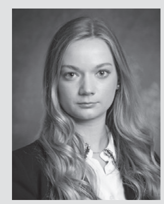

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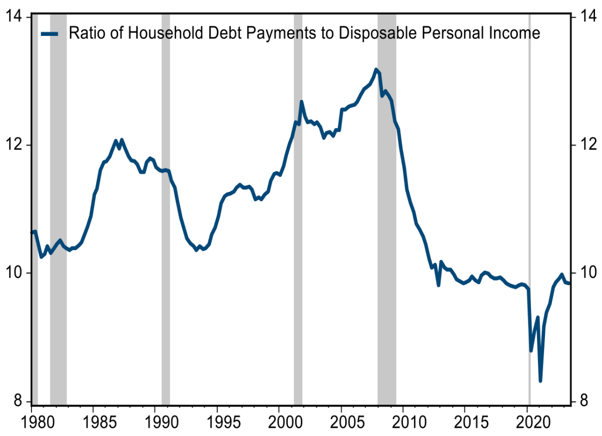
above that needed to drive joblessness higher into the Fed's full employment range. Ongoing slower but positive hiring will furthermore likely continue to support elevated wages, resulting in an ongoing positive real rate of earnings. While expectations of slower growth in 2024 and reduced momentum in consumer activity will result in progress softening the divide between labor demand and labor supply, the current environment of a *"fully employed"* economy will not yet result in the Committee's desired period of below trend job growth.

A solid labor market with real earnings trending positive since January 2023, coupled with upward revisions showing a slower depletion of pandemic savings, relatively weaker inflation and growing interest earnings, have worked to offset a loss of fiscal and other lingering pandemic supports, pushing out anticipated weakness in topline spending to the second half of 2024. Still nominally elevated prices and a return of student debt payments at an average monthly cost of $200-$300 will continue to compound pressure on household balance sheets; however, an increased appetite for borrowing will soften the pace and magnitude of the decline. The trend of intergenerational wealth transfers, tapping into 401ks, drawing down savings, relying on *"buy-now, pay-later"* options and ramping up credit card usage will expectedly remain throughout the foreseeable future, or at least as long as the household balance sheet remains stable. Currently near an all-time low, maintaining a post-pandemic trend pace of ascent, the debt-servicing ratio is likely to remain sufficiently below the threshold associated with a period of pronounced consumer weakness.



Source: Federal Reserve Board/Haver Analytic

Of course, higher borrowing costs will compound the *real* burden of debt, resulting in not only a significant rise in nominal levels outstanding with credit card balances alone bloated at $1.1T as of Q3, but also likely a further backup in delinquency rates with credit cards and auto loans already showing a slight uptick in Q2. This will act as an early warning sign for a more precipitous pullback in the consumer or at the very least, a reminder that consumers cannot indefinitely finance elevated spending with the ongoing willingness to *"put it on plastic"* more solid than the consumer's actual *ability* to spend.

For some, household net worth has risen substantially throughout 2023, with a net gain of $7T over the first three quarters of the year, boosted by elevated asset valuations from equities to housing. Most households, however, find themselves in the middle or on the lower end of the income spectrum and less likely to have a stake in the equity market or own property. Thus, a sizable portion of the population has largely been precluded from enjoying the benefits of rising net worth, exacerbating the growing concentration at the top with the upper 10% holding roughly 69% of the wealth.

Looking out to 2024, a significant easing in housing market conditions is unlikely without a meaningful influx of new supply. Thus, the resulting elevated housing valuations will expectedly provide ongoing support to household balance sheets that are largely composed of hard assets. A correction (or lack of upward momentum) in the equity

GLOSSARY

AI – Artificial Intelligence

CPI – Consumer Price Index

FRED – Federal Reserve Economic Data

LTV – Loan to Value

GDP – Gross Domestic Product

PCE – Personal Consumption Expenditures

SAAR – Seasonally Adjusted Average Rate

USD – U.S. Dollar

UST – U.S. Treasury

YoY – Year over Year

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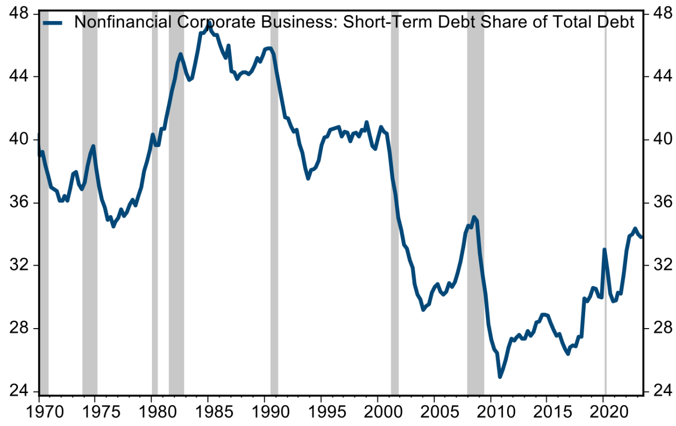
market, meanwhile, could weaken spending among wealthier consumers specifically. For others, the broader notion of a reduced or evaporated wealth cushion is already causing an outright shift or reduction in buying habits. Still spending at a positive pace, the *"resilience"* of the U.S. consumer will continue to be tested, forcing shoppers to reduce the quantity of purchases, the quality, or both.

Given the expected extended timeline for a return to price stability, businesses will also continue to struggle under the weight of higher prices and elevated cost of parts, materials, rents, and labor, along with a limited ability to pass on rising costs without the risk of losing market share. Some corporations have already announced sizable layoffs or hiring freezes in the wake of ample volatility and a rising fear of recession in 2024. Others, particularly small businesses, have slowed or stalled investment. This growing trend for the better part of the past two years will presumably drive investment growth into net negative territory by early 2024, if not sooner, leading to a rising number of closures and/or bankruptcies, particularly as reduced profits – and profit expectations – will lead to credit quality problems.

Additionally, some businesses, particularly larger businesses, or those with more access to capital, will continue to attempt to counterbalance declining rates of efficiency with the work-from-home model found to reduce productivity by 10-20%.[1] Others will push for alternatives to offset the rising cost of labor as an input, increasingly turning to technology which could permanently displace some job positions, particularly on the lower end of the skills spectrum. Sizable layoffs are likely to continue, particularly in the technology sector. Thirty-seven percent of all companies have indicated that artificial intelligence (AI) has replaced some workers, and nearly half of all companies are reporting plans to replace workers as a result of AI over the next 12 months.[2]

Amid rising economic uncertainty, companies of all sizes will expectedly focus on cost cutting and inventory management in 2024 to maintain profits and potentially improve margins. With notable missteps in the past, accurately assessing consumer sentiment will also remain a key focus amid a still toxic political environment and an ever-changing and hypersensitive social atmosphere



Source: Federal Reserve Board/Haver Analytic

Of course, while higher capital costs will work to undermine a further allocation of new capital, the broader impact of an elevated rate environment on corporate balance sheets may be significantly reduced compared to past cycles given the relative decline in short-term debt issuance. As such, this will potentially mitigate downside risk and aid the Fed's attempt for a soft landing. While rising somewhat in recent years, leverage in the non-financial corporate business sector broadly remains well below previous crisis levels with specifically a decline in short-term debt relative to total debt working to reduce corporate sensitivity to the Fed's interest-rate cycle.

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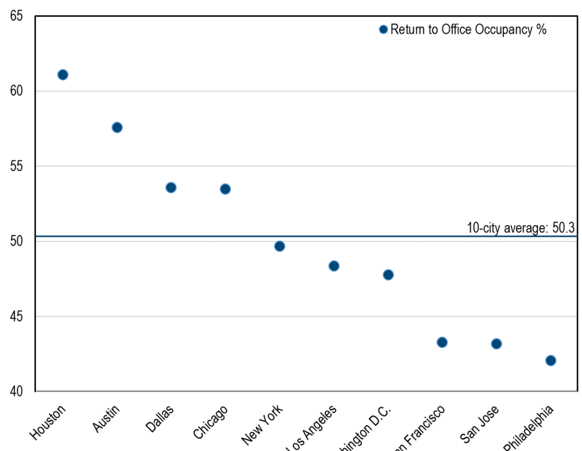
THE HOUSING MARKET

Elevated interest rates continue to be a barrier to enter and exit the housing market, with a weak return-to-office threatening commercial real estate and the institutions that hold the paper.

Higher borrowing costs have created a sizable barrier to enter *and* exit the U.S. housing market. Despite the fastest ascent in rates in four decades, coupled with lackluster real income growth since the end of the pandemic with real earnings trending negative for more than 10 months, a tight supply of housing stock has established a floor to home prices. A welcome support for existing homeowners, near record-low affordably has created a sizable barrier for *potential* homebuyers. Furthermore, with the rapid backup in rates following a prolonged period of historically low rates, market conditions have created a substantial lock-in effect, precluding would-be-sellers from offloading or replacing current property ownership with mortgage rates accelerating from 2.9% at the start of 2021 to a recent high of 7.90%.[3] In other words, if a homeowner wished to move or downsize, even purchasing a lower cost nominal asset could result in a sizable increase in monthly payments.

Further mitigating the presumed rate-sensitive nature of the housing market, the current cycle began with a significant supply deficit that has only been exacerbated by a growing reluctance to sell by homeowners who bought or refinanced at low rates in 2020/21, a surge of post-pandemic Millennial demand, and a work-from-anywhere environment dispersing demand into areas with insufficient supply. Thus, even with demand cooling slightly off of peak levels amid a material slowdown in the pace of traditional household formation, and supply rising off of lows as builders slowly increase construction, by the nature of normal population growth and immigration, there remains a sizable disconnect between housing supply and demand. Anticipating little reprieve in today's rate environment throughout the new year as the Fed holds rates higher for longer, as long as the current appetite for housing outpaces the available stock of available units, a natural support to prices will continue.



Source: Kastle

The biggest near-term risk over 2024, however, does not appear on the residential side but rather emerges from the commercial side of real estate as higher borrowing costs undermine affordability for buyers as well as valuations for investors. Trillions of dollars in commercial loans coming due over the next one to three years, most of which will be resetting from LTVs of 40% to LTVs of 60 or 70%, perhaps higher, will require a significant amount of additional capital. While commercial real estate is not necessarily the "next shoe to drop," particularly in the traditionally "hot" downtown urban markets where return-to-office rates are 50% on the top end, there may not be the population support to justify an additional infusion of cash.

Additionally, the uncertainty and risk of the commercial market expands beyond primary office space to secondary and tertiary businesses as well. After all, if there isn't a physical return to offices, workers don't need anywhere to park their car or drop off dry

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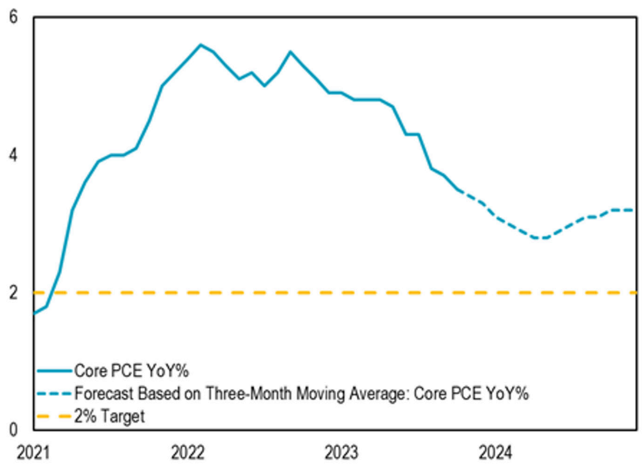
cleaning. Such a contagion effect raises sizable concerns for the U.S. financial sector as the majority of such paper, roughly three-quarters, is being held on the balance sheet of midsized financial institutions with less than $250 billion in assets.[4] As exemplified with the failures of Silicon Valley Bank and Signature Bank in March and First Republic Bank in May, the Fed is able and willing to step in with the needed funding or liquidity facilities to stabilize one-off instances. A more broad-based or multi-institutional scenario, however, may prove more problematic for the central bank to quietly and orderly backstop.

INFLATION, RATES, AND MONETARY POLICY

Inflation remains elevated with a disappointing pace of improvement, forcing the Fed to consider additional policy action and a delay in rate cuts resulting in a higher-for-longer rate scenario.

Inflation has moved in the right direction, declining markedly from peak levels. The painfully slow pace of improvement, however, suggests the Fed may still have work to do. While some Fed members have expressed being more comfortable with a position on the sideline *hoping* for further disinflation, the longer the Fed slow plays its war against elevated price pressures, the more likely the Committee will eventually need to raise rates further or hold them at an elevated level for a longer period of time. While continuing to show improvement, the disinflationary trend has failed to demonstrate any lasting downward momentum in price pressures. In other words, assuming an ongoing commitment to 2% inflation, there is still more progress to be made.

With housing costs up near 7%, the core PCE at 3.5%, and the supercore still nearly two times the desired level as of November, there is a clear lack of downward momentum across key measures of inflation. More recent improvement, particularly in the headline Consumer Price Index (CPI), following upward and sideways movement has worked to reinstate optimism of eventually reaching the Fed's 2% goal as well as a return to easing monetary policy. Inflation, however, has offered a number of *"head fakes"* before. Thus, even if inflation continues to descend, there is still more ground to cover as 3% is not 2%, and 'no further rate *hikes*' does not yet translate into rate cuts. For Fed officials, it has never been about making it halfway or declining from 6% to 3.5%, but continuing along a pathway to a 2% level of inflation on a *sustained* basis.



Source: Bureau of Economic Analysis/Haver Analytics/Stifel

At the current monthly pace of increase, this remains insufficient or inconsistent with 2% year-over-year inflation, potentially leaving core prices nearer 3% in the long run. Furthermore, with potential upside risks to inflation and ongoing sticky wage pressures, inflation is likely to remain well above the intended 2% target over the next year and potentially into 2025, despite investors' optimism or *overreaction* to the smallest of improvements.

Regardless of the painfully slow pace of improvement and the long road to ahead to reach price stability, investors are holding firm to a preconceived notion of a return to

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easy money policy. Led by an experiential basis where the *"normal"* world or the only world known is that of the low yields of 2012-2019, market participants continue to challenge the notion of a new normal with the expectation that history will repeat itself sooner than later. As such, the market has been preemptively calling for an end to rate hikes for the better part of the past two years and pricing in rate cuts that have yet to come to fruition. However, investors have been wrong before, each time reminded of the old adage, *"Don't fight the Fed."*

Despite the market's blinders, the Fed may still be considering additional policy action or at least firmer policy for longer than the market anticipates. Continuing to acknowledge the improvement in price pressures, even with a third-round pause in December, officials have not gone so far as to say their mission of price stability has been accomplished. They have maintained the statement language, *"In determining the **extent** of any Additional policy firming that may be appropriate [emphasis added]."*

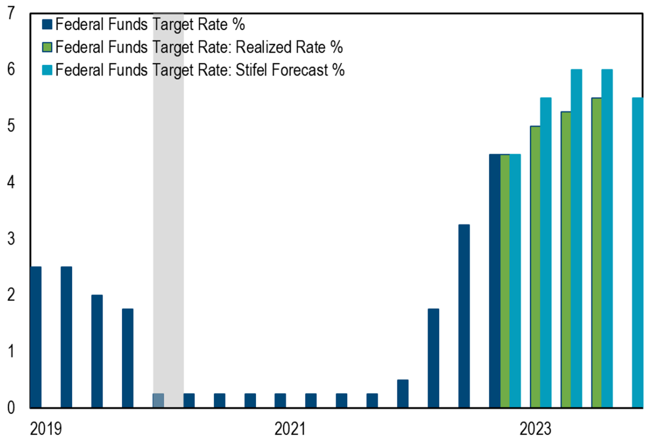
Of course, a willingness to act does not imply certainty of action, particularly as Fed Chairman Jerome Powell acknowledged that officials discussed the topic of rate cuts in December. Rather, with a data-dependent position, policy decisions will be dictated by the evolution of the performance of inflation and the underlying economy.

According to the Fed's December outlook, inflation is expected to fall to 2.4% by the end of 2024, down from an earlier forecast of 2.5%. Excluding food and energy, the core measure of inflation is expected to fall to 2.4%, also below earlier projections of 2.6% at the end of 2024. As such, based on a forecast of further disinflation, and despite uncertainty in the realized inflation data, in the latest December edition of the Summary of Economic Projections (SEP) the Committee *increased* expectations for a reduction in rates off the terminal level when the time comes to implement less restrictive policy. Updated projections now show the majority of officials potentially see as many as three 25bp cuts in 2024 as opposed to two proposed in the September outlook, which would lower rates to roughly 4.625%, resulting in arguably still restrictive, but significantly less restrictive policy.

Should inflation continue to perform as expected, *a bold assumption*, the Fed's next move increasingly appears to be a rate cut. Alternatively, should inflation prove stickier in nature, falling short of expectations, the Fed remains willing to take further action or maintain an elevated level of rates for longer.

The earlier backup in longer-term rates offered a compelling case there may no longer be a need for additional rate hikes, essentially making the argument that an organic shift in credit conditions was doing some of the Fed's last work. More recently, however, the unexpected selloff in longer-term Treasury yields with the yield on the 10-year UST dropping from an October 23 peak of 5.00% to a recent low of 3.83%,[5] supports the thesis that the momentum higher was in good part a reflection of changed expectations for Fed policy along with structural factors, such as fiscal deficits. An ongoing decline in longer-dated yields, rising equity market valuations, a more confident and *"spendy"* consumer, and high investor confidence for a first-quarter rate cut creates far from ideal market conditions for the Fed's still not yet complete price-stability mission.

If the Fed wishes to maintain or renew upward pressure on rates to help achieve restrictive policy, it might need to follow through with earlier expectations of higher rates for longer. In other words, the recent movement lower in yields does less to ensure a patient Fed, but rather could ramp up pressure on the Committee to take further action or hold the federal funds rate at an elevated level beyond the market's current forecast to ensure persistent pressure on longer-term treasury rates. The Committee remains committed to *ensure* rather than hope for a return to price stability.



Source: Bloomberg/Stifel

Of course, whether or not the Fed raises rates one more time or has reached its terminal level is somewhat of a moot point at this late stage in the tightening cycle as the Committee attempts to simply fine tune the fed funds rate with an implied level of precision beyond which it can actually provide. The more important takeaway is that the Fed will remain committed to higher for longer amid presumed less favorable inflationary conditions. Despite the Committee opening up the conversation to include the idea of future rate cuts and increasing the number of forecasted cuts, a lack of conviction in achieving the goal of price stability will likely force the Fed to keep rates elevated throughout the new year with the possibility of the first rate cut delayed until the second half or more likely, the final quarter of the year, with policy presumably staying well above neutral out beyond 2025.

The Fed continues to struggle amid the prospect of a soft landing, potentially avoiding more profound pain for the broader economy and more significant pressure on the labor market, against the threat of stubbornly elevated inflation. Should the Fed move too slowly, remain on the sideline for too long, or begin to cut rates too soon, the Committee could inadvertently allow inflation to remain above the 2% target and elevated price pressures to become entrenched in the economy. As a result, eventual slower growth coupled with above-target inflation would force the economy into a dangerous period of stagflation, or alternatively, potentially force the Fed to take further action and disrupt the underlying economy more than would have otherwise been necessary if the Committee had dealt with inflation the first time around.

Aside from navigating an appropriate peak level in policy and reinstating price stability, the Fed continues its venture to reduce the size of the balance sheet via a significant reduction in its holdings of Treasury debt. Of course, as the Treasury is expected to finance a rising debt, coupled with a reduced international appetite for dollar assets, with the annual deficit expected to average $2.0 trillion over the next 10 years, any assumption that rates will return to the historically low environment of 0.25%-0.50% appears unfounded.

GROWTH, THE SHAPE OF THE RECOVERY, AND THE USD

Growth continues to slow, stopping short of a technical recession as the Fed allows above-target inflation to persist amid the possibility of a soft landing, the threat of stagflation, and a softer USD.

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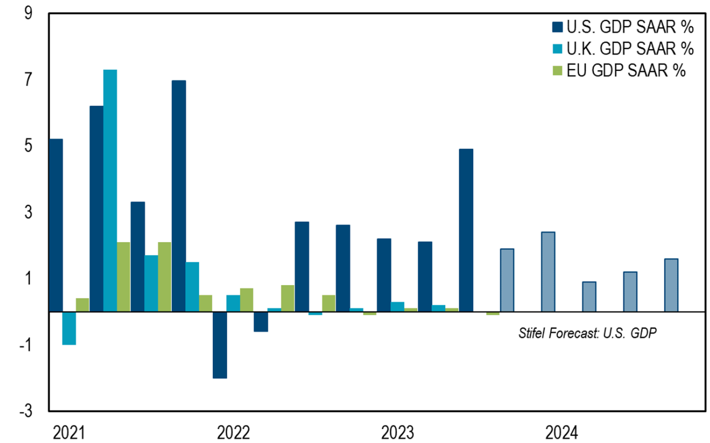
The Fed remains optimistic the Committee can achieve a soft landing whereby monetary policy raises rates to a sufficiently restrictive level to eventually tame inflation without significantly undermining economic activity. In other words, the Fed returns relative price stability to the economy over the next two-to-three-year period while avoiding an outright recession. Historically, however, the Fed does not have a great track record for achieving such a delicate balance. The Fed has only attained such a utopic outcome once — in the 1990s — through the 11 economic cycles of the last 60 years. Nevertheless, at the same time growth is accelerating (at least as of Q3 2023), inflation appears to be moderating, perpetuating the Fed's assessment of still elevated but improving inflationary conditions and possibly avoiding a hard landing.

Broadly speaking, the prospect of higher rates for longer will continue to weigh on consumers and businesses as temporary supports fade and the ability to borrow and finance spending at record rates is maxed out. As the consumer slows and business investment wanes, other segments of the economy will begin to show signs of fatigue as well. As a result, nearer term, the U.S. economy is poised to remain positive but lose significant momentum at least from the third quarter's outsized rise, likely slowing to less than half the pace of Q3 in the final quarter of 2023, before slowing further into 2024 with an expected average annual growth rate of 1.5%.



Source: Census Bureau/Bloomberg/Stifel

That being said, while the potential for recession remains very real at 55-60%, the bigger concern and likelihood is not an outright downturn, but a period of *stagflation*. The economy will expectedly slow to a sluggish pace of activity in 2024, but the Fed, attempting at all costs to avoid a dip into negative territory will presumably fail to raise rates to a sufficiently restrictive level to squash inflation or opt to back off from even the prospect of additional policy action too soon, resulting in stubbornly elevated inflation nearer 3%, or at least above its 2% target for some time. The risk of monetary policy was never that the Fed raises rates too much, but that the Committee loses resolve and fails to raise rates enough, potentially forcing the Fed to hold rates elevated for a longer than anticipated time frame or even come back into the market and react with a second round of policy firming akin to the scenario of the late 70s early 80s. If the Fed is wary of slowing the economy more than necessary, policy makers may inadvertently allow higher than appropriate price pressures to linger in the economy, further eroding the purchasing power of the broader populace.

The yield curve will expectedly remain inverted, as it has been since July 2022, over the course of the next 12-18 months with the prospects of avoiding a meaningful downturn, or worse, a recession leaving ample upside potential for rates.

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Additionally, leading indicators are down 7.6% over the past year as of November. Nevertheless, taken together, the U.S. economy has avoided recession thus far, and as aforementioned, may continue to do so with perpetual – albeit slower – momentum in the consumer, the backbone of the economy. Of course, such *"rules"* as investors reference in the shape of the curve and forward-looking indices to predict recessions should more aptly be seen as guidelines which have lost their prestige amidst unprecedented monetary and fiscal policy intervention, arguably perverting market metrics.

Whether the U.S. economy is able to bypass a technical recession, a downturn, or more simply, a cumulative unwinding of economic activity with growth slowing to virtually a nonaccelerating pace, hardship will continue to mount as the Fed potentially maintains restrictive policy for an extended period of time.

Global central banks face a similar conundrum of slower growth and still elevated inflation with some developed counterparts, such as the U.K., the EU, and Australia, being in a more desperate position. Thus, while the U.S. economy will struggle in the coming year(s), the relative performance of domestic consumers, businesses, and investors will likely outperform most developed counterparts, providing welcome support for a troubled U.S. dollar. While a meaningful reduction in inflation could add pressure to the greenback, the lingering struggle and *"patient"* approach to cost control suggests elevated prices will linger.

Meanwhile, several of the largest economies and most populous countries around the world are promoting a *"de-dollarization"* movement with several events suggesting some momentum is building behind the cause. China's national energy trading platform, for example, announced the completion of its first yuan-settled trade for liquid natural gas in October of this year. Of course, the thread of thinking that countries would circumvent the U.S. dollar and by extension, undermine its position as the proverbial reserve currency of the world is certainly nothing new. Yet to date, the dollar remains relatively the strongest currency in the world and the U.S. is the largest and most liquid market in the world. Despite proposed alternatives, the U.S. greenback remains the safest store of value based on the confidence that the United States will continue to pay its debts amid a stable and sound economy. That being said, going forward into 2024 and beyond, an appetite for dollar alternatives will expectedly grow as the global market becomes increasingly intolerant of elevated inflation, the ongoing and seemingly perpetual showdowns surrounding the U.S. debt ceiling, and large deficit spending.

FISCAL POLICY

Bloated deficits and an ongoing propensity to expand the government's balance sheet provide a floor to longer-term rates, complicating the Fed's ability to tackle inflation as politics heat up.

Despite higher borrowing costs and an already massive debt level, Congress continues to consider another year-end tax package that would on the one hand, offer assistance to struggling consumers and households, while on the other, offer a sizable addition to the federal debt (assuming no equal offsets to spending elsewhere). Expanding the child tax credit and extending a number of corporate tax breaks, according to the Committee for a Responsible Federal Budget, could reportedly add $800 billion in debt over the next 10 years.[6] While further fiscal

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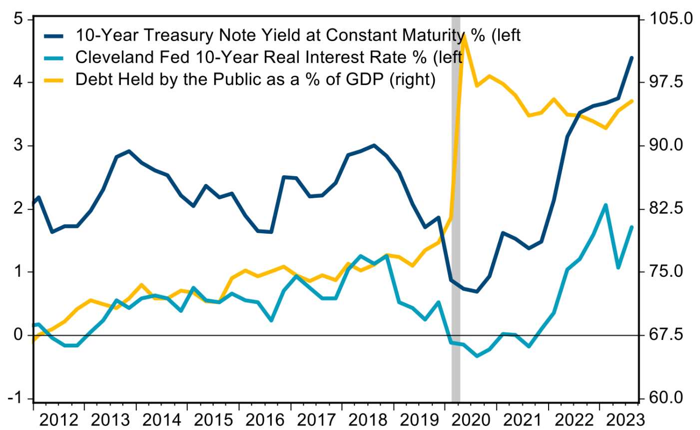
assistance may be needed to comfort the many Americans living paycheck to paycheck or small businesses feeling the pinch of higher financing costs, additional expansion of the government's balance sheet will have further inflationary implications and could potentially worsen other aspects of federal finances such as entitlements. Social security, for example, continues to trend in the wrong direction, threating insolvency by 2035 with three workers supporting a retiree vs. 42 workers in 1940.[7]

While some have espoused optimism about the federal debt picture amid an improved *outlook*, legislation implemented to *"rein in federal spending,"* such as the bipartisan Fiscal Responsibility Act passed in June 2023, has simply reduced the projected increase in debt by $1.5 trillion to $45.2 trillion over the next decade compared to an earlier expectation of $46.7 trillion in total debt held by the public.[8] While even small steps in the right direction are welcome, with the government's balance sheet growing over 96% in the last ten years to a nominal level of over $33 trillion dollars, a few billion dollars is more of a rounding error than a meaningful adjustment. Additionally, with a presidential election around the corner, politicians will be quick to promise constituents the world regardless of the price tag, mitigating the Federal Reserve's ability to conquer inflation as expansionary fiscal policy works contrary to contractionary monetary policy goals.



Sources: FRB, FRBCLE, TREASURY/Haver

According to Congressional Budget data, the federal deficit as a percent of GDP is currently at 5.5% and is expected to rise over 6% in 2024 and over 7% by 2033. A persistent and growing scenario of fiscal deficits will expectedly lead to a stubbornly elevated level of real rates over time or at least a relatively higher floor to longer-term rates. While a welcome catalyst to returning a more historically normal shape to the yield curve, the *"benefits"* of structural normality will only return when the Fed is able to reduce policy from restrictive to less restrictive and further to a (near) neutral level of rates.

As the 2024 election approaches, a country already fiercely divided by politics is likely to feel salt poured on an open wound, particularly amid the prospects of a rematch between former President Donald Trump and current President Joe Biden. 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 inflict destruction on personal and work relationships and the mental well-being of all Americans. Both candidates come with sizable baggage and shortfalls particularly given the realities of functionality limitations and lifespan. A race too close to call in a second round Biden-Trump match-up will mostly likely be won by the first side willing to offer a fresh alternative. Along the way, tensions will

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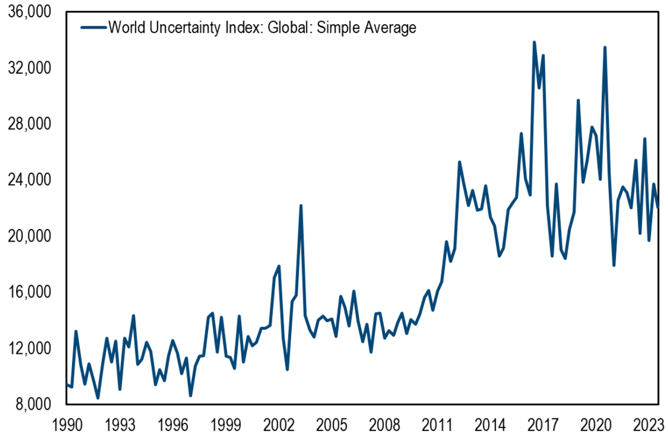
expectedly ratchet up towards year-end as the far fringe of both parties make claims less desirable to markets – and the *average* American.

INTERNATIONAL WILD CARDS, ENERGY, AND LONGER-TERM THEMES

Foreign challenges to U.S. leadership abroad will expectedly intensify in the new year as weak political and economic standing have resulted in sizable uncertainty.



Source: FRED

Lower energy prices were a just-in-time Christmas present for American households, lessening the nondiscretionary monthly burden and freeing up additional spending power. Sustainability of lower cost fuel, however, remains a significant wild card, particularly heading into 2024 as many anticipate Russia to curtail supplies ahead of the U.S. presidential election and international shipping stalls in the Red Sea. Although the impact of such manipulation could be lessened should the UAE step in with additional supply, leaving oil with an upside potential of $100 a barrel.

The push for clean energy remains and could gain significant momentum depending on the occupancy of the White House in 2025. The vast global energy system, however, will not be replaced any time soon, although investment in low carbon technologies will expectedly continue to be a sizable draw for investors in the coming years.

Middle East conflict is likely to escalate in size and scope moving beyond the Gaza strip, expanding the humanitarian crisis, and threatening to engage Iran's nuclear capabilities and broader socioeconomic ambitions. Ongoing cease-fires are a welcome step toward negotiation, as well as the flow of additional aid and hostage releases, although each delay or pause offers opportunity for the other side to reorganize and re-weaponize. Military assistance from the U.S. and its allies has significant support from the U.S. Congress, but the depleted U.S. weapons arsenal will expectedly slow any immediate outlays.

"Strategic containment" has failed to limit domestic threats from China, Russia, and Iran, with further diplomatic efforts likely to prove ineffective. China has called on the Biden administration to lift unilateral sanctions and provide a non-discretionary environment for Chinese companies. Other issues, such as tariffs, Taiwan, and microchips have gone unresolved with tensions still apparent as the administration repeatedly refers to the Chinese leader as a *"dictator."* Further talks are unlikely to result in a reduction of tension given the uncertainty of leadership in the U.S. with the 2024 presidential election on the horizon, as well as the growing Russia-China connection leaving Taiwan an increasingly probable target. Should China wish to make a move to further ensure Taiwan remains under its thumb, the current administration may provide a more fortuitous

opportunity given the less-than-robust perception of the administration's current international policy agenda and ability.

At the very least, global politics are shifting perceptions, market metrics, and potential policy directives. Capital flows continue to drain out of 2023 conflict areas extending to regions of upside risk with 75% of foreign money, for example, invested in Chinese stocks already fleeing. Also, while any additional conflict and military response overseas may be cause to adjust domestic monetary policy and prompt the Fed to take a more cautious or even dovish stance amid uncertainty, a renewed threat of elevated price pressures – be that from food, energy, or fertilizer – if *sustained*, could threaten additional core price growth and a more firm stance from the U.S. central bank.

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2023 Outlook

[1] **Source:** https://www.forbes.com/sites/tracybrower/2023/08/06/the-productivity-problem-with-reote-work/?sh=2115624d34b3
[2] **Source:** https://www.forbes.com/sites/serenitygibbons/2023/12/07/how-ai-might-impact-the-job-market-in-2024/
[3] The high of 7.90% for the 30-year fixed-rate mortgage was recorded on October 20, 2023.
[4] **Source:** https://www.wsj.com/real-estate/commercial-real-estate-regional-banks-9f8f591d
[5] The 10-year fell to a recent low of 3.83% on December 20, 2023.
[6] **Source:** https://www.crfb.org/blogs/year-end-tax-deal-could-cost-over-800-billion-if-made-permanent
[7] **Source:** https://www.cbpp.org/blog/social-security-is-not-bankrupt#:~:text=In%202035%2C%20if%20nothing%20else,media%20attention%2C%20projections%20are%20uncertain. & https://www.uvm.edu/~dguber/POLS21/articles/quick_facts_on_social_security.htm
[8] **Source:** https://www.cbo.gov/publication/59235
[9] **Source:** https://www.ft.com/content/20c5d5c8-dd64-4c22-a3fc-60d4a8336aeb

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