

EQIS Quarterly Commentary

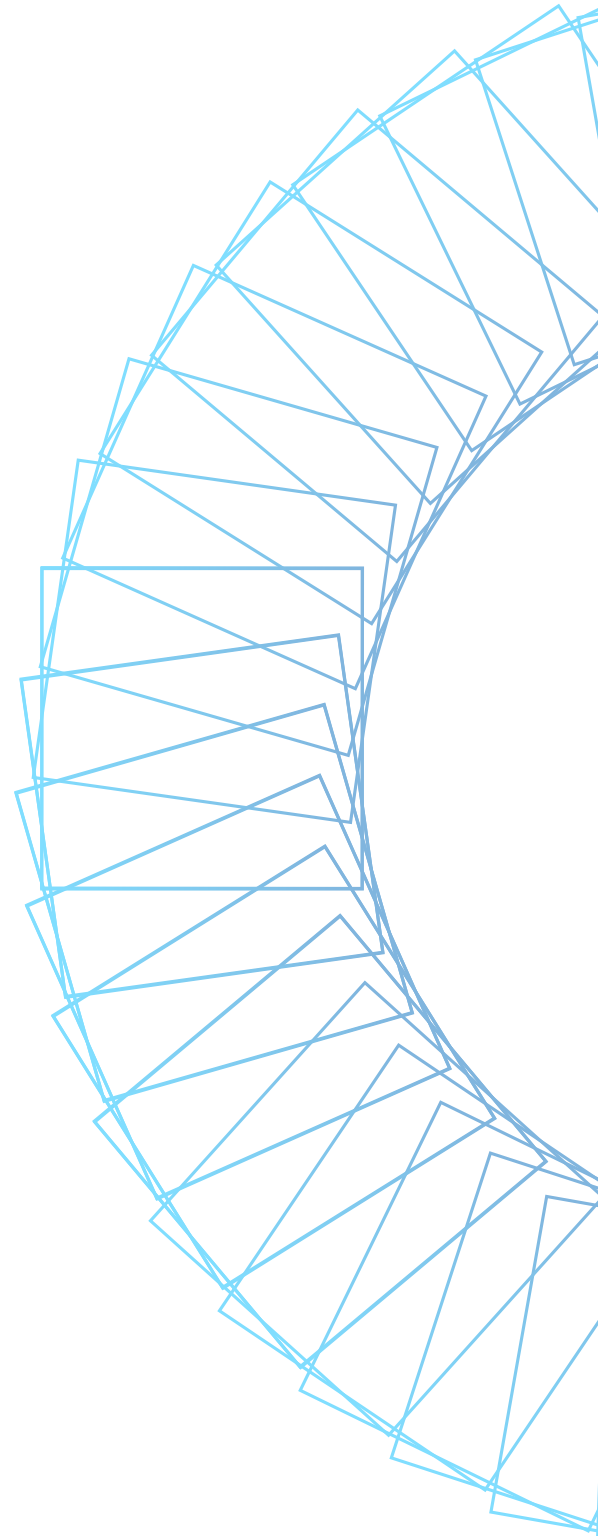
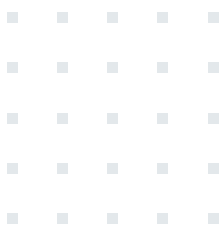
Q4 2022 Review and 2023 Outlook

Easing Pain but Prepare for a Long Recovery



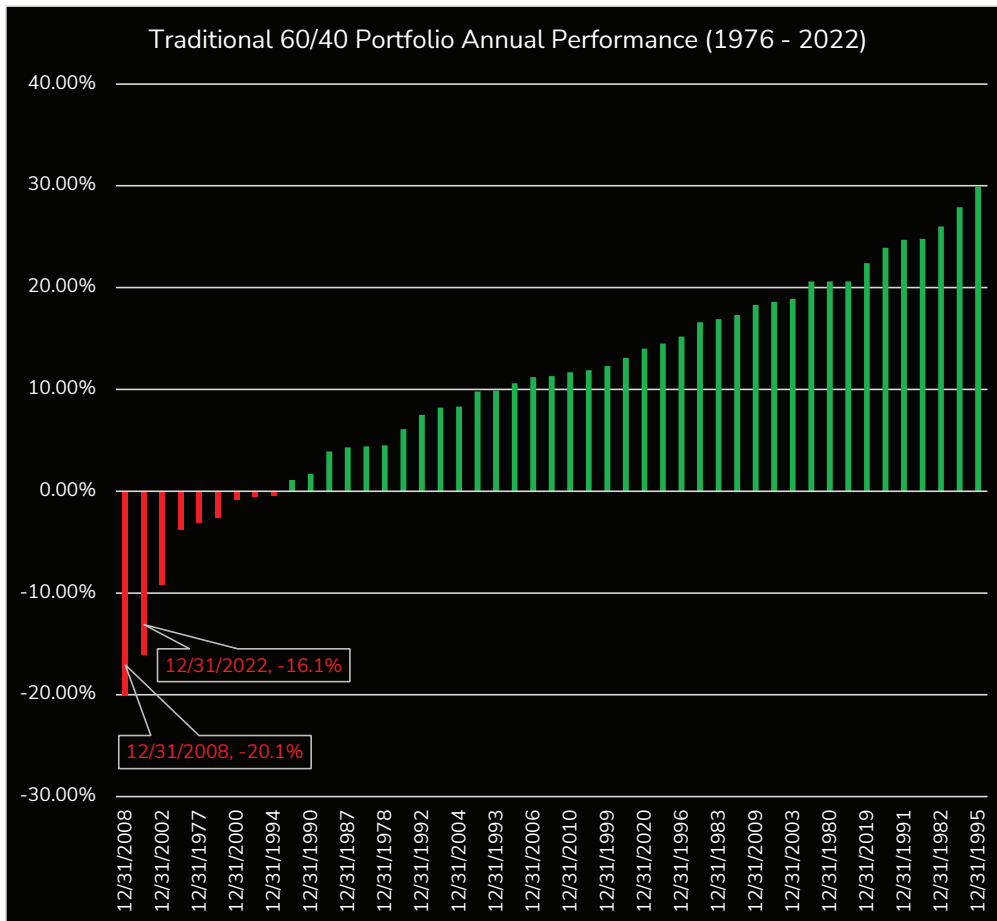
EQIS believes that setting capital market expectations (CME) is fundamental to portfolio management. The objective of setting our CME is to develop projections and make appropriate investment changes to our portfolios. Although we present some of our observations in these annual papers, we continually monitor and update them throughout the year. The conclusions we reached from our research into asset classes, economics, technical, and risks are incorporated into the management of our portfolios. This process is used throughout the EQIS Portfolio suites of globally balanced total portfolio allocations suited for specific risk tolerances.

While being adaptively allocated to take advantage of established and emerging trends, 2023 brings an opportunity to seek diversification benefits in fixed-income markets and a return to income-producing yields and strong total returns. The period of near-zero interest rates that fueled the rise of technology companies over the last decade has given way to value-oriented stocks as inflation took hold. Investors have changed their preference towards companies positioned to weather a looming recession and benefit from an environment of higher starting interest rates. Market risks are currently tilted towards a Fed-induced recession but leave the door open for active investment management to take advantage of changing market cycles. Our asset class analysis identifies potential trends that we expect to emerge as the US and global economies recover from a shallow recession.



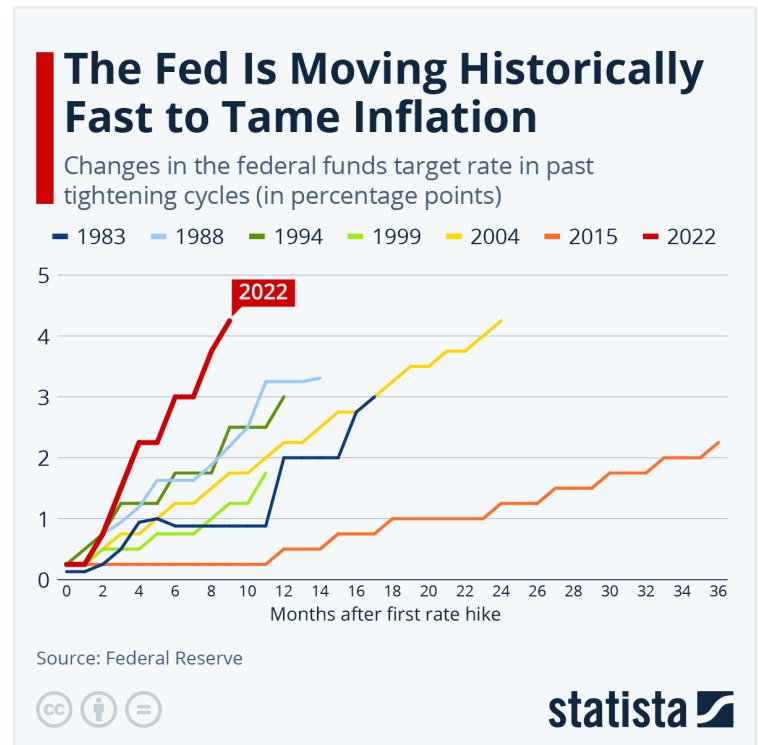
Economic Review

2022 ended on a down note as broad-based asset classes registered some of their worst losses in 40 years. Similarly, traditional 60/40 stock-bond portfolios experienced an unusually painful year as the blended portfolio ended down 16.1%, its second worst year since 1937. Only 2008 proved to be a more difficult time for the balanced portfolio as the stock market rout that year led to a 37% drawdown and was only incrementally offset by bonds providing a 5.2% return.

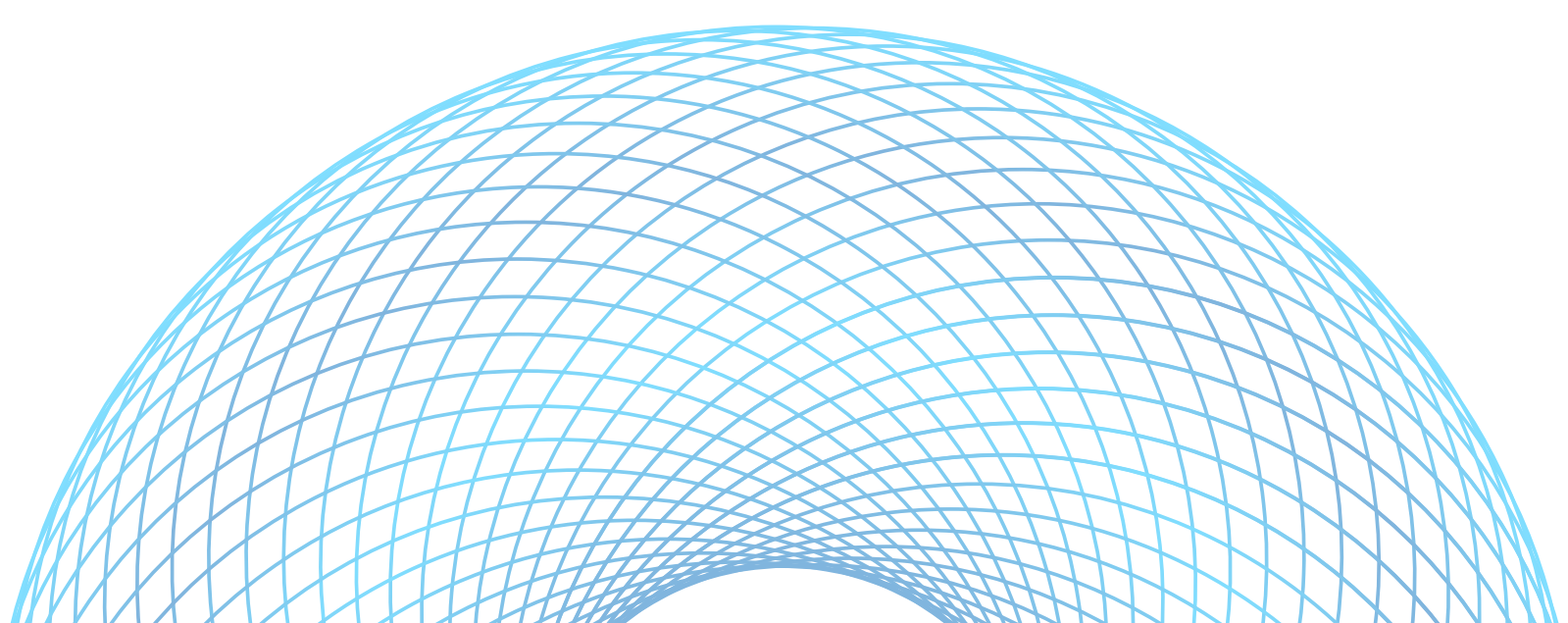


Source: Bloomberg

The Federal Reserve continued its rate hiking cycle by increasing rates by 0.5% during its last meeting of 2022. The decision to slow increases by 25 basis points from previous hikes of 75 basis points highlights that the Fed has entered a new phase of policy tightening. The initial rapid pace of rate hikes came in response to inflation levels reaching 40-year highs and was marked by the fastest increase in rates in the past several rate tightening cycles. The Fed increased rates an unprecedented 425 basis points from March through December and signaled that officials are anticipating terminal rates to peak between 5% and 5.5% in 2023. Additionally, Fed Chairman Jerome Powell acknowledged in his post-meeting comments that there is still pain to come in 2023, saying, “Without price stability, the economy doesn’t work for anyone. My colleagues and I are acutely aware that high inflation imposes significant hardship as it erodes purchasing power, especially for those least able to meet the higher costs of essentials like food, housing, and transportation.”



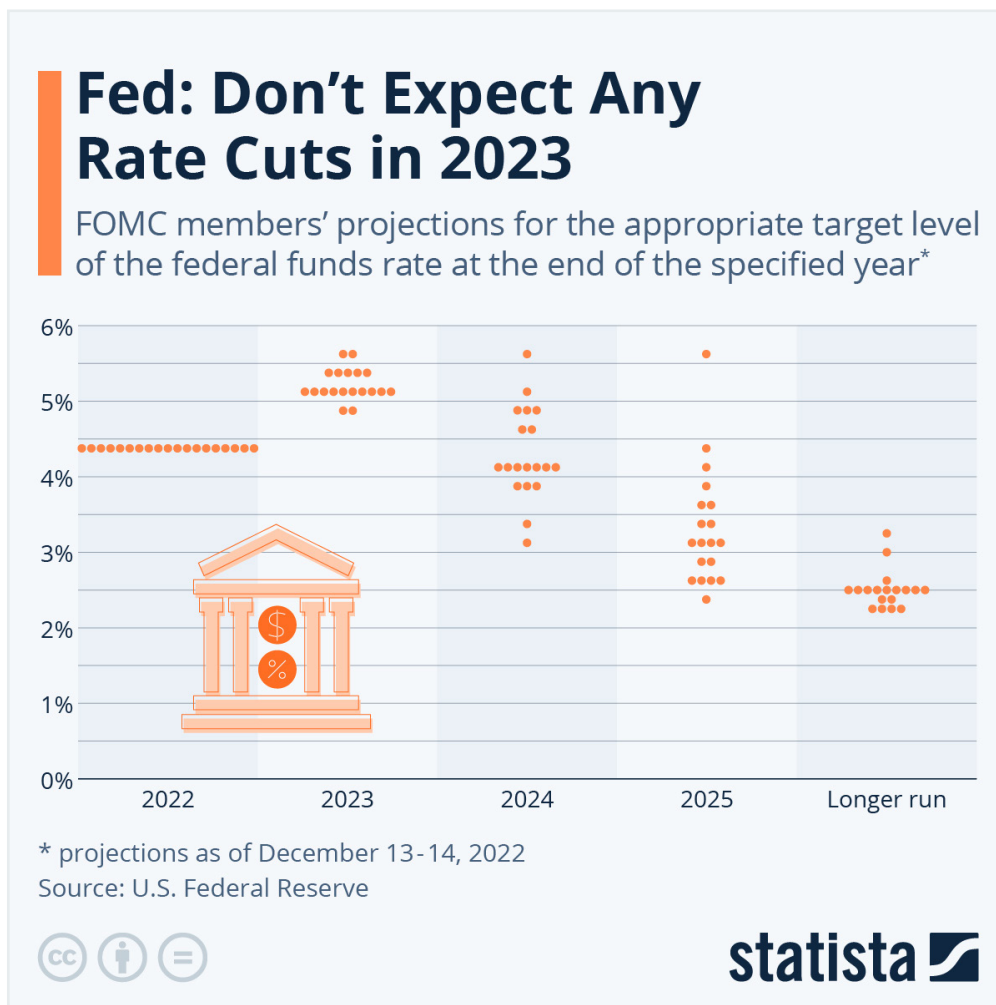
Source: <https://www.statista.com/chart/28437/interest-rate-hikes-in-past-tightening-cycles/>



Fed officials commented that they expect to hold rates throughout 2023 and not begin cutting until they are confident that inflation is moving down to the 2% target sustainably.

FOMC members' comments indicate that softening inflation figures are evidence that rate hikes have been working. However, the tight labor market may mean that rates may need to stay higher for longer to bring inflation down to the Fed's 2% target. Powell cautioned investors that the officials still have a "ways to go" before rates are at the level that is sufficiently restrictive to tame inflation running at three times the 2% goal.

The Fed dot plot indicates that the FOMC expects at least 50 basis points in hikes in 2023 before a potential rate-cutting cycle in 2024.



Source: <https://www.statista.com/chart/29055/fomc-projections-for-the-federal-funds-rate/>

Investors seem to agree that the Fed will be increasing rates in 2023 between 50 – 75 basis points but are pricing in an expectation that the Fed will need to cut rates later this year as unemployment rises beyond their target and inflation levels fall faster than anticipated.

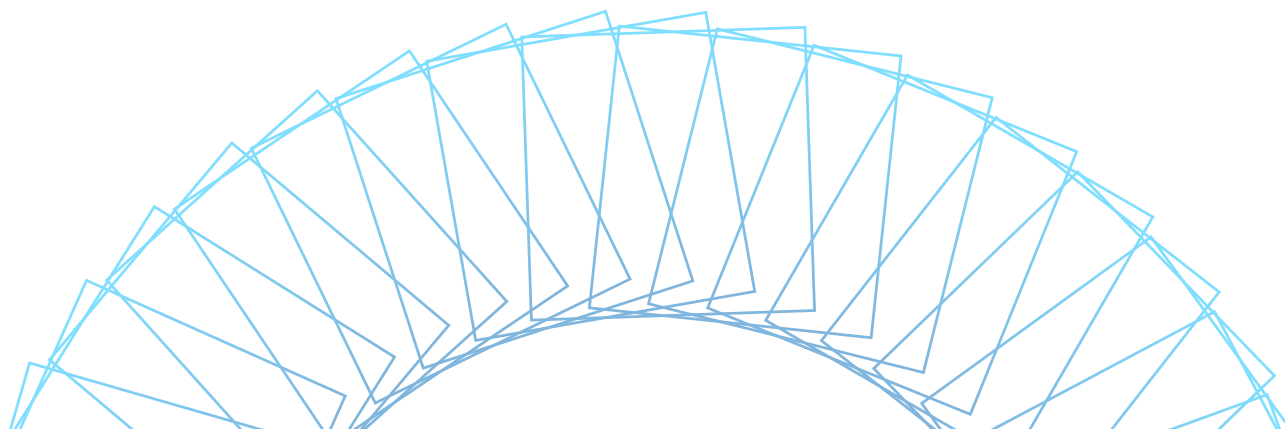
Region: United States >			Instrument: Fed Funds Futures >		
Target Rate	4.50		Pricing Date	01/04/2023	
Effective Rate	4.33		Cur. Imp. O/N Rate	4.331	
Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M.
02/01/2023	+1.334	+133.4%	+0.334	4.665	0.250
03/22/2023	+2.125	+79.1%	+0.531	4.863	0.250
05/03/2023	+2.524	+39.9%	+0.631	4.962	0.250
06/14/2023	+2.602	+7.9%	+0.651	4.982	0.250
07/26/2023	+2.365	-23.7%	+0.591	4.923	0.250
09/20/2023	+2.005	-36.0%	+0.501	4.833	0.250
11/01/2023	+1.488	-51.7%	+0.372	4.703	0.250
12/13/2023	+0.827	-66.1%	+0.207	4.538	0.250
01/31/2024	+0.135	-69.2%	+0.034	4.365	0.250

Source: Bloomberg

During the last five rate hiking cycles, the central bank has held peak rates for an average of 11 months. The messaging coming from FOMC committee members follows a similar timeline, with officials not anticipating a cut until early 2024. However, the conflicting outlook with investors centers around the possibility of an impending recession and a belief that disinflationary forces will cause prices to fall faster than officials believe. As a result, economists and investors believe the Fed may be making another misstep in holding rates higher for longer, which could cause unnecessary stresses on an already battered economy.

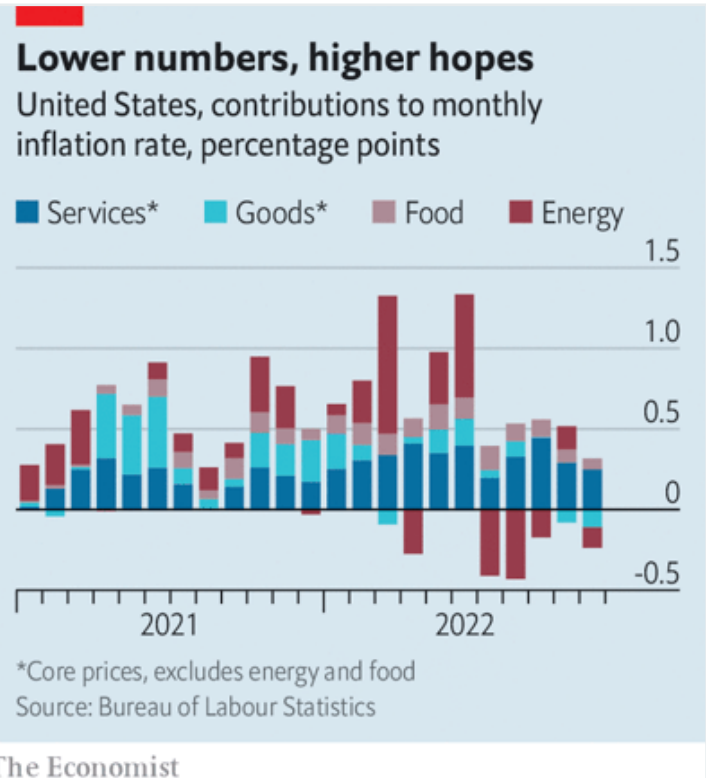
'For Some Time'				
Average rate between peak rate and first cut is 11 months				
Peak	Cut	Months	Peak rate	Cut Until
Feb-95	Jul-95	5	6.00%	5.25%
Mar-97	Sep-98	18	5.50%	4.75%
May-00	Jan-01	8	6.50%	1.00%
Jun-06	Sep-07	15	5.25%	0.25%
Dec-18	Jul-19	7	2.50%	0.25%

Source: <https://www.bloomberg.com/news/articles/2022-12-11/fed-message-that-rates-will-spend-some-time-on-hold-clashes-with-rate-cut-bets>



While supply chain issues continue to show signs of easing, there are reasons for the Fed to take a cautious approach to inflation readings, as geopolitical conflicts and commodities prices could continue to cause friction in the global economy. Officials warned that “the sluggish growth in real private domestic spending expected over the next year, a subdued global economic outlook, and persistently tight financial conditions were seen as tilting the risks to the downside around the baseline projection for real economic activity.” Fed officials also commented that “an unwarranted easing in financial conditions, especially if driven by a misperception by the public of the committee’s reaction function, would complicate the committee’s effort to restore price stability.” U.S. central bankers continue to warn investors that the inconsistencies in market pricing vs. the Fed messaging could complicate their policy tightening and risks a potential overtightening scenario. The next FOMC meeting will take place on January 31st and February 1st.

A misperception of a softening Fed stance risks fueling a market rally that would pressure inflation upward. While monetary tightening occurred at a breakneck pace in 2022, the effects have only recently begun filtering through to the broader economy. The reality is that inflation remains uncomfortably high and complicates the assessment of the Fed’s effectiveness. In December’s report of month-over-month price changes for November, there was a surprise to the downside in increases of only 0.1%. Looking further into the core CPI readings, there were encouraging signs that the price deceleration has continued for a second straight month.

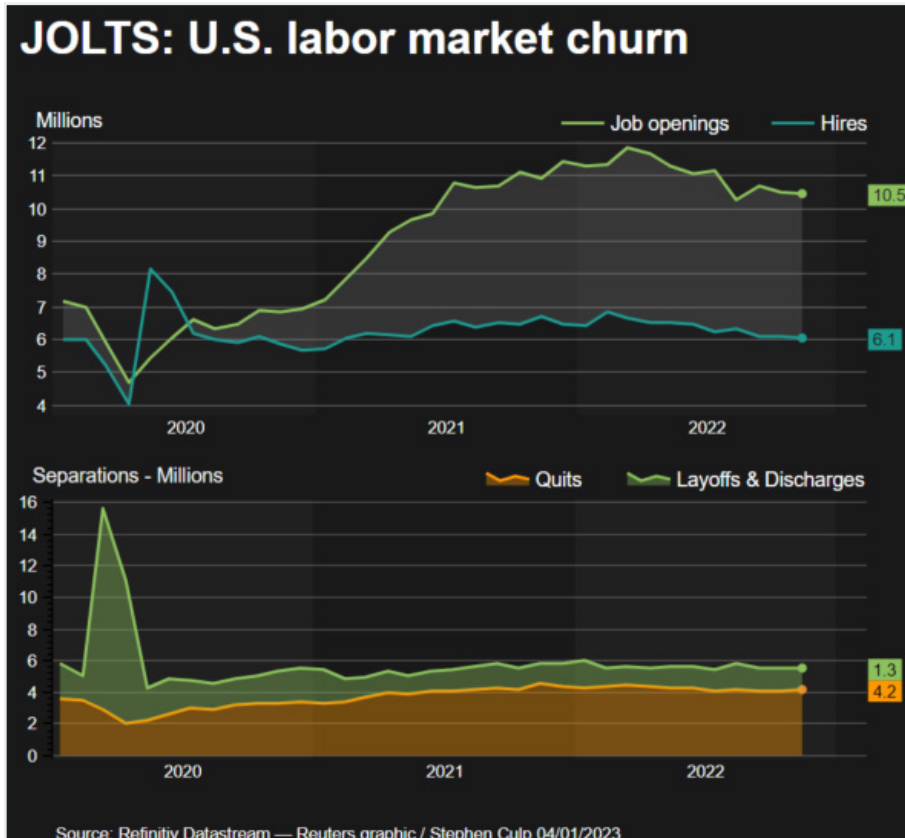


Source: <https://www.economist.com/finance-and-economics/2022/12/13/americas-inflation-fever-may-be-breaking-at-last>

Shelter costs have begun to ease in recent months as the data showed only a 0.6% increase, the smallest advance in four months, and signals that the most significant contributor to the overall CPI index is softening. Other notable changes in the month-over-month readings included used-car prices falling 2.9%, energy prices decreasing 1.6%, airfares dropping 3%, and medical-care service costs falling a record 0.7%.

While consumer goods, housing, and energy prices have continued to trend lower in signs of easing inflation, a tight labor market remains a potential headwind against reaching the Fed's target inflation level.

The resiliency of the labor market has continued to underpin demand and has kept employers from laying off workers due to a shrinking labor force. The most recent Job Openings and Labor Turnover Survey (JOLTS report) showed that there were 10.458 million openings at the end of November and a stubbornly high 1.74 jobs for every unemployed person. The quits rate, viewed by economists as a measure of job market confidence, rose to 2.7% from 2.6% month-over-month. The level of quit rates can fuel wage growth in the market and puts more pressure on firms to avoid laying off employees who stay.

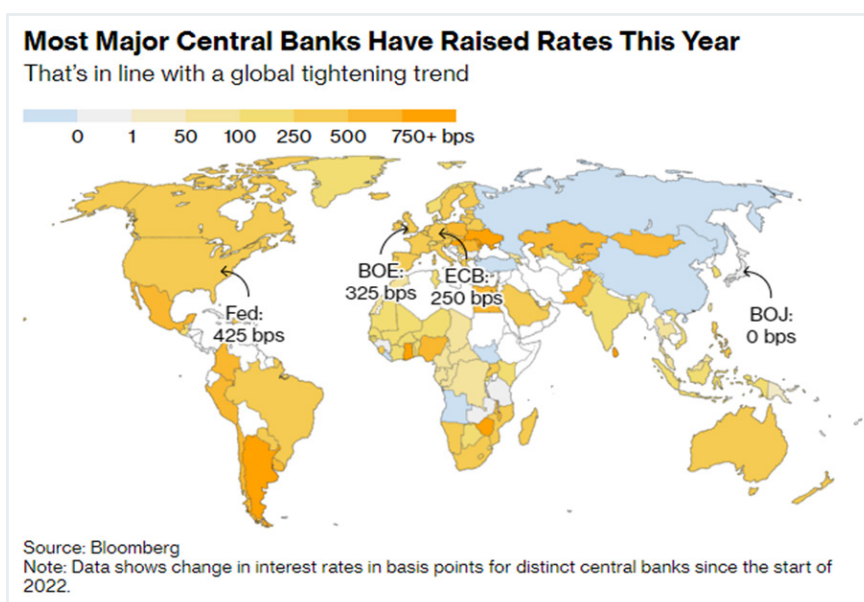


Source: <https://www.reuters.com/markets/us/us-job-openings-fall-less-than-expected-november-2023-01-04/>

Even with recent layoff announcements from tech companies, the jobless rate remained at a historically low level of 3.7% in November. In addition, average hourly earnings grew 5.1% year-over-year, above the pre-pandemic pace of 3%, and the labor force participation rate remained below pre-pandemic levels and ticked down again. The labor force currently has a shortfall of roughly 3.5 million workers following the COVID-19 pandemic. Economists indicate that 2 million of those workers opted for early retirement, and the remaining 1.5 million can be attributed to lower net immigration and COVID-19 deaths.

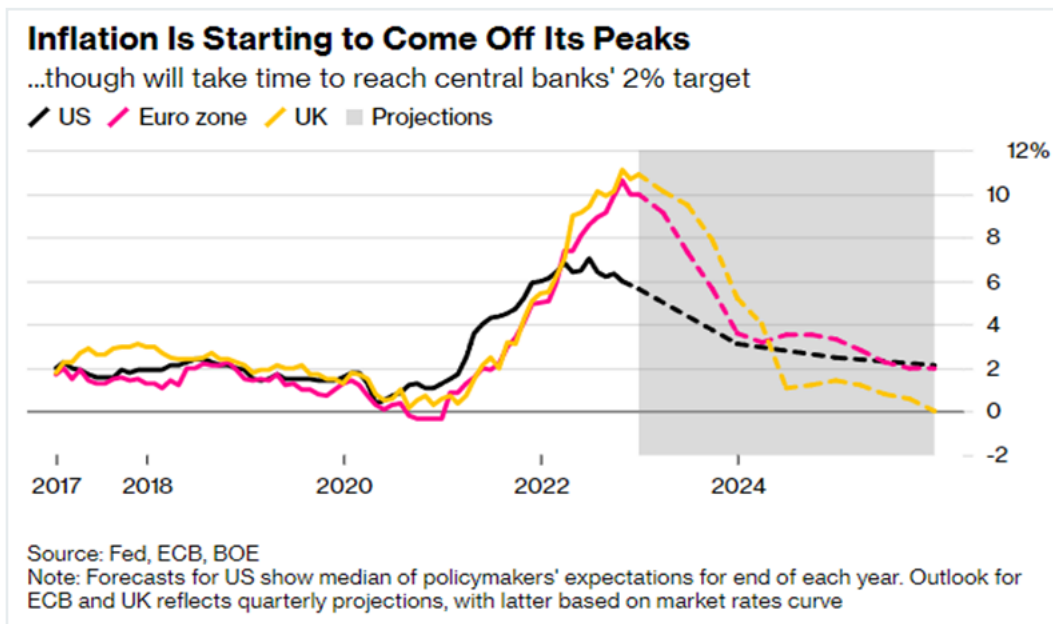
For the Fed to achieve its 2% inflation rate goal, the labor market will remain in sharp focus. Any signs of rising unemployment are expected to feed through to lower job openings and quit rates. Wealthier Americans who left the job market for early retirement continued to be buoyed by rising home values and asset prices. However, the lower-income workers who have remained out of the labor force are the more difficult segment to understand. Some economists expect that the retreat may only be temporary as these workers have not yet found suitable work or are still concerned over fears of COVID-19 infections. So far, it is unclear how many workers will be lured back into the labor market with higher wages and better jobs and how many have permanently left the labor force.

Central bankers across the globe increased their benchmark lending rates, signaling that a recession may also be coming for the broader global economy. The heads of the European Central Bank and the Bank of England echoed a similar sentiment as the U.S. Federal Reserve in acknowledging that rate hikes are likely to continue in 2023 as their local economies weaken. The headline risk to the global economy is a potential slump in consumer demand that forces a second recession soon after the pandemic-driven shutdown in 2020.

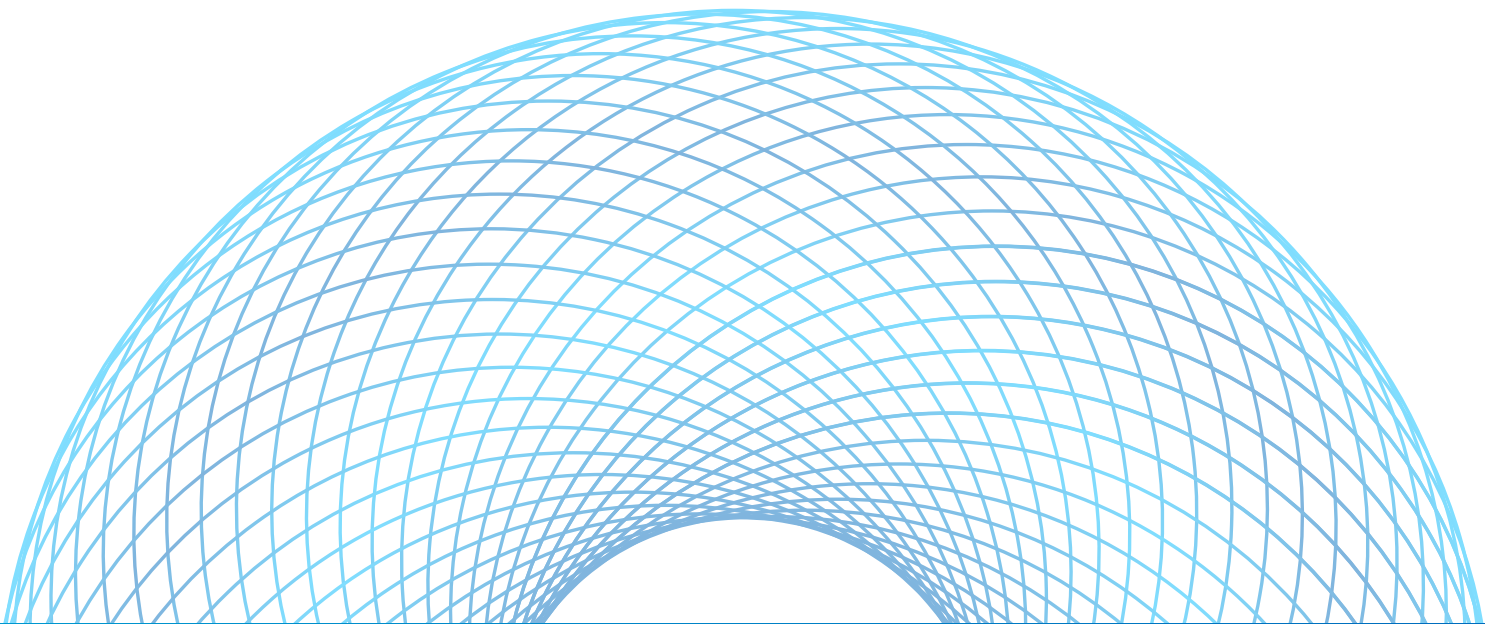


Source: <https://www.bloomberg.com/news/articles/2022-12-16/global-recession-risks-rise-as-central-banks-raise-rates?srd=markets-vp>

Central bankers have taken a much more hawkish tone in fighting inflation globally. They are more focused on tamping down inflation and potentially over-tightening than risking a scenario where they ease too soon and have to re-enter a new hiking cycle. The initial downplaying of inflation as transitory played out in global markets and allowed inflation to run away. While price pressures have slowly eased in developed international markets, the focus remains on ensuring inflation does not become entrenched as it did in the 1970s.



Source: <https://www.bloomberg.com/news/articles/2022-12-16/global-recession-risks-rise-as-central-banks-raise-rates?srd=markets-vp>



Asset Classes

U.S. Equities

U.S. equity markets finished the year on a relatively positive note after falling for much of the first three quarters. The S&P 500, Dow Jones Industrial Average, and Russell 3000 closed out the final quarter with gains while the tech-heavy Nasdaq Composite continued its slide. However, three of the four indices finished the year deep in double-digit negative territory, with the Nasdaq Composite taking the brunt of the rate hikes finishing down 32.5%.

Despite positive gains for the final quarter, the equity market capitalization and style segments all suffered negative returns on the year. No segment recovered from the steep losses sustained earlier in the year. The value style led all relative returns across large-, mid-, and small-cap stocks.

Earnings growth has slowed heading into the final quarter of 2022 and is expected to continue its downward trend in 2023. The first two quarters of 2022 saw earnings growth in the S&P 500 of 9.4% and 5.8%, respectively but trended down to 2.5% in Q3 and a projected -2.8% for Q4. Eight of the 11 sectors are expected to post year-over-year growth, led by energy, industrials, and Real estate. The three sectors expecting to post year-over-year declines are Financials, Communication Services, and Consumer Discretionary. The Energy sector has been such a strong driver of earnings growth for 2022 that removing the sector from the S&P 500 would change the anticipated growth for 2022 from 5.1% to -1.8%.

US Markets	QTD%	YTD%
S&P 500 TR USD	7.6	-18.1
DJ Industrial Average TR USD	16.0	-6.9
NASDAQ Composite TR USD	-0.8	-32.5
Russell 3000 TR USD	7.2	-19.2

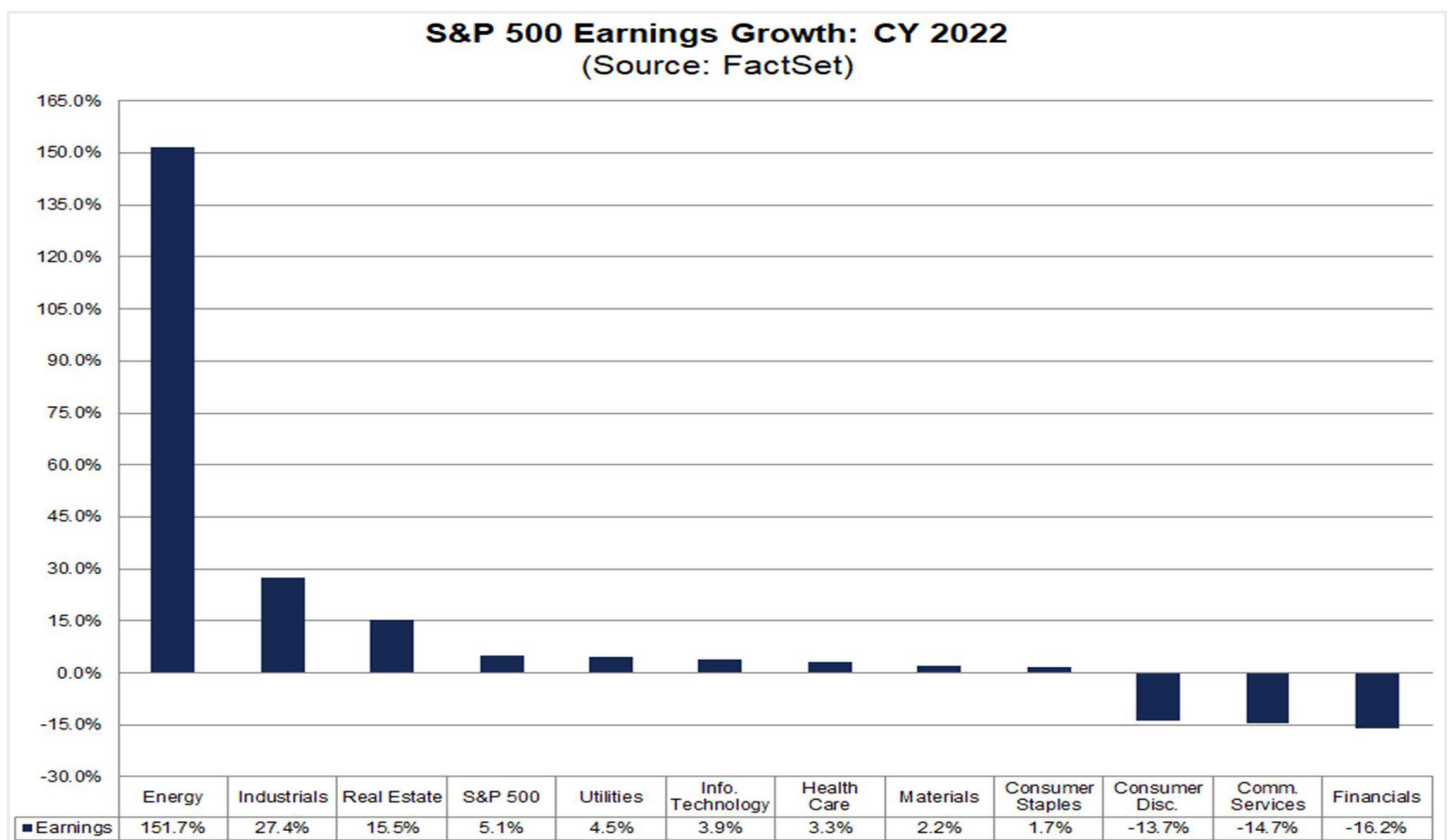
Source: Morningstar Direct

US Equity Size & Style	QTD%	YTD%
Russell 1000 Growth TR USD	2.2	-29.1
Russell 1000 TR USD	7.2	-19.1
Russell 1000 Value TR USD	12.4	-7.5
Russell Mid Cap Growth TR USD	6.9	-26.7
Russell Mid Cap TR USD	9.2	-17.3
Russell Mid Cap Value TR USD	10.5	-12.0
Russell 2000 Growth TR USD	4.1	-26.4
Russell 2000 TR USD	6.2	-20.4
Russell 2000 Value TR USD	8.4	-14.5

Source: Morningstar Direct

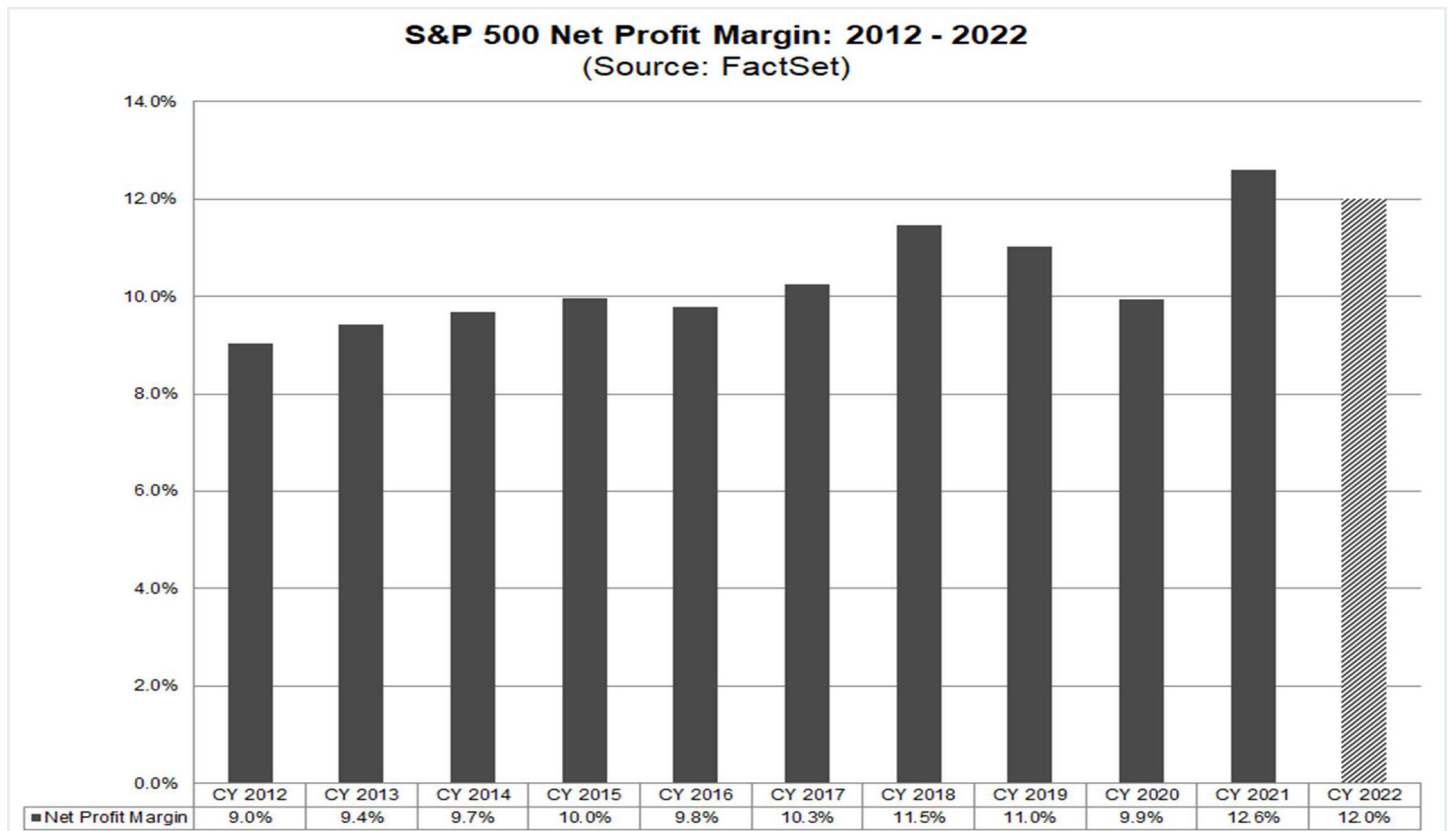
The Financial Services sector proved to be a tough allocation for 2022 as it is expected to report the most significant earnings decline on a year-over-year basis at -16.2%. At the industry level, four of the five industries show declines in margins, with Consumer Finance, Banks, Capital Markets, and Insurance posting double-digit declines.

There is the expectation for 2023 that earnings will decline and that margins will be compressed as the broader economy dips into a recession. Economists have raised the probability of recession to around 70% for the year with many believing that we have already entered a recession. However, the National Bureau of Economic Research (NBER), the organization that officially declares a recession, usually does not make that call until the economy is well into or coming out of recession.

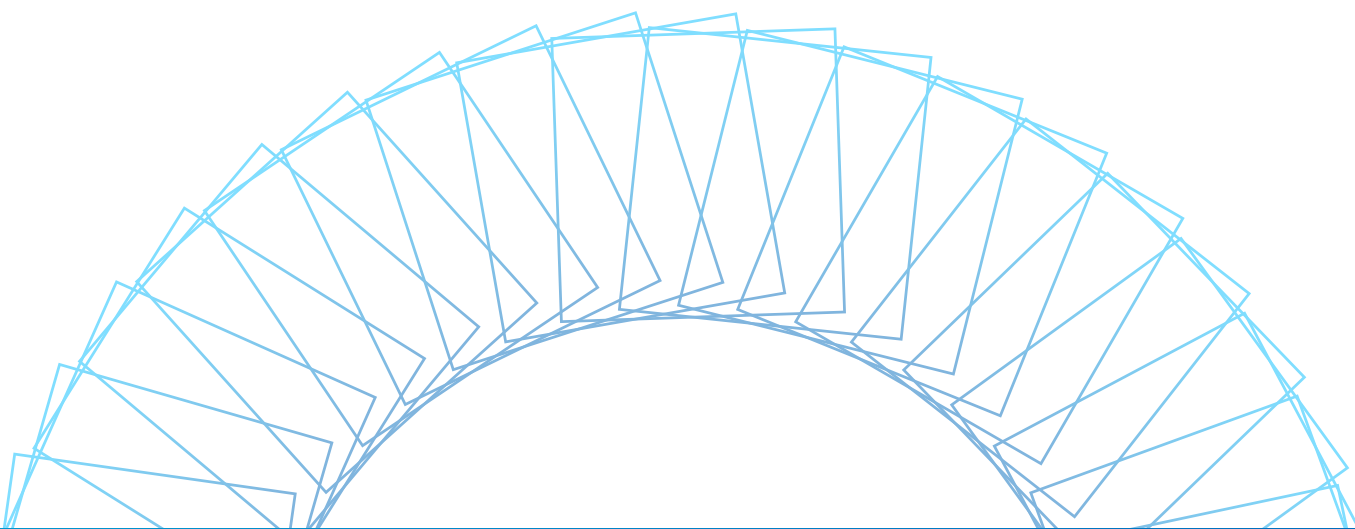


Source: https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_121522C.pdf?hsCtaTracking=31d0f488-5c02-4193-b93b-f1708067f4fa%7Cb994622e-6b82-4c98-ad34-76c848088314

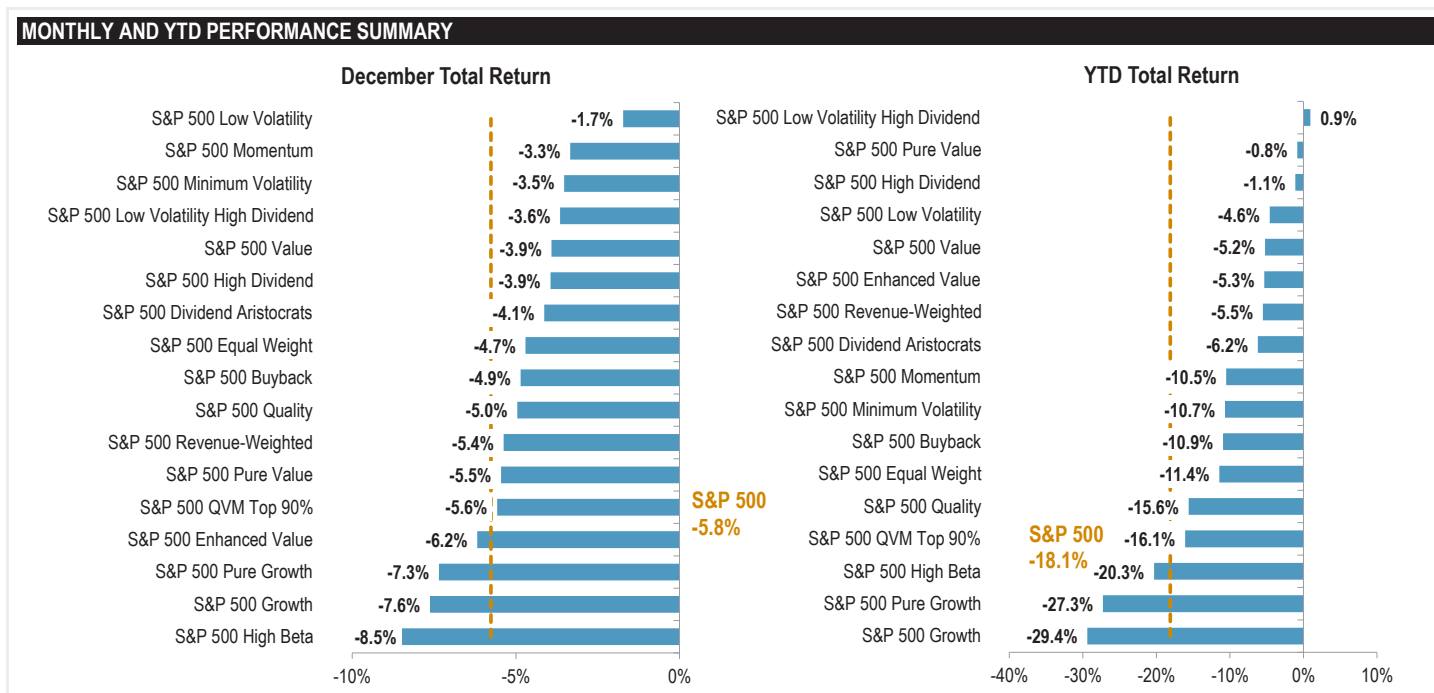
Profit margins for companies in the S&P 500, based on aggregate estimates for revenues and earnings, are expected to finish near 12.0% for 2022. While that is below the 12.6% reported for 2021, it remains above the 10-year average annual net profit margin of 10.3%. It would mark the index's second-highest net profit margin since FactSet began tracking this metric in 2008.



Source: https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_121522C.pdf?hsCtaTracking=31d0f488-5c02-4193-b93b-f1708067f4fa%7Cb994622e-6b82-4c98-ad34-76c848088314

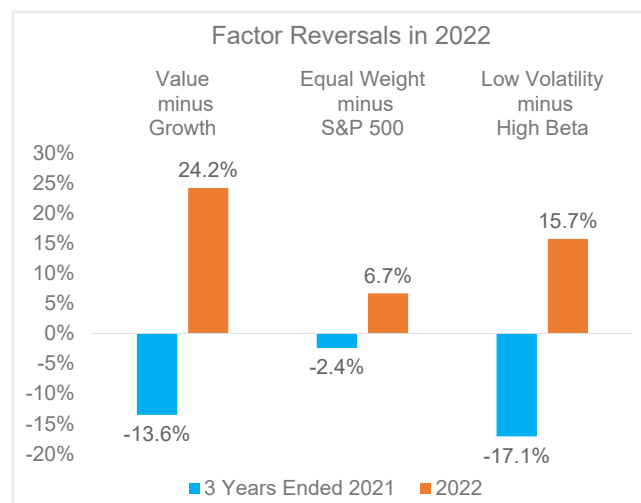


Factor returns posted similarly disappointing numbers, as all but one segment finished the year in negative territory. The S&P 500 Low Volatility High Dividend was the only positive factor for the year, with a return of 0.9%. Pure Value, High Dividend, Low Volatility, and Value rounded out the top five performing factors: Growth, Pure Growth, and High Beta had the most significant contractions for the year.



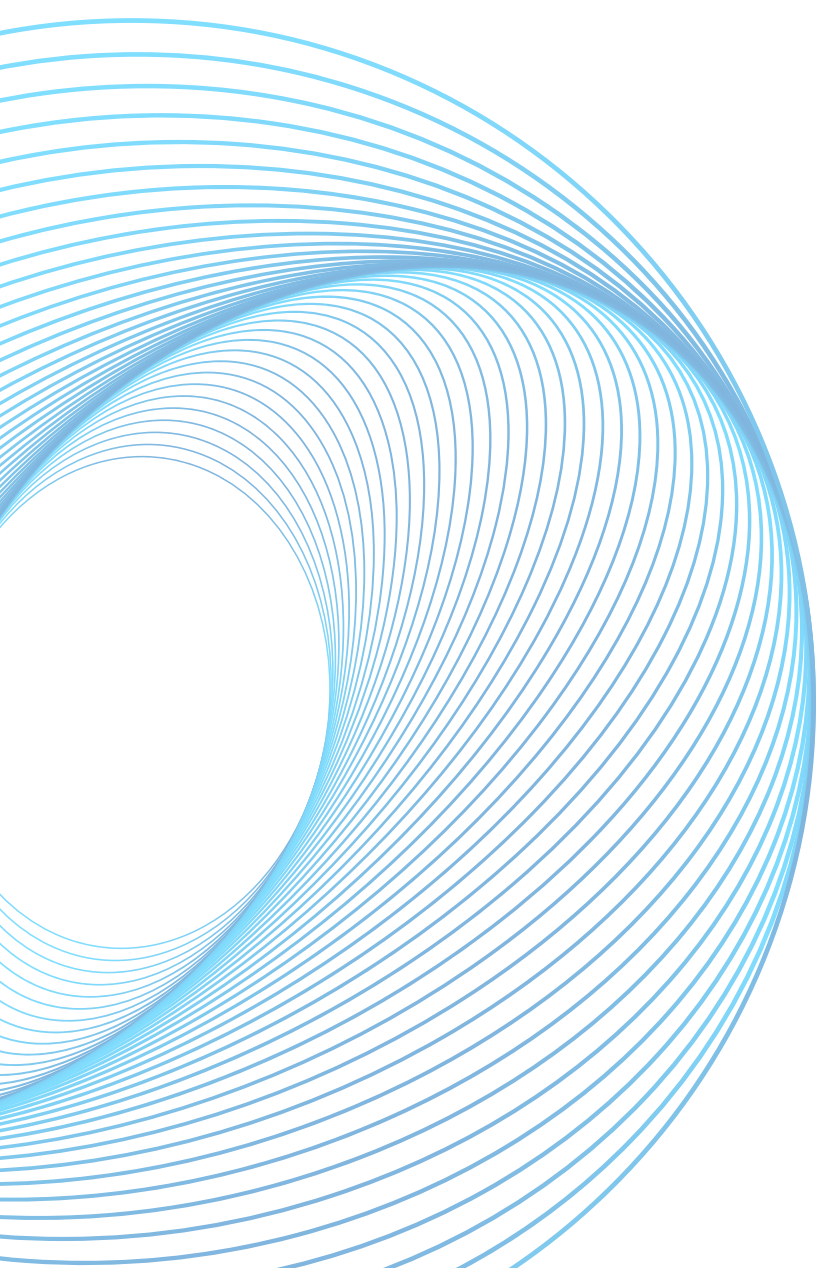
Source: https://on.spdji.com/rs/838-LDP-483/images/dashboard-sp-500-factor-2022-12.pdf?mkt_tok=ODM4LUxEUC00ODMAAAGJGA3a4GJcD0BPLNsQTbB_YdrhzaY-uE0AMpaOABZzhE9ofGu57IYuo6VGORacnN3NvW8kcm26JqZwgWO3tByNgAMUK_8cCaaePFXVwPcdw

The market last year had an abrupt turnaround in factor returns as the prior three-year history showed outperformance in growth over value of an annualized 13.6%, S&P 500 market cap weighted over an equal-weighted S&P 500 of 2.4%, and high beta over low volatility of 17.1%. The quick change in factor leadership highlights how quickly market dynamics can change and the difficulty in maintaining an active allocation model through rapidly changing environments.



Source: https://on.spdji.com/rs/838-LDP-483/images/dashboard-sp-500-factor-2022-12.pdf?mkt_tok=ODM4LUxEUC00ODMAAAGJGA3a4GJcD0BPLNsQTbB_YdrhzaY-uE0AMpaOABZzhE9ofGu57IYuo6VGORacnN3NvW8kcm26JqZwgWO3tByNgAMUK_8cCaaePFXVwPcdw

While factor returns reflected the painful returns of 2022, the outlook for 2023 and the longer term appear attractive. As equity markets have experienced a reset in valuations and multiples, the U.S. Value, Quality and Momentum factors look cheap relative to historical levels. Coupled with easing year-over-year comparisons and the expectations of a new recovery cycle, equities may be poised for a resurgence in returns.



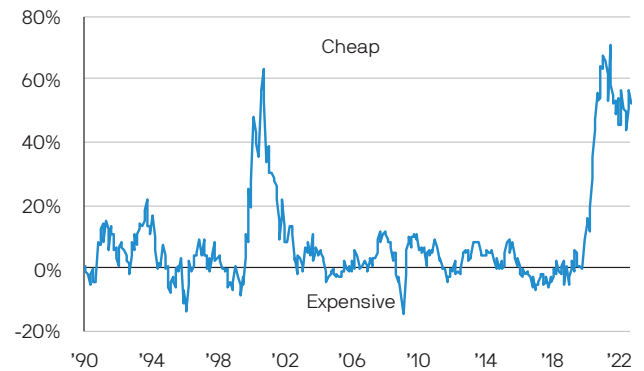
Our long-only factor strategy return assumptions reflect favorable valuations across a wide range of factors

Exhibit 6A: Factor valuations, 1990–2022

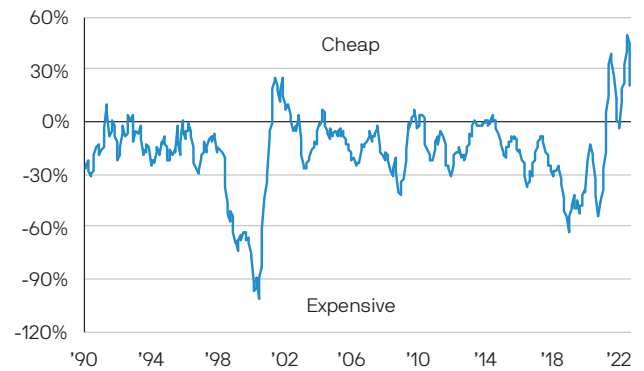
U.S. Value: E/Y spread**



U.S. Quality: E/Y spread**



U.S. Momentum: E/Y spread**



Source: J.P. Morgan Asset Management; data as of September 30, 2022.

** Valuation spread is defined as the difference in valuation (forward earnings yield) between top-ranked (Q1) and bottom-ranked (Q4) stocks, relative to a broad market universe.

Source: <https://am.jpmorgan.com/us/en/asset-management/institutional/insights/portfolio-insights/lcma/>

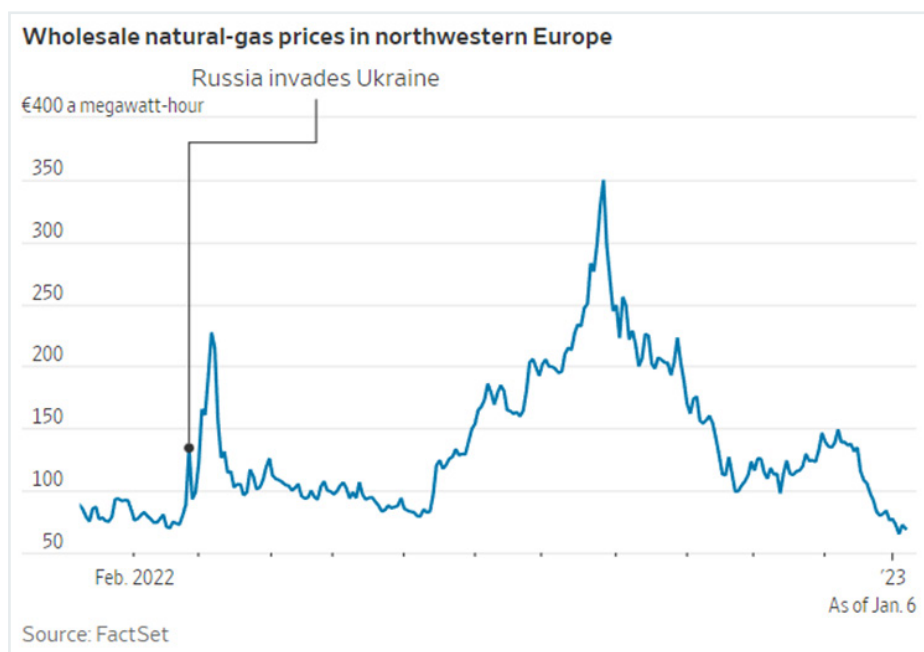
International Developed Markets

International developed markets suffered a similar fate as the U.S. equity markets, with broad double-digit yearly declines. European equities remain tightly correlated with the Russian invasion of Ukraine and subsequent energy supply shortages. The European continent experienced early problems in 2022 as the fallout from sanctions and energy shocks fed through to every corner of the region. The price pressures on energy have eased since the initial invasion as European governments sought to decrease their dependence on natural gas supplies from Russia and enacted policies to encourage individuals and businesses to lower their energy consumption. However adjacent inflation remained persistent as it did in the U.S.

Intl Equity	QTD%	YTD%
MSCI World ex USA NR USD	16.2	-14.3
MSCI EAFE PR USD	17.0	-16.8
MSCI Europe NR USD	19.3	-15.1
Nikkei 225 Average NR JPY	0.8	-7.8
MSCI EM NR USD	9.7	-20.1
MSCI China NR USD	13.5	-21.9

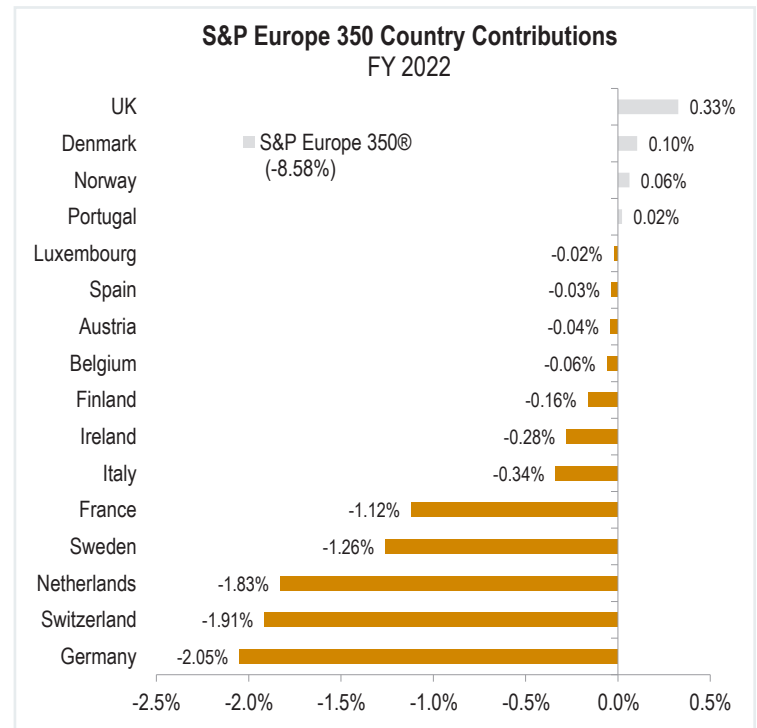
Source: Morningstar Direct

European Energy Ministers reached an agreement in December on natural gas price caps to help ease the burden on consumers and businesses as costs have skyrocketed since February. However, many countries warned that it might have unintended consequences and leave the Eurozone with supply shortages when needed. The benchmark European gas futures contracts have traded between €100 – 150 since late October after spiking in August to €350.



Source: <https://www.wsj.com/articles/sliding-natural-gas-prices-deal-surprise-relieve-to-europe-11673005590>

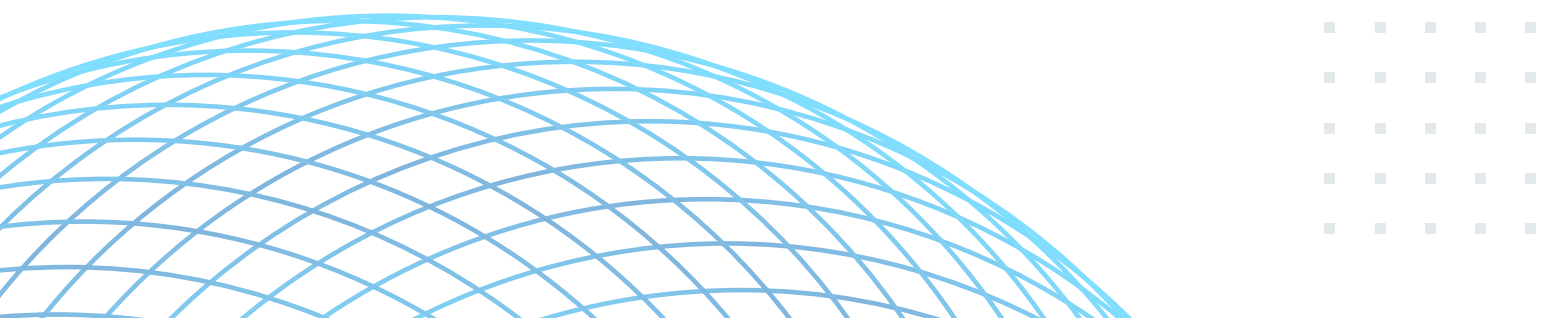
The European Equity Market remains attractive because of low valuations, but the broader economic conditions warrant caution. Price pressures in the region have eased a bit as household demand for goods softened and led to factory production slowdowns that are helping to ease congested supply chains. The resulting slowdown has led to a deceleration in price increases and slowing global trade activity. The European economy is expected to show a contraction by the 2022-year end, but the downturn has been milder than initially anticipated. Improvements in securing non-Russian energy supplies and government subsidies have helped local businesses and households weather the higher prices.



Source: https://on.spdji.com/rs/838-LDP-483/images/dashboard-europe-2022-12.pdf?mkt_tok=ODM4LUxEUC00ODMAAAGJBCX_D5bRrwYBiBSSLKxrBqqxDpTn9xkvH20RET_LDpGmlrkR1s_uaeJTY6d_S5q6QTF-O1A4mt_Q13htlgDm2BkUCYhfqRX1RTD2ezlOTA

The foresight of governments to replenish gas reserves before the beginning of winter has helped keep the countries from running into serious problems while simultaneously decreasing energy consumption. As a result, the European Union reported that energy consumption was down 23% in November from the prior year.

A recent FactSet poll on the Eurozone economy shows expectations for a contraction, and some economists suggest that a shallow recession may have already started. However, the milder-than-expected fallout for the market has led the Euro Stoxx 50 to outperform the S&P 500 since September. The Eurozone still presents risks to investors relative to domestic U.S. equities in the short run. U.S. households came out of the pandemic with more robust savings and benefited from less reliance on other countries for energy supplies.



International Emerging Markets

Equity markets in China finished down 20%+ for the second consecutive year. The continued drop marks one of the most prolonged periods of sustained losses for China. The country has struggled with COVID-19 restrictions, a nearly bursting real estate bubble, and regulatory crackdowns on private businesses. Recently the country rolled back many of the strict quarantine rules that led to mass lockdowns and battered the economy. In addition to loosening pandemic-related policies, the government has implemented new policies to stabilize the struggling real estate market. New measures from party officials include extending maturities for debt tied to construction financing, support for bond issuance from privately owned developers, and decreasing mortgage rates, which have fallen 1.29% since the start of 2022.

China	QTD%	YTD%
MSCI China A NR USD	4.3	-25.9
CSI 300 NR USD	4.0	-26.7
S&P China BMI NR USD	12.8	-21.9

Source: Morningstar Direct



Source: <https://www.wsj.com/articles/chinas-covid-easing-and-policy-pivots-brighten-outlook-for-stocks-11672396205?page=1>

While COVID-19 cases are expected to rise sharply for the country in 2023, the rolling-back of lockdowns may help the economic recovery in the latter half of the year. Moreover, as Beijing tries to set the country back on a path toward economic growth, the recent announcements from American accounting regulators receiving access to audit papers of U.S.-listed Chinese companies have helped provide a tailwind to technology companies. The tension over auditing U.S.-listed Chinese equities has been a particular pain point as they were being threatened by potential de-listings over access to financial statements.

In tandem, all the recent moves by China point towards a positive outlook for the country in the long term, but the short term remains a bumpy ride as COVID infections could continue to cause significant disruptions. The World Bank estimates that China's real GDP growth will reach 4.3% in 2023 after slowing to 2.7% in 2022. Strategists at Morgan Stanley have their base case scenario returning low double-digit returns in 2023.

Still, they acknowledge that there is potential for more upside to 25% or, if things take a step in the wrong direction, a potential fall of roughly 28%. There are strong tailwinds in the market as China is not currently experiencing the same level of inflation as much of the rest of the world is, and the subsequent rising interest rates. The broader emerging market Asian region could potentially benefit from spillover effects from China’s rebound as exports and tourism pick up. While reopening the world’s second-largest economy is a positive step in further easing supply chains, the demand for commodities raises another potential headwind to ease inflation globally.

All Country Asia Index	QTD%	YTD%
S&P China BMI NR USD	12.8	-21.9
S&P India BMI NR USD	2.1	-7.8
S&P Japan BMI NR USD	12.9	-15.8
S&P Korea BMI NR USD	17.8	-29.9
S&P Taiwan BMI NR USD	9.0	-27.9
MSCI AC Asia NR USD	12.0	-18.6

Source: Morningstar Direct

Indian markets fared better than their Asian peers as the broad S&P India Index returned -7.8% for 2022. India looks like a potential diversifying allocation for investors as businesses look to move some of their operations away from China. The recent announcements from Foxconn, a Taiwanese iPhone manufacturer, of shifting some operations for the phone parts and semiconductors hints at the country’s potential for large manufacturing hubs. The country also has strong growth potential in its home-grown I.T. firms that will benefit from

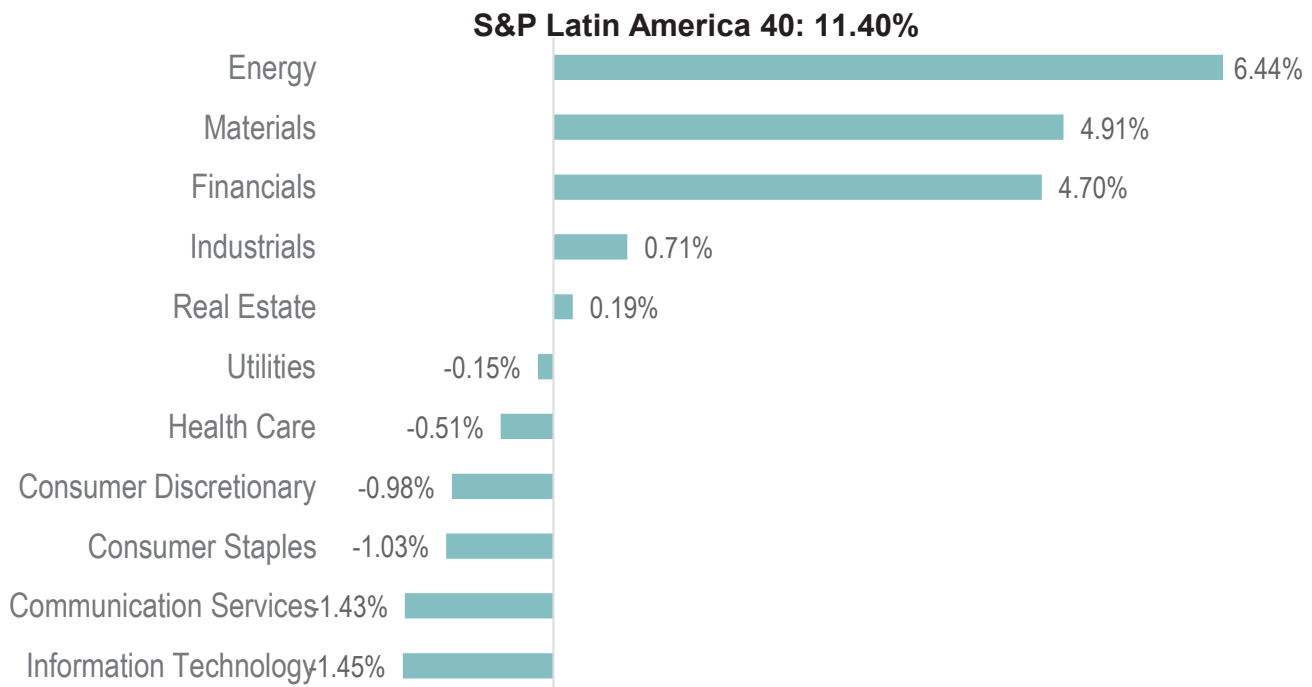
continued outsourcing trends, but the current market valuations will continue to be a headwind. The forward price-to-earnings ratio of roughly 22 for Indian equities is double the current multiple for Chinese stocks and more than three times the Brazilian market multiple of 7. Even compared to American tech companies, Indian equities currently look expensive. The country is currently experiencing a retail trading surge, like the rise of Robinhood in the U.S. during lockdowns, and recent movements by the central bank to raise rates have not had similar consequences to multiple expansion. The number of participants in the Indian markets has tripled since the start of 2022 and retail trading volume rose by \$36 billion.

Latin American equity markets finished the year with mostly positive results as the broad-based S&P Latin America BMI rose 4.9% and the S&P Latin America 40 notched a double-digit gain of 11.4%. Despite global inflation, geopolitical conflicts, and energy shortages the region produced some of the best returns globally as Argentina and Chile posted double digit U.S. dollar denominated returns. The energy, real estate, and commodities sectors provide a strong tailwind. The region may be set up for another positive year as a reopening Chinese economy could increase demand for raw inputs for manufacturing.

Latin American	QTD%	YTD%
S&P Argentina ADR NR USD	35.3	55.4
S&P Chile BMI NR USD	9.5	21.7
S&P Peru BMI NR USD	16.5	7.5
S&P Brazil BMI NR USD	0.5	5.4
S&P Mexico BMI NR USD	13.9	-0.1
S&P Latin America BMI	4.9	4.9
S&P Latin America 40	5.0	11.4

Source: Morningstar Direct

S&P Latin America 40 Sector 2022 Contribution



Source: <https://on.spdji.com/rs/838-LDP-483/images/dashboard-latin-america-2022-12.pdf>

Fixed Income

High inflation and central banking tightening led to the most significant nominal drawdown in the J.P. Morgan Government Bond Index (GBI) since its creation. The real return drawdown in 2022 matched the severe fall from the 1970s. In addition, nearly every corner of the fixed-income market experienced sharp losses as interest rates rose to their highest levels since the early 2000s.

Fixed Income	QTD%	YTD%
ICE BofA US Corporate TR USD	3.53	-15.44
Bloomberg US Corporate High Yield TR USD	4.17	-11.19
Bloomberg US Convertible Comp TR USD	1.62	-18.90
Bloomberg Municipal TR USD	4.10	-8.53
Benchmark 1: Bloomberg US Agg Bond TR USD	1.87	-13.01

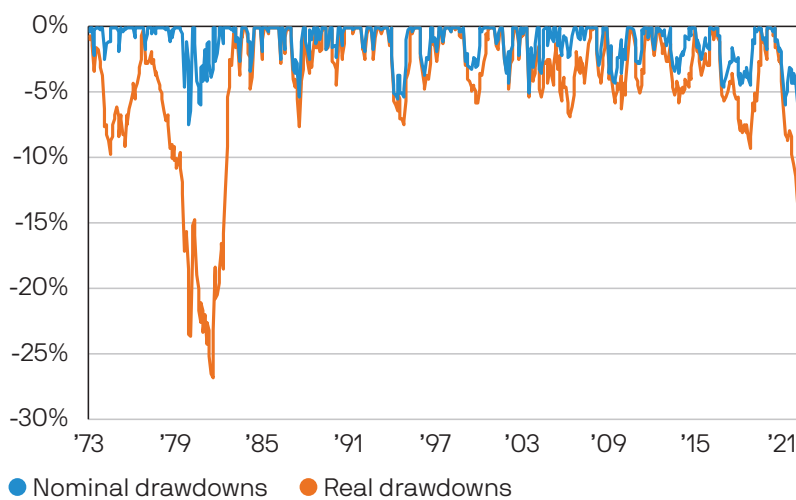
Source: Morningstar Direct

The U.S. Federal Reserve will likely continue to view disinflation through the lens of softening employment and maintain that unemployment needs to rise from the current level of 3.7% to achieve the longer-term target of 2% inflation. Current readings have shown a deceleration in prices while wage growth remains strong, and unemployment remains unchanged. Fed comments point to an expected painful reset in the economy as steeper financing costs lead companies to lay off employees in cost-cutting measures. The Fed is projecting that unemployment will reach the range of 4% to 5%. Still, achieving a soft landing where unemployment only incrementally increases while the broader economy remains stable is challenging. If the Fed's efforts to cool inflation are overdone, they raise the risk of the economy falling into an unemployment spiral that leads to depressed spending, lower revenues and even further corporate cost-cutting. Given the Fed's recent decision to slow rate hikes, the FOMC seems to be taking a wait-and-see approach as the impact of interest rate increases flows through the economy.

High inflation and more hawkish central banks prompt the biggest-ever nominal decline

Exhibit 6: U.S. Treasury index drawdowns (% from peak)

U.S. Treasury index drawdowns, % from peak



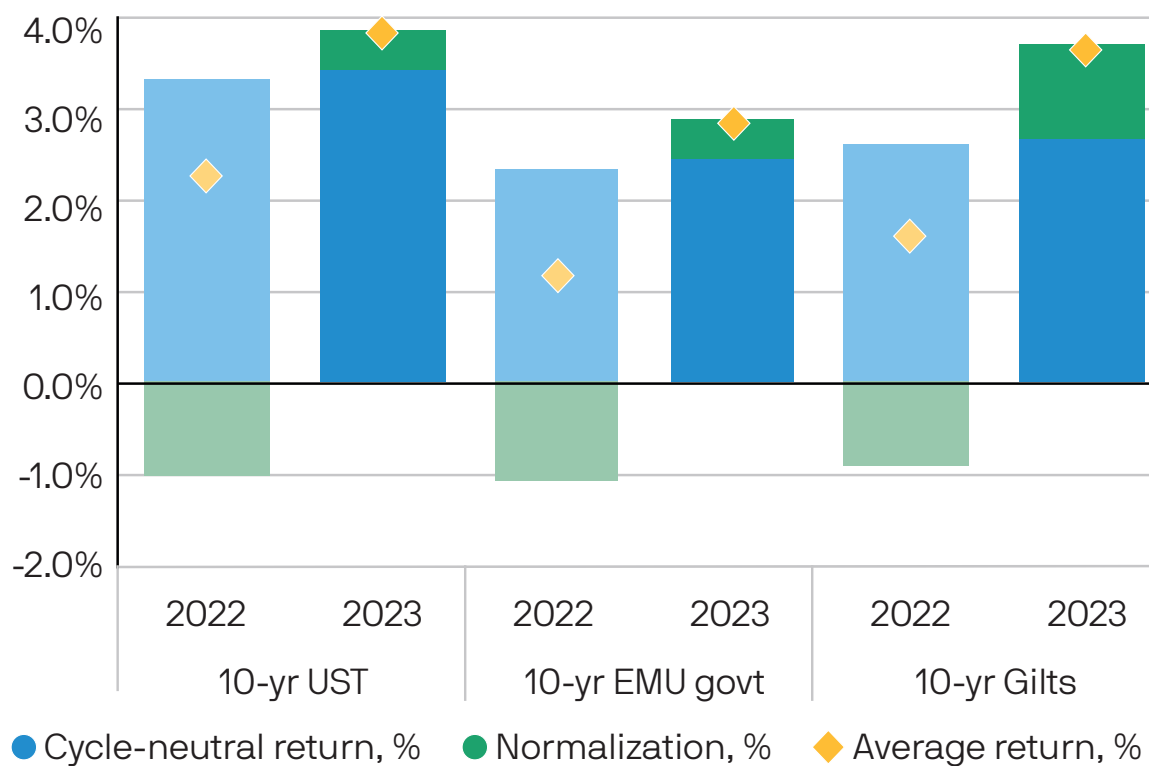
Source: J.P. Morgan Asset Management; data as of September 30, 2022.

Source: <https://am.jpmorgan.com/us/en/asset-management/institutional/insights/portfolio-insights/ttcm/>

With the ultra-low interest rate environment post-Great Financial Crisis (GFC) finally ending, the typical asset allocation approach for bonds can again provide a meaningful ballast and hedge to a risky equity allocation. Fixed income yields have again become an attractive alternative to the “there is no alternative” (TINA) to equities mindset and may provide strong total return and income opportunities in the face of a looming recession. The long-term drag on returns from rate normalization has eased and is expected to be further minimized over the next 2-3 years.

No more drag from normalization

Exhibit 5: Major fixed income market return assumptions with normalization component, 2022 vs. 2023



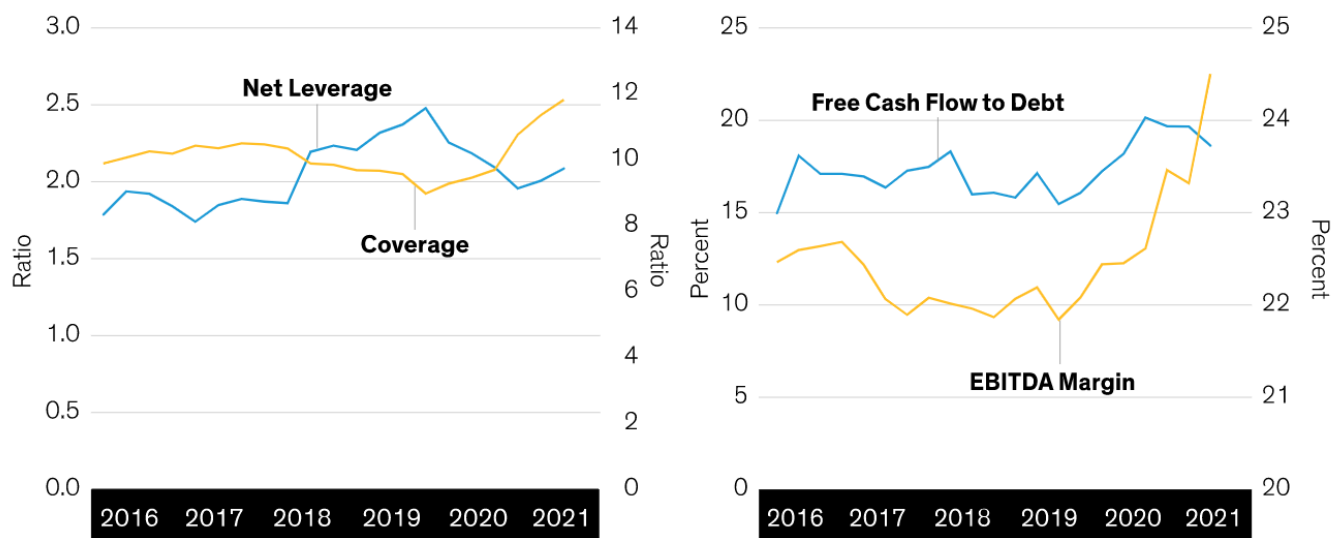
Source: J.P. Morgan Asset Management; data as of September 30, 2022.

Source: <https://am.jpmorgan.com/us/en/asset-management/institutional/insights/portfolio-insights/lcma/>

With reasonable alternatives now, the attractiveness of fixed-income yields is more significant than their equity counterparts, with stock earnings yields lagging bonds as rates climbed in 2022. With household and corporate balance sheets showing resilience, there are attractive opportunities within investment-grade corporate bonds. Historically recessions occur in tandem with weakening credit fundamentals, downgrades, and an increase in default rates as growth and demand slow. However, the recent economic downturn during the pandemic and resulting default cycle allowed the surviving companies to be well-positioned for a shallow recession. The current fundamentals for credit show that businesses have strong interest coverage ratios, free-cash-flow-to-debt, and EBITDA margins. Additionally, companies managed their liquidity conservatively in the years between the pandemic and now, a moderate deterioration in earnings will not be as painful.

Balance Sheets Are Much Healthier Today

US Investment-Grade Corporates "Constant Universe"



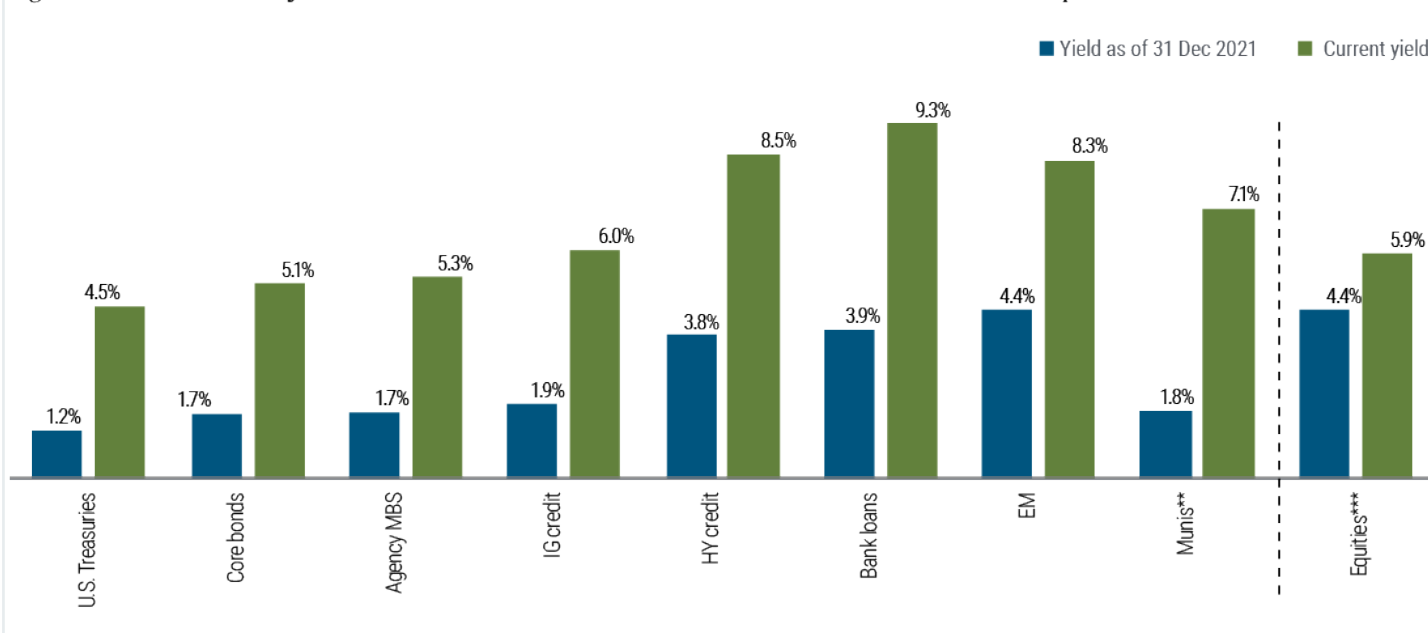
Historical and current analyses do not guarantee future results.

As of May 31, 2022

Source: AB

Source: <https://www.alliancebernstein.com/corporate/en/insights/investment-insights/investment-grade-corporates-on-the-express-track.html>

Figure 2: The increase in yields* for fixed income has created more attractive alternatives for equities



Source: PIMCO, Bloomberg as of 24 October 2022. Index proxies for asset classes displayed are as follows: U.S. Treasuries: Bloomberg U.S. Treasury Index, Core bonds: Bloomberg U.S. Aggregate Index, Agency MBS (mortgage-backed securities): Bloomberg MBS Fixed Rate Index, IG (investment grade) credit: Bloomberg Global Aggregate Credit Index (USD Hedged), HY (high yield) credit: ICE BofAML U.S. HY BB-B Rated Index, Bank loans: JP Morgan Liquid Loan Index, EM (emerging markets): J.P. Morgan EMBI Global, Munis: Bloomberg Municipal Bond Index, Equities: S&P 500 Index.

*Yield to worst, which is the yield resulting from the most adverse set of circumstances from the investor's point of view, or the lowest of all possible yields.

**Municipal yields are the tax equivalent yields, or the yield to worst adjusted by the highest marginal tax rate (40.8%). Tax equivalent yield is intended for U.S. domiciled investors and is the return that a taxable bond would need to equal the yield on a comparable federal tax-exempt municipal bond. The yield to worst for municipals is 1.1% as of 31 December 2021 and 4.2% as of 24 October 2022.

***Yield for equities is forward earnings yield for the S&P 500 Index.

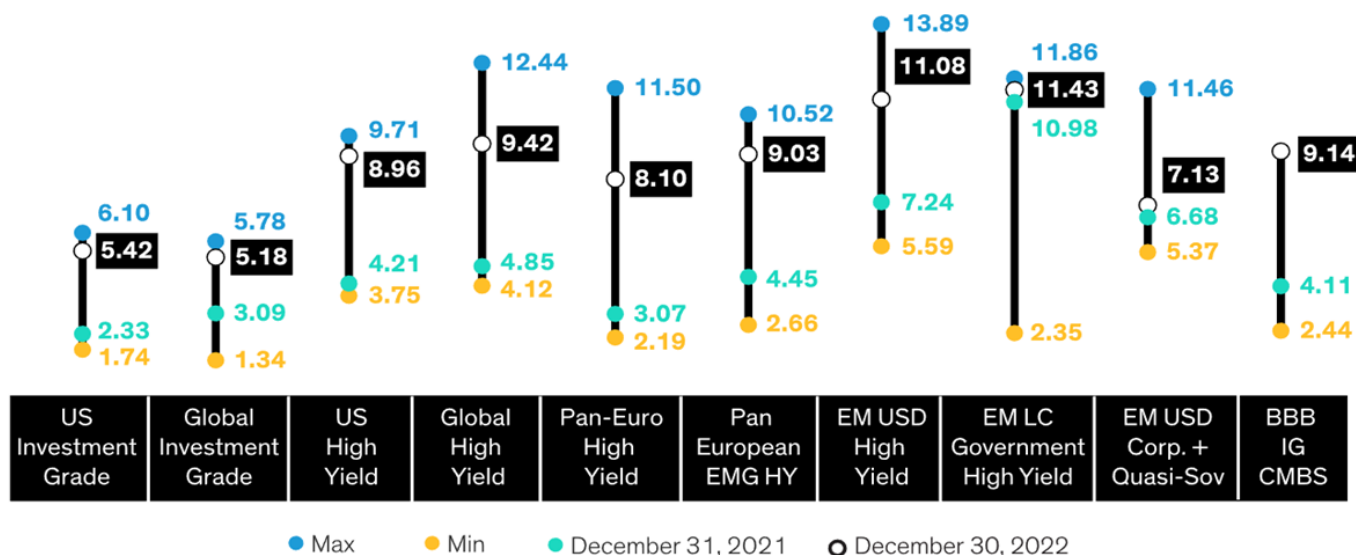
Source: <https://global.pimco.com/en-gbl/insights/economic-and-market-commentary/global-markets/asset-allocation-outlook/risk-off-yield-on>

We see a shift to structurally higher interest rates across the globe that give way to attractive investment opportunities outside of the U.S. In addition, the coordinated effort to combat inflation globally has led to a positive environment for expected fixed income returns in several markets. As a result, global multi-sector approaches should be able to outperform in the coming year as conditions and valuations shift in favor of higher yields in several different markets.

Yields Are Near 10-Year Highs Across Much of the Bond Market

10-Year Yield-to-Worst Range

December 2011–December 2022



Past performance does not guarantee future results.

CMBS: commercial mortgage-backed securities; EM: emerging markets; EMG: emerging; LC: local currency; USD: US dollar

Historical information provided for illustrative purposes only. US Investment Grade represented by Bloomberg US Agg Corporate Index; Global Investment Grade represented by Bloomberg Global Agg Corporate Index; US High Yield is represented by Bloomberg US High Yield Corporate Index; Global High Yield represented by Bloomberg Global High Yield Corporate Index; Pan-Euro High Yield by Bloomberg Pan-European High Yield; Pan-European EMG HY by Bloomberg Pan European EMG High Yield; EM LC Gov't HY by Bloomberg EM Local Currency Government High Yield; EM USD High Yield by Bloomberg EM USD Sovereign High Yield; EM USD Corp + Quasi-Sov by Bloomberg EM USD Corp + Quasi Sovereign High Yield; BBB IG CMBS by Bloomberg CMBS IG BBB Index.

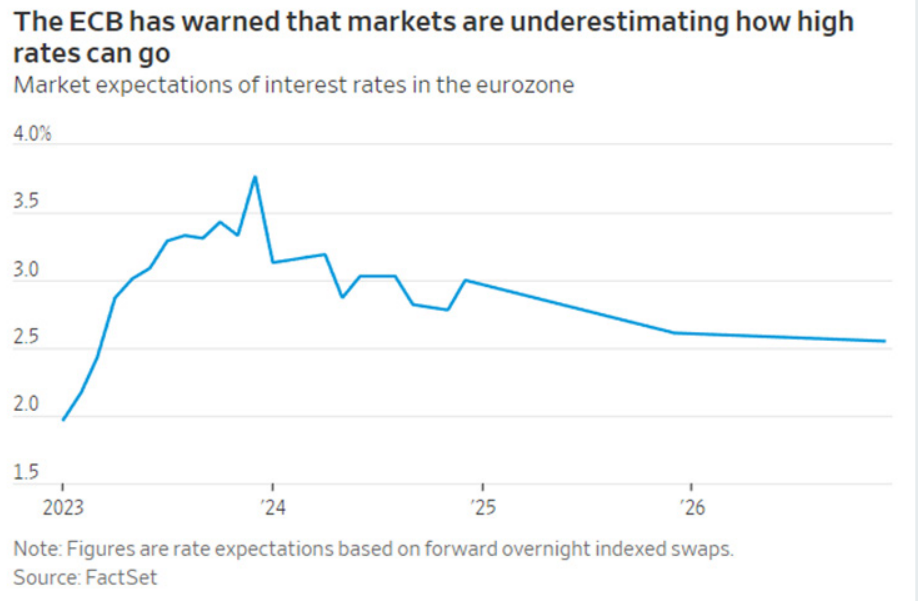
As of December 30, 2022

Source: Bloomberg and AllianceBernstein (AB)

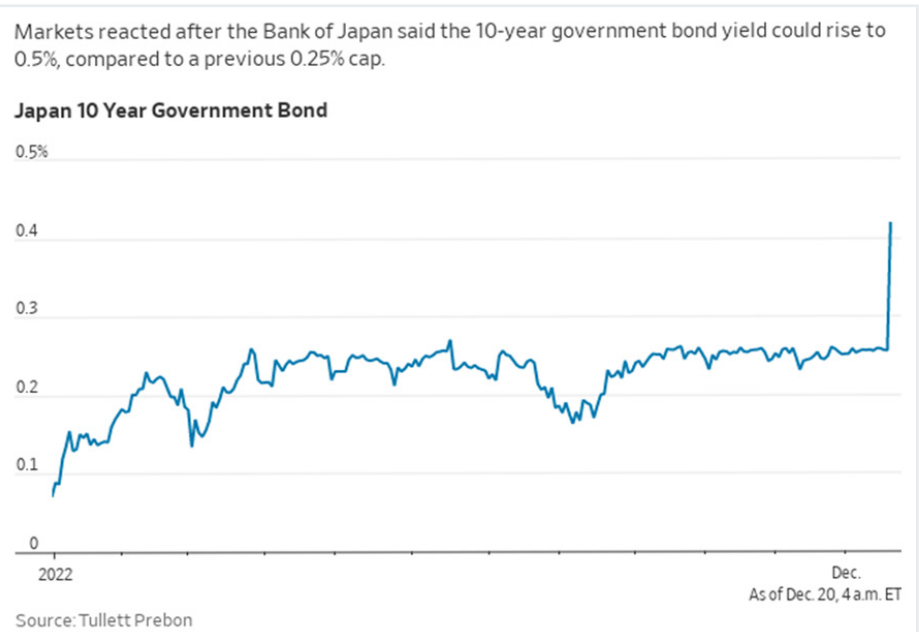
Source: <https://www.alliancebernstein.com/corporate/en/insights/investment-insights/turning-point-2022-redefines-the-investing-calculus.html>

While European credit appears attractive from a yield perspective there is still an expectation that rate hikes will continue in 2023 and beyond. The fact that the economic fallout from the Russian invasion has been less severe than expected has given the central bank an opportunity to continue monetary tightening. Christine Lagarde of the ECB echoed similar sentiment as Powell when she warned markets that “Anybody who thinks that this is a pivot for the ECB is wrong.” Investors have held out hopes that a slowing pace of interest rate hikes might hint that the central banks are closer to a dovish pivot than their actions suggest. However, much like Powell’s post meeting conference, Lagarde set out to correct that misconception.

The Bank of Japan adjusted its yield curve control program to allow the 10-year borrowing costs to rise to approximately 0.5% vs the prior 0.25%. The unexpected adjustment to the yield target from the BoJ sent ripples through the fixed income markets as Japanese government bond prices fell and the Yen climbed against the U.S. dollar. The BoJ was one of the last major central banks to hold lending rates at near zero levels. The door is now open for the central bank to continue on a rate normalization path in 2023.



Source: <https://www.wsj.com/articles/europe-is-weathering-russias-energy-stormand-the-ecb-knows-it-11671197731>



Source: https://www.wsj.com/articles/the-bank-of-japan-steals-christmas-11671531489?mod=article_inline

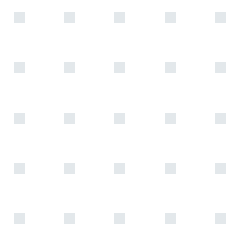
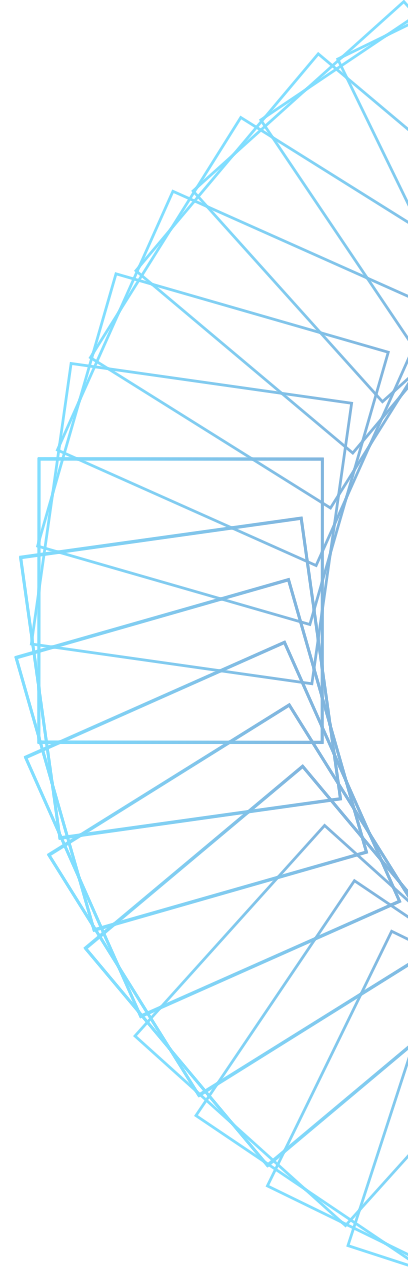
Asset Allocation Implications

Our 2023 outlook shifts closer to a neutral 60/40 stock bond allocation as fixed income return expectations rise and equities prepare for an economic slowdown. Higher bond yields provide more opportunities for income for investors. There may be opportunities for price appreciation this year as well, given the expectations for the Federal Reserve's hiking cycle to come to an end in the middle of 2023. The shift back towards a positive environment for credit also opens the door for a more meaningful diversification benefit as correlations between equities and bonds diverge.

We anticipate a slowing economy as interest rate hikes feed through the market, ultimately lowering consumer demand. As households spend down their remaining savings from the pandemic, we believe the economy may dip into a shallow recession before ultimately returning to growth in the latter half of the year and into 2024. As a result, our asset allocation model favors value over growth and large-cap over small-cap stocks. Value returned to favor in the latter half of the year and remains the dominant trend. We do not anticipate an impending reversal to favor growth and the high-flying tech names that historically have benefitted from lower interest rates. Small-cap valuations are becoming increasingly attractive; however, a potentially worsening economy due to a Fed-induced recession could deteriorate the attractiveness of small-cap stocks in the short term.

Our allocation model tilts towards a preference for domestic U.S. equities over international and emerging markets as conditions abroad have deteriorated with global inflation. The economic impacts of the war in Ukraine and China's zero-COVID policy could both potentially see resolutions this year. While we are not market timers, we recognize that there may be an opportunity to reallocate to those markets as conditions shift to a bottoming out and reorient towards growth.

There is likely more pain in store for equity markets as analysts have only recently begun pricing in EPS declines for the fourth quarter of 2022 and decreasing projections for the entire 2023 year. Nevertheless, our portfolios will remain well diversified and seek to take advantage of shifting trends as the year unfolds.



These are our updated asset class preferences for 2023.

Asset Class	Asset Class Preference for 2023			Change in Opinion from Last Outlook
	Concern	Neutral	Constructive	
Equities		0		
Bonds		0		+1
Equity				
Geographic Exposure				
US			1	
Intl Developed		0		
EM	-1			
Size				
Large			1	
Mid		0		
Small	-1			
Style				
Growth	-1			
Value			1	
Fixed Income				
Geographic Exposure				
US		0		+1
Intl Developed	-1			
EM	-1			
Credit Exposure				
Treasuries	-1			+1
IG Corporates			1	
High Yield		0		-1
Interest Rate Exposure				
Duration	-1			+1
Alternatives				
Liquid Alts (F)			2	+1
Commodities			1	-1
Real Estate			1	

Key	-2	-1	0	1	2
Relative Weighting	Very Underweight	Underweight	Neutral Weight	Overweight	Very Overweight

[See commentary from our sister company, 3D→](#)

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This should not be considered a recommendation to buy or sell individual securities, nor should this information be relied upon as research or investment advice regarding any security in particular. Diversification does not ensure a profit or protect against loss.

Except as otherwise specifically stated, all information and portfolio manager commentary are as of December 31, 2022.