2023 outlook

Turning the corner

2022's market themes of inflation, the Fed and the economy are still behind the wheel in 2023. However, we think these conditions are heading toward a turning point, which should produce a more favorable outcome for market performance in the year ahead.

The ride is likely to start out bumpy, but we think 2023 will ultimately steer in a positive direction as a new expansion and bull market take shape.

Here are 10 of our key views for 2023

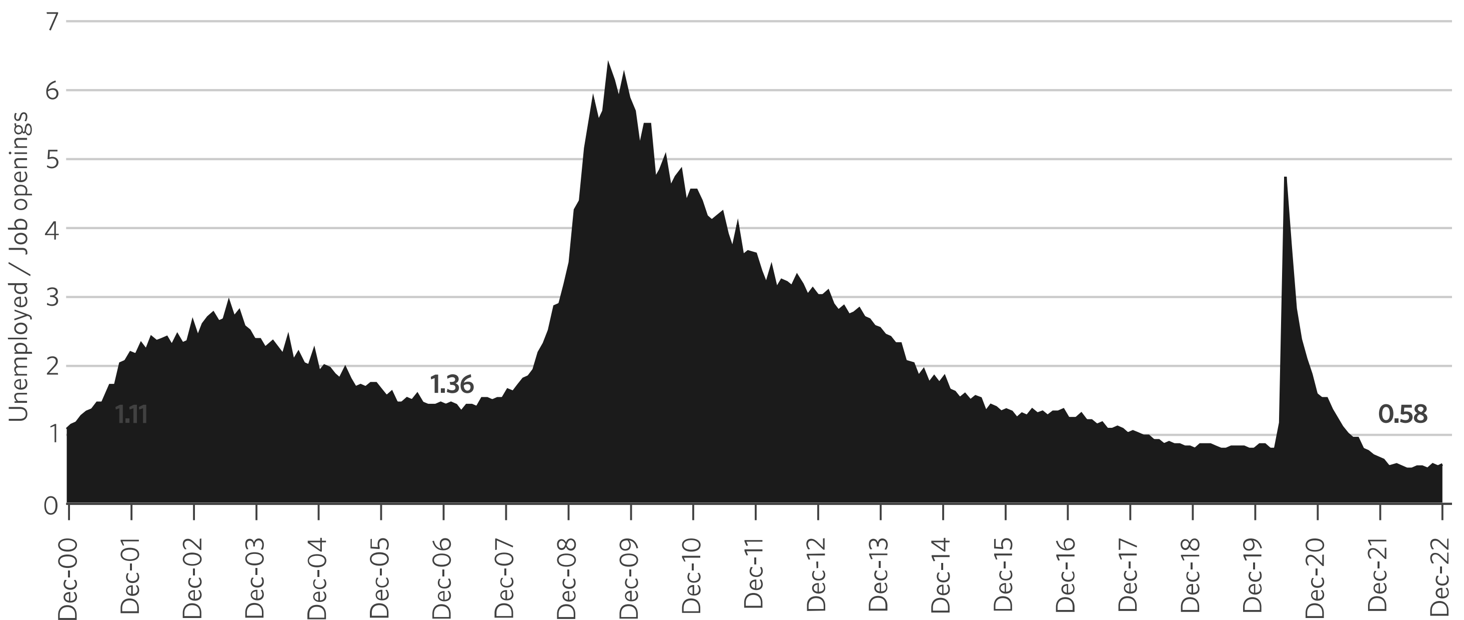
1. A mild recession emerges in the first half of the year.
2. Unemployment rises but stays below 5%.
3. Core inflation falls, approaching 3% as the year progresses.
4. The Fed pauses when the policy rate nears 5%; discussions of rate cuts emerge late in the year.
5. Longer-term rates fall as the focus shifts from inflation to growth.
6. The U.S. dollar weakens further, supporting international equity returns.
7. Near-term equity volatility gives way to a new bull market in the second half.
8. Bonds bounce back — look for opportunities to add duration.
9. Equity leadership becomes more balanced.
10. Broad individual federal, gift and estate tax law changes are unlikely in 2023.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

1. A mild recession emerges in the first half of the year.

Low unemployment and elevated job openings should help cushion the blow for consumer spending

Total unemployment per job opening



Source: Bloomberg.

While the housing market has seen the most immediate effects of aggressive rate hikes, we don't think the full impact of the Federal Reserve's restrictive policies has fully filtered its way through the economy. We expect to see an economic slowdown as consumers and businesses pull back on spending.

Although downturns are never desirable, we'd emphasize two points:

- We think a recession would be mild compared to history, especially the downturns in 2008, 1981 and 1974. Looking at the past 50 years, the average unemployment rate at the beginning of each recession was 5.2%. With unemployment below 4% (only slightly above a half-century low),[1] the labor market's strong starting point should foster a shallow economic slowdown.
- We expect a new economic expansion to take shape in the second half of 2023, ushered in by falling inflation and the end of the Fed's tightening campaign. This should be accompanied by renewed positive phases for consumer spending and corporate earnings.

We think 2022's bear market largely priced in a recession. While we don't see materially more downside beyond last October's lows, the stock market is unlikely to completely dismiss the arrival of a recession, since slower economic activity threatens corporate earnings growth.

Importantly, in the recessions between 1970 and 2020, a new bull market began an average of five months before the recession ended, with an average return of 49% in the first 12 months.[2] We think this highlights the forward-looking nature of the financial markets and supports the case for opportunistic investing in 2023.

[1] As of Dec. 5, 2022.

[2] Source: FactSet.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

2. Unemployment rises but stays below 5%.

We expect the unemployment rate to start rising in early 2023 as restrictive Fed policy catches up with the economy and we head into a potential economic downturn. Historically, the labor market tends to be a lagging indicator of economic activity. We continue to see the U.S. unemployment rate hold up at multi-decade lows, close to 3.7%.*

Although we expect unemployment to rise in 2023, the labor market is starting the year relatively strong, and job openings remain elevated. We see the unemployment rate rising from current levels, but not as much as it historically has over the length of a recession. We're expecting it to remain below 5% in the year ahead.

*As of Dec. 5, 2022.

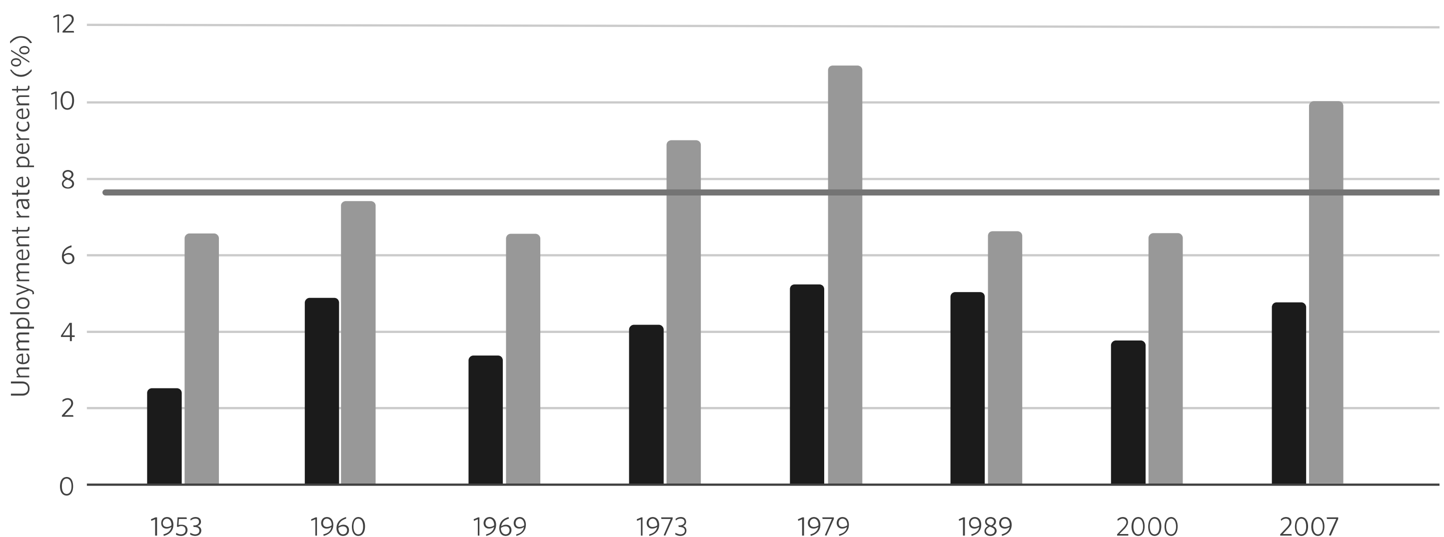
The labor market showed remarkable resilience in 2022, putting upward pressure on wages and boosting inflationary pressures. The Fed is closely monitoring wage growth as a signal of inflation in services. Fed Chair Jerome Powell has indicated that the Federal Open Markets Committee (FOMC) would like to see wage growth head toward 3.5%, below the current 5% level.

In our view, given the softening labor market trends, a potential rise in unemployment, and early signals of hiring freezes and layoffs in some sectors, we believe wage gains should moderate over time, alongside easing inflationary trends. Nonetheless, we would expect this trend to unfold gradually and not deter the Fed from maintaining its restrictive policy stance for much of 2023.

The unemployment rate tends to rise before and during a recession

Unemployment rate through recessionary periods

- Unemployment trough
- Unemployment peak
- Average peak unemployment rate



Source: FRED, FactSet.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

3. Core inflation falls, approaching 3% as the year progresses.

We expect price pressures to ease meaningfully in 2023, providing relief to consumers and central banks. Though the path could be bumpy at first, we see core inflation (excluding the volatile categories of food and energy) falling below 4% in the second half of the year and approaching 3% by year-end.

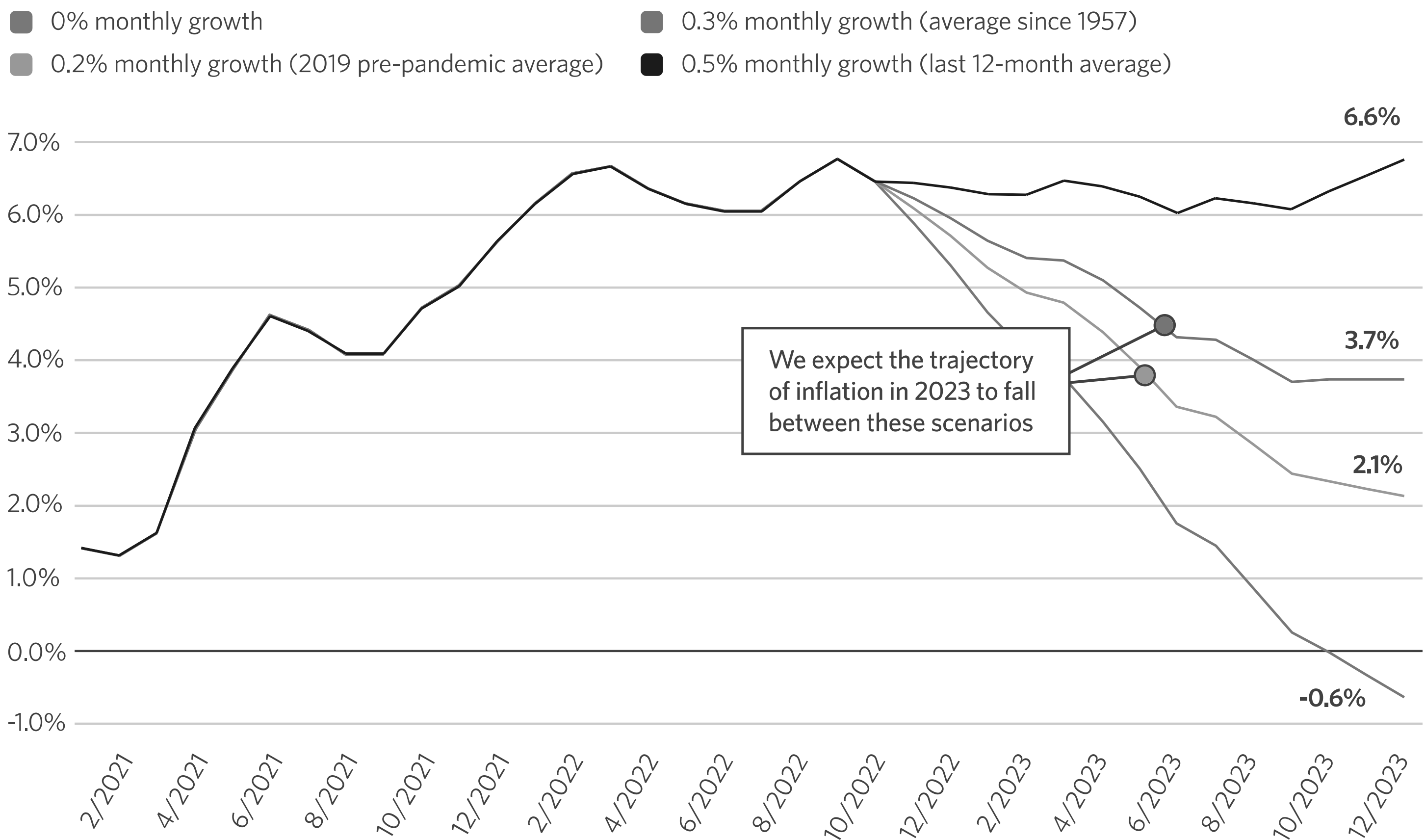
Historically, once inflation peaks, it tends to decelerate at a steady pace. That was the case even in the 1970s and '80s, with the rise and fall of the inflation rate proving to be symmetric.

This round of inflation was fueled by a sharp rise in prices for goods, which then broadened to include higher prices for services. Easing supply shortages, lower consumer demand and excess retailer inventories should all contribute to a sharp slowdown in goods inflation.

Price increases for services tend to be more persistent and slow-moving, but will also likely shift in the right direction as the year progresses. Housing inflation, the biggest services component, is poised to slow as home prices cool under the weight of higher borrowing costs. And a gradual easing in labor market conditions should keep downward pressure on wage growth, which tends to drive inflation for other services.

The inflation tide will likely turn as we move through 2023

Inflation scenarios (core CPI)



Source: Bloomberg, Edward Jones calculations.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

4. The Fed pauses when the policy rate nears 5%; discussions of rate cuts emerge late in the year.

		Stock market performance				
	Total amount of rate hikes	During final 1% of rate hikes	During final 3 rate hikes	12 months after final rate hike	24 months after final rate hike	Our perspective
1980-81	10.50%	0.3%	9.1%	-11.2%	37.6%	Market gained strength; high inflation phase finally ended.
1983-84	3.25%	9.7%	8.7%	18.2%	64.5%	Short rate hike cycle; market gained as economy rebounded.
1986-89	3.90%	-2.9%	4.9%	18.9%	36.2%	Markets performed well following Black Monday crash.
1994-95	3.00%	4.2%	8.2%	35.6%	69.9%	Early stage of economic expansion supported strong market returns.
1999-2000	1.75%	2.3%	2.3%	-10.6%	-22.9%	9/11 and pop in tech bubble weighed on market returns.
2004-06	4.25%	2.7%	-0.2%	20.6%	4.7%	Pop in housing bubble + global financial crisis weighed on returns years later.
2015-18	2.25%	-6.1%	-6.3%	31.5%	55.7%	Strong market returns despite global pandemic.
2022	4.25%					
Average	**4.1%**	**1.5%**	**3.8%**	**14.7%**	**35.1%**	

Source: Bloomberg. Past performance of the markets is not a guarantee of what will happen in the future.

We expect the Fed to pause rate hikes when the overnight policy rate reaches around 5%. This won't be a cure-all, but we believe the Fed needs to move to the sidelines for markets to find more sustainable footing.

In rate-hiking cycles since the late 1970s, the stock market averaged a nearly 4% gain during the period of the final three Fed rate hikes. Larger upward momentum came when the Fed stopped hiking rates, producing an average return of nearly 15% after 12 months and 35% over the two years following the last rate hike.

We expect the Fed to take a cautious approach even as inflation pressures recede, holding rates at restrictive levels for an extended period to avoid reigniting any smoldering inflation embers. Despite this, we think an economic slowdown will ultimately stoke calls to ease monetary policy later in the year. With the Fed exerting the most forceful headwind to markets throughout 2022, we think 2023 will see it slowly progress from punitive to positive for stock and bond market performance.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

5. Longer-term rates fall as the focus shifts from inflation to growth.

Historic inflation and aggressive Fed rate hikes pushed short- and long-term bond yields sharply higher in 2022. As inflation starts to moderate and the Fed's tightening campaign ends, interest rate volatility is likely to settle down, with upward pressure on yields starting to ease. Historically, the peak in yields has occurred about two months ahead of the last Fed rate hike, which we think will happen in the first half of 2023.

The 10-year Treasury yield could make another run toward 4% early in the year, since the Fed will still be hiking and shrinking its balance sheet. But we think it won't be long until the focus shifts from inflation to economic growth, which will be the catalyst for interest rates to fall. We see the 10-year yield staying in the 3%-4% range for the year.

The yield curve, which is one of the most reliable predictors of an economic slowdown, is deeply inverted, with short-term rates higher than long-term rates. This signals Fed policy is already overly tight. Yields undershot leading indicators of economic activity in 2021 but are now overshooting them. As this divergence starts to close, we believe the 10-year yield could fall toward 3%.

Economic indicators suggest long-term yields might have peaked

Source: Bloomberg. Past performance is not a guarantee of future results.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

6. The U.S. dollar weakens further, supporting international equity returns.

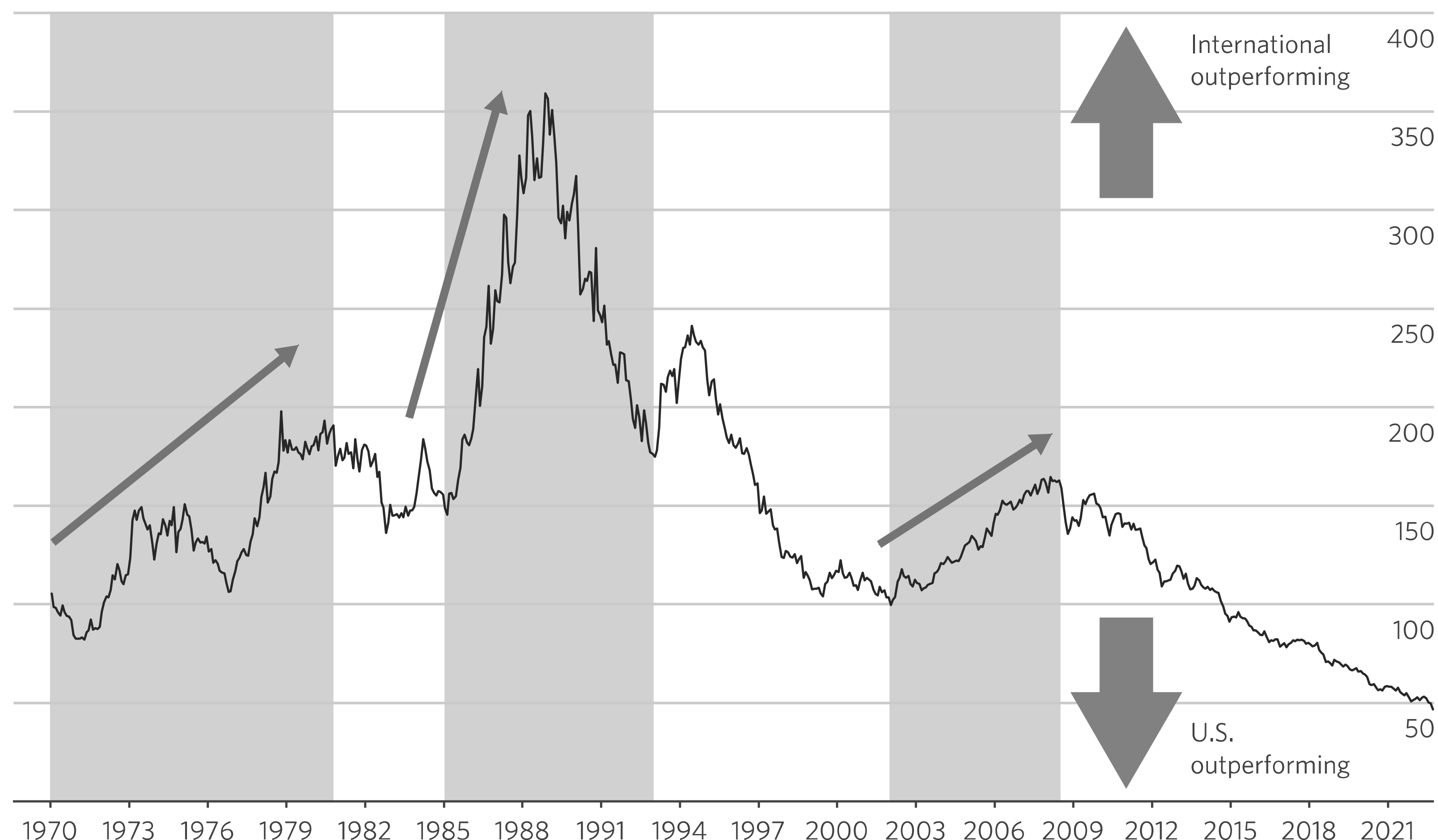
The dollar strengthened to a 20-year high in 2022. The Fed hiked further and faster than most other central banks, while geopolitical and global growth concerns rose. We think the dollar could soften as improving inflation trends allow the Fed to pause its aggressive move higher in rates in 2023. Also, global growth could start to recover in the back half of the year.

Historically, international equities tend to perform well during periods of a weakening dollar, while U.S.-based investments typically outperform during periods of a strengthening dollar. Even a modest shift lower in the dollar could be a catalyst for international equity performance to improve.

In addition to the potential for more favorable currency swings, we think emerging-market equities have the potential to outperform. Growth in China could reaccelerate, helped by the easing of its zero-COVID policy and policy stimulus. While the European economy and international developed stocks face significant headwinds, the deeper pullback in valuations likely already prices in a higher likelihood of recession, in our view, providing a reason to stay invested internationally.

International markets tend to outperform during periods of dollar weakness

Performance indexed to 100



Source: Bloomberg, Edward Jones calculations. Past performance is not a guarantee of future results. There are special risks inherent to international and emerging-market investing, including currency risks, political, social and economic risks.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

7. Near-term equity volatility gives way to a new bull market in the second half.

The stock market tends to move ahead of the economy, and this dynamic was on full display in 2022. The S&P 500 entered a bear market as the unemployment rate fell to 3.5%, matching its lowest level in the past 50 years. While the economy could possibly enter a mild recession in 2023 as the lagging impact of higher interest rates feeds through, this outcome is well-anticipated, in our view, and stocks can start looking past the downturn.

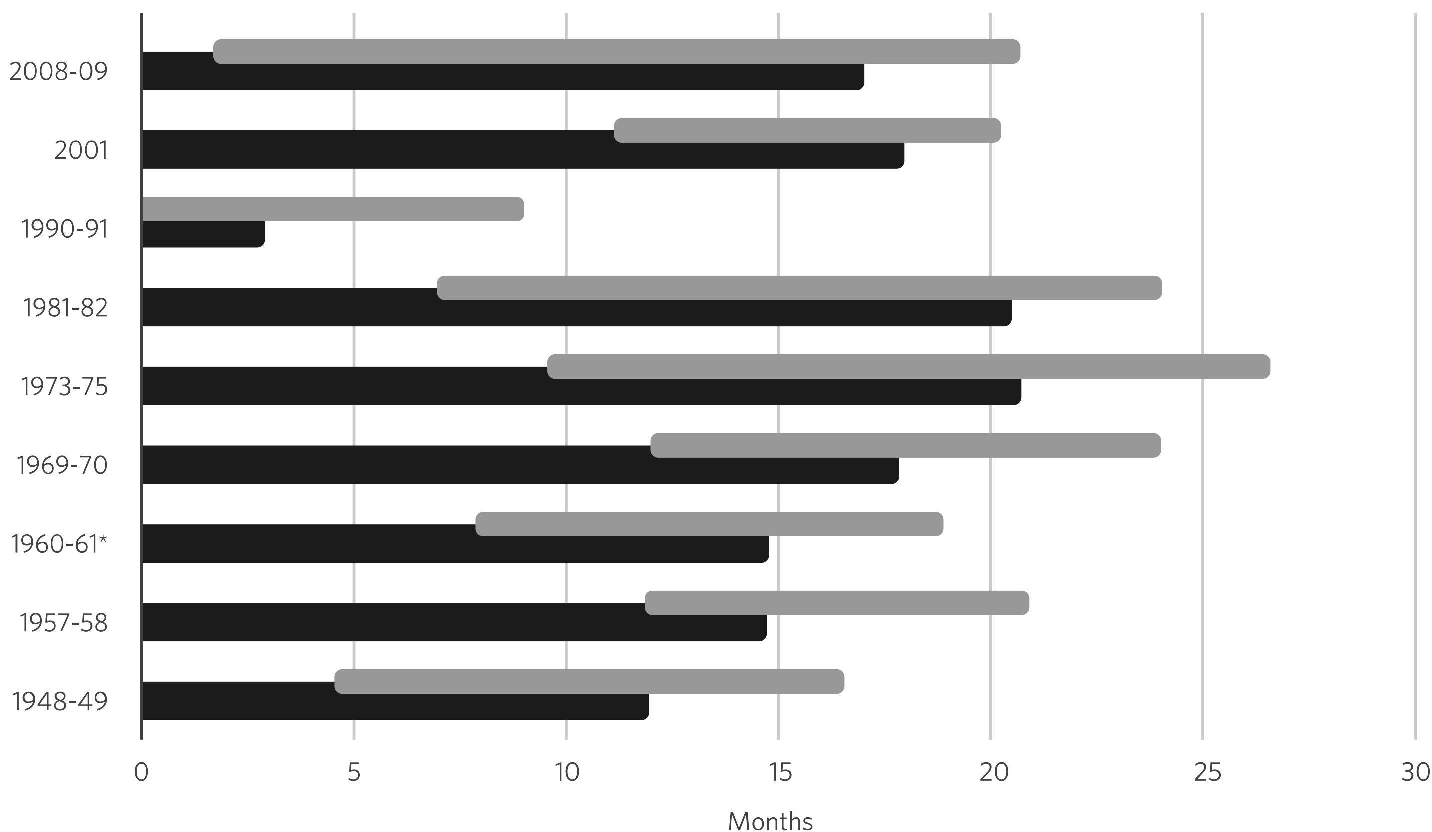
It will likely be a bumpy ride early in the year as economic data possibly underwhelms. Yet we think equities can navigate a U-shaped recovery, with the right side of the U emerging in the second half.

Corporate earnings could be a key focus for investors in 2023 but also a potential instigator of volatility. As the economy slows, earnings will likely come under pressure. But assuming the recession is not deep or prolonged, corporate profits should hold up better than during past downturns.

The decline in valuations this year provides a potential buffer. Once inflation starts to moderate and the Fed pauses, valuations could stabilize and possibly expand, supporting positive and potentially above-average returns for the year.

Investing in equities involves risks. The value of an investor's shares will fluctuate, and you may lose principal.

Stocks move ahead of the economy



*The 1960 market pullback dropped around 17%, close to the generally accepted 20% bear market threshold.

Source: FactSet. The S&P 500 is an unmanaged index and cannot be invested in directly. Past performance is not a guarantee of future results.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

8. Bonds bounce back — look for opportunities to add duration.

2022 was unprecedented for investors in that both equities and bonds fell into bear market territory by the second half of the year, as the rapid rise in interest rates put downward pressure on both markets. This was particularly painful for investors who had hoped their bond portfolios would provide a buffer during equity market volatility.

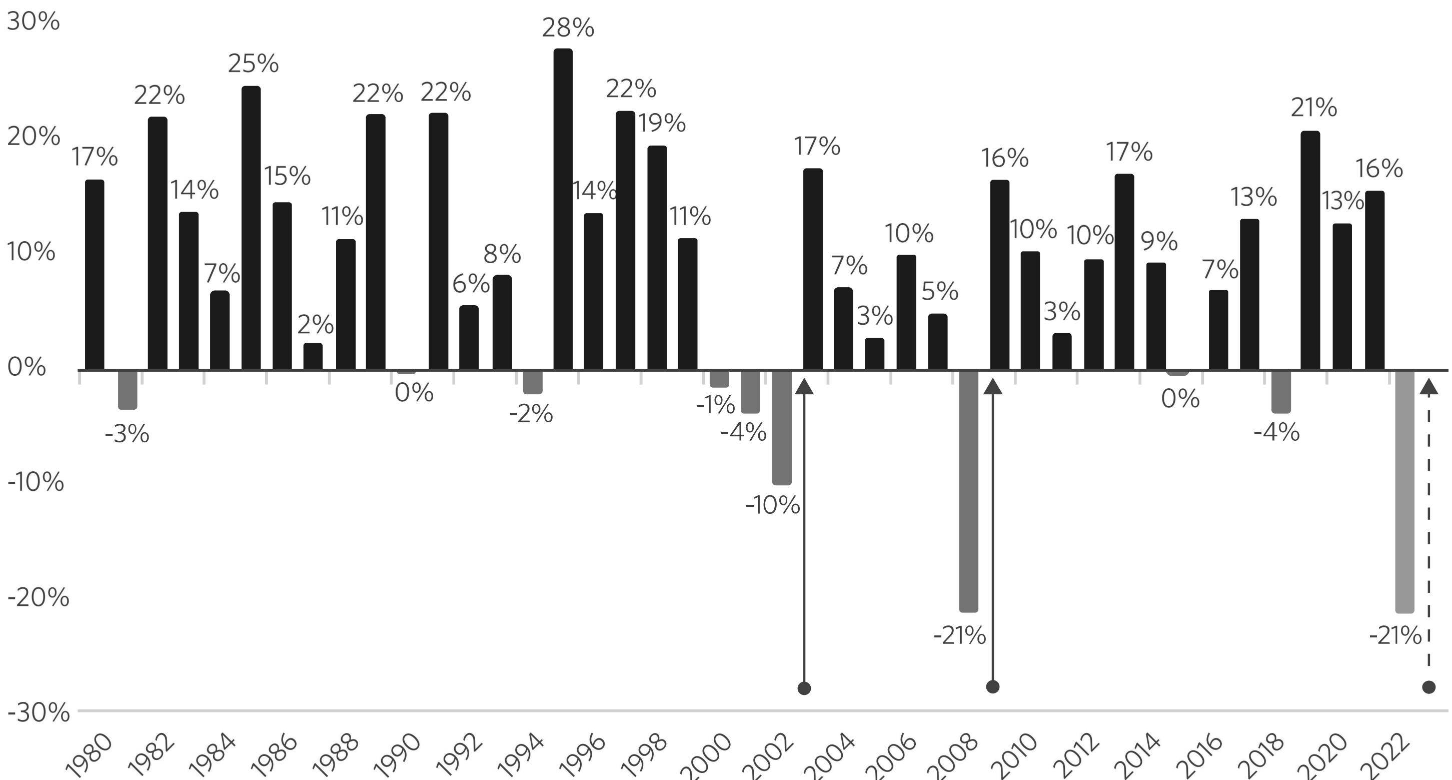
However, there is likely good news for bond investors ahead: We believe the stage may be set for bonds to play their more traditional diversification role in 2023, and perhaps offer outsized returns as well. The Fed is likely toward the end of its rate-hiking cycle, with a more gradual pace of hikes ahead, yields and income opportunities are higher than in recent history, and there is potential for price appreciation if bond yields peak and start to trend lower.

In 2023, we believe investors can look for opportunities to complement their shorter-duration bond portfolios (CDs, one- or two-year Treasury bonds, etc.) with longer-duration investment-grade fixed income. These bonds not only offer the opportunity to lock in higher yields for a longer period but also provide exposure to higher-rated credits, which may hold up better if economic growth softens.

Before investing in bonds, you should understand the risks involved, including credit risk and market risk. Bond investments are also subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease, and the investor can lose principal value if the investment is sold prior to maturity.

Stronger returns often follow drawdowns of 10% or more

60/40 portfolio calendar-year returns



The graph shows the total return of a traditional 60/40 portfolio of stocks (60% S&P 500) and bonds (40% Bloomberg US Agg).

Source: Morningstar Direct, Edward Jones. Past performance is not a guarantee of future returns. Indexes are unmanaged, cannot be invested in directly and do not depict the performance of an actual investment.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

9. Equity leadership becomes more balanced.

In 2022, value and defensive sectors were relative leaders in the stock market. Aside from energy, the top-performing sectors were consumer staples, health care and utilities. These are traditionally considered defensive, as they can outperform during economic downturns and inflationary environments.

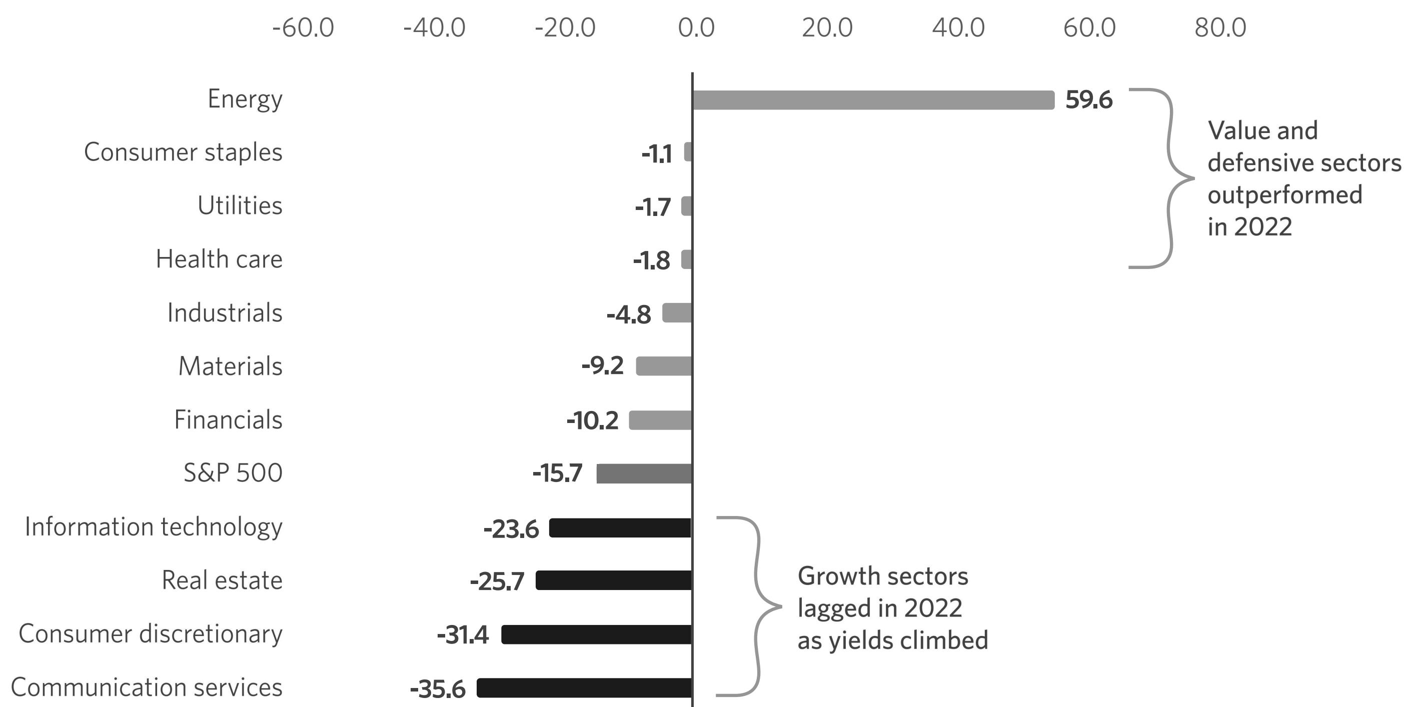
As we head into 2023, the defensive and value parts of the market may continue to hold up, particularly earlier in the year as the U.S. economy softens and potentially heads into a mild downturn.

However, equity markets have historically been forward-looking, recovering anywhere from three to six months before the end of a recessionary period. In our view, market leadership may broaden in the next 12 months to include areas that do well in a recovery period, including cyclical sectors, quality growth and parts of the technology space.

As with the bond market, we would expect some longer-duration parts of the equity market to rebound as yields peak and provide a more favorable backdrop for market sentiment. Overall, we see more balanced equity market leadership emerging between defensive and cyclical sectors in 2023.

Sector leadership may be more balanced in 2023

S&P 500 sector performance, year-to-date as of Dec. 5, 2022



Source: FactSet. Past performance is not a guarantee of future results.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

10. Broad individual federal, gift and estate tax law changes are unlikely in 2023.

With split control of the House and Senate, broad changes to the individual tax rates in the next two years seem less likely. Both parties have key priorities that for the most part are not aligned. While a few targeted pieces of legislation could be advanced, we don't expect any broad, sweeping tax legislation.

With that in mind, it's important to note that the individual tax relief in the Tax Cuts and Jobs Act of 2017 (TCJA), such as reduced marginal income tax rates and the increase in the estate and gift tax exemption, are set to sunset at the end of 2025.

- We anticipate the historically low individual federal income tax rates from the TCJA will remain in place for 2023. This is a good time to meet with your tax advisor to discuss how to manage your income tax liabilities.
- It appears the federal government won't reduce the estate and gift tax exemption of $12.92 million in 2023. You may want to review your gift and estate plans to determine if you would like to explore making gifts that use a portion of your exemption.

Planning strategies and considerations for 2023

Moderating inflation but higher expenses

Although we anticipate inflation to moderate, prices are higher than they were a year ago. Your expenses may be higher now, and you may have had to dip into your emergency cash to cover them.

- **Review your budget.** Check your budget for opportunities to adjust expenses as necessary.
- **Replenish your emergency cash.** If you spent from your emergency cash fund or simply want to build it up, we recommend having three to six months' worth of living expenses in cash or cash equivalents for emergency needs.
- **Don't forget about student loans.** Student loan repayments are scheduled to resume sometime in 2023. Be sure to factor them into your 2023 cash flow projections if applicable.

Increased interest rates and costs of borrowing

- **Review the return on your cash and cash equivalent accounts.** Interest rates have risen for investments such as CDs and fixed annuities, which could provide opportunities. Although you may be looking only for the highest yield, remember to review the liquidity and duration of the instrument to avoid a potential cash crunch should you need to access your funds prematurely.
- **Review your debt.** Prioritize reducing any high-interest debt first. If rates start to decline, fixed-interest-rate debt could be an alternative to variable-rate debt.
- **Do the math before you buy a home.** Although mortgage rates are higher, some market values have moderated or even declined in some locations, which could make the property still attractive. It may be beneficial to make a larger down payment to negotiate a fixed or more favorable rate.
- **Don't forget about annuities.** Payout rates for annuities have increased, which could be an attractive solution if you're looking for a consistent income stream. When evaluating an annuity, it's important to consider how inflation may impact your fixed payments over the long term.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

Investment opportunities

- **Take advantage of higher contribution limits.** A positive outcome of 2022's inflation is the increase in the 2023 allowable contribution amounts to retirement and health savings accounts and the Roth eligibility threshold. As you review your portfolio for potential investment opportunities, check your budget to determine if you can take advantage of these increased limits.

	2022	2023
401(k) and 403(b) contribution limits		
Elective deferrals	$20,500	$22,500
Catch-up contributions (age 50+)	$6,500	$7,500
Roth and traditional IRA contribution limits		
IRA contribution limit	$6,000	$6,500
IRA catch-up contributions (age 50+)	$1,000	$1,000
Roth IRA eligibility complete phase-out (no contribution) — modified adjusted gross income (MAGI)		
Single or head of household	$144,000 or above	$153,000 or above
Married filing jointly	$214,000 or above	$228,000 or above
Married filing separately (living with spouse)	$10,000 or above	$10,000 or above
SIMPLE IRA contributions		
SIMPLE IRA contribution limits	$14,000	$15,500
Catch-up contributions (age 50+)	$3,000	$3,500
Health saving account (HSA)		
Single coverage	$3,650	$3,850
Family coverage	$7,300	$7,750
Catch-up contributions (age 55+)	$1,000	$1,000

Source: irs.gov.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

Increases in individual taxes unlikely

While broad changes to tax legislation seem unlikely in the near term, provisions in the Tax Cuts and Jobs Act of 2017 (TCJA) are set to sunset at the end of 2025 without additional legislation. Talk with your tax advisor and financial advisor if any of the following apply:

- **Large income event —** If you plan to sell a business, exercise stock options or potentially gain excess income at retirement, review the timing of the transaction in light of this historically low individual tax rate environment.
- **Large gifts —** If you plan to make a large lifetime gift, speak with your tax and legal advisors to determine if you should use a portion of your lifetime exemption prior to the sunset at the end of 2025.
- **Estate plan —** Review your estate plan to ensure it's drafted with flexibility to take advantage of the current estate tax environment.

Considerations for higher-net-worth individuals

In 2023, the annual gift exclusion increased to $17,000 and the federal estate and gift tax exemption increased by $860,000 to $12.92 million. Based on current law, the lifetime exemption amount is scheduled to be cut roughly in half beginning Jan. 1, 2026.

- **Lifetime exemption —** Consider taking advantage of the exemption ahead of the planned reduction, since it might help manage future estate taxes.
- **Marital planning —** If you're married and your combined estates might be greater than your combined exemption amounts, consider discussing some advanced planning concepts, such as spousal lifetime access trusts (SLATs), with your estate attorney.
- **Advanced planning techniques —** 2023 is a good time to explore advanced planning strategies. Strategies such as charitable remainder trusts (CRTs) and qualified personal residence trusts (QPRTs) may have become more attractive with the current increase in interest rates.
- **State estate taxes —** Although the federal estate and gift tax exemption is large, many states have put transfer taxes in place. Ensure your estate plan accounts for state tax obligations.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

5 portfolio strategies you can use today

1. **Balance your stocks and bonds.** We believe a neutral mix between stocks and bonds can help smooth the path ahead. Stocks may search for their footing early in the year, but valuations have already taken a hit, which could help improve returns. And with interest rates higher than they were a year ago, bonds can offer more income and are better positioned to provide diversification, particularly if the economy weakens.

2. **Consider adding international equity investments.** International stock valuations have become more attractive relative to U.S. stocks as prices declined over the past year. Additionally, a weakening dollar could boost international returns. Look at emerging-market stocks in particular: If China eases monetary and zero-COVID policies, this could be a tailwind for emerging-market returns.

Opportunistic asset allocation guidance

Our opportunistic asset allocation represents our timely investment advice based on current market conditions and our outlook over the next one to three years, and is relative to our strategic asset allocation guidance. We believe incorporating this guidance into your portfolio may enhance your potential for greater returns without taking on unintentional risk.

	Underweight	Neutral	Overweight
Equity	·	●	·
U.S. large-cap stocks	·	●	·
International large-cap stocks	·	●	·
U.S. mid-cap stocks	·	●	·
U.S. small-cap stocks	●	·	·
International small- and mid-cap stocks	·	●	·
Emerging markets	·	·	●
Fixed income	·	●	·
U.S. investment-grade bonds	·	●	·
U.S. high-yield bonds	·	●	·
International bonds	·	●	·
International high-yield bonds	·	●	·
Cash	·	●	·

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD

Equity sector guidance

Our equity sector guidance represents our view of the attractiveness of each sector over the next six to 12 months and is relative to the S&P 500 sector weights.

	Underweight	Neutral	Overweight
Communication services	●	•	•
Consumer discretionary	•	●	•
Consumer staples	•	•	●
Energy	•	●	•
Financial services	•	●	•
Health care	•	•	●
Industrial	•	●	•
Materials	●	•	•
Technology	•	•	●
Utilities	●	•	•

3. **Check your sector diversification.** Investing across a variety of sectors and styles can help spread out your portfolio's risk. We favor sectors that can provide defense as the economy weakens, such as health care and consumer staples. Overweighting technology stocks may also prove beneficial if interest rates trend lower, particularly given their relatively attractive valuations.

4. **Develop your rebalancing strategy.** We expect markets to focus on more than just inflation in the year ahead. As this happens, different markets are more likely to move in different directions, increasing the chances your portfolio may move away from its target allocation. A rebalancing strategy can help you stick to your long-term plan and stay aligned with your financial goals.

5. **Consider systematic investing.** We're likely to hit more bumps in 2023 as investors evaluate central bank policies and their impacts to economic growth. But it's stressful to try to time the market's ups and downs. Investing at regular intervals can take the guesswork out of investing, helping you take advantage of more favorable prices as markets fluctuate — by dollar cost averaging — and providing natural rebalancing opportunities for your portfolio.

Talk with your financial advisor about how these portfolio strategies may help you position your portfolio for 2023.

Investing in equities involves risks. The value of your shares will fluctuate, and you may lose principal. Special risks are inherent to international investing, including those related to currency fluctuations and foreign political and economic events. Before investing in bonds, you should understand the risks involved, including credit risk and market risk. Bond investments are also subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease, and the investor can lose principal value if the investment is sold prior to maturity. Systematic investing does not guarantee a profit or protect against loss. Investors should consider their willingness to keep investing when share prices are declining. Diversification does not ensure a profit or protect against loss in a declining market.

 ©2022 EDWARD D. JONES & CO., L.P. ALL RIGHTS RESERVED. AECSPAD