2022 had the highest inflation in 40 years, increasing recession fears, skyrocketing interest rate and increasing valuation risks.

How inflation comes down, demand vs. supply-side, and how much longer until it returns to target, will influence whether it hurts economic potential productivity and financial market risk premiums.

2023 outcomes are likely to influence overnight real interest rates, longer-term inflation risk premiums and cycle longevity expectations and thus equity risk premiums for the rest of the decade.

This struggle with inflation is compounded by a war entering its second year that is dangerous and the most divisive between the great powers of the east and west since the rise of the Berlin Wall.

How and what kind of peace Russia and Ukraine find will affect Europe and U.S.-China relations for the rest of this decade.

We can expect a small U.S. and European recession in the first half of 2023 led by declines in goods consumption and manufacturing and disinflation, not deflation.

We expect a relatively soft landing in the U.S. jobs market due to resilience in services and tightness in labor supply.

Because we expect limited damage to employment and household assets, we think 2023 presents opportunities in credit investing and banks.

We are sticking with short duration bonds and net interest income sensitive banks until there is more economic clarity and stability in the 10-year Treasury yield.

We think the Fed could raise rates to between 5% and 5.25%. Since 1982, the average hiking cycle was near 300 basis points over about 15 months. If interest rates began plateauing towards the end of first quarter of 2023, it would be a 500+ basis point increase in one year.

This should slow inflation and the economy unless the recession is deeper or longer than expected. Rate cuts are unlikely before 2024 to ensure inflation has been suppressed.

Long-term interest rates are expected to rise to the pre financial crisis range with the expected 10-year Treasury yields at about 4.20% by the end of 2023 and long-term inflation expectations at around 3.0%.

There will be strong secular trends that are resistant to cyclical disruptions such as healthcare solutions for an aging world, productivity enhancers for a tight labor market specifically in tech services and industrial capital goods, experience providers for in-person social and business gatherings, aerospace and defense, clean energy, and electrification plays offering fair equity returns.

The preferred industry remains banks because of higher interest rates, higher normalized earnings per share and return on equity.

Competitive U.S. corporate tax rates, a strong dollar, and higher interest rates are robust supports for small vs. large cap secular performance. Banks and Industrials are big sectors for

profitable small caps.

Foreign equities provide opportunities for value and lower correlations. Exposure to China as it gradually reopens; including its premier digital enterprises which are heavily discounted for government risk.