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2023 SECOND QUARTER OUTLOOK

Preparing to Land

At-A-Glance

The Atlanta Fed is estimating Q1 GDP growth of over 3% as we get close to quarter end.

In February, the Consumer Price Index (CPI) showed the smallest 12-month increase since September 2021, but it was still running hot at 6%.

The Federal Reserve increased interest rates by 0.50% in the first quarter, having increased rates by 0.25% in each of the first two FOMC meetings of 2023, putting the current target range at 4.75% to 5%.

Stocks started the year strong as investors anticipated a Fed pivot, and the S&P 500 was up over 10% by early February. That reversed as economic data came in stronger than expected. Higher expectations for a more aggressive Fed ensued.

Bonds also had a choppy quarter, rising, falling and rising again. Large swings were seen. In mid-March, the 2-year Treasury yield posted its biggest 3-day drop since the 1987 stock market crash.

Volatility will continue as investors digest data and anticipate the Fed's policy response. Sectors are struggling with high interest rates and rising recession risks.

Overview

Higher interest rates are starting to take their toll on the economy. We had seen their impact on home and automobile sales, but in the first quarter, it became clear that higher interest rates also hurt start-up companies and banks.

With higher interest rates clearly making their mark, recession risks are growing. Investors grapple with what type of recession we could have and discuss it in terms of a plane landing. Will a potential recession be a hard landing (deep recession)? Will it be a soft landing (mild recession)? Or will we see a goldilocks scenario, where areas of the economy enter a recession at different times?

We think the answer will be somewhere in the middle. Our base-case scenario is for a soft landing. So far, the economy has been resilient. This is evident in manufacturing, which is in contraction and already in a recession. It was one of the first sectors to benefit from the pandemic stimulus money because of a surge in goods demand, and one of the first to decline. While in contraction, it is currently a mild contraction. Additionally, the labor market is strong, with nearly two job openings for every single individual looking for work. As a consumer driven-economy, this is good news. People tend to spend money if they have a job and don't fear having to find a new job if they lose their current one.

Aware of the impact of actions to date on the economy, the Fed is also widely expected to dial back their future interest rates hikes and some even anticipate they will cut rates later in the year. This has led to more investor optimism and is hopefully the silver lining in the bad bank news that rippled through markets.

Stock markets are forward looking and anticipate future Fed moves as well as future economic growth and inflation. Large cap stocks, as represented by the S&P 500, are not cheap from a valuation perspective, but they are less expensive than they were at the start of last year. Smaller company stocks have better valuations. Earnings growth is expected to be negative in the coming months, but this could set up upside surprises later in the year.

Bond markets are also forward looking and have been volatile as bond investors try to account for what the Fed may do next. The good news is that bonds pay a lot more yield than they did a year ago and can buffer more price volatility.

Your financial professional can help you stay on track and keep focused on your personalized long-term plans, helping you navigate through market volatility.

For a more detailed look into what we are thinking and what is happening in the economy and markets, continue reading our second quarter 2023 outlook.

This report is created by Cetera Investment Management LLC. For more insights and information from the team, follow @CeteraIM on Twitter.

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Additional risks are associated with international investing, such as currency fluctuations, political and economic instability, and differences in accounting standards.

A diversified portfolio does not assure a profit or protect against loss in a declining market.

Glossary

The S&P 500 is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The NASDAQ Composite Index includes all domestic and international based common type stocks listed on The NASDAQ Stock Market. The NASDAQ Composite Index includes over 2,500 companies, spanning all 11 sector groups.