Market & Economic Outlook – 2023: Life in a Bear Market

2022 Returns*	Value	Price Return	Total Return	All-Time High	% from High
S&P 500	3,817.66	-19.9%	-18.6%	4,796.56	25.6%
Dow Jones Industrial Average	32,757.54	-9.9%	-8.0%	36,799.65	12.3%
NASDAQ Composite	10,546.03	-32.6%	-32.0%	16,057.44	52.3%
Russell 2000	1,738.58	-22.6%	-21.5%	2,442.74	40.5%
MSCI EAFE (USD)	1,930.27	-17.4%	-14.7%	2,398.71	24.3%
MSCI Emerging Markets (USD)	957.64	-22.3%	-19.8%	1,444.93	50.9%
Bloomberg Commodity Index	111.64	12.6%	14.7%	237.95	113.1%
Barclays U.S. Aggregate Bond	90.32	-13.8%	-11.7%	112.07	24.1%

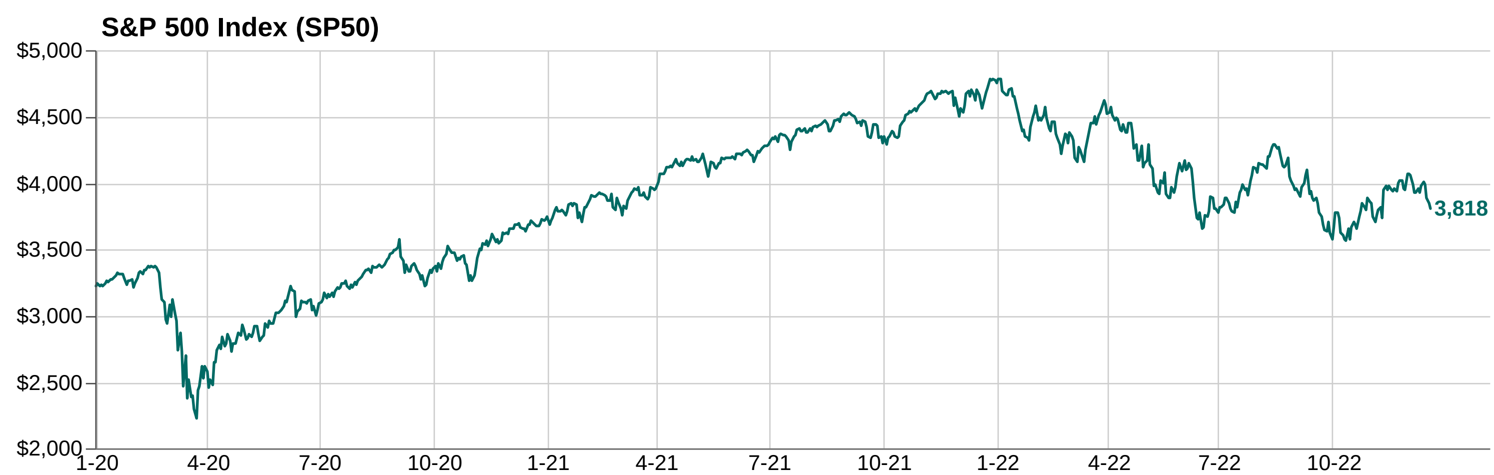
**From 12/31/2021 to 12/19/2022; Total returns include dividends paid* *Data Source: FactSet*

Outlook Summary:

Investors face numerous challenges entering 2023 as the U.S. Federal Reserve Bank (Fed) remains committed to raising short-term interest rates to stifle decades-high inflation pressure. This "tight" monetary policy is expected to limit economic and employment growth and create corporate earnings uncertainty, including a potential year-over-year (Y/Y) earnings decline for the widely followed S&P 500 index. Our S&P 500 fair value estimate is 3,900, which is 2.6% above the index closing price on 12/19/22. We see a highly uncertain environment for 2023 economic growth due to slowing consumer spending growth throughout 2022, weak housing investment, and concern that eroding manufacturing data reflects increasingly cautious business investment. This is somewhat positively offset by a strong labor market (monthly jobs gains and wage growth), solid technology spending from large corporate enterprises, and a gradual reopening of China's economy following the easing of its zero-COVID lockdown policy. Given the Fed's goal to slow economic growth by keeping interest rates high and monetary conditions tight, there is widespread debate regarding the depth of the resulting economic slowdown from that policy. An often-discussed "soft landing" remains a best-case outcome, in our view, where economic growth (as measured by real gross domestic product, or GDP) is modestly positive (less than 1%). Our view of a mild recession (our most likely potential outcome) reflects a 2023 GDP decline of roughly 0% to -1.0% and would likely lead to a reduction in earnings estimates below what current consensus reflects. A more severe recession, which would be a GDP decline approaching -2.0% or more, is not currently priced into earnings estimates, in our view, and could drive equity prices down from current levels. We look for the Fed to increase its fed funds target to 5.0%, indicating that U.S. Treasury yields (a measure of interest rates across various maturities) are likely to move higher from current levels.

Our cautious outlook is balanced by our view that, at some point in 2023, the Fed is likely to pause its interest rate hikes, inflation levels are expected to continue to ease, and investors will begin to look at earnings growth potential in 2024. Based upon that expectation, we want to build equity portfolios of high-quality companies (strong profitability and cash flow) and remain broadly diversified across industry sectors.

Year in Review. Through mid-December, global equities were down year-to-date (YTD). The widely followed U.S. S&P 500 index was down 18.6%, including dividend reinvestment (total return), through 12/19/22, its worst calendar year performance since a 37.0% total return decline in 2008, and only the second down year in the 14 years since 2008. If the 4Q22 positive total return of 6.9% through 12/19/22 holds through year-end, it will end three consecutive quarters of total return declines in 2022, with 1Q22 down 4.6%, 2Q22 down 16.1%, and 3Q22 down 4.9%. Investors faced numerous challenges as 2022 began, led by ongoing COVID-19 cases from the Omicron variant, elevated consumer inflation, and Russia's invasion of Ukraine creating chaos in commodities markets. In March 2022, the Fed began to address inflation pressures that were no longer transitory and increased its fed funds interest rate target for the first time since 2018. Higher interest rates weighed on equity valuations, as did trade imbalances (from COVID-19 and the Ukraine War), and U.S. economic growth was negative in the first half of the year despite solid monthly gains in new jobs. While equities markets struggled all year, the S&P 500 had several rallies from near-term lows along the way.



Data Source: FactSet as of 12/19/22. S&P 500 Daily Closing Prices 12/31/19 to 12/19/22

The index rallied 6.2% in late January to early February, 11.2% in the second half of March, 6.0% the final week of May, and 17.4% from 6/16/22 to 8/16/22. Each time, however, those rallies stalled and the S&P 500 weakness continued, falling to new, lower lows. When the S&P 500 closed at 3,577 on 10/12/22, it was down 25.4% from the 1/3/22 closing high, which, as of the date of this note, was the lowest close of 2022. More recently, the S&P 500 rallied 14.1% from 10/12/22 to 11/30/22; while some of those gains have reversed in December, the index has remained above that October low.

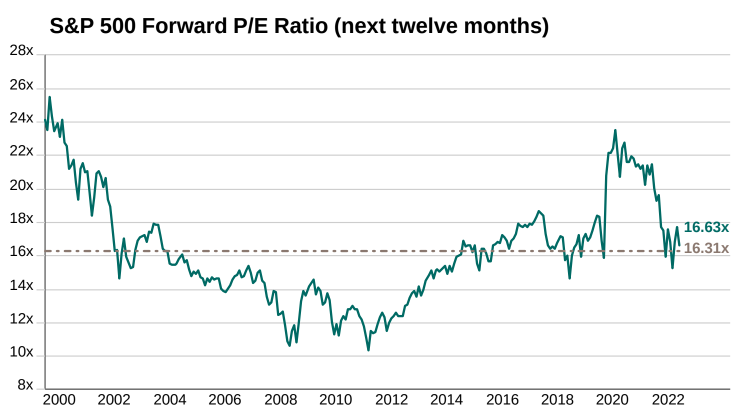
The 2022 bear market. On 6/13/22, the S&P 500 index closed at a price that was down 21.3% from the peak closing price of 4,796 on 1/3/22, still the all-time closing high for the S&P 500. This met our definition of a bear market, which is a peak-to-trough decline of 20% or more. While the definition is somewhat arbitrary, we define a market correction as a peak-to-trough decline of more than 10% but less than 20%. But bear markets are less frequent, and on average play out over a longer time period (longer to set a bottom, and longer to establish new highs). The 2022 bear market is the 10th greater-than-20% S&P 500 price decline since 1960, a period of 62 years (an average of one every 6.2 years). On average, the peak-to-trough S&P 500 price decline was 37.2%, with a range of down 22.1% in 1966 to down 56.8% in 2009 (Global Financial Crisis, GFC). In addition, the average duration of the drawdown was 14 months and the average time to recovery (back to the previous high) was 27 months. The 2022 drawdown, so far, has lasted 11 months, approaching that 14 month average. The good news is that the S&P 500 has generated strong average returns over 1-, 3-, and 5-year periods following a bear market. We looked at each bear market from the day the price decline exceeded 22% (the lowest point that included all nine bear markets) From that point, the S&P 500 index was higher in six of the nine bear markets after one year, higher in seven of eight after three years (the 2020 bear market has only been two years), and higher for all bear markets after five years. In addition, in all 9 previous bear markets, the S&P 500 index has ultimately established news highs, which, in our view, is an important pattern to recognize for long-term investors.

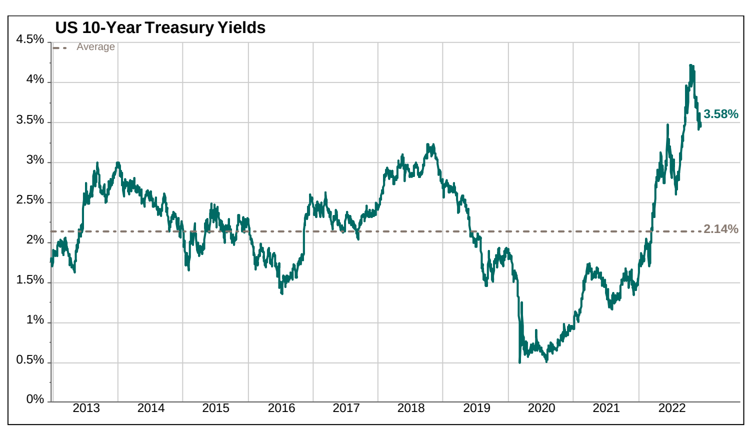
S&P 500 Bear Markets Since 1960

Date of Index Low	S&P 500 Price at Low	% Index Decline	Recession?	Peak-to-Trough # of Months	Low-to New High # of Months	Date of 22% Decline	Forward Price Returns from 22% Decline 1-year	3-year	5-year
6/26/1962	52	-28.0%	no	7	15	5/28/1962	26.6%	52.4%	67.1%
10/7/1966	73	-22.1%	no	10	7	10/7/1966	32.9%	27.2%	36.6%
5/26/1970	69	-36.1%	yes	18	21	4/22/1970	22.9%	32.4%	3.3%
10/3/1974	62	-48.2%	yes	19	67	12/4/1973	-28.0%	9.8%	2.7%
8/12/1982	102	-27.1%	yes	20	3	6/16/1982	55.4%	71.9%	179.9%
12/4/1987	224	-33.5%	no	4	20	11/19/1987	18.5%	42.0%	88.4%
10/9/2002	777	-49.1%	yes	30	56	3/12/2001	-1.2%	-4.8%	8.6%
3/9/2009	677	-56.8%	yes	17	49	9/15/2008	-11.7%	1.4%	41.5%
3/23/2020	2,237	-33.9%	yes	1	5	3/12/2020	59.0%		
Average		-37.2%		14	27		19.4%	29.0%	53.5%
10/12/2022	3,577	-25.4%		10		6/14/2022			

Data Source: FactSet, St. Louis Federal Reserve Bank, and D.A. Davidson & Co. S&P 500 price uses daily closing prices. Does not include the impact of dividends. Bear market defined as a peak-to-trough decline (using closing index prices) of 20% or more.

Market Valuation. Our S&P 500 fair value estimate of 3,900 represents a price-to-earnings (P/E) of 17.0x the 2023 S&P 500 FactSet consensus EPS estimate of $230. Our fair value is approximately 2.2% above the index closing price on 12/19/22 and, along with a current S&P 500 dividend yield of 1.7%, suggests a 2023 total return of less than 4%. Over the past 23 years, the S&P 500 has traded at an average P/E ratio (using the consensus estimate of the next four quarters) of 16.3x. Our fair value estimate assumes a P/E modestly above that long-term average, after trading well above the average since early 2020. After a year of aggressive Fed rate hikes, we believe that interest rates are normalizing, leading to valuation levels in-line with historical averages. Given high levels of macro uncertainty in a challenging economy, potential lower revisions to earnings estimates, and higher U.S. interest rates due to Fed policy, we see the potential for significant market volatility and S&P 500 levels that could trade in a wide range. While the S&P 500 2023 consensus earnings estimate has declined nearly 4% since our Market Outlook in October (to $230 from $239), and is down nearly 8% since June 2022, the estimate still reflects Y/Y earnings growth of 5.3%. This appears optimistic to us in a recession scenario as S&P 500 earnings erosion is almost always endured during economic downturns. In the ten U.S. recessions (as defined by the National Bureau of Economic Research, NBER) since 1957, S&P 500 earnings declined every time on a trailing four quarters basis, with an average decline of 29.5% (although the average included the extreme economic events of the 2001 bursting of the technology bubble and the 2008/2009 GFC). The smallest earnings decline was -4.6% in 1980.



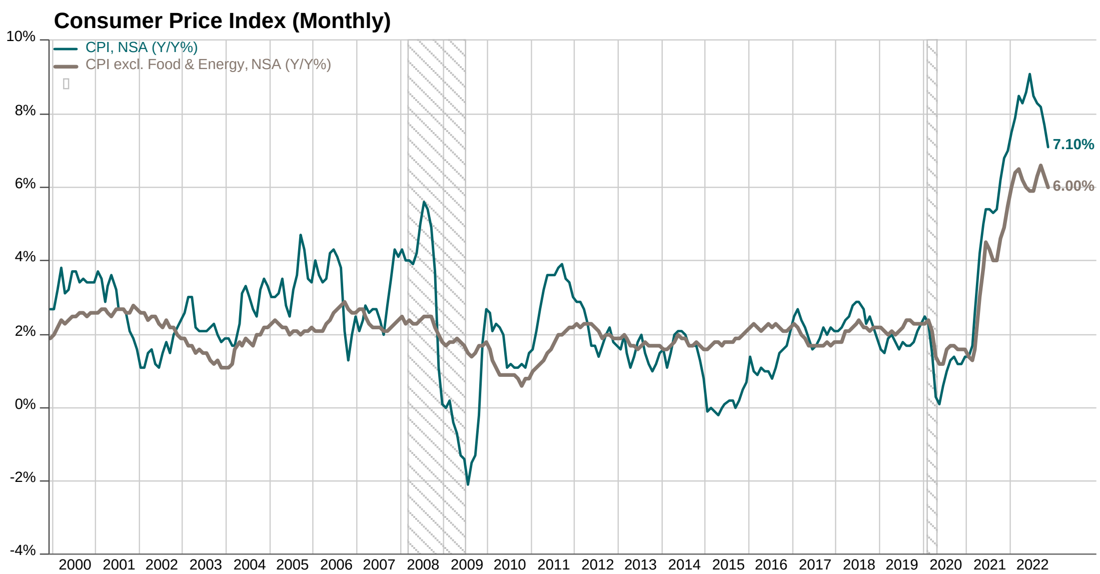


Data source: FactSet, using exchange data, as of 12/19/22 (see Other Disclosures on page 8 for further discussion of P/Es and Treasury yields)

Should the U.S enter into a mild recession in 2023, causing earnings to decline by 5% Y/Y, a below-average P/E multiple of 15.5x would result in an S&P 500 level of 3,210, a new cycle low and down 15.9% from the index price on 12/19/22. On the other hand, if the Fed is successful in navigating a soft landing, inflation continues to decline, and short-term interest rates stabilize near current levels, investors would likely begin to look to potential growth in 2024 earnings and the S&P 500 could trade back to 4,300. That is a wide potential range, reflecting considerable uncertainty, and we expect the index to remain well below its 1/3/22 all-time high of 4,796. The S&P 500 bear market will not be officially over until the index establishes a new high but, in our view, the downturn creates many attractive opportunities in individual equities for long-term investors.

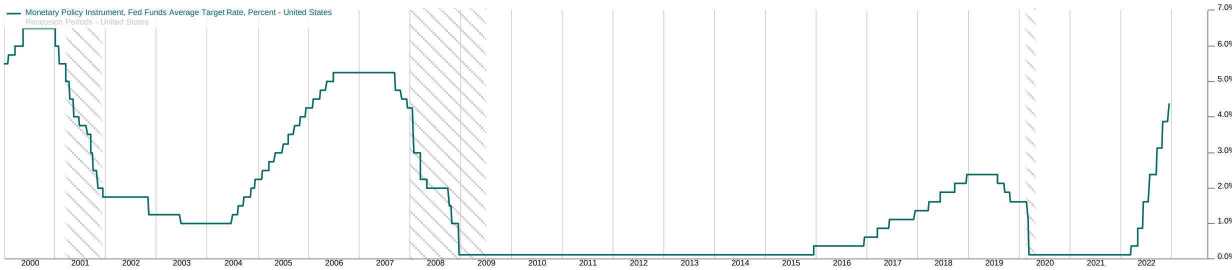
Inflation has moderated but not enough to say the job is done. Recent inflation data has reflected improving trends on both a Y/Y and month-to-month (M/M) basis, although prices for many important consumer items remain elevated. The November consumer price index (CPI), reported monthly by the Bureau of Labor Statistics (BLS), showed a Y/Y increase of 7.1%, the fifth consecutive lower monthly Y/Y increase since peaking at 9.1% in June 2022. The BLS also reports "core CPI" data, measuring price changes for consumer items excluding the often more-volatile food and energy categories. November core CPI increased 6.0%, the second consecutive month of moderation since peaking at 6.6% Y/Y in September 2022. This suggests to us that Federal Reserve interest rate increases earlier in the year have effected some of the desired impact on consumer prices, especially for "goods," which comprise approximately one-third of consumer spending (according to the BEA). Within the recent CPI report, inflation for goods increased just 3.7% in November, down from 6.6% two months earlier. Prices for services, however, which comprise roughly two-thirds of consumer spending, have remained stubbornly high and increased 6.8% Y/Y in November, which was higher than the September Y/Y increase of 6.7%. Part of this divergence in pricing trends between goods and services can be explained by changing consumer patterns during the pandemic. In 2020 and most of 2021, consumers reduced activities outside the home and splurged on goods, driving product demand higher and creating supply chain disruptions that drove prices higher. Beginning in late 2021, however, spending shifted away from goods to services as consumers eagerly began to travel (driving hotel and airline prices higher) and resumed visits to doctors' offices and other service providers. A large component of consumer services inflation is derived from shelter, which includes rent and an adjustment for owners' equivalent rent. Beginning in 3Q22, national home prices started falling month-to-month (still higher Y/Y). In addition, oil prices have followed a recent path lower as well. The bellwether U.S. oil contract, West Texas Intermediate, or WTI, was $78.45 per barrel on 12/21/22. This was down 12.4% from $89.55 on 8/31/22, and significantly below the post-Russia invasion of Ukraine price above $120 per barrel in March 2020. According to the Automobile Club, the U.S. national average price per gallon for unleaded gas peaked at $5.02 per gallon on 6/14/22. As of 12/20/22, the average price was $3.11, and was lower compared to prices both one month and one year earlier.

As we look at the four major categories of consumer inflation, food, energy, consumer goods, and consumer services, we see easing price pressure from three of the four categories. Food prices, both at home (grocery) and away from home (restaurants), have remained high due to grain disruptions from Russia and Ukraine, high fertilizer prices (also geopolitically driven), and high transportation costs. We look for continued improvement in inflation but expect CPI to remain well above the Fed's stated 2.0% goal throughout 2023. As of 12/20/22, the FactSet consensus estimate (from Wall Street economists) for U.S. CPI inflation in 2023 was 3.8%. In our view, CPI inflation could end up modestly lower than that if the U.S. enters into a modest recession as demand erosion would likely dampen prices.



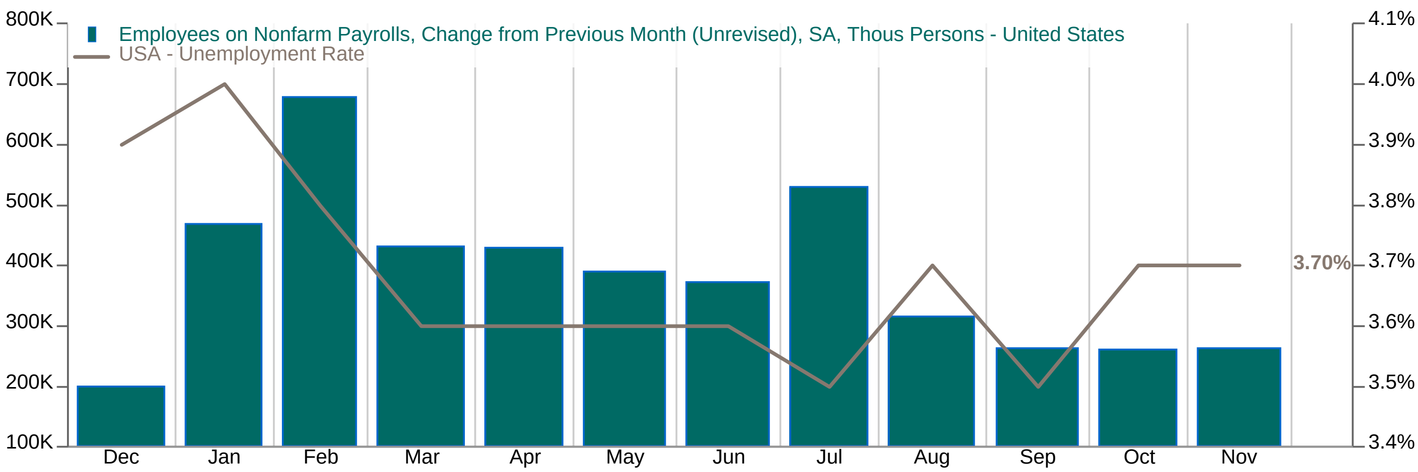
Data Source: FactSet, Bureau of Labor Statistics as of 11/30/21. The consumer price index (CPI) is a measure of average change over time in the prices paid by urban consumers for a market basket of goods and services (shaded areas are recession periods).

The Fed's interest rate target range is at its highest level in 15 years. The U.S. Federal Reserve Bank (Fed) raised its overnight bank lending fed funds interest rate target at seven of its eight Federal Open Market Committee (FOMC) meetings in 2022, including a 0.50% (50 basis points, bp) hike at its most recent meeting that ended on 12/14/22. This put the fed funds target range to 4.25% to 4.50%, up from 0% to 0.25% at the beginning of 2022, and the current range is the highest since December 2007 (when it was also at 4.25%). The Fed's aggressive interest rate increase policy in 2022 is designed to relieve inflation pressure by tightening financial conditions and slowing economic activity. The rapid pace in 2022 has created investor uncertainty because there is often a considerable lag period from the point when interest rates are higher to when the economy feels the full impact of higher borrowing costs and lower capital investment. This increases the chances of a policy mistake, which is defined as the possibility of the Fed raising rates more than necessary as it waits for activity to slow, and ultimately leads to a recession when the lag effect continues to slow the economy even as inflation becomes benign. Chairman Powell, at the post-meeting press conference on 12/14/22, said that the U.S. economy has "slowed significantly" from a "rapid pace" in 2022, and listed lower real disposable income, tighter financial conditions, and weakness in the housing sector as contributing factors. Not only have higher interest rates weighed on the housing sector, but business investment has been weaker as well. Despite this, the Fed is concerned that inflation remains elevated and that the labor market is "very, very strong," as both new jobs and wages are rising. Due to large gaps between labor supply and demand, the Fed believes that it will take awhile to return to balance, requiring ongoing rate hikes and higher interest rates for an extended period of time.



Data source: FactSet and Board of Governors of the Federal Reserve System, as of 12/15/22. Prior to December 2008, the Fed provided a single point fed funds target (shown on the chart). Since December 2008, the fed funds target is given in a 25bp range (chart shows the average).

The Fed expects higher interest rates and higher unemployment in 2023. At the December FOMC meeting, the Fed updated its Summary of Economic Projections (SEP), individual estimates of key economic and inflation data from FOMC meeting participants Using a median of all estimates, the December SEP reflected an expectation of a 2023 year-end fed funds rate of 5.1% (up from 4.25% to 4.50% currently); 2023 year-end core PCE inflation (see disclosures for a description of this alternative consumer inflation number) of 3.1% (vs. 5.6% to end 2022); an unemployment rate of 4.6% (vs. 3.7% to end 2022); and growth in real gross domestic product (GDP) of 0.5% in 2023. The interest rate projection suggests the potential for 75bp of additional fed funds increases in 2023, taking the target range to 5.00% to 5.25%. At the same time, the projection of an unemployment rate of 4.6% in 2022 is an increase from the recent November reported unemployment rate (from the BLS) of 3.7%. To get to an unemployment rate of 4.6%, the U.S. economy would need to lose an estimated 1.6 million jobs, or 133 thousand (K) per month over a 12-month period. This would represent a significant reversal from jobs gains in 2022 which, according to the BLS, averaged +392K monthly through November and +272K monthly over the most recent three months. We believe that the relative strength of new jobs and wages in recent months is the primary reason for the Fed's higher interest rate outlook as it wants to see a much weaker jobs market before declaring that inflation is controlled. Because of this, we expect to see monthly jobs losses in the months ahead. A spike in the unemployment rate to 4.6% or higher would suggest a potential recession and a worse economic outcome than the Fed's 2023 GDP growth projection of 0.5% growth.



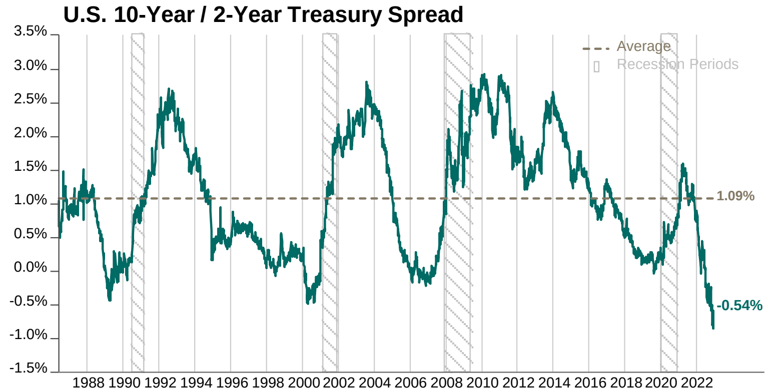
Data source: FactSet and U.S. Bureau of Labor Statistics, unemployment rate as of 11/30/22, unemployed persons as of 11/30/22.

U.S. Federal Reserve Bank Summary of Economic Projections
Federal Open Market Committee (FOMC) as of 12/14/22

	2022-median	2022-range	2023-median	2023-range
U.S. GDP Growth	**0.5%**	**0.2%-0.5%**	**0.5%**	**-0.5%-1.0%**
Unemployment Rate	**3.7%**	**3.7%-3.9%**	**4.6%**	**4.0%-5.3%**
PCE Inflation	**5.6%**	**5.5%-5.9%**	**3.1%**	**2.6-4.1%**
Year-end fed funds rate	**4.4%**	**4.4%**	**5.1%**	**4.9%-5.6%**

Data Source: federalreserve.gov, as of 12/14/22. The Summary of Economic Projections, or "Dot Plot", is compiled from Federal Reserve Board members and Federal Reserve Bank presidents.

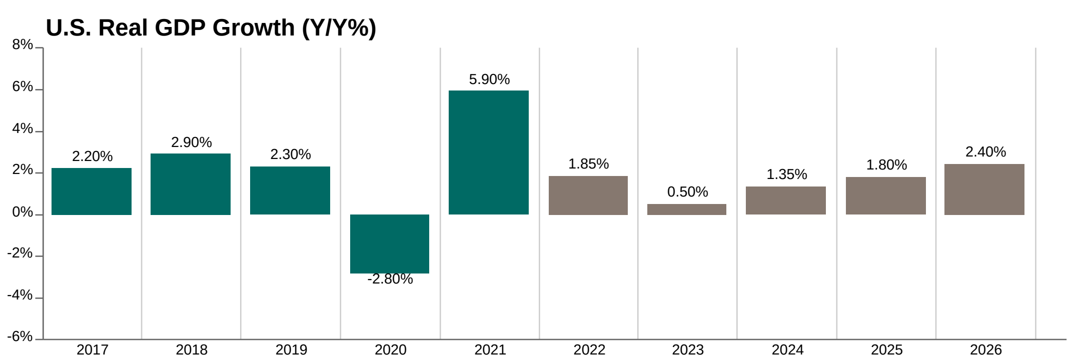
Recession indicators are growing. In our view, the U.S. Treasury yield curve provides valuable information regarding investors' assessment of economic growth prospects. In general, short-term interest rates, or yields, provide information about the near-term environment, and long-term interest rates are more reflective of a longer term view. Treasury securities are available across numerous maturity periods from overnight to 30 years. We often will look at the 2-year Treasury yield as a very liquid (heavily traded) representation of short-term rates and the 10-year Treasury yield as a gauge of long-term rates. We typically expect to see higher yields on longer maturities as investors demand higher interest rates for investing funds for a longer time period. This is called an upward sloping yield curve. The current yield curve is not upward sloping.



Data source: FactSet and U.S. Treasury securities market, as of 12/15/22

The U.S. Treasury yield curve in mid-December is inverted (and has been since July 2022) as many short-term yields are higher than long-term yields. This is acute in the spread between the 2-year Treasury (yielding 4.22% as of 12/21/22) and the 10-year Treasury (yielding 3.68% on the same date). In each of the past six U.S. recessions since 1980, the 10-year/2-year Treasury spread has inverted and the 12/21/22 spread of -54bp (peaked at 80bp in early December) is the largest in 40 years. Since 1980, the spread inverted without a recession twice, but a 10-year/2-year inversion has been a consistently reliable recession indicator. We interpret the inversion to a view that the Fed must keep short-term interest rates elevated in an attempt to slow economic growth and halt inflation. But bond investors fear that the elevated short-term rates will overshoot the mark and cause recession, which typically leads to future interest rate cuts (lower fed funds rates) by the Federal Reserve Bank. Since we believe that a mild recession in 2023 is quite possible, it appears that the current inverted yield curve indicator will be proven correct.

U.S. GDP growth has slowed after the pandemic recovery in 2021. When measuring U.S. economic activity, we look at real gross domestic product, which is the inflation-adjusted value of goods and services produced, reported by the Bureau of Economic Analysis (BEA). The U.S. saw two years of abnormal economic activity during the pandemic; GDP declined 2.8% in 2020 due to constrained economic activity exacerbated by government lockdowns, then grew a strong 5.8% in 2021 stoked by reopening and government stimulus. In 2022, as of late December with 4Q22 GDP activity not yet reported, the full-year 2022 FactSet consensus estimate of +1.85% suggests that GDP trends have somewhat normalized, although remain below the three-year (2017 to 2019) pre-pandemic average annual GDP growth of 2.5%. But the path to get to estimated 2022 growth of 1.85% has not been normal. Real GDP declined 1.6% and 0.6% in 1Q22 and 2Q22, respectively, and then rebounded to 3.2% growth in 3Q22. The major components of U.S. GDP include consumer spending (67% of 3Q22 GDP), business investment (14%), government expenditures (16%), and housing investment (3%). Those categories are then adjusted for changes in inventory levels and international trade (exports add to GDP, while imports subtract from as they are not produced in the U.S.). Over the first three quarters of this year, the inventory and trade adjustments were larger than normal so we like to look at the contribution from consumer, business and government as a baseline. On that basis, growth was positive all three quarters in 2022, with 2Q22 the weakest and 3Q22 the strongest. That is why, despite the two quarters of negative GDP growth to start 2022, we don't believe that it was a recession, but the trend of estimates in upcoming periods reveals that economists see a slowdown ahead. The full-year 2023 consensus GDP estimate is just 0.5%, and the 2024 estimate is only 1.35%. After a 4Q22 estimate for growth of 1.1% (lower than 3Q22), the consensus estimate for 1Q23 and 2Q23 are -0.2% and -0.4%, respectively. This time, if driven by a decline in consumer spending and business investment, two quarters of negative GDP growth will likely meet the NBER definition of recession, although relatively mild.

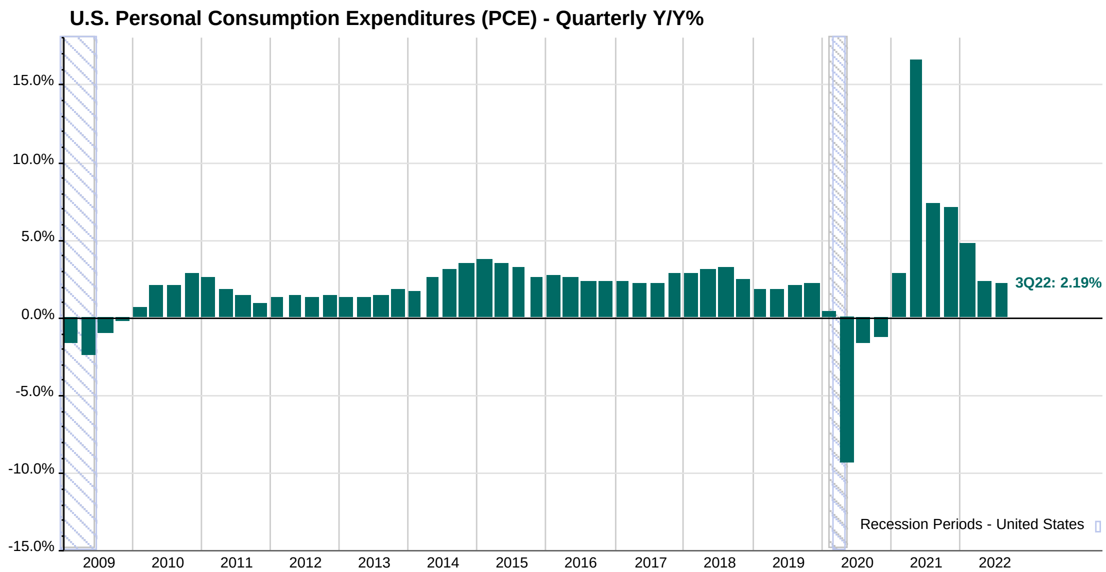


U.S. Quarterly Real GDP Actual (A)/Estimates (E)	
1Q22A	-1.6%
2Q22A	-0.6%
3Q22A	3.2%
4Q22E	1.1%
1Q23E	-0.2%
2Q23E	-0.4%

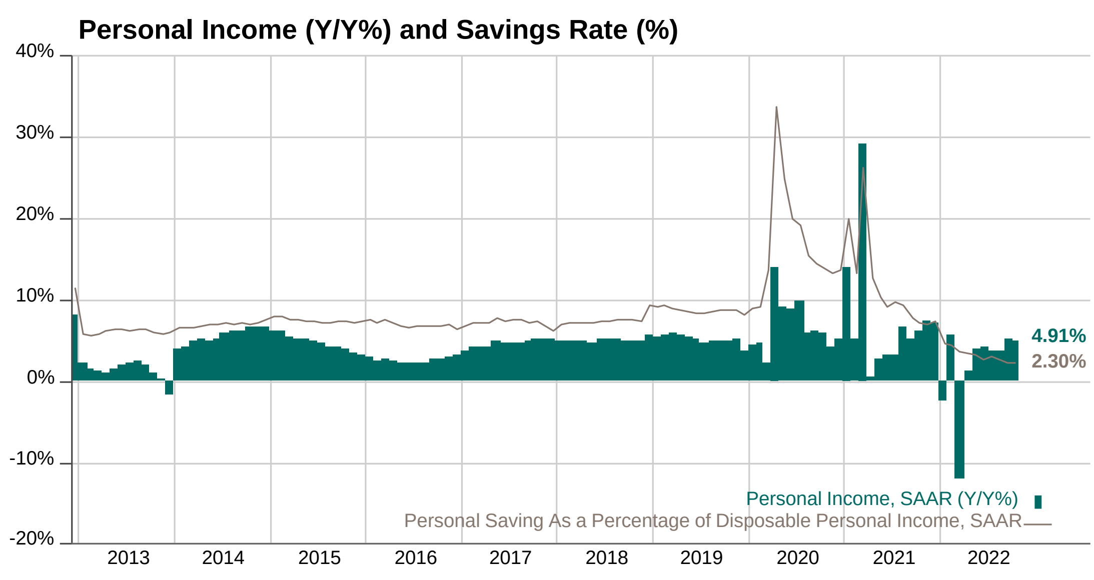
Data Source: FactSet consensus estimates and Bureau of Economic Analysis, as of 12/22/22, chart shows annual real GDP reported by the BEA 2017-2021 (green bars), and FactSet consensus estimates 2022-2026 (gray bars). Table shows the real quarterly GDP (reported as sequential change annualized) reported data for 1Q22, 2Q22, and 3Q22, and FactSet consensus estimates for 4Q22, 1Q23 and 2Q23.

What could make the difference between a mild and more severe recession? We attribute the better-than-expected economic activity in the second half of 2022 to a resilient consumer. Despite multi-decade highs in inflation and surging interest rates, spending has exceeded expectations as the jobs market is strong (monthly jobs growth has continued and job openings remain near record-highs) and wage growth averaged 5.3% in 2022 through November (using the monthly change in hourly average earnings from the BLS). The quarterly personal consumption expenditure (consumer spending) report from the BEA reveals that Y/Y growth in spending has moderated in 2022 but still remains above quarterly Y/Y growth trends throughout 2019 (pre-pandemic). The 2022 growth is impressive, given that the Y/Y comparisons are against that massive reopening and stimulus-driven growth rates of 2021. The relative strength in consumer spending and the labor market makes the Fed's job more difficult as Federal Reserve Chairman Jerome Powell has said that the Fed would like to see slower growth in jobs and wages before pausing its interest rate hikes. While acknowledging that higher interest rates have already negatively impacted housing investment and home purchases, as well as business investment, Mr. Powell said the Fed is concerned about the lack of a corresponding slowdown in labor markets.

Despite the strength in spending growth in recent quarters, the Y/Y growth rate has slowed for five consecutive quarters; if that trend continues, the consumer spending picture could be very different next year. In addition, the monthly personal income and savings rate chart, reported monthly by the BEA, shows a rebound in Y/Y income growth in 2022 after some abnormal comparisons with the prior year in January through April. We attribute the income strength to the jobs and wage growth discussed above. But the personal savings rate has dropped every month of 2022 and was just 2.3% in October. From 2013 to 2019, the savings rate ranged between 6% and 9%, but surged in 2020 as workers stayed home and people who lost jobs received pandemic relief. In dollar terms, according to the BEA, personal savings in 4Q19 (pre-pandemic) totaled $1.4T and then spiked to $4.9T in 2Q20. In the most recent quarter (3Q22), personal savings had dropped to $508 billion.. It appears that spending levels in 2022 were boosted by consumers using pandemic-era accumulated savings and a lower monthly savings rate. At some point this becomes unsustainable, and we would expect the savings rate to reverse higher if consumer confidence continues to fall. In our view, the expected 2023 GDP slowdown will be highly dependent on consumer spending. If consumer resiliency continues, the expected downturn could indeed remain mild.



Data source: FactSet and BEA; through 9/30/22. Updated after the latest BEA GDP revision on 12/22/22.



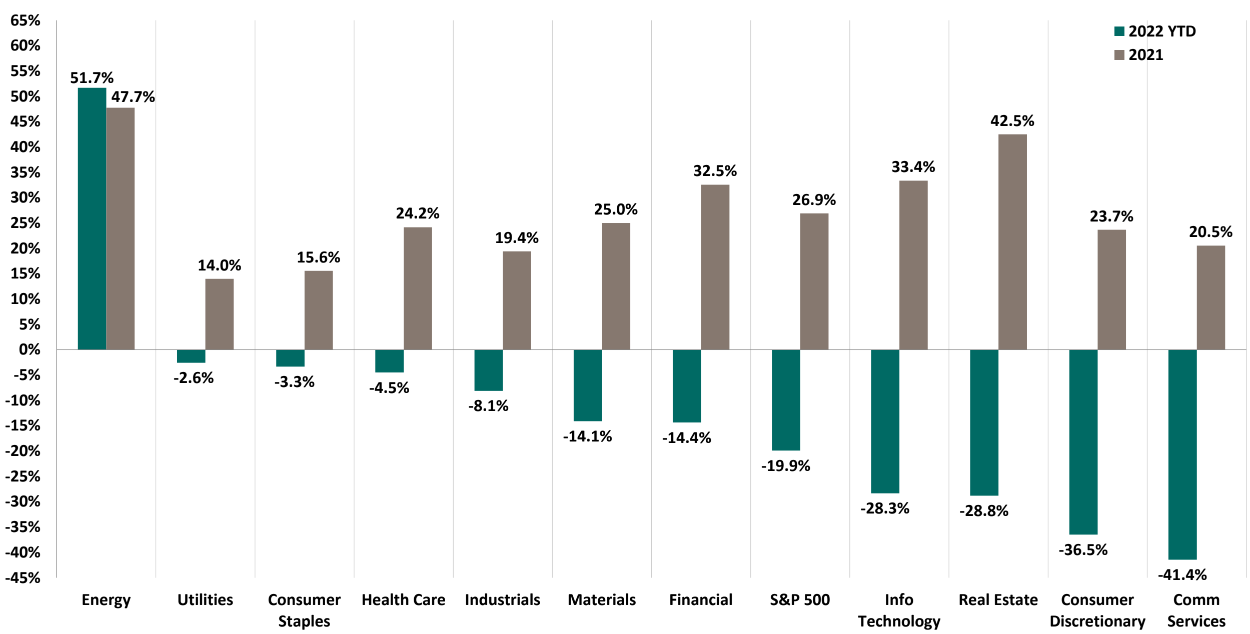
Data source: FactSet and BEA; through 10/31/22, reported monthly.

With the exception of Energy, sector leadership came from defensive sectors in 2022, a reversal compared to 2021. The chart below shows the price performance (not including dividends) of the S&P 500 index separated into its 11 Global Industry Classifications Standard (GICS) sectors. Repeating its 2021 outperformance, the Energy sector led the market in 2022, but in more dramatic fashion. In 2021, all 11 GICS sectors were positive for the year as the equity bull market raged on, while this year, Energy was the only positive sector YTD through 12/21/22, with a 51.5% gain. In 2021, the sector returned to profitability after two years of profit declines and industry-wide losses in 2020. This year, the sector has benefitted from energy inflation (which has reversed in 4Q22), global sanctions on Russia, and supply limitations in the U.S. and the Middle East. Many U.S. producers are also beneficiaries of a surge in oil and gas exports. In early 2020, the Energy weighting in the S&P 500 had dropped to 2.5%; as of 11/30/22, that weighting had surged to 5.1%. Prior to posting the top sector returns in 2021 and 2022, the S&P 500 Energy sector was the worst performer each year for 2018, 2019, and 2020, an indication of the sector's volatility as well as a reminder that sector rotation relative to performance is constant, helping to make the case for diversified portfolios.

As for the other 10 sectors (comprising nearly 95% of the S&P 500's market capitalization), six of those sectors declined less than the S&P 500 through 12/19/22 with Utilities, Consumer Staples, and Health Care being the relative "best performers." These are traditionally "defensive" sectors, representing companies that should be less exposed to economic cycles. This was the same at the end of 3Q22, and to us is an indication that many equity investors have positioned for an economic downturn that includes a recession. At the other end of performance, the largest quarterly declines came from Communication Services, Information Technology, Real Estate, and Consumer Discretionary. With the exception of Real Estate, each are heavily weighted with technology-centric, large-company growth stocks, many of which have led market gains over the past few years. These stocks have suffered in 2022 as investors became more disciplined in how much they were willing to pay today for future growth in revenue and earnings. We attribute weakness in Real Estate Investment Trusts (REITs) first to economic growth concerns impacting investment markets in general, but also to rising interest rates, which can lead to pockets of price declines in REITs, which pay dividends to investors. It is also possible that some REIT investors with a focus on dividend income have reduced REIT positions as yields have risen in other securities, such as government or corporate bonds. While earnings are expected to increase 5.8% in 2022, three sectors are on pace to show double-digit percentage earnings declines. Not surprisingly, two of those sectors, Communications Services and Consumer Discretionary, are the worst performers in 2022. The third, Financials, has dropped in 2022 but has outperformed relative to the index, and earnings results this year were lower because 2021 earnings were helped by a reduction in loan loss reserves (making for tough comparisons this year). In 2023, earnings for the Financials sector are expected to return to growth. Looking at estimates for 2023; S&P 500 index earnings growth is estimated to increase 5.3%, with growth from eight sectors and declines from three sectors (Energy, Materials and Health Care). We look for value (largest sectors: Financials, Health Care and Industrials) to outperform growth (largest sectors: Technology, Consumer Discretionary, and Health Care) but still advocate for high-quality (market share leadership, resilient profitability and strong balance sheets) leaders broadly diversified across sectors.

On a price-to-earnings basis, six sectors now trade at a discount to their average P/E over the past ten years. Those sectors are Energy, Communication Services, Consumer Discretionary, Financials, Real Estate and Materials. Finally, as we expect sector leadership to rotate over time, we do not expect Energy to lead the index for a third consecutive year, and we expect better relative performance from Consumer Discretionary and Communication Services.

S&P 500 Sector Performance – 2022 Year-to-Date price returns (through 12/19/22) and Full-Year 2021



Data source: FactSet as of 12/19/22, S&P 500 GICS sector indices maintained by S&P Global & MSCI

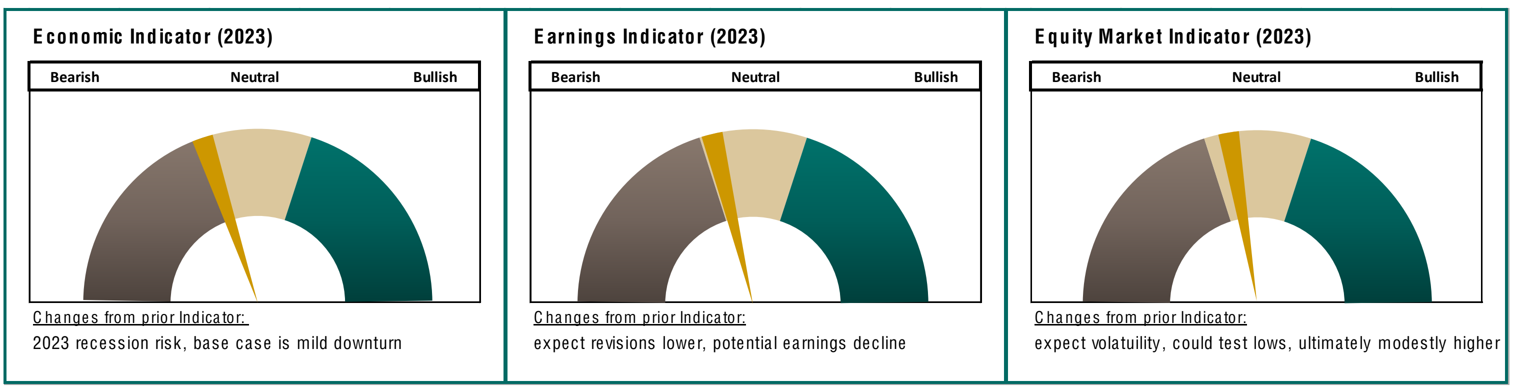
Sector weightings. The S&P 500 rallied in the fourth quarter after closing at a fresh 2022 low on 10/12/22. Both October and November were higher, and despite a December decline approaching 5%, the index was up 8.2% in 4Q22 through 12/21/22. This did not erase the YTD declines in most equities, but reflects the trend of positive fourth quarter returns after three consecutive quarters of lower equity index values in 2022. S&P 500 4Q22 sector gains were led by Energy, Industrials, and Materials, while Consumer Discretionary and Communication Services were the only two sectors lower. The strength of these more "cyclical" sectors, which we define as sectors more likely to benefit from positive sustained GDP growth, suggests that investors were increasingly confident that the Fed could engineer a soft landing , which would avoid a recession in 2023. Over the past few weeks, the soft landing outlook has eroded to some extent and we are skeptical that the cyclical leadership in the fourth quarter will continue. We have made a few changes to our sector weighting recommendations since our July outlook, and we have updated those recommendations in the table below. We believe that companies with market-leading products that can gain market share and hold or expand margins can do well in the current environment. Diversification is important to help minimize risk.

S&P 500 Sector Recommendations - December 2022

GICS Sector	S&P 500 Weight by Market Cap	WM Research 2023 Outlook	Notes (reflect current expectations and are subject to change)	Change
Technology	26.4%	underweight	keep exposure but valuation concerns due to hawkish Fed	was marketweight
Health Care	15.2%	overweight	still our favorite defensive sector	
Financials	11.6%	marketweight	should benefit from higher lending rates, but recession would hurt loan growth	
Consumer Discretionary	10.4%	marketweight	be wary of high valuations, but good value can be found for long-term investors	
Industrials	8.4%	marketweight	strong 4Q22 performance creates premium valuation, reduces upside potential	was overweight
Communications Services	7.5%	marketweight	underperforming sector, with consumer spending concerns, be selective	
Consumer Staples	7.0%	underweight	safe haven in down market, remain selective 2022 relative outperformance	
Energy	5.1%	marketweight	Despite huge year, earnings growth expected, attractive on pullbacks	
Utilities	3.0%	marketweight	beneficiary of infrastructure & energy transition, valuations elevated	
Real Estate (REITs)	2.7%	overweight	valuation more attractive following double-digit percentage 2022 declines	was marketweight
Materials	2.7%	marketweight	some winners in this group for companies that have pricing power	

Data source: D.A. Davidson Wealth Management Research as of 12/22/22.

Wealth Management Research Investment Cycle Gauge



Source data: D.A. Davidson & Co. as of 12/22/22

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Market Indices: The information on indices is presented for illustrative purposes only and is not intended to imply the potential performance of any fund or investment. Indices provide a general source of information on how various market segments and types of investments have performed in the past. Index performance assumes the reinvestment of all distributions, but does not assume any transaction costs, taxes, management fees, or other expenses. You may not invest directly in an index. Past performance is not an indicator of future results. The S&P 500 Index is a market cap weighted index that is designed to measure the US large-cap equity performance. The index is composed of the 500 leading publically traded US companies based on size, liquidity, industry, and profitability criteria. The Dow Jones Industrial Average is a price weighted index that tracks 30 large, publicly-owned companies trading on the New York Stock Exchange (NYSE) and the NASDAQ. The NASDAQ Composite Index measures all NASDAQ domestic and international based common type stocks listed on The NASDAQ Stock Market. Today the NASDAQ Composite includes over 3,000 companies. The Russell 2000® Index is a market cap weighted index that measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The MSCI EAFE® Index (Europe, Austral, Asia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US and Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. Bloomberg Commodity Index (BCOM) is calculated on an excess return basis and reflects commodity futures price movements. The index rebalances annually weighted 2/3 by trading volume and 1/3 by world production and weight-caps are applied at the commodity, sector and group level for diversification. The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market.

Other Disclosures:

The forward S&P 500 price-to-earnings ratio (P/E) is a valuation measure, calculated by dividing the price of the S&P 500 index over the weighted average earnings per share (EPS) estimate of each company in the index. Earnings are based on "forward" consensus estimates expected over the next 12 months (NTM), using quarterly analyst estimates as provided by FactSet.

Fair value refers to a valuation method based on our view of the intrinsic value of an asset or index, determined by macroeconomic factors and earnings expectations rather than current market prices. This is our view of intrinsic value as of the date of this report.

Gross domestic product (GDP) refers to the monetary measure of the market value of all final goods and services produced within a country's borders within a specific time period. Real GDP is adjusted for the impact of inflation. GDP numbers are compiled by the Bureau of Economic Analysis (BEA), a division within the U.S. Department of Commerce. Quarterly GDP is reported as a percentage change from the prior quarter, annualized. The BEA also reports data on a year-over-year percentage change from the same period one year prior. The most recent GDP report can be found at www.bea.gov.

FactSet is a data aggregation software utilized by D.A. Davidson's Wealth Management Research. The FactSet Consensus refers to the aggregate of all analyst estimates from firms that submit estimates to FactSet for a given financial metric.

The annual price returns of the S&P 500 index are calculated using index closing value on 12/31 of one year to 12/31 of the next year. 2022 returns are calculated as of 12/19/2022. Intra-year peak-to-trough percentage declines are calculated using the index closing prices from an intra-year high date to a subsequent low date. Closing prices are provided by S&P Global through FactSet. Averages across years are calculated using the arithmetic mean.

S&P 500 earnings growth reflect the year over year change in operating earnings on a per share basis. Earnings data are aggregated for all S&P 500 constituents and are measured according to the relative market capitalization weights for each company. Estimated earnings are the combined FactSet estimates of analysts covering each company included in the index.

The Federal Reserve Bank's Open Market Committee (FOMC) consists of twelve members--the seven members of the Board of Governors of the Federal Reserve System; the president of the Federal Reserve Bank of New York; and four of the remaining eleven Reserve Bank presidents, who serve one-year terms on a rotating basis. The FOMC holds eight regularly scheduled meetings per year. At these meetings, the Committee reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth.

The Federal Reserve Summary of Economic Projections (SEP) is sourced from federalreserve.gov, as of 12/14/22. Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. The projections for the federal funds rate are the value of the midpoint of the projected appropriate target range for the federal funds rate or the projected appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run. The Summary of Economic Projections is compiled from Federal Reserve Board members and Federal Reserve Bank presidents.

The term "monetary policy" refers to the actions undertaken by a central bank, such as the Federal Reserve, to influence the availability and cost of money and credit to help promote national economic goals. The Board of Governors of the Federal Reserve System is responsible for the discount rate and reserve requirements, and the Federal Open Market Committee is responsible for open market operations. The Federal Reserve influences the demand for, and supply of, balances that depository institutions hold at Federal Reserve Banks and in this way alters the federal funds rate. The federal funds rate is the interest rate at which depository institutions lend balances at the Federal Reserve to other depository institutions overnight.

The Treasury yield curve displays the market interest rate across different contract lengths for U.S. Treasury bonds, indicating the relationship between the interest rate and the time ("term") to maturity. The yields of the 2-year and 10-year U.S. Treasury bonds are widely followed barometers of the current U.S. interest rate environment. Treasury bond data used in calculating interest rate spreads is obtained directly from the U.S. Treasury Department, through FactSet.

U.S. Personal Consumption Expenditures (PCE) is an indicator of the growth in consumer spending and measures the value of goods and services purchased by persons who reside in the U.S. It is reported monthly by the Bureau of Economic Analysis.

The National Bureau of Economic Research (NBER) is a private non-profit research organization. The NBER is widely used as an organization that analyzes U.S. economic data and the business cycle and determines the start dates and end dates of economic recessions. The NBER defines recession as “a significant decline in economic activity that is spread across the economy and that lasts more than a few months;” and also looks at the depth, diffusion, and duration of the downturn.

The Bureau of Labor Statistics (a division of the U.S. Department of Labor) publish a monthly employment report, The Employment Situation. It presents statistics from two monthly surveys to report labor force status, including unemployment and demographics. The unemployment rate is the number of unemployed as a percent of the labor force.

The consumer price index (CPI) is a measure of average change over time in the prices paid by urban consumers for a market basket of goods and services. It is reported monthly by the U.S. Bureau of Labor Statistics.

PCE inflation is the percentage rates of change in the price index for personal consumption expenditures (PCE). The index is published monthly by the U.S. Bureau of Economic Analysis.

Volatility is how much and how quickly prices move over a given span of time. In the stock market, increased volatility, in the form of rapidly falling prices is often a sign of rising uncertainty.

The U.S. Census reports annualized monthly data on housing starts, permits and completions. It is a widely followed measure to track construction activity in the residential housing market. New Home sales measures sales of new single family homes and is a measure of the demand for housing. Home price data is monitored from the S&P CoreLogic Case-Shiller Home Price Index.

We define a Bear Market as a peak-to-trough decline (using closing prices) of 20% or more. We generally use the S&P 500 index as a proxy for the broad market for large, leading U.S. companies.

Daily prices for West Texas Intermediate (WTI) crude oil from Cushing, Oklahoma are quoted daily on a price per barrel basis and are available from the U.S. Energy International Administration. Data can also be found from the St. Louis Federal Reserve Bank at fred.stlouisfed.org.

The Bureau of Labor Statistics (BLS) compiles U.S. labor statistics from two monthly surveys. The household survey measures labor force status by demographics; the establishment survey measures nonfarm employment and data by industry. The nonfarm payrolls component of the establishment survey are drawn from private businesses and government entities. The nonfarm payrolls number is among the most widely used data points to assess U.S. employment trends. The unemployment rate is the percentage of the labor force that is jobless and actively willing and available to work.

Personal Savings is reported monthly by the Bureau of Economic Analysis for individuals and is defined as personal income less personal outlays and taxes. The personal savings rate is personal savings as a percentage of disposable personal income.

The Global Industry Classification Standard (GICS) is a four-tiered, hierarchical industry classification system. Companies are classified quantitatively and qualitatively. Each company is assigned a single GICS classification at the Sub-Industry level according to its principal business activity. MSCI and S&P Dow Jones Indices use revenues as a key factor in determining a firm’s principal business activity.