



Economic Review & Outlook

FIRST QUARTER | 2023

Putting out the Fire that is Inflation

For a fire to burn, it needs heat, fuel, and oxygen. Extinguishing any fire requires removing one of those three elements. Economically speaking, the fire that raged in 2022 was inflation. As the firefighters, the U.S. Federal Reserve (Fed) is trying to deprive the fire of oxygen by increasing interest rates and attempting to remove excess liquidity from the economy. The challenge, aside from putting out the fire, is to do without severely harming the economy itself and tipping the country and/or world into a deep recession.

During the Great Financial Crisis (GFC) of 2007-2008, the Fed lowered its benchmark federal funds interest rate from around 5% to near 0%, fueling economic growth and the longest bull market in history. Except for a handful of rate hikes from 2015-2018, when rates peaked near 2.5% before the pandemic forced the Fed to cut them back, the key rate remained near zero until 2022. At the same time, the Fed grew its balance sheet from less than \$1 trillion in 2007 to the \$4.5 trillion range (2014-2018). Then, to protect the economy from the pandemic, the Fed increased its balance sheet to nearly \$9 trillion by early 2022, through a massive buying spree of U.S. Treasuries and mortgage-backed securities. Add in approximately \$4.5 trillion in COVID-relief funding from the U.S. government, and the result was a lot of easy money, which eventually resulted in roaring inflation.

Trust and investment management accounts and services offered by Ronald Blue Trust, Inc. are not insured by the FDIC or any other federal government agency, are not deposits or other obligations of, nor guaranteed by any bank or bank affiliate, and are subject to investment risk, including possible loss of the principal amount invested. Ronald Blue Trust is a Tennessee chartered public trust company.

Injecting liquidity and stability into the economic system and financial markets spurred economic growth, as intended. However, it also encouraged excessive borrowing and risk-taking. In other words, if COVID, supply chain issues, and the war in Ukraine provided the spark of heat, then the Fed provided the fuel and the oxygen, which resulted in roaring inflation. Now, the Fed is trying to slow inflation by raising rates and reducing its balance sheet. It's not an easy task, and it was a primary factor that made 2022 a difficult year for investors. However, at this point it's necessary and will hopefully pave the way for future growth.

Economic Overview

INTEREST RATES ROSE AT AN HISTORIC PACE

The Fed swiftly cut interest rates to 0% during the height of the pandemic, providing economic stability and helping equities quickly pull out of a sharp bear market. However, inflation surged with the U.S. Consumer Price Index (CPI) accelerating to a 41-year-high of 9.1% in June 2022. After eliminating the often-used descriptor of “transitory” to describe rising prices for months, central bankers moved aggressively the other way with seven rate increases from March to December 2022—including four consecutive hikes of 75 basis points (bps)—bringing the benchmark federal funds rate to a range of 4.25-4.50%.

The pace of rate increases was unprecedented in recent history, spurred by hopes that higher rates would reduce liquidity, borrowing, and demand from both consumers and businesses. Ideally, the move is designed to slow the economy without derailing it into a deep recession—to bring the inflationary fire under control and save the building. So far, it's working. Stocks and bonds saw significant declines, but inflation appears to have peaked. However, we haven't entered a recession yet, according to the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER), an independent non-profit that officially declares U.S. recessions. (Often, it should be noted, NBER announces recessions months after the fact.) It's a delicate balance because if the Fed tightens its policy too much, a recession would almost undoubtedly follow; but if officials reverse too quickly, it could intensify the fire and drive inflation higher once again.

MIDTERM ELECTIONS SURPRISE

Given the low approval ratings for President Biden and Congress, the inflation situation, the bear market in stocks, and one of the most difficult periods in history for U.S. bonds, many expected the Republican party to take control of the U.S. House of Representatives and the Senate in dominating fashion. The Republicans did take control of the House, but the anticipated “Red Wave” didn't quite happen as the Democrats picked up a seat in the Senate and will likely remain in control with three Independent Senators who tend to align with the Democrats.

Whether this split government is good news or bad depends on your political preferences, but this gridlock can lead to less uncertainty, which is generally favored by the markets. A split government could also positively impact inflation. Why? With a divided Congress, passing new spending bills will likely be more difficult than if a single party was in control. If the government continues to excessively print money, it will only fuel inflation and make the Fed's job more difficult, in our view. On December 23, Congress hastily passed a \$1.7 trillion spending bill known as the “Consolidated Appropriations Act of 2023.” This omnibus bill will fund the government through 2023, thus avoiding a shutdown, but there were numerous other spending packages included that were rubber-stamped, which again, could only make the Fed's job harder. To learn more about how this bill could impact you, read our recent blog, [“How Will SECURE Act 2.0 Impact Your Retirement Plan?”](#)

CRYPTO CRASH

In November, cryptocurrency exchange FTX suspended customer withdrawals amid a liquidity crisis, setting off a chain of events that led to FTX filing for bankruptcy along with a host of crypto stocks losing more than half of their value. Crypto, a volatile nascent asset class, has long driven investment experts to disagree on whether it is really here to stay. FTX was headed by Sam Bankman-Fried (SBF), a former quant trader and hedge fund manager who grew into a crypto celebrity known for his Super Bowl ads and efforts to make FTX a household name; his relationships with venture capitalists, major institutional investors, and A-list celebrities; his apparent altruism; political activism; and bailouts of other crypto firms.

CHANGE IN EFFECTIVE FEDERAL FUNDS RATE



The effective federal funds rate is a weighted average of the rate banks use to lend each other overnight. It is determined by the market but is influenced by the Federal Reserve's target. Month 0 is the month when the first interest rate hike in the cycle occurred. We considered an interest rate cycle to be any time period when the Federal Reserve raised rates at two or more consecutive meetings. Source: www.visualcapitalist.com/comparing-the-speed-of-u-s-interest-rate-hikes/, Economic Research Division Federal Reserve Bank of St. Louis - Federal Funds Effective Rate, Percent, Monthly, Not Seasonally Adjusted

FTX benefited from the crypto boom of 2020-2021, fueled by lowered barriers to retail trading and stuck-at-home consumers flush with government stimulus checks from the pandemic. The company was worth \$32 billion in early 2022 and recognized as the fourth-largest crypto exchange. The largest, Binance, is headed by Changpeng Zhao, a former FTX investor whose relationship with SBF had soured. Binance sold off large holdings of FTX's native token or digital currency, FTT, in November, which helped drive the crisis for FTX. As FTT crashed and FTX began looking for a bailout, Zhao announced that he would buy FTX, but abruptly walked away and criticized the company's management and operations, which ignited panic across the industry and increased government scrutiny. SBF was later arrested for a variety of fraud-related charges in December.

The long-term result of all of this is unknown. Bankruptcy proceedings will take years to play out, but in the meantime, a lot of people lost a lot of money—FTX has more than one million creditors and owes more than \$3 billion to the largest 50. Concerns have also risen around increased regulation, contagion across the crypto universe, and even the future of crypto as a whole.

Asset Class Performance

Equities rallied in the fourth quarter, with the S&P 500 Index advancing 7.5%, but the index finished with its worst calendar-year return since 2008, down 18.1%. It was the eighth time in 50 years that the index finished the year with a double-digit decline and the fourth-worst full year since 1937. Inflation, interest rate hikes, and a series of geopolitical issues—from the Russia-Ukraine war to continuing supply-chain disruptions—weighed on growth stocks and investor sentiment as fears of a recession intensified. The Dow Jones Industrial Average and the Nasdaq Composite also posted their worst year since the GFC.

U.S. stocks broadly trailed both developed and emerging market stocks in the fourth quarter, and closed the year in between the two, as emerging markets struggled amid risk aversion and a strong U.S. dollar. The U.S. economy returned to growth after gross domestic product (GDP) contracted in the first half of 2022, with a 3.3% third-quarter gain. Experts have similar expectations for fourth-quarter GDP numbers, which will be released on January 26. Consumer confidence, which broadly followed a downward trajectory in 2022, showed signs of improvement toward the end of the year, but U.S. home sales reached their lowest levels since the pandemic, and retail sales fell sharply in November.

The Bloomberg U.S. Aggregate Bond Index returned -13.0% in 2022, the worst year since its 1976 inception. Previously, the index's weakest annual performance was a 2.9% decline in 1994. The market priced in expected rate hikes through 2023, and while credit quality and spreads affect bond prices as well, so far, the drawdown is predominantly due to interest rate expectations. The closely watched yield curve between the 10-year and two-year U.S. Treasury notes remained inverted at year-end, after reaching levels in November and December not seen since the 1980s. A yield curve inversion does not guarantee a recession, but it has preceded every U.S. recession since the 1960s.

Oil prices, which reached historic highs in February and June, declined modestly in the fourth quarter but finished an extraordinarily volatile year up slightly. Gold followed a similar path, hitting post-pandemic highs in March before retreating across

much of the year, then rising to close 2022 with a slight annual decrease. The year's big winner was commodities, with broad indexes posting double-digit gains for 2022, helped by strength in the agricultural group.

	Q1	Q2	Q3	YTD
	Commodities 25.6%	Diversified Bonds -4.7%	Commodities -4.1%	Commodities 16.1%
	Gold 6.6%	Commodities -5.7%	Diversified Bonds -4.8%	Gold -0.7%
	U.S. Stocks -4.6%	Gold -7.6%	U.S. Stocks -4.9%	Diversified Bonds -13.0%
	Int'l Developed Stocks -5.8%	Emerging Market Stocks -11.3%	Gold -7.9%	Int'l Developed Stocks -14.0%
	Diversified Bonds -5.9%	Int'l Developed Stocks -14.3%	Int'l Developed Stocks -9.3%	U.S. Stocks -18.1%
	Emerging Market Stocks -6.9%	U.S. Stocks -16.1%	Emerging Market Stocks -11.4%	Emerging Market Stocks -19.7%

Indices used: Commodities—Bloomberg Commodity Index, Diversified Bonds—Barclays Aggregate U.S. Bond Index, Gold—S&P GSCI Gold Index, U.S. Stocks—S&P 500 Index, Int'l Developed—MSCI EAFE Index, Emerging Markets—MSCI Emerging Markets Index. Indices do not reflect the deduction of advisory fees, transaction charges, and other expenses. You cannot invest directly in an index. Past performance does not indicate future returns.

Our Perspective

THE FED IS DOING A GOOD JOB, SO FAR

In a challenging year—to say the least—and with the global spotlight focused on its every move and utterance, we believe the Fed has done a good job of balancing inflation risk with recession risk, except for possibly waiting too long to begin raising interest rates. Inflation appears to be slowing and may have already passed its peak. November's CPI figure dropped to 7.1% year-over-year, from June's 9.1% high. While the tight labor market remains a headwind to the Fed's goal, there have been signs of softening. In December, the Fed raised its key interest rate by 50 bps, after four consecutive increases of 75 bps, setting up expectations for slower rate increases into 2023. Policymakers now project that the benchmark federal funds rate will reach 5.0-5.25% in 2023 (up, somewhat startlingly, from March 2022's 1.9% projection) and forecast rising unemployment and tepid economic growth.

If they are right—a big if, of course—we may achieve something close to the “soft landing” they've sought since the beginning of the rate cycle, an outcome that has looked less and less realistic over time. We believe that while higher rates are often painful for borrowers and investors, they are better for the overall economy. While we may not see as much economic growth as we did from

2010-2020 when ultra-low rates helped generate activity, higher (but still normalized, compared to the long-term historical averages) rates encourage companies to manage their resources more efficiently and responsibly. Likewise, while the Fed's loose policy provided stability during the pandemic and its immediate aftermath, we believe that preventing bankruptcies is not always a good thing from an efficient market perspective. The government should allow poorly managed companies to go bankrupt, in our view, in order to allocate capital to better-run firms.

IMPACT OF RECENT EVENTS

The results of November's election surprised many, and the split government seemed to give markets a boost in the immediate aftermath, helping to fuel equities' broad fourth-quarter gains. The bottom line, from our perspective, is that election cycles come and go, and while the economy and the markets often respond to them in the short term, the impact is generally minor over longer periods. After all, while there is always fear surrounding who is in control—especially if they are not members of our preferred party—we know that God appoints all earthly rulers, and that He is truly in control.

The FTX crash is a reminder that investing, whether in perceived "safe-haven" assets or the far end of the spectrum, involves risk. You should only invest what you are willing to lose. After all, even the smartest people in the room are sometimes wrong. Well-known venture capital investors, pension funds, and respected consulting groups all recommended investing in FTX, even after doing their due diligence.

Initial public offerings slowed dramatically last year. The big, flourishing technology stocks that drove the recent, long bull market struggled mightily in 2022, and the red-hot housing market cooled significantly. The ultimate lesson, which bears repeating no matter what direction the market is heading: Don't make emotional

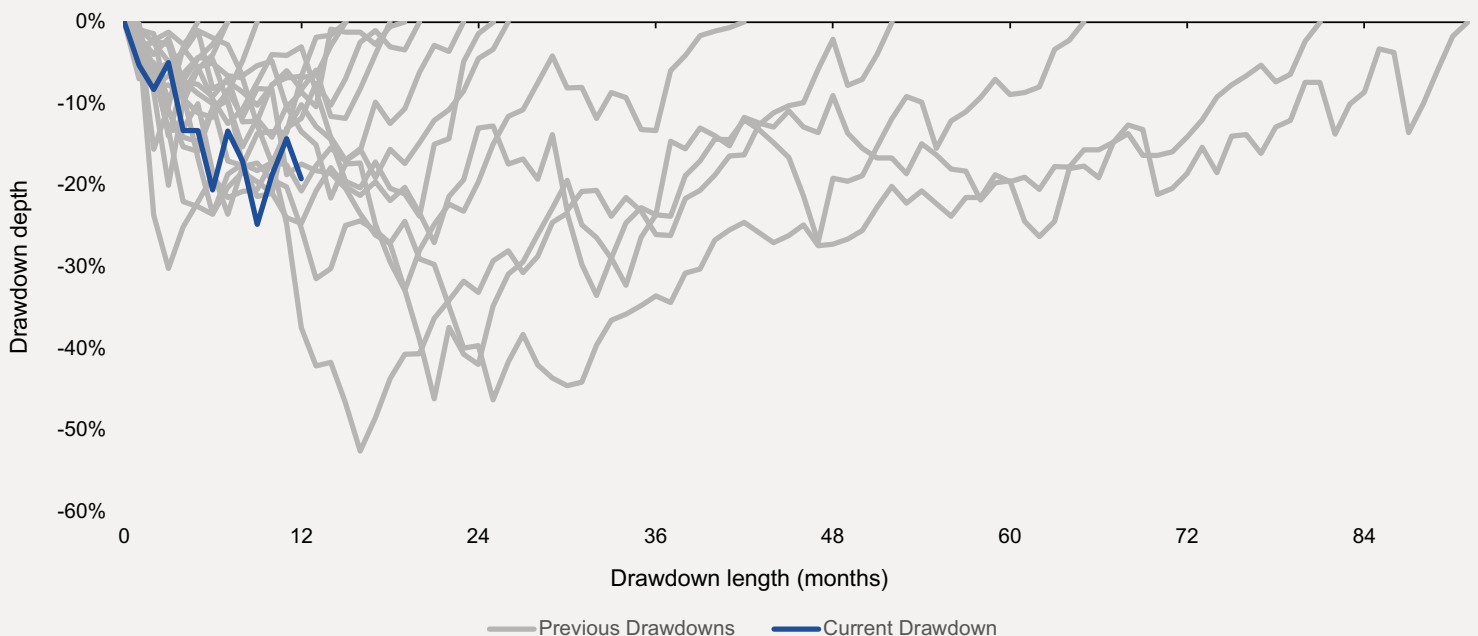
decisions based on fear of missing out (FOMO) or by the herd behavior of investors, no matter how smart the people leading the charge appear to be.

HAVE WE SEEN THE MARKET BOTTOM?

This past year was a painful one for investors, but it is important to remember that it's nothing we haven't lived through before, and generally prospered after. Markets regularly suffer sharp pullbacks. Since World War II, U.S. stocks have declined 10% or more from their all-time peak on 18 occasions—approximately once every four years. Each time, they've bottomed out, then climbed their way back to previous peaks and reached new highs. No one knows if the recent low from the summer of 2022 will mark that bottom. Our principle of uncertainty means acknowledging that we don't know what's going to happen going forward, and we need to plan, save, and invest for the future. When the S&P 500 reached an all-time closing high on January 3, 2022, the first trading day of the new year, it was nothing shocking, as the index had set such a record nearly 70 times over the previous 12 months. Few investors thought that it would be the last all-time high for a while, or that the index would fall nearly 24% in the first three quarters of 2022.

Whether we've hit bottom or not is impossible to predict given the danger of a recession, the Fed's delicate balance, and the risk that some event—geopolitical or otherwise—could drive markets sharply down (or up). Still, we can look to history for clues. Of the 17 prior drawdowns, 11 were accompanied by a recession. Among those instances, equities only bottomed out before the start of the recession on one occasion. Every other time, equities hit bottom during or after the recession. It's also true that previous downturns took as long as 25 months to reach their lowest point, and we're only 12 months into this one.

U.S. MARKET DRAWDOWNS GREATER THAN 10%



Source:FactSet, Ibbotson, as of 11/30/22.

Our Investment Strategy

Markets like the one we saw in 2022 are challenging, and that is likely an understatement. However, it's important to remember that it was just one year, a relative blip on the typical investor's time horizon, or even a full market cycle. Full market cycles are generally defined as the period from one stock market peak to another, including a price decline of at least 20% and a rebound that establishes a new, higher peak and typically last from five to 20 years. With that in mind, we've made changes during the year to better prepare our portfolios for the increasing probability of a recession. We've also taken advantage of higher interest rates in our short-term solutions. Meanwhile, we are keeping our focus on the long term, and we advise investors to do the same. Our long-term solutions are diversified to help cushion losses in the case of a recession, but we still believe you should hold stocks in your long-term portfolios and that you shouldn't be overly concerned with short-term pullbacks, no matter how uncomfortable they may feel at the time. With that in mind, it may be a good time to revisit your cash-flow planning with your advisor during your annual review, to ensure that you will have enough cash on hand if we do experience a recession.

Conclusion

Fighting the fire that is inflation, with its corresponding interest-rate hikes and recessionary fears, is difficult. No matter how quickly or carefully you extinguish a fire, you are likely to have damage in the aftermath. At the same time, fires, especially in nature, clear the way for new growth to take hold. History tells us that however long this fire burns, and however much damage it does, markets have rebounded. This past year represents the twelfth time since the Great Depression that the S&P 500 declined 10% or more in a calendar year. Six times, it bounced back the following year, posting an average gain above 30%. Of course, that means it fell again five times over the 12 months after a double-digit decline, putting the average five-year return at 6.4%. However, over the three years after a drawdown, it rose 10 out of 11 times, posting an average cumulative gain of more than 35%. Stretch it to five years, and the index gained in every such period. Remarkably, following the worst 11 years of S&P 500 returns since 1930, the average five-year advance was just shy of 80%. That's not to say it will happen this time, but it does provide perspective and optimism in a time of great uncertainty. These statistics also provide a reminder: Sticking to your structured, well-thought-out financial and investment plan tends to work out quite well over the long haul.

RonaldBlueTrust®

Wisdom for Wealth. *For Life.*®

For more information please contact your financial advisor, call us at **800.841.0362**, or visit our website at **www.ronblue.com**.

Ronald Blue Trust advisors apply biblical wisdom and technical expertise to help clients make wise financial decisions to experience clarity and confidence and leave a lasting legacy. With over \$13.5 billion of assets under advisement and a nationwide network of 16 offices, we offer comprehensive financial services and objective advice to over 9,000 clients across the wealth spectrum in all 50 states. As of 4/1/2022 and subject to change.

The views expressed herein are provided by Ronald Blue Trust. Ronald Blue Trust is discussing the asset classes, sectors and portfolios they oversee at a macroeconomic level. They are not recommending or endorsing the purchase of any individual security. Any investment strategies presented may not be appropriate for every investor and investors should review the terms, conditions and risks involved with specific products or services with their financial professional. Unless stated otherwise, any estimates, projections (including performance and risk), or predictions (including in tabular form) given in this presentation are intended to be forward-looking statements. Although Ronald Blue Trust believes that the expectations in such forward-looking statements are reasonable, it can give no assurance that any forward-looking statements will prove to be correct. Such estimates are subject to known and unknown risks, uncertainties, and other factors that could cause actual results to differ materially from those projected. These forward-looking statements speak only as of the date of this review. As with any investment strategy, there is the potential for profit as well as the possibility of loss. Ronald Blue Trust does not guarantee any minimum level of investment performance or the success of any portfolio or investment strategy. Past performance does not guarantee future results.

Diversification does not guarantee investment returns and does not eliminate loss.

16238566-01-23