FOURTH QUARTER 2022 REPORT

ENTERPRISE
WEALTH MANAGEMENT
A division of Enterprise Bank

IN THIS ISSUE

A Messy, Messi Year

Congratulations to Argentina for winning their third World Cup, putting them behind only Brazil (5), Germany (4) and Italy (4) for most World Cup titles. Team captain – and global superstar – Lionel Messi's only World Cup title certainly came during a messy year for financial markets. Despite healthy gains in the fourth quarter, financial markets were not completely able to fix the mess they had created for themselves throughout much of 2022. Global equities' 9.9% fourth quarter gain still left investors down 18.0% for the full year. And despite investment grade fixed income finally posting a quarterly gain (+1.9%), the usually safer part of the investor portfolio lost 13.0% in 2022. In fact, the only asset class outpacing the return of "risk-free" cash last year was natural resources (+10.3%) – and that was thanks to an incredibly strong fourth quarter (+17.2%).

Goal of the Century. For some (notably England fans), seeing Messi win his World Cup may bring back memories of Diego Maradona winning Argentina's second World Cup back in 1986. Maradona's performance in the quarterfinal match against England that year inspired former Bank of England Governor Mervyn King's "Maradona theory of interest rates." Called the *Goal of the Century*, Maradona went over half the field – evading five defenders – to put the ball in the net. King observed Maradona's path to the goal effectively took him in a straight line – and he was able to do so because the defenders expected him to go left or right. King theorized that central bankers could also "move in a straight line" (maintain steady monetary policy) so long as market participants expected more central bank activity. Bringing the analogy to present day, central banks

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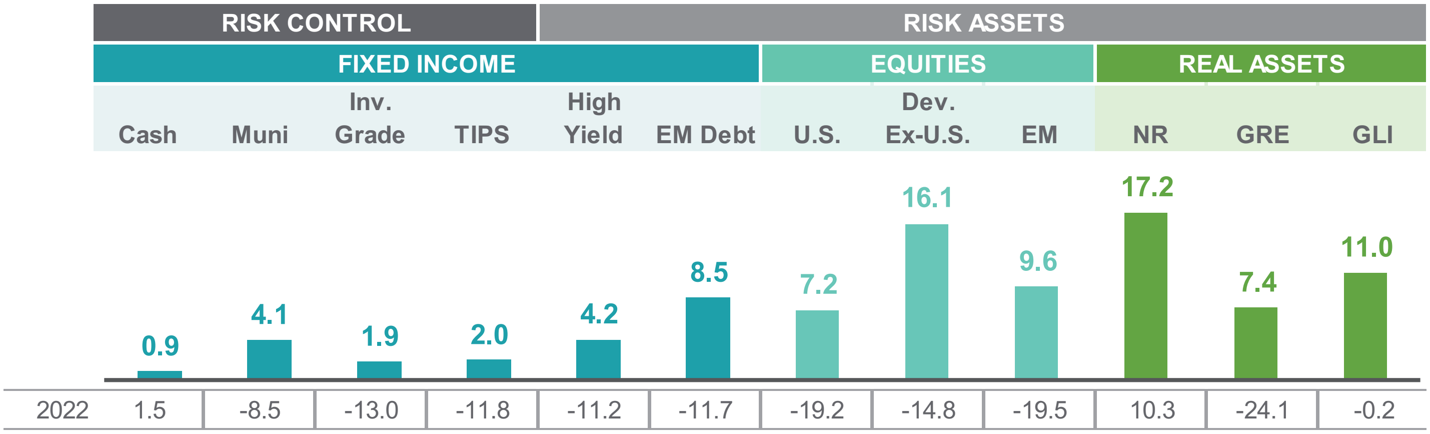
– but especially the Federal Reserve – are greatly focused on regaining credibility such that they can "Maradona" the way through most of 2023. That is, the Fed is hopeful its strong message to the markets that they will extinguish inflation – along with a few more rate hikes – will allow them to finally take a straight line for the rest of 2023. Putting numbers and dates to the above, the Fed policy rate (currently at 4.5%) is expected to peak between 5%and 5.25% by either at or near the May Fed meeting.

Hand of God. In fact, Maradona had two noteworthy goals in that 1986 quarterfinal match. The other – called *the Hand of God* – was a goal thought to be off Maradona's head but was actually off his hand (this was pre-Video Assistant Referee). Sometimes you need a bit of luck. Certainly the Fed could use some luck in bringing inflation down toward its 2% target. The record pace of rate hikes in 2022 should assist – as should the invisible hand (not God's – Adam Smith's) as it continues to heal supply and demand mismatches. The supply/demand mismatch to watch at this point is in the labor markets, where Fed tightening has yet to notably slow hiring or overall labor demand. Should the Fed be able to quickly and effectively address the labor/wage issue, 2023 could be less Messi and more Maradona.

FOURTH QUARTER 2022 TOTAL RETURNS (%)

Financial markets rebounded in the fourth quarter, yet most major asset classes still ended with double-digit losses in 2022.



Source: Northern Trust Asset Management, Bloomberg. NR: Natural Resources; GRE: Global Real Estate; GLI: Global Listed Infrastructure. Indexes are gross of fees.

KEY DEVELOPMENTS

China Changes Course

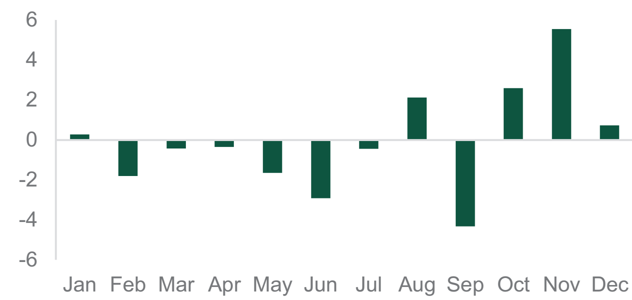
A negative investor reaction to the readout from China's Party Congress involving a more state-led economic approach pushed China equity markets down more than 15% in October. However, China equities sharply reversed course and outperformed other regions for the quarter as policymakers announced a number of moves pivoting away from zero-Covid policies (less testing, quarantines, travel restrictions, etc.). Despite the reopening, the near-term growth outlook remains fairly uncertain given public health risk from the virus.

Inflation Still in the Spotlight

Inflation retained its spot as a key area of focus for investors in the fourth quarter. In the U.S., Consumer Price Index (CPI) inflation reports were generally the most market-moving data releases in 2022. Inflation data released in the quarter was more favorable with deceleration in headline and core figures from both year-over-year and month-over-month standpoints – with equity markets responding favorably to this (see chart). However, lingering strength on wage growth and the services side of the economy remains a concern.

CHINA EQUITIES RELATIVE PERFORMANCE (%)

S&P 500 RETURNS ON DAY OF U.S. CPI RELEASE (%)



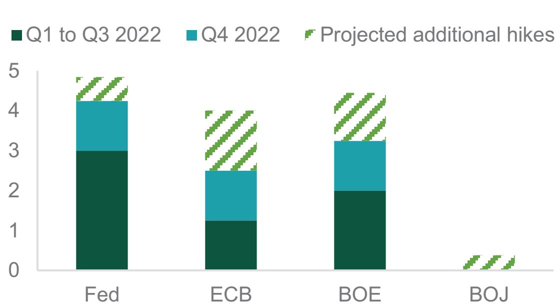
Approaching the Destination

2022 was a year of historic central bank tightening with many central banks raising rates by 3% or more. In the fourth quarter, central banks slowed the pace of tightening, with investor debate shifting to the peak level of policy rates and the duration of restrictive policy. The Fed and European Central Bank (ECB) both raised rates by 1.25% in the quarter while the Bank of Japan (BOJ) surprised investors by widening its target rate bands for yield curve control; implying an exit from its ultra-accommodative policy is more likely in 2023.

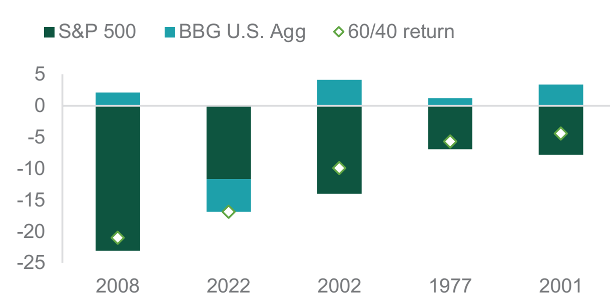
60/40 Struggles

Despite some gains in the fourth quarter, 2022 was a rough year for investors with double-digit losses in both equity and fixed income markets. Inflation, central bank tightening and rising interest rates played a key role in the losses for both equities and fixed income, while equities were further hit by growth concerns and geopolitical uncertainty. In a historically weak year for a 60/40 portfolio mix (second only to 2008), 2022 was the only year where bonds did not play a diversifying role to help offset material losses in equities.

CENTRAL BANK TIGHTENING (%)



HISTORICAL ANNUAL RETURN BREAKDOWNS (%)



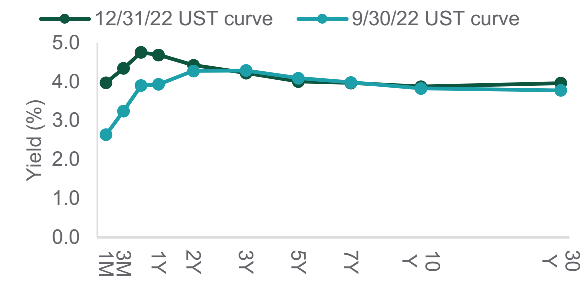
Source: Northern Trust Asset Management, Bloomberg (BBG). Top chart uses MSCI indices. EM = emerging markets; UST = U.S. Treasury. Data as of 12/31/2022.

Market Review

Interest Rates

After hiking 75 bps in November, the Fed executed a "hawkish deceleration" in December. It downshifted to a 50-bp pace, but simultaneously raised its projected year-end 2023 rate to 5.1%. While 75-bp hikes may no longer be the status quo, price stability is still the Fed's top priority. Short-term Treasury yields rose on ongoing tightening, while the rise in longer yields lost steam as investors priced in an upcoming pause in the rate cycle as well as the economic impacts of the tightening. The Treasury curve is deeply inverted headed into 2023.

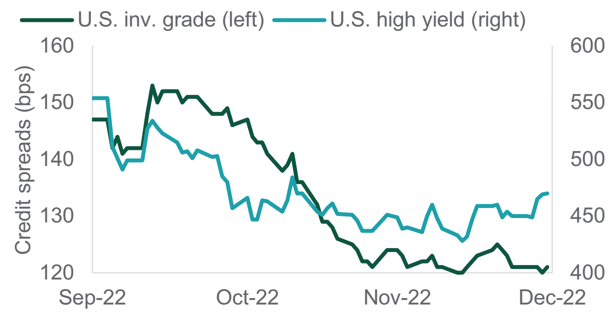
U.S. TREASURY YIELD CURVE



Credit Markets

Barring a swift move higher in early-to-mid October as investors tried to assess the Fed policy trajectory, credit spreads contracted for most of the quarter. Credit sentiment improved as central banks beginning to pivot toward less aggressive policy tightening raised hope that adverse-case default scenarios can be avoided. High yield (+4.2%) outperformed investment grade fixed income (+1.9%). High yield benefited from its higher starting point yield, less direct exposure to interest rate volatility and greater leverage to corporate resilience.

CREDIT SPREADS



Equities

Global equities gained 9.9% as a relief rally took hold. Fundamentals held up relatively well, while valuations rose as sentiment turned more positive on signs of receding inflation risk and greater monetary policy certainty. While the rally was broad-based, stocks with resilient fundamentals did particularly well. Regionally, non-U.S. equities (dev. ex-U.S. equities up 16.1% and emerging market equities up 9.6%) bested U.S. equities (up 7.2%), helped by more market friendly central bank activity, a declining dollar and a reopening China.

REGIONAL EQUITY INDICES

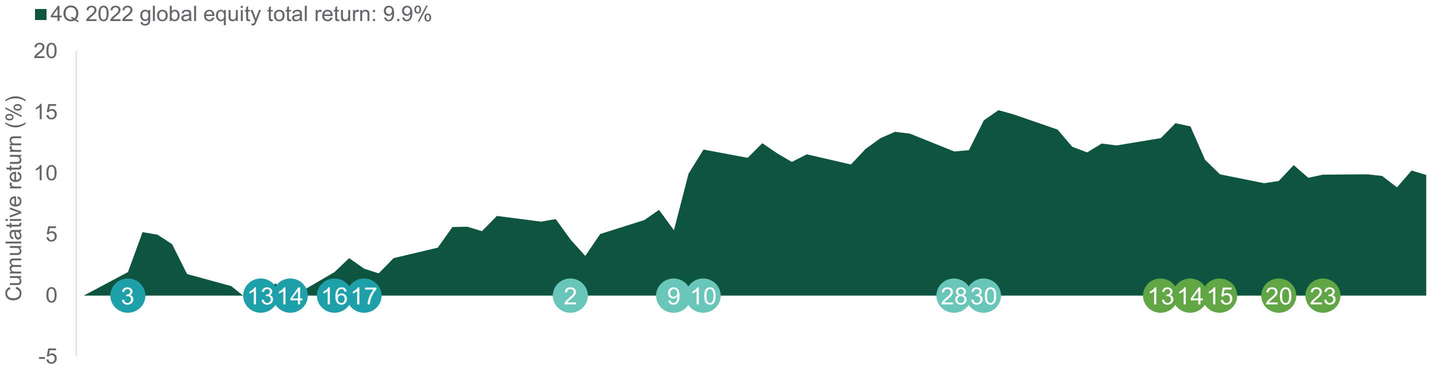
Real Assets

Natural resources (NR) closed out its standout year with a strong quarter, gaining 17.2% versus 11.0% for global listed infrastructure (GLI) and 7.4% for global real estate (GRE). NR benefited from strong fundamentals, tight commodity supply and a better demand outlook due to China's reopening as well as the potential for less central bank headwinds moving forward. GLI was also helped by energy-related exposure, albeit less than NR. GRE underperformed global equities, with office and residential sector weakness serving as a drag.

REAL ASSET INDICES

Source: Northern Trust Asset Management, Bloomberg. Bp(s) = basis point(s). Returns in U.S. dollar terms. UST = U.S. Treasury. Indexes are gross of fees.

Market Events



OCTOBER	NOVEMBER	DECEMBER
3 Global Manufacturing Purchasing Managers' Index falls into contractionary territory for the first time since mid-2020.	**2** Fed hikes 75 bps and Chair Powell indicates that the peak rate may end up being higher than previously thought.	**13** Sam Bankman-Fried, former CEO of major cryptocurrency exchange FTX, is charged with fraud following FTX's collapse that shook the crypto industry.
13 U.S. Consumer Price Index (CPI) accelerates month-over-month with core services particularly strong.	**9** U.S. midterm elections produce split government with Democrats retaining Senate control and Republicans later clinching a House majority.	**14** Fed downshifts to a 50-bp rate hike but emphasizes commitment to price stability by raising its projected year-end 2023 policy rate to 5.1%.
14 Third quarter earnings season unofficially kicks off; proceeds to deliver results a touch above expectations, but 2023 estimates trend down.	**10** U.S. CPI decelerates more than expected month-over-month, sparking a ~5% rally in U.S. equities on the day.	**15** European Central Bank hikes 50 bps (with a third of members opting for 75 bps), guides ongoing rate hikes and start to quantitative tightening in March.
16 China National Congress begins; President Xi secures a third five-year term and later consolidates power within the Chinese Communist Party.	**28** Protests against zero-Covid policies erupt across China, eventually leading to a pivot away from most of its restrictions.	**20** Bank of Japan loosens yield curve control by allowing the 10-year yield to rise up to 50 bps (previously 25 bps).
17 Spillover risks from U.K. fiscal crisis decline after Chancellor Hunt reverses proposed tax cuts (Prime Minister Truss is later replaced by Rishi Sunak).	**30** Equities rise following a speech from Fed Chair Powell that indicates that the central bank could soon begin slowing interest rate increases.	**23** U.S. Congress enacts a $1.7 trillion 2023 funding bill – a modest boost to the deficit that pales in comparison to Covid-era stimulus.

Prepared by Northern Trust Asset Management for Enterprise Wealth Management.

Indexes used: Bloomberg (BBG) 1-3 Month UST (Cash); BBG Municipal (Muni); BBG Aggregate (Inv. Grade); BBG TIPS (TIPS); BBG High Yield 2% Capped (High Yield); JP Morgan GBI-EM Global Diversified (Em. Markets Fixed Income); MSCI U.S. Equities IMI (U.S. Equities); MSCI World ex-U.S. IMI (Dev. ex-U.S. Equities); MSCI Emerging Market Equities IMI (Em. Markets Equities); S&P Global Natural Resources (Natural Resources); MSCI ACWI IMI Core Real Estate (Global Real Estate); S&P Global Infrastructure (Global Listed Infrastructure).

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From the Managing Director

Dear Clients and Friends,

Having closed the books on a tumultuous year, we can all hope for peace, happiness, and better investment markets in 2023. 2022 was an unusual and negative year for investment markets across the globe. With few exceptions, most global equity and bond markets experienced negative returns last year. Inflationary pressures moved interest rates higher and put pressure on equity prices. Major central banks around the world raised interest rate targets to fight widespread and persistent inflation. Supply chain difficulties and significantly higher energy prices were primary drivers of the increased inflation levels.

Looking ahead to 2023 and the years ahead, there is reason for optimism. Although interest rates have moved higher, they are not above normal historical averages. For the first time in several years, investors can earn something closer to normal interest on their bond investments. There is a chance we might experience a recession in the U.S. in 2023, but many analysts expect it will be shallow and brief compared to typical downturns. And markets have already priced in some of that expectation, so the declines we saw in 2022 may pave the way for improved stock and bond performance this year.

Our investment approach, as always, is to focus on our clients' long-term goals and stay fully invested throughout the inevitable market ups and downs. Over the past year we have increased diversification to non-correlated market segments, reduced internal portfolio costs in several asset categories, harvested capital losses where appropriate, and dialed back the risk exposure of our allocation strategies. It is impossible to predict exactly when markets will change direction. Our long-term focus and consistent asset management approach affords each of you the optimal opportunity to meet your goals.

Best wishes to all of you from your team at Enterprise Wealth Management! The opportunity to meet in-person with many of you during recent months after a period of mostly video interactions has been wonderful. We are thankful for your relationship with Enterprise Wealth Management and value the trust you place in us. We look forward to working with you for years to come.

Sincerely,

Stephen J. Irish, CFP®, CPA
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Chief Operating Officer, Enterprise Bank

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