April 18, 2023

Dear O'Brien client,

The more things change, the more they stay the same. Although we begin the quarter on a positive footing, our outlook is not without a cautionary note.

The strong risk rally into year-end 2022 continued through the first quarter of 2023. Global stocks jumped another 7%, led by developed markets. Fixed income rose 3% as well, with credit sensitive markets outperforming. Over the past six months, global stocks are now up a whopping 18% – roughly the same as the gains posted in all of calendar years 2020 and 2021. The NASDAQ has risen over 20%, meeting the technical definition for the start of a new bull market for that marketplace.

The table below summarizes 1Q returns across the subsets of the stock and fixed income markets and compares that performance to both 2022 and the past three years.

	1Q	2022	3 Years		1Q	2022	3 Years
Non-U.S. Developed Market Stocks	8.5%	-14.5%	13.0%	Investment Grade Bonds	3.5%	-15.3%	-0.7%
Gold	8.1%	-0.7%	5.9%	Treasuries	3.0%	-12.5%	-4.2%
U.S. Large Cap Stocks	7.5%	-18.1%	18.6%	**U.S. Aggregate Bond Index**	**3.0%**	**-13.0%**	**-2.8%**
Global Stocks	**7.3%**	**-18.4%**	**15.4%**	Municipal Bonds	2.8%	-8.5%	0.3%
Non-U.S. Stocks	6.9%	-16.0%	11.8%	U.S. Small Cap Stocks	2.7%	-20.4%	17.5%
U.S. Mid Cap Stocks	4.1%	-17.3%	19.2%	Mortgage-Backed Bonds	2.5%	-11.8%	-3.3%
Emerging Market Stocks	4.0%	-20.1%	7.8%	Real Estate Stocks	1.7%	-24.9%	10.2%
High Yield Bonds	3.7%	-11.2%	5.8%	Commodities	-5.4%	16.1%	20.8%

Past performance is no guarantee of future returns. You cannot invest in an index. 3 year returns are annualized.
Source: Morningstar Direct, O'Brien Wealth Partners, as of 3/31/23.

Yet, 1Q also saw a sharp rally in treasuries, two of the three largest bank failures in the history of the U.S., and the Federal Reserve (Fed) issuing new liquidity support measures. Participation in the stock rally was narrow, with 90% of the S&P 500 gains driven by the 10 largest stocks in the index (and fully half of the rally due to just Apple, Microsoft, and Nvidia)[1]. Stocks and bonds also continue to move in the same direction, suggesting diversification is still lacking.

Clearly, there is not a consistent message being provided by markets. This lack of consistency increases the risk that investors draw erroneous conclusions, as they can easily find data points to support any preconceived frames of reference they hold about the outlook. One potential consequence of this framing bias is becoming overly focused on short-term price fluctuations when making investment decisions, to the detriment of longer-run considerations.[2]

Given this risk, we think it is prudent to start our outlook with what has – or has not – changed in our long-term outlook (e.g. 10 years or more).

Despite today's still-elevated inflation, we believe the Fed is credible and will eventually slow inflation to a more reasonable pace. Economic growth will likely be more modest, on average, because of aging demographics. And, although the recent rally has increased market valuations, they are still more

[1] Source: Charles Schwab, O'Brien Wealth Partners, as of 4/3/23.
[2] Source: "The Behavioral Biases of Individuals", CFA Institute (2023) Page 11, O'Brien Wealth Partners, as of 1/1/23.

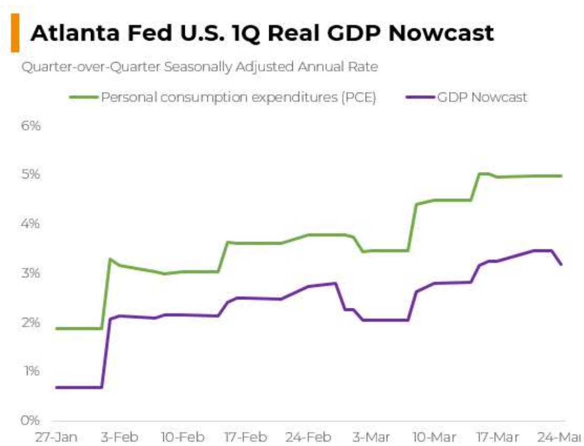
attractive than they were entering last year – particularly for fixed income. These dynamics point to a long-term environment that, on average, should be positive for asset markets and the return of diversification.

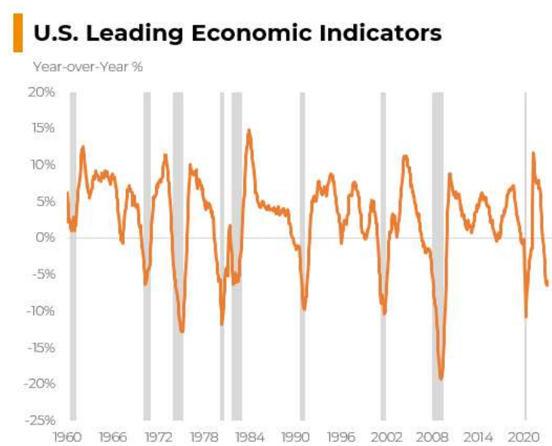
The primary risks to that outlook are that inflation stays elevated and that the recent banking crisis leads to reduced willingness of banks to lend for an extended period. Sustainably higher inflation has historically reduced the diversification benefits between stocks and bonds. Financial crises have tended to correlate with subdued economic recoveries due to banks remaining reticent to lend money.[3] This helps explain the Fed's response to 1Q's banking sector woes, as they acted quickly to hopefully mitigate that banking crisis risk. Both risks warrant monitoring, but as of now are not part of our base case outlook.

Against that long-term outlook, there is a mix of positive and negative cyclical (e.g. one-to-three years) dynamics – as well as a growing list of known unknowns. Our base case outlook here is still that it is likely more a matter of "when" than "if" a recession will occur, but recent economic developments suggest "when" may not be as immediate as it looked a few months ago.

Starting with the positives, consumer spending (green line below) accelerated during the first quarter, in turn boosting overall economic growth (purple line). To some extent this was due to fading drags that occurred a year ago – such as the onset of the war in Ukraine, the end of the zero-COVID policy in China, and the de-bottlenecking of global supply chains. That said, resilient demand is a positive for both labor markets and corporate profits.

Turning to the negatives, leading economic indicators (orange line) for the U.S. are still contracting and warn of elevated recession risks as 2023 progresses. These indicators have never been this weak without a recession eventually occurring.





LEFT: Source: Atlanta Fed, O'Brien Wealth Partners, as of 3/27/23. RIGHT: Gray bars denote U.S. recession as identified by the National Bureau of Economic Research (NBER). Source: S&P Global, The Conference Board, NBER, O'Brien Wealth Partners, as of 2/28/23.

While the odds of recession in the U.S. are elevated, the magnitude of any economic downturn is likely to be muted due to a lack of significant fiscal imbalances in the private sector. Both business and

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[3] "Credit Conditions and Recoveries from Recessions Associated with Financial Crisis", IMF Working Paper (2010/083) by Prakash Kannan, O'Brien Wealth Partners, as of 3/31/10.

household balance sheet metrics remain solid – particularly compared to their levels during the Global Financial Crisis.

On the inflation front, better-than-expected economic growth translated to sticky inflation during the quarter – particularly for services – but we expect prices to begin slowing again. Shelter costs – which lag house prices by about a year – remain elevated but asking rents – a leading indicator – have cooled meaningfully.

Labor markets and wages are another major driver of service prices. Here, too, leading indicators, such as the number of people quitting their job for a new one, have started to roll over – suggesting wage growth is also poised to continue slowing.

All this points to room for the Fed to moderate its pace of rate hikes. While financial markets react in real-time to changes in central bank policy, those policy changes impact economic activity with long and variable lags. Those impacts are likely still flowing through the economy. Tightening going forward may therefore be more likely to come from further shrinking of the Fed's balance sheet and more restrictive lending conditions following recent banking system woes than further significant rate hikes.

These macro crosscurrents point toward continued elevated uncertainty for asset market performance in 2023 and the need to not lose sight of longer-term context and goals. For example, despite the sell-off in 2022, global stocks are still up 52% since 2019 and a 60/40 global stocks/U.S. bond portfolio is still up 33%.[4]

And while we cannot rule out the potential for additional market downside from the risks outlined above – along with other potential catalysts such as the looming debt ceiling debates – empirically we know that roughly 80% of the stock market's best days over the past 30 years have come during either bear markets or early on in bull markets[5]. Therefore, the most important thing to do in these environments is to stay disciplined toward long-term goals and remain invested.

As always, we aim to rebalance your portfolio if the deviations become too large, look to de-risk portfolios within asset classes if economic conditions deteriorate, and add opportunistic investments as the backdrop improves.

We hope you are all taking care and staying healthy. If you have questions, or would like to talk, please reach out to your Advisor or any member of our investment team.

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[4] Past performance is no guarantee of future returns. You cannot invest in an index.
[5] Source: Ned Davis Research, Morningstar, Hartford Funds, O'Brien Wealth Partners, 2/28/22.

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