Quarterly Investment Perspective

2023 Outlook: Assessing the Aftershocks

Holly H. MacDonald
Chief Investment Officer

Executive Summary

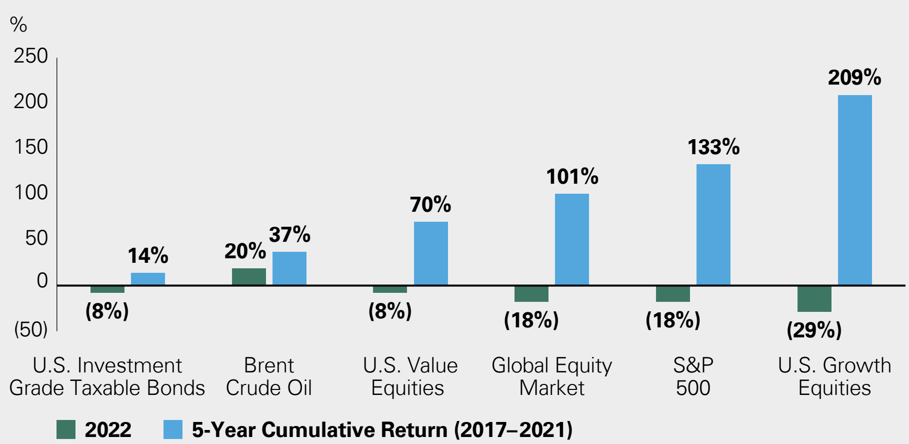
- **Last year saw extreme shocks to the global economy, including reopening challenges, a commodity surge following Russia's invasion of Ukraine, soaring inflation, and an aggressive monetary policy response to inflation, which drove weakness in stocks and bonds.**
- **We expect the aftershocks of these events to dominate in 2023, principally in the form of still elevated bond yields and inflation. For the U.S. economy, a controlled slowdown is our base case. A modest recession is also possible as the Fed attempts to slow growth just enough to keep inflation trending downward. We are not expecting a severe recession at this point.**
- **We are maintaining a balanced, diversified positioning with a modest overweight to equities and continued emphasis on alternative and private markets. Our forecast for a controlled slowdown or moderate recession with declining inflation suggests that the Fed is close to completing its hiking cycle, which should allow both bonds and stocks to post positive returns as volatility subsides.**

2022 was a year of extreme shocks to the global economy, and we believe the aftershocks will drive the narrative in 2023. The shocks are well known: COVID-related reopening challenges coupled with extreme fiscal and monetary stimulus provided the kindling to ignite inflation, and the commodity price surge following Russia's invasion of Ukraine was the match that caused inflation to blaze. A rapid and massive policy response to inflation drove concurrent weakness in stocks and bonds, with both asset classes posting losses on the year for the first time in nearly five decades. Our expectations for 2022 were for growth to moderate and for inflation to remain higher than trend, but we underestimated how the various factors would combine to trigger such high levels of volatility across asset classes.

While the shifts in trends have undoubtedly been significant, most of last year's moves were not enough to negate the trends of the prior five years (Exhibit 1). The weakness in bonds and strength in commodities were most notable vis-à-vis prior performance. Still elevated bond yields and inflation are likely to be the main sources of aftershock in 2023 (Exhibit 2). We devote this publication to analyzing their likely effects on the global economy.

Exhibit 1: 2022 and Prior Five Years Asset Class Performance

Key Takeaway: 2022 saw a reversal but not a negation of prior trends.



As of December 31, 2022. Five-year cumulative return through December 31, 2021. Returns look at total return of each asset class where applicable. The asset class performance is measured using the following indices: Value equities (Russell 1000 Value), growth equities (Russell 1000 Growth), global equity market (MSCI AC World IMI), U.S. investment grade taxable bonds (ICE BofA 1–10 Year AAA-A U.S. Corporate and Government Index).

Source: Bloomberg

The challenges of 2022 emphasized the importance of teamwork and the power of bringing diverse opinions together to set the path for our investment platform. I am gratified that many team members have contributed to the outlook for 2023, and in the pages that follow, they are noted as authors of the sections they contributed to this Quarterly Investment Perspective.

Despite the rampant negativity from financial media and economic strategists, there are important pillars of strength in the U.S. economy leading us to maintain our base case of a controlled slowdown (Exhibit 3). A modest recession is also highly plausible as the Federal Reserve attempts to slow growth just enough to keep inflation on its downward trajectory. A severe recession, however, seems unlikely to us absent an unrelated and unforeseen additional shock — there is not enough leverage in the economy to trigger a significant contraction. If anything, the biggest risk to our more benign outlook is that growth remains strong enough that the Fed hikes interest rates much more than expected, an outcome we also think has a reasonably low probability but is worth noting. Even as the market reacts in the coming months to nuances in the inflation and Fed interest rate hike trajectories, we think both have peaked already in terms of market pricing. This should lower volatility and provide support for valuations in the year ahead amid a more subdued earnings trajectory compared to 2021 and 2022 — both of which saw the highest corporate profitability levels in decades.

Challenges are greater outside of the U.S. The war in Ukraine looks unlikely to subside in the near term, and even a positive surprise would not reverse the economic conditions now in place, including stickier inflation compared to the U.S. and continued energy-related challenges. In China, weakness in the property sector, misguided COVID policy, and a focus on national security and stability over economic growth are likely to remain drags and limit investment opportunities. While there are some positive developments in other emerging market countries — some central banks were quicker than the Fed to react to inflation in 2022 — a recent shift to populist policies indicates that the decline in inflation may be short-lived. The strong dollar, which was a

Exhibit 2: Key Economic Metrics (U.S. and World)

Key Takeaway: Economic forecasts for 2022 missed by a wide margin yet appear reasonable for 2023.

Most forecasts for 2022 underestimated inflation and the resulting actions the Fed and other central banks would take in response. Investors rightly anticipated that U.S. inflation would end the year above the Fed's 2% target, but the 4.4% estimate was short of the actual reading (7.1%). Surprised by inflation's resilience, the Fed hiked the federal funds rate to 4.25%–4.50% by year end, when the market had initially expected 1%! Stubbornly high price pressures, and the countermeasures from central banks, led to disappointing but still positive GDP growth numbers in 2022. Forecasts for 2023 call for even slower growth paired with declining but still elevated inflation and bond yields.

		2022 Forecast	2022 Actual	2023 Forecast
Real GDP (YoY)%	U.S.	3.9%	0.3%*	0.3%
	Global	4.4%	3.2%**	2.1%
Inflation (YoY)%	U.S.	4.4%	7.1%	4.0%
	Global	3.9%	10.0%	5.2%
Fed Funds Rate	U.S.	0.8%	4.5%	4.6%

As of December 31, 2022 for 2023 forecasts. 2022 actual data reflects most recent data points for each metric: GDP growth (September 30, 2022), inflation (November 30, 2022), fed funds rate (December 15, 2022). Forecasts for 2022 are taken from the end of 2021. 2023 fed funds rate forecast reflects fed funds rate futures forecasts for December 31, 2023. Real GDP and inflation forecasts use Bloomberg consensus.

*Represents annualized cumulative real GDP through the third quarter of 2022.

**Represents Bloomberg consensus estimate for year-end 2022.

Source: Bloomberg

Exhibit 3: Changes in 2022 Versus 2023 Trends

Key Takeaway: Although the outlook remains complicated, some areas of the economy are improving.

Improving	Worsening	Ongoing
Inflation outlook	U.S. growth outlook	Geopolitical tensions
Monetary tightening	European growth outlook	Market volatility
Supply chain dynamics	Low-end consumer	Poor sentiment

Source: Bessemer Trust

continual weight on emerging markets in 2022, is likely to be more mixed in 2023, thereby potentially allowing room for emerging markets to find a relative bottom as these other factors materialize through the year.

Amid this complicated backdrop, we maintain a balanced and diversified positioning with a modest overweight to equities and a continued emphasis on alternative and private markets. Our forecast for a controlled slowdown or moderate recession alongside sustainably declining inflation suggests that the Fed is close to completing its hiking cycle, allowing both bonds and stocks to post positive returns as volatility subsides.

While the quality factor was under pressure in 2022, over long time periods, quality companies with strong balance sheets tend to outperform. Our tilt toward quality and growth equities, both of which underperformed in this environment, detracted from returns in 2022 while our private markets and hedge fund investments held up relatively well. We maintain our emphasis on quality even as we have increased exposure to defensive, commodity-oriented, and higher dividend-yielding companies over the past year. We keep a heavy overweight to the U.S., where there is a greater opportunity set of high quality companies, and where the outlook, though complicated, is more favorable than elsewhere in the world on the whole. There are exciting opportunities in private markets as technological innovation continues and real assets are more in focus than ever. At the same time, there is value in unconstrained hedge fund strategies, which can take advantage of the likely still volatile conditions. And so, as we assess the aftershocks of 2022, we are encouraged by the opportunities that 2023 provides.

Anthony M. Wile, Associate Portfolio Manager

Growth Outlook: Slowing Continues, Private Sector Is Prepared

It's important to assess the current state of the economy to better understand its trajectory in 2023. Thus far, the data remain encouraging. The labor market has continued to defy expectations of an abrupt slowdown. Employment data has shown some softening in underlying details, specifically falling job openings and slowing household employment, without a material increase in the unemployment rate. Economic output has remained below potential with cumulative real GDP growth in 2022 at only 0.3%. Importantly, the components of growth point to the effects of monetary and fiscal tightening. Residential investment, goods consumption, and inventory stocking all remained significant headwinds in 2022, highlighting the impact of higher mortgage rates and lower consumer real income. This contrasts with strong services consumption, which typically displays the highest sensitivity to the labor market (Exhibit 4). With inflation beginning to fall, current growth data remains consistent with a soft landing.

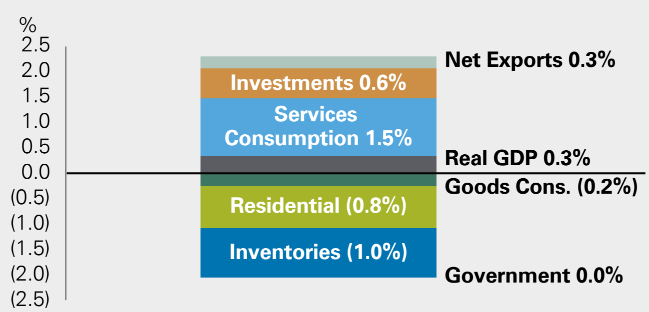
Looking ahead, we remain constructive on the U.S. growth outlook but acknowledge that the path ahead for a soft landing is complicated. While below-potential growth is an outcome required to tame inflation, it remains historically true that slow growth environments often yield unforeseen consequences. To that end, we see two plausible economic environments in the year ahead. The first is a continued and controlled economic slowdown. Although recession risk continues to make headlines, underlying details point to pivotal tailwinds in 2023. With inflation dynamics improving and average hourly earnings increasing nearly 6% year-over-year — the highest level since the 1970s — real consumer incomes are likely to grow again in the year ahead, a significant contrast to 2022. While financial markets have remained volatile and home prices have started to decline, household net worth remains substantially above pre-pandemic levels. Perhaps most importantly, many households still have significant excess savings to buffer consumption in 2023. We estimate consumers have $1.3 trillion, or 5% of nominal GDP, in additional savings from the pandemic.

The second scenario we find plausible is a modest economic contraction resulting in a moderate recession. Despite the tailwinds discussed above, the Federal Reserve is actively seeking to slow growth and, in turn, increase unemployment. Any evidence of a reacceleration in consumer demand may be met by tighter monetary policy. The consumption of durable goods such as vehicles and furniture is often correlated to home purchases; goods consumption and manufacturing activity, in turn, both have a persistent headwind of higher interest rates weighing on housing demand at the moment. While services consumption served as the bedrock of growth in 2022, it is historically the last component of output to feel the effects of tighter monetary policy as consumers eventually cut back on more discretionary purchases.

Given the last few recessions, why don't we believe a severe contraction is likely in 2023? Severe economic contractions are typically associated with excess debt levels on private sector balance sheets. As households and companies extrapolate a positive environment into the future, they tend to increase their credit and debt usage. When overly optimistic expectations meet the new reality of a less benign growth environment, painful deleveraging leads to a disproportionate fall in GDP and, perhaps more importantly, corporate earnings. This does not seem to be the current dynamic. The Survey of Professional Forecasters probability of economic contraction in the year ahead sits at 44%, the highest level since the survey began in 1967. Most people expect a recession and are preparing in kind. This has further strengthened corporate and household balance sheets, which remain in excellent condition and should dampen the likelihood of severe contraction in the year ahead.

Exhibit 4: YTD 2022 U.S. GDP Growth

Key Takeaway: Service consumption continues to offset interest rate-sensitive categories of growth.



All data as of September 30, 2022.

Source: Bureau of Economic Analysis

Anthony M. Wile, Associate Portfolio Manager

Inflation: Peak Inflation Behind Us, Composition Still Matters

Perhaps no greater factor has affected global financial markets and the U.S. economy over the past two years than inflation. Reopening frictions caused by COVID-constrained supply chains masked overly stimulative fiscal and monetary policy and prompted the most hawkish response from the Federal Reserve in decades. Looking into 2023, we believe "peak inflation" is finally behind us, providing partial clarity to markets going forward.

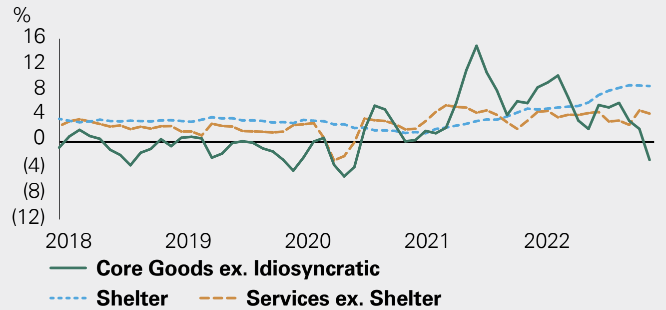
As discussed in our last Quarterly Investment Perspective, a useful approach to analyzing inflation is to break it down into its main components. The Fed's preferred price measure, the core Personal Consumption Expenditures Price Index (PCE), has three main categories: core goods, shelter, and services excluding shelter. As shown in Exhibit 5, the inflation picture has remained nuanced as each of these components has diverged in driving overall inflation. In 2023, we do not expect this to change.

On core goods, disinflation in supply-constrained categories finally seems to have materialized. In the three months through November 2022, motor vehicle prices fell by an annualized rate of 5%, driven by a 26% collapse in used auto prices. Leading indicators suggest this dynamic will continue, with the Institute for Supply Management's prices paid survey pointing to continued weakness ahead. Weakening goods prices should serve as a significant headwind for overall inflation in 2023.

Aside from core goods, the picture is less clear. Shelter inflation, one of the stickiest categories of PCE, continues to accelerate, reaching a 7% year-over-year increase in November's report. Given the housing category's weight of 17% in core PCE, continued strength in the category will provide a higher floor to overall disinflation in the year ahead. However, shelter prices measure both new and existing rental agreements, with the existing component causing a lagged response to the current economic environment. Alternative measures of new leases, such as the Zillow Observed Rent Index, continue to point to a softening shelter backdrop ahead. In light of these dynamics, the Fed has recently highlighted services excluding shelter as the focal point for measuring progress on inflation. This allows it to separate out categories (including travel and leisure) that tend to display a meaningful relationship to wage growth and overall core inflation. While current quarterly rates remain elevated at an annualized 4.4% versus an average of 2.2% over the last business cycle, constrained real incomes and a loosening employment situation should have a dampening effect on the more discretionary spending categories in the year ahead.

Exhibit 5: Main Components of Core Inflation

Key Takeaway: Inflation dynamics to improve in 2023 on the back of falling goods prices.



All data as of November 30, 2022. Core goods basket excludes idiosyncratic items including pharmaceuticals, tobacco, and jewelry. Services exclude energy services and shelter prices. All data reflect 3-month SAAR (seasonally adjusted annualized rate).

Source: Bureau of Economic Analysis

Taken together, we do believe the inflation backdrop will materially improve in 2023. This is not to say that inflation will return to the Fed's 2% target immediately, and we expect that the Fed may need to acknowledge later in 2023 that a more stable rate around 3% could be acceptable in the short term. The risks to this outlook remain twofold and rooted in the growth outlook. Rapidly falling inflation driven by services would be indicative of a severe recessionary environment, which we find as the lowest-probability outcome as discussed in our growth outlook on the previous page. On the other hand, stubbornly higher inflation would be a result of a stronger-than-expected growth environment. We view this as more probable than lower inflation due to a severe recession, but the risk still seems low in light of the already noticeable effects of tighter monetary policy on the economy in 2022 and the Fed's willingness to tighten further in a strong growth environment. The inflation path is likely to remain choppy in the coming months, and we will provide updates on the topic throughout the year given how central it is to the overall outlook.

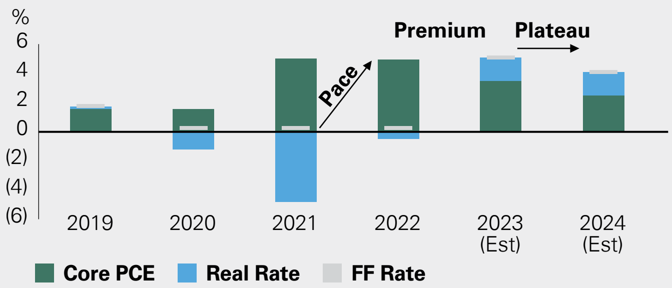
Jared Olivenstein, Co-Portfolio Manager

The Federal Reserve: A Calmer Fed Precipitates Less Interest Rate Volatility

Exhibit 6: Fed Funds Rate, Decomposed, and Job Openings Versus the Unemployment Rate

Key Takeaway: The Fed is near the peak of its hiking cycle, and how long it keeps rates at the plateau depends on the labor market.

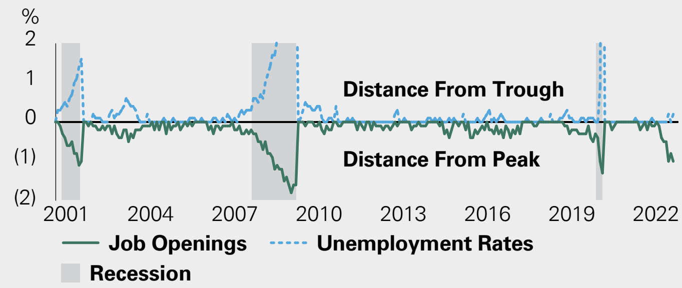
Slowing Pace of Hikes Transitions to Premium and Plateau of Policy



As of December 14, 2022.

Source: Bloomberg, Federal Reserve

Balancing Act of Job Openings Versus Job Losses



As of December 12, 2022.

Source: Bureau of Labor Statistics

Inflation and the Federal Reserve's pronounced adjustment to monetary policy were the largest shocks to markets in 2022. The shift was a surprise to its members as well. In its December 2021 Summary of Economic Projections, only three rate hikes were forecasted for the coming year. In an effort to combat inflation, the Fed raised rates by 4.25 percentage points to 4.25%–4.50% and sped up plans to unwind its balance sheet (quantitative tightening).

We think of the Fed playbook as the "three Ps" of policy: pace, premium, and plateau. This hiking campaign was the most aggressive since the Volcker years. Policymakers are aware of the lagged and variable impact of tightening policy and, therefore, already have toned down their *pace*. The events to follow in 2023 will be based on realized growth and inflation relative to their projections to determine if the *premium* of rate hikes ultimately needs to adjust higher. As of now, the market is closely pricing in Fed projections of peak rates around 5.0%–5.25% (Exhibit 6, left-hand side). The final aspect to measure is how long this level of the fed funds rate *plateaus*. As rate hikes permeate the economy and slow growth, the Fed will most likely adjust policy in accordance with its dual mandate. The market is factoring in easing by end of 2023 while the Fed is forecasting holding the plateau longer.

The Fed's policy prescription is delicate as it looks to avoid tipping the U.S. economy into recession. Hiking interest rates pressures growth, and slower growth slows business hiring and, in turn, job growth, which ultimately cools wage inflation. This cooling of wage inflation is the key to controlling service inflation. We are closely watching how distortions in the labor market evolve. The Fed is managing historic levels of job openings relative to job seekers while cautiously walking the line regarding job losses. This rebalancing should cool wage pressures (Exhibit 6, right-hand side). We expect the result to be a more normal equilibrium of job matching and an overall cooling labor market alongside lackluster growth.

There are other aspects to monetary policy. Quantitative tightening is running in the background and is a focal point as the Fed wants to ensure "ample reserves" are in the financial system. Another important secondary aspect of monetary policy is the large appreciation of the U.S. dollar and the global impact it has on valuations and liquidity among other financial market and economic implications.

In 2023, we foresee the Fed decelerating interest rate hikes with a focus on growth and inflation harmonizing with its projections. The market is indicating that the interest rate premium (or terminal interest rate) will be contained, which should help control interest rate volatility going forward, yielding a calmer trajectory than 2022.

Kenneth Grimes, Senior Investment Strategist

Valuation Multiples and Earnings: Can Less Ultimately Deliver More?

Price-to-earnings (P/E) ratios fell and drove sharp declines in equities worldwide in 2022. The next-12-months forward price-to-earnings multiple (NTM PE) for the S&P 500 declined from 21.4x at the start of the year to 17.3x by year end, falling below its five-year average. High inflation, interest rate hikes, and slowing corporate profit outlooks roiled markets — especially long-duration assets (i.e., companies whose profit streams are tilted further into the future). A turnaround in the trajectory of multiples and sentiment will likely require confidence that a severe recession is avoided.

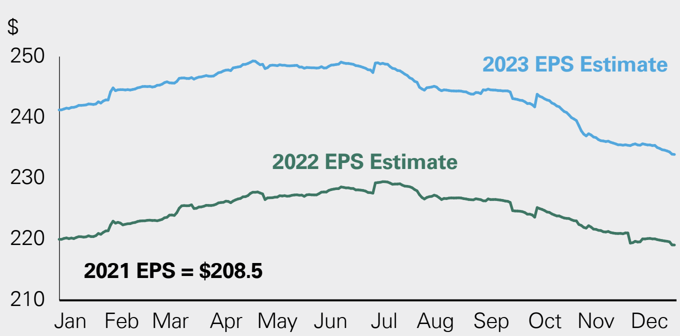
Aggregate earnings increased modestly in 2022 despite negative headwinds. However, earnings estimates have trended down since the first quarter of 2022 (Exhibit 7, left-hand side), and there is now a chance that we see declines in corporate profits in 2023. Downward shifts in earnings forecasts have been broad with only positive directional changes for utilities and energy. Exhibit 7 (right-hand side) highlights the revisions in earnings for the S&P 500 as well its 11 sectors. But, bottom-up consensus S&P 500 earnings per share (EPS) forecasts still call for 5.1% growth for 2022 and 5.3% growth for 2023, as strong earnings by energy companies will have driven gains for 2022 while consumer discretionary and industrials are expected to be the key contributors in 2023.

Several current and near-term data trends, especially earnings revisions, suggest that the market environment could remain challenging. 4Q 2022 results and guidance for 2023 will be key. The downside risk of softening earnings is something the market and investors need to brace for and acknowledge. However, that downside risk may likely be asymmetric going forward: Higher quality, stronger companies with more robust revenues and profits should fare better than weaker, lower quality companies. If so, many of the high quality names that underperformed last year may prove more resilient going forward. In 2022, several companies with high return on equity (ROE) and consistent profit margins (for example, Apple and Microsoft) couldn't avoid the market downdraft and underperformed. We do not see this pattern repeating and our continued focus on high quality names should bode well for future relative returns, especially if a severe recession is avoided.

Exhibit 7: S&P Earnings per Share Estimates and Changes in 2023 Estimates by Sector Since January 2022

Key Takeaway: Earnings remained robust overall in 2022 with the energy sector the standout even as estimates were reduced notably, especially in communication services and consumer discretionary sectors.

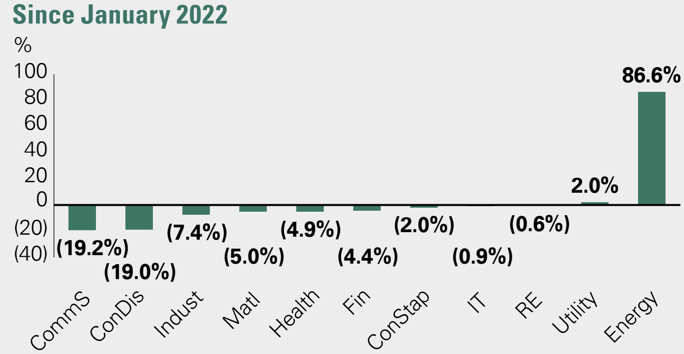
S&P 500 Earnings per Share (EPS) Estimates



As of December 20, 2022. Earnings growth for 2022 and 2023 reflect Bloomberg consensus estimates.

Source: Bloomberg

Changes in 2023 S&P 500 EPS Estimates by Sector Since January 2022



As of December 20, 2022. Estimates are Bloomberg consensus. Earnings growth for 2022 and 2023 reflect Bloomberg consensus estimates. CommS stands for communication services. ConDis stands for consumer discretionary. Indust stands for industrials. Matl stands for materials. Fin stands for financials. ConStap stands for consumer staples. IT stands for information technology. RE stands for real estate.

Source: Bloomberg

Bree Sterne, Senior Investment Strategist

Europe: Economic Challenges Remain

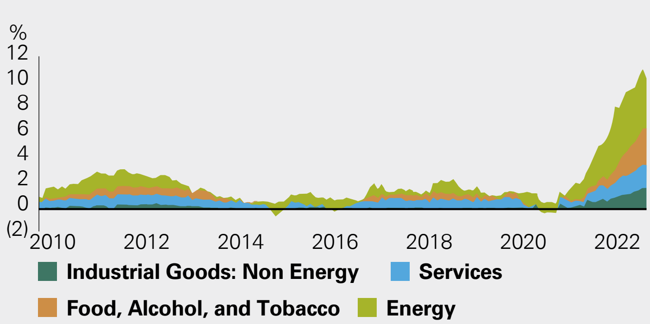
Europe continues to face a challenging macroeconomic backdrop given the ongoing energy crisis and tightening monetary policy in response to elevated inflation. Economic activity is expected to slow in 2023 as inflationary pressure, especially driven by food and energy prices, hampers consumer purchasing power.

Since Russia's invasion of Ukraine, disrupted energy markets and the resulting spike in commodity prices have remained a focal point for Europe. Inflation surged 10% year-over-year on the back of higher energy and food prices (Exhibit 8). Gas prices have declined from summer highs as Europe entered the winter in a better position than feared several months ago with high energy storage levels and unseasonably warm fall weather. Still, the natural gas market remains tight, and prices are likely to remain elevated relative to prior years. We expect euro area inflation to peak this winter and decline during 2023 as energy price caps come into effect, pricing power is diminished, and base effects become a drag. In the best case, Europe is roughly six months behind the U.S. with regard to inflation's trajectory.

Europe's energy crisis could push euro-area economies into a recession in 2023 as high prices weigh on industrial activity. Persistently high inflation should act to reduce real household incomes and push down consumer spending with the hit to disposable incomes likely to be felt most acutely this winter. Household consumption has been remarkably resilient given post-pandemic tailwinds with Europe benefiting from reopening and a resulting rebound in the service sector. Additionally, household savings and consumer credit can provide a buffer, and governments have provided significant fiscal measures to offset the contraction in real incomes. Despite these supports, the path to a soft landing in Europe appears less likely than in the U.S. given more pronounced inflation and its negative impact on corporate profits and consumers' real income, in turn lowering investment and consumption. We believe the European Central Bank (ECB) will hike interest rates modestly before pausing its hiking cycle at some point in 2023, likely after the U.S. Federal Reserve. The ECB is likely looking for a credible peak in inflation in addition to several months of data suggesting a slowing economy before it will stop hiking.

Exhibit 8: Euro Area Inflation

Key Takeaway: Energy and food have been the drivers of inflation in Europe.



As of November 30, 2022.

Source: Exante Research

Unfortunately, the war in Ukraine looks to be a continued focal point for Europe in 2023; a long and drawn-out conflict is our base case. We do not rule out a positive surprise, but even in that scenario, the effects of the war are likely to linger in Europe for some time. Europe's current gas supply situation remains fragile; storage is likely to be low after winter, and it may be difficult or expensive to fill the gas tanks ahead of next winter, especially assuming increased demand in global markets after China's reopening. Importantly, the war has forced Europe to reevaluate its dependence on energy from Russia, and as a result, Europe's energy industry is likely to see substantial changes in the years ahead. Energy market dynamics are likely to have a negative effect on the competitiveness of some energy-intensive manufacturing industries on the continent, but could simultaneously spur energy-related infrastructure development.

Bessemer equity portfolios remain underweight European equities relative to respective benchmarks. While valuations appear cheap relative to the U.S., they do not look as attractive when adjusted for sector and industry composition; meaningful risks to the downside remain, including further energy supply disruptions or a particularly cold winter. As the outlook for Europe is influenced by both weather and war, we highlight the difficulty of predicting what lies ahead for Europe in the near term, and as such, while not our base case, we must also acknowledge that a quick and substantial resolution to the war or energy crisis could see a meaningful relief rally in European markets. Should this materialize, we are likely to adjust our tactical positioning.

Dartagnan Howell, Investment Strategies Analyst

Emerging Markets: A Divided Landscape

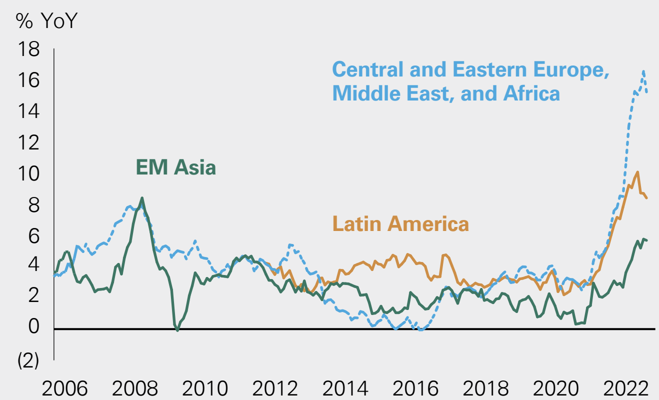
Emerging markets experienced a difficult year in 2022, with equity indices dropping 20%, falling two percentage points more than U.S. markets. The narrative was dominated by rising inflation, a stronger U.S. dollar, and a slowdown in China's growth due to its COVID-zero and housing policies, which are discussed in more detail in the following section. While 2023 should see some abatement in these headwinds, a slowdown in global growth, higher interest rates, and greater focus on domestic politics in certain emerging market countries could present additional headwinds. The picture overall remains nuanced given the dispersion among emerging market countries with regard to these economic and political factors. It is too early to say the tide has turned meaningfully, and we remain cautious and underweight emerging markets overall.

Emerging market policymakers, excluding those in China, have been focused on keeping inflationary pressures under control over the past year. Supply chain bottlenecks, higher commodity prices, pent-up demand for goods and services, and looser monetary policy drove inflation to multidecade highs in many emerging market regions (Exhibit 9). While we expect continued easing of supply chain and commodity pressures to reduce inflation in the coming year, the timing of the disinflation is unlikely to be uniform across countries. Latin America should see stronger disinflation this year, in part reflecting the region's earlier move to tightening; on the other hand, a delayed reopening and hiking cycle in emerging Asia may cause the region to see a smaller reduction in inflation over the course of this year.

As inflation appears to have peaked and hiking cycles come to an end across emerging market regions, only a few countries' central banks may ease in 2023 as those policymakers shift focus to slowing growth. By region, Latin American countries currently stand out

Exhibit 9: Emerging Market Median Headline CPI Inflation by Region

Key Takeaway: Inflation across emerging market regions has reached multidecade highs.



As of October 31, 2022. Excludes Argentina from Latin America.

Source: Goldman Sachs, Haver Analytics

with the highest real interest rates, and central banks could begin reducing rates this year. Asia lagged its peers in raising interest rates and may hold them higher for longer. Though Latin American countries may see greater disinflationary pressure and a looser monetary policy stance than their emerging market peers, recent elections generally moved in a populist direction, suggesting more inflationary stimulus may be coming, which could, in turn, limit monetary easing.

Though improving dollar dynamics and China's policy easing should provide tailwinds to emerging markets, we recognize the disparate fundamentals and growth by country and region. Bessemer's All Equity Model Portfolio remains underweight emerging markets relative to the benchmark as we remain cognizant of these headwinds.

Calvin C. Huang, Senior Investment Strategist

China: Property Sector, COVID Policy, and Geopolitics Remain Overhangs in 2023

2022 was an eventful year for China. Throughout most of the year, China adhered to its zero-COVID policy while most countries fully reopened their economies. The tough lockdown measures dampened economic growth and exacerbated global supply chain and inflation issues. The restrictive policies also created distortions in China's balance of payments, a situation that we are closely monitoring. In October, President Xi Jinping was reelected to a third five-year term. Going forward, the Chinese government is expected to place a greater emphasis on state-owned enterprises at the expense of the private sector. The Chinese equity markets underperformed broad developed and emerging market indices in 2022 as market sentiment was weighed down by these factors and disappointing economic growth.

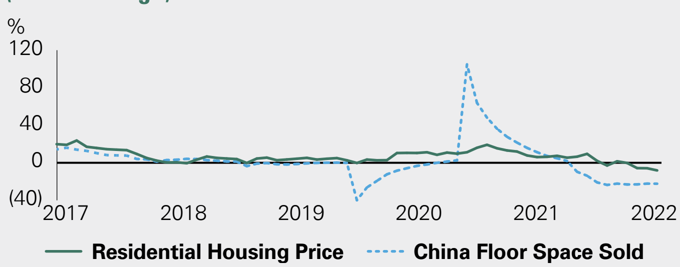
The property sector has been an especially weak part of the Chinese economy, with sales volumes and prices both experiencing negative growth (Exhibit 10, left-hand side). Many Chinese property developers have been over-leveraged for years and are now facing cash flow shortages. The resulting construction delays and cancellations have significantly worsened buyer sentiment. Housing-related economic activity accounts for roughly 25% of China's GDP, and the sector's slowdown is estimated to reduce 2023 real GDP. On the bright side, the challenges in the property sector are unlikely to cause a widespread economic crisis. The big Chinese banks are well capitalized, and Chinese consumers in aggregate have more than enough home equity to withstand a moderate drop in home prices.

Looking to the year ahead, China's COVID policies and daily infection rates will be the primary focus. Recently, the Chinese government announced plans to loosen some restrictions, such as reducing mass quarantines and removing testing requirements for public transportation. Concurrently, daily new cases have surged to all-time highs due to a relatively low percentage of the population having previous exposure to the virus as well as low vaccination rates. The government is now in a difficult position, tackling the economic reopening while managing stress on the healthcare system. Historical data shows that personal consumption decreased sharply in neighboring Asian regions during the initial stages of their respective reopenings, and we expect China to follow a similar trend (Exhibit 10, right-hand side). While there are select compelling opportunities longer term in China, Bessemer portfolios hold only around 3% of equity exposure in the country as the combination of rising COVID cases, property sector difficulties, and geopolitical risks keeps the outlook highly uncertain.

Exhibit 10: Average Housing Price and Floor Space Sold (Left, Year-Over-Year % Change) and Private Consumption Versus Quarter Before Reopening (Right, % Change)

Key Takeaway: China's property sector has weighed on growth, and consumption faces continued headwinds as the economy reopens.

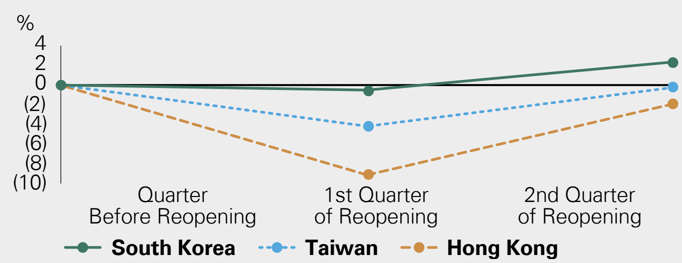
Average Housing Price and Floor Space Sold (YoY% Change)



As of October 31, 2022. Housing prices represented by CRIC 50 cities residential housing average price.

Source: Bloomberg, National Bureau of Statistics of China

Private Consumption Relative to Quarter Before Reopening



As of November 17, 2022. Hong Kong and South Korea reopened in Q1 2022, Taiwan reopened in Q2 2022.

Source: Goldman Sachs Global Investment Research, Haver Analytics

Peter J. Langas, Chief Portfolio Strategist

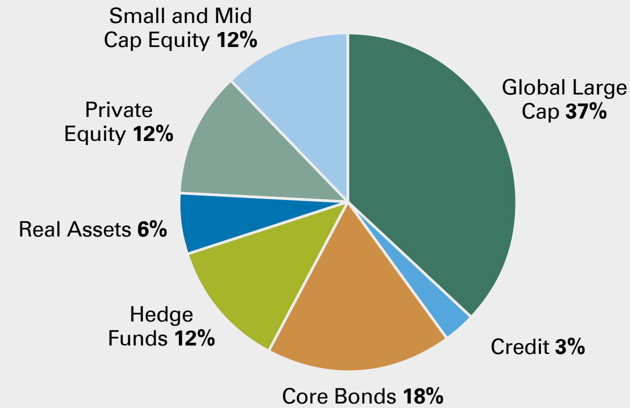
Portfolio Positioning: Opportunities Increase as Volatility Subsides

Maintain Stock-Bond Balance

With many crosscurrents at play in a complex macroeconomic backdrop, the wide range of outcomes makes asset allocation for 2023 challenging. From a near-term perspective, market volatility may continue in light of a challenging economic environment. Longer term, bear markets have historically been followed by some of the strongest periods of market returns. Getting defensive during a bear market or making a large bet on market recovery could prove costly to the long-term growth of capital. Therefore, our conviction is in maintaining a balanced and diversified position with a modest overweight to equities versus balanced benchmarks, as moderation in inflation and stabilization of interest rates can disproportionately benefit equity returns in comparison to bonds or cash. Further, given that we anticipate a controlled slowdown or only a moderate recession, which we believe is largely expected and reflected in market prices at this stage, we favor remaining invested. In this scenario, we expect both stocks and bonds can post modest gains in the year ahead, with the former likely to outperform the latter.

Exhibit 11: Balanced Growth 70/30 With Alternatives Asset Allocation

Key Takeaway: Bessemer has increased its exposure to private equity and balanced its hedge fund allocation.



As of December 31, 2022.

Source: Bessemer Trust

Focus on Quality, Increased Emphasis on Dividends

We believe that focusing on quality and growth is the key to long-term success in equity investing. In the long term, companies that grow their earnings faster than the market average prove to be the outperformers, with many companies who do not do so ceasing to exist over time. Within our portfolios, we aim to invest in a range of internally and externally managed strategies that are diversified by market capitalization and geography and express growth and quality characteristics in different ways. We have reduced exposure to strategies that focus on the highest growth companies, which generally tend to have the highest valuations. We remain confident in the capabilities of these managers and the long-term fundamentals of their holdings. However, higher interest rate levels will continue to be a headwind warranting a thoughtful allocation. The majority of equity exposure is in strategies focused on quality and durable growth with increasing exposure to companies with attractive dividends and strong dividend growth. We believe companies that reliably compound their earnings and produce strong cash flows represent the best investment opportunities as economic growth moderates.

By sector, the largest weight is technology, where advancements in cloud computing improve corporate enterprise efficiency and benefit software providers such as Microsoft, Oracle, and ServiceNow. With increasing needs for computing power globally, demand for computer chips from companies such as Nvidia, Broadcom, and Qualcomm, in addition to semiconductor equipment manufacturers KLA Corp. and ASML, will continue to grow among other technology themes. Our equity teams are finding quality opportunities in other sectors such as industrials as well. Years of underinvestment in defense and safety are increasing demand for new systems to respond to modern threats to public safety and driving growth at Motorola Solutions, Lockheed Martin, and Northrop Grumman. The move to alternative power and the adoption of electric vehicles benefit electrification equipment manufacturers such as Eaton and builders such as Quanta Services, in addition to utility companies such as NextEra Energy. Energy and materials companies generally do not meet our criteria for quality. However, we believe companies such as Vulcan Materials and Freeport-McMoRan, which are low-cost providers with long asset lives, can outgrow the industry through the cycle. Additionally, oil services supplier Schlumberger has solid growth opportunities as oil companies will need to invest in order to sustain supply.

Overweight U.S. Equities

We maintain our overweight position to U.S. equities given the challenges that other developed markets, especially Europe, and emerging markets are currently facing combined with the U.S. having many more dominant global companies. When investing globally, there are two components to returns: the change in stock price and the change in currency. The dollar has been strong recently, which has been a tailwind to U.S. market performance and a headwind to non-U.S. market performance. Our research indicates that the drivers of dollar strength are showing signs of abating, so we are selectively adding non-U.S. exposure through high quality companies.

Bond Yields Attractive, Finally

The sharp uptick in bond yields has made yields and the total return potential of high quality bonds the most attractive we have seen in years. While we strategically take a conservative approach to duration or interest rate sensitivity, over the last few months, we have extended the duration of bond portfolios to take advantage of these higher yields. We currently have a slightly longer-duration posture than our corresponding conservative benchmarks. We believe the remaining Federal Reserve interest rate hikes are, for the most part, already reflected in bond prices, and we expect the volatility of bond yields to subside in the coming months as the Federal Reserve's hiking cycle winds down. Higher yields and lower volatility provide both an attractive entry point and greater protection to interest rate movements in contrast to the extraordinarily low yields of the recent past.

Corporate credit spreads have modestly widened but are not showing signs of significant stress. As the economy slows, spreads may widen further. Therefore, we are maintaining our moderate exposure to high-quality corporate bonds while looking for opportunities to add more credit exposure in taxable bond portfolios if corporate spreads widen.

In municipal bonds, the fundamental and technical underpinnings of the market appear to be supportive. Portfolios are positioned in high credit quality across a variety of sectors including state and local general obligation bonds, water and sewer providers, toll roads, and airports. We also have exposure to top-tier issuers in higher education and healthcare, though we are much more selective about securities held and exiting positions that are more exposed to some of the macroeconomic pressures currently affecting those sectors.

Hedge Funds Well Positioned

We expect the market environment will be favorable for hedge funds. Elevated market volatility and dispersion across asset classes, sectors, and securities provide unique opportunities for skilled hedge fund managers. Strategies that have less directional exposure, a disciplined investment process, and strong risk management should deliver attractive risk adjusted returns.

Private Market Opportunities in Infrastructure

We expect the slowdown in private equity realizations to continue this year as the public markets remain volatile and private valuations slowly reset. This resetting is creating a more attractive environment for new investments, both in terms of lower entry valuations and more time to conduct due diligence. At the same time, increased interest rates will create challenges for private equity managers that primarily rely on leverage to generate returns — an approach not used frequently among the managers in Bessemer's private equity program.

Longer term, we believe innovation at its earliest stages continues to present some of the greatest investment opportunities, and selectivity will remain the key to success. In the real assets space, exit activity has remained strong, especially in energy and real estate. The CHIPS and Science Act, Inflation Reduction Act, and Infrastructure Investment and Jobs Act are providing tailwinds to real assets, creating financially compelling opportunities to invest in the development of infrastructure and revitalize domestic manufacturing, expand clean electricity and transportation, and modernize ports, airports, rails, roads, and communications.

Holly H. MacDonald, Chief Investment Officer

Conclusion

Much of what has occurred in the global economy in the past three years has been without precedent, from the pandemic and shutdown to record stimulus, a semi-synchronous reopening and the related waning and surging demand for goods and services, respectively, and, of course, raging inflation. At the same time, there have been some silver linings: leaps in technological innovation, a greater awareness of long-term resource constraints, and a few examples of positive global coordination to tackle emerging challenges.

As we enter 2023, accordingly, we know that more unexpected developments are likely to occur, and we stand ready to assess the landscape and adjust our views in line with what we see as likely to yield the best long-term risk adjusted returns. Along with my fellow authors — shown on the next page — and the many colleagues at Bessemer working on your behalf, I look forward to engaging with you in the year ahead to help you meet your long-term goals. Thank you for your continued trust in us.

Authors in Order of Appearance

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About Bessemer Trust

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