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AMG National Trust

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Three-Year (2023 to 2025)

Economic Outlook

A look at probable economic scenarios and asset class expected return projections

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Introduction to the Scenarios

"Ordinary" is not a descriptor that comes to mind when contemplating the near-term outlook for the economy. With the world decelerating from the post-COVID-19 surge, the economic path for the next two years is particularly uncertain, and prudent investors should be aware of possible alternative developments for the economy and financial markets as they revisit their portfolios.

To this end, AMG has developed seven distinct scenarios that illustrate different paths that the economy may take during the 2023-25 period. AMG's Base Case, or most likely scenario, is titled Flatline, because by the end of 2023 economic output will likely not be significantly larger than at the start.

Summaries and highlights of each scenario are presented on the next few pages. Each scenario's three-year economic and two-year asset class performance projections provide the estimated expected return information required for the formulation of a client's efficient frontier.

Economic Backdrop for Scenarios

AMG systematically constructs several comprehensive economic scenarios in order to project the most likely central tendencies of investment results for various classes of assets. The multi-scenario approach permits an examination of the probable effects (both good and bad) of the most prominent foreseeable risks that may lie on the path of the economy and, by extension, investment returns.

The structural fallout from the Great Shutdown (due to the COVID-19 pandemic) and weighty palliative policy responses on a global scale have made forecasting the course of the economy even more challenging than under normal circumstances. Recurring waves of infectious variants have humbled even the most astute forecasters in 2022, as has the patchwork of policy responses. The domestic economy—especially the labor market—continued to demonstrate impressive resilience to each sequential rise in new cases even as some sectors—healthcare and services in particular—remained strained throughout 2022.

AMG expects the domestic economy to lose some of its momentum over the 2023-25 period as the fading reopening surge combined with tightening monetary policy encumber the economy's engines. AMG's Base Case projects growth that, on average, approximates the growth of the sustainable economic capacity of the economy. The path of growth will not be smooth because "run-of-the-mill normal" remains a good bit in the distance. Although both growth and investment returns have upside potential, volatility should be anticipated as withdrawal—if gradual—of monetary and fiscal stimulus programs coincides with decelerating economic activity.

Results for each scenario depend on its starting point, so it is appropriate to summarize broad economic conditions in early 2023. Although it may now feel like an eternity, merely three years ago the domestic economy was reliably creating jobs without runaway inflation, while increases in productivity broadly offset declining labor participation. Household leverage hovered near pre-Great Recession levels and household debt service—relative to disposable income—was near three-decade lows.

A mere two months into the pandemic—roughly in the spring of 2020—economic output was collapsing at an unprecedented rate and few forecasters ventured a guess as to when the decline would end. Consumer spending and housing activity screeched to a halt, with service sectors pummeled particularly hard by social distancing mandates. The spread of the novel coronavirus suppressed economic activity before vaccines could subsequently change the course of the economy's trajectory.

Then, during 2021, economic recovery transpired at a rapid rate before stalling in the first half of 2022. The unemployment rate declined from 6.7% in December 2020 to 3.6% in November 2022; private payrolls expanded by 11.2 million during the same timeframe. The economy finished July 2022 with roughly as many jobs as existed before the pandemic began.

Globally, COVID-19 has not exited the economic stage quite yet, though most people have increasingly adapted to living with a pandemic. Even so, the broad labor market has made significant improvement since the pandemic's worst days, and, on the whole, the economy has continued to recover. In the next phase of the economic expansion—during the initial years of the projection horizon of the scenarios—fiscal and monetary policies will become less supportive as the economy approaches a self-sustaining path.

Table 1

Overview of 2023-2025 Economic Scenarios

Scenario Title	Scenario Description	Duration and Severity of Domestic Recession	"Peak" Fed Funds Rate
#1 Flatline *(Base Case)*	The U.S. economy experiences a mild recession (or severe slowdown) with growth slightly below zero in the first half of 2023. The recession is investment driven, but consumer spending is not particularly strong. Recovery is tepid and growth remains below potential through 2024. Inflation slows in 2023, largely as supply chain issues lessen and as economic slack increases in 2024. The federal funds rate "maxes out" in middle of second quarter of 2023 and eases during 2024.	Mild and shallow recession during the H1[1] of 2023.	The federal funds rate maxes out in the late H1 2023 and eases during 2024.
#2 Inflation "Head Fake"	The economy slows to negative growth in early 2023. Labor demand slows, but does not sink to typical recession levels. The domestic economy is stuck operating above sustainable potential throughout the forecast horizon, but inflation eases faster than generally anticipated during 2023 as the unwinding of supply-chain bottlenecks and China's slow growth rapidly diminish upward price pressures. Even as real output remains above sustainable potential, inflation falls below 3.0% before end of 2023, but then it comes roaring back in 2024. After plateauing at 5.0% in the second half of 2023, but with less-than-desired inflation progress, the federal funds rate is pushed higher, reaching 8.0% in 2024 and inducing a recession that eventually lowers inflation to less than 2.0% in late 2025.	Mild, shallow recession during the H1 2023. Outer quarters (2024) have lower output than in The Base Case due to delayed tightening.	**After a plateauing at 5.0% in second half of 2023, with less than desired inflation progress, the federal funds rate is pushed higher, reaching 8.0% in 2024 and inducing a recession that eventually lowers inflation to less than 2.0% in late 2025.**
#3 Inflation Down, Growth Up	Inflation eases faster than generally anticipated in 2023 as the unwinding of supply-chain bottlenecks continues and stabilizes in early 2024 near the Fed's 2.0% target. Real GDP growth is slow in H1 2023, and employment weakens, but as the year progresses, labor force growth accelerates, technology-led efficiency gains, and global supply-chain inefficiencies enhance productivity growth. The Fed takes its foot off the monetary brake in 2023, and real growth accelerates, but inflation remains under control as faster growth of potential real GDP maintains some economic slack. Real GDP growth exceeds an annualized 3.0% by late Q4[2] 2024.	Modest (but below-trend) growth in 2023 followed by at-trend growth for most of 2024, reaching an annualized 3.0% in final quarter.	The Fed takes its foot off the monetary brake in 2023.
#4 Average Recession	A recession occurs in the first 9 months of 2023 and real GDP falls a cumulative 1.9%. Recovery takes 6 months (approximate averages of post-WWII recessions, excluding Great Financial Crisis). The federal funds rate peaks in March 2023 at circa 6.0%. The policy rate then falls to a level consistent with the long-term normal by about September 2024. Inflation drops to the Fed's target early in 2024 and remains roughly stable. The key idea for the scenario is that current conditions are not really all that unique, and that the slowdown being initiated will not be all that different from previous ones, except perhaps for some starting conditions.	**Nine months (three quarters), cumulative drop of 1.9%; 3Q SAAR[3] $19,693 equals roughly 98.1% of Q4 2022 SAAR.**	The federal funds rate increases peak in March 2023, circa 6.0%. The rate falls to a level consistent with a long-term normal by about Sept. 2024.
#5 Global (But Not Domestic) Recession	Global economic growth outside of the United States decelerates rapidly in 2023 and prices of commodities plummet dramatically, resulting in faster-than-expected deceleration of inflation across advanced economies, including in the United States. The U.S. economy experiences tepid real growth throughout the forecast horizon, but a broad recession is avoided. A combination of low foreign demand, surge in foreign production slack, and eventual untangling of supply-chain issues cause domestic inflation to drop rapidly, delaying a "peak" in the federal funds rate until late 2023 after which the rate remains at a plateau for the remainder of the forecast horizon.	The U.S. economy experiences tepid real growth throughout the forecast horizon, but a broad recession is avoided.	Same as Base Case.
#6 Structural Fallout From Pandemic	The unique collection of shocks from the pandemic structurally reshaped the global economic landscape but policymakers and, to lesser extent, financial markets will not fully recognize the "new normal" in time to course correct during the forecast horizon. Specifically, global advanced economies suffered the following during the pandemic: significant medium-term impairment of potential productivity growth, significant medium-term impairment to labor force growth, and a material setback in the volume of traded goods and services (as a percent of global GDP). Consequently, during the forecast horizon, the domestic and global economies are characterized by a combination of above-target inflation and below-trend growth.	Mild, shallow recession during H1 2023. Outer quarters experience (second half 2024) lower output than in the Base Case due to overtightening.	The federal funds rate maxes out late in H1 2023 and eases until mid-2024, when the Fed acknowledges structural shifts and begins tightening again.
#7 Dollar Decline	A confluence of geopolitical trends results in substantive and sustained lessening of the U.S. dollar's (USD) footprint as the "world's reserve currency." Inflation eases slower than generally anticipated through 2024 as the global purchasing power of the USD wanes and "imported deflation" declines. Real GDP growth remains slow and USD-denominated interest rate instruments decline in relative value (versus other sovereign borrowers) as real return premium is required to offset declining currency. USD rates remain elevated for longer than in other scenarios.	Mild, shallow recession during H1 2023. Outer quarters have (second half 2024) higher output than in Base Case due to a lift from trade.	Same as Base Case.

[1] H1 = First half
[2] Q4 = 4th Quarter, etc.
[3] SAAR = Seasonally Adjusted Annualized Rate

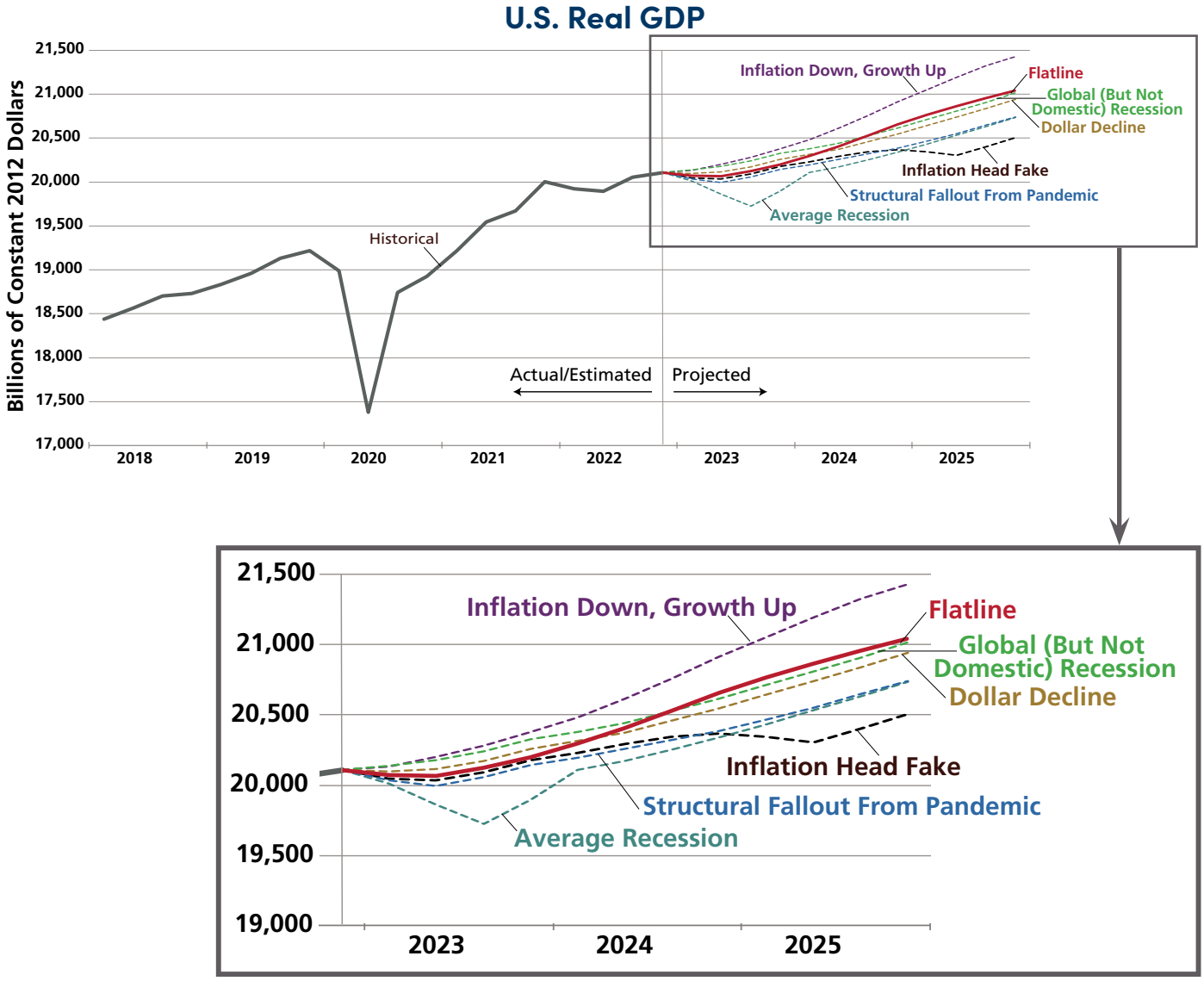
**Realized inflation is the rate of inflation that actually happens, versus forecast or projected.*
Bold = *Significantly different than Base Case*

Path of U.S. Consumer Inflation	U.S. Fiscal Policy	Economic Landscape Outside of the United States
Inflation slows in 2023, largely as supply chain issues lessen and economic slack increases in 2024.	Unlike during the forecast horizons amidst the pandemic and shortly thereafter, in 2023-25 domestic fiscal policy is not expected to play a substantively deterministic role.	Ongoing normalization of monetary and fiscal policies that delivered unprecedented support during the pandemic throttle demand as policymakers aim to steer inflation back to their respective targets. After reaching 3.2% in 2022, global growth decelerates to 2.7% in 2023 (from 6.0% in 2021). About a third of the world's economies—including some key U.S. trading partners—will experience outright contractions.
Inflation eases faster than generally anticipated in 2023 as the unwinding of supply-chain bottlenecks and China's slow growth rapidly diminish upward price pressures. Inflation falls below 3.0%. However, it comes roaring back in 2024, as the economy is still operating above potential.	Same as Base Case.	Same as Base Case.
Inflation eases faster than generally anticipated in 2023 as the unwinding of supply-chain bottlenecks continues and stabilizes in early 2024 near the Fed's 2.0% target. Inflation remains under control as faster growth of potential real GDP maintains some economic slack.	Same as Base Case.	Same as Base Case.
Inflation drops to the Fed's target in early 2024 and remains roughly stable.	Same as Base Case.	Same as Base Case.
A combination of low foreign demand, a surge in foreign production slack, and eventual untangling of supply-chain issues cause domestic inflation to drop rapidly.	Same as Base Case.	Same as Base Case.
Above-target inflation throughout the forecast horizon.	Same as Base Case.	**Economies worldwide suffered the following during the pandemic, adversely impacting future economic output: significant medium-term impairment of potential productivity growth, significant medium-term impairment to labor force growth, and a material setback to the volume of traded goods and services (as percent of global GDP).**
Inflation eases more slowly than generally anticipated through 2024 as the global purchasing power of the U.S. dollar wanes and "imported deflation" declines.	**A string of deadlocks regarding debt-ceiling and federal budget skirmishes reignites reassessment of the United States' sovereign credit rating, which in turn contributes to the currency's decline.**	**A confluence of geopolitical trends results in substantive and sustained lessening of the U.S. dollar's footprint as the "world's reserve currency."**

Calculating Expected Total Return Estimates

Estimates of expected returns for the 19 asset classes used by AMG to develop clients' strategic investment plans are provided for each economic scenario. These estimates for the aggregate of investment in each asset class were obtained using the following procedure.

- Identify key economic indicators—the most prominent of which are growth in real GDP, the rate of consumer price inflation, paths of long-term interest rates (10-year Treasury bond yields), short-term interest rates (90-day Treasury bill rates), oil prices, and changes in the foreign-exchange value of the dollar (trade-weighted index).
- Develop projections for the numerical values of the various economic indicators that are consistent with each scenario.
- Enter the projected indicator values, together with certain other data, in AMG's proprietary statistical tools for investment-return projections.
- Apply the extensive judgment and experience of AMG's research staff to analyze and adjust the results obtained from the investment-return projections to calculate expected return estimates.



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Denver – *Corporate Headquarters*
6295 Greenwood Plaza Blvd.
Greenwood Village, CO 80111
800.999.2190
303.694.2190

Asheville – *Boys Arnold Office*
1272 Hendersonville Road
Asheville, NC 28803
800.286.8038
828.274.1542

Boulder – *Main Banking Office*
1155 Canyon Boulevard, Suite 310
Boulder, CO 80302
888.547.8877
303.447.8877

Cheyenne
Office hours by appointment only
1623 Central Avenue, Suite 106
Cheyenne, WY 82001
800.999.2190

Chicago
180 North LaSalle Street, Suite 2925
Chicago, IL 60601
877.662.8243
312.263.5235

Hilton Head – *Boys Arnold Office*
4 Dunmore Court, Suite 201
Hilton Head Island, SC 29926
866.422.1442
843.342.8800

Morristown
163 Madison Avenue, Suite 200
Morristown, NJ 07960
800.888.2777
973.455.0202

Virginia Beach
780 Lynnhaven Parkway, Suite 140
Virginia Beach, VA 23452
866.872.9578
757.368.4466

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