December 5th, 2022

VERED WEALTH MANAGEMENT (CANADA) COMPANY LIMITED

Weekly Market Guide

Fed Chair Powell's much-anticipated speech yesterday was far less hawkish than anticipated, resulting in lower market-implied rate hike expectations in the outlook, lower bond yields, and sharply higher equities. For example, the S&P 500 and Nasdaq were up 3.1% and 4.4% in yesterday's trading with strong internals.

There was a sense of investor hesitancy in the lead-up to yesterday's speech with many expecting Powell to suppress the market's optimism since the October CPI report, as the Fed does not want financial conditions to ease too early. To be sure, he discussed the high uncertainty in predicting the inflationary outlook, that inflation is still far too high, and that the Fed has more work to do (none of which was new news). However, his tone seemed more balanced between the risk management of being careful not to hike too aggressively or not enough. He all but confirmed a slower 50bp hike for December, and likely what got markets excited was spending time to discuss the still plausible chance of a soft landing (potential for rate hikes to hit high job openings, rather than resulting in spiked unemployment). The shift in tone to a more delicate approach is justifiably positive for equities, but we do not believe the market is ready to exit this bear market that easily.

Ultimately, the degree of inflation moderation ahead, in turn Fed policy, and how much damage will be inflicted on the economy (to bring inflation under control) will remain the primary influences on earnings and multiples in our view. We do believe that we are in the late stages of this bear market, due to our belief that inflation is set to moderate over the next year and that the recession will be mild. However, the Fed remains in tightening mode, tightening acts with a lag on the economy, and it will likely take time for the Fed and investors to have high conviction on the inflationary and economic outlook- resulting in more time needed before equities are able to show sustainable upside in our view. Next major catalysts include the FOMC decision and press conference on 12/14, along with November CPI the prior day on 12/13.

The underlying technical backdrop has improved in the second half of this year, and the percentage of stocks above their 200 DMA is now at its highest level since January. There are encouraging signs technically that market trends are attempting to become more supportive, however equities are also now overbought in the short-term (following a 17% rally since the 10/13 lows). With overbought conditions, along with expected choppiness ahead, we maintain our overall stance to refrain from chasing the rally periods and to build exposure in the weak periods.

Equity Market Indices	Price Return Year to Date	Price Return 12 Months
Dow Jones Industrial Avg	-4.8%	0.3%
S&P 500	-14.4%	-10.7%
S&P 500 (Equal-Weight)	-8.6%	-3.1%
NASDAQ Composite	-26.7%	-26.2%
Russell 2000	-16.0%	-14.2%
MSCI All-Cap World	-16.4%	-13.2%
MSCI Developed Markets	-16.8%	-12.6%
MSCI Emerging Markets	-21.1%	-19.8%
NYSE Alerian MLP	27.6%	32.2%
MSCI U.S. REIT	-22.8%	-16.5%

S&P 500 Sectors	Price Return Year to Date	Sector Weighting
Energy	64.2%	5.1%
Consumer Staples	-0.1%	7.0%
Utilities	-0.7%	3.0%
Health Care	-1.5%	15.2%
Industrials	-4.1%	8.4%
Financials	-7.3%	11.6%
Materials	-8.8%	2.7%
S&P 500	***-14.4%***	-
Information Technology	-22.4%	26.4%
Real Estate	-24.3%	2.7%
Consumer Discretionary	-29.6%	10.4%
Communication Svcs.	-35.3%	7.5%

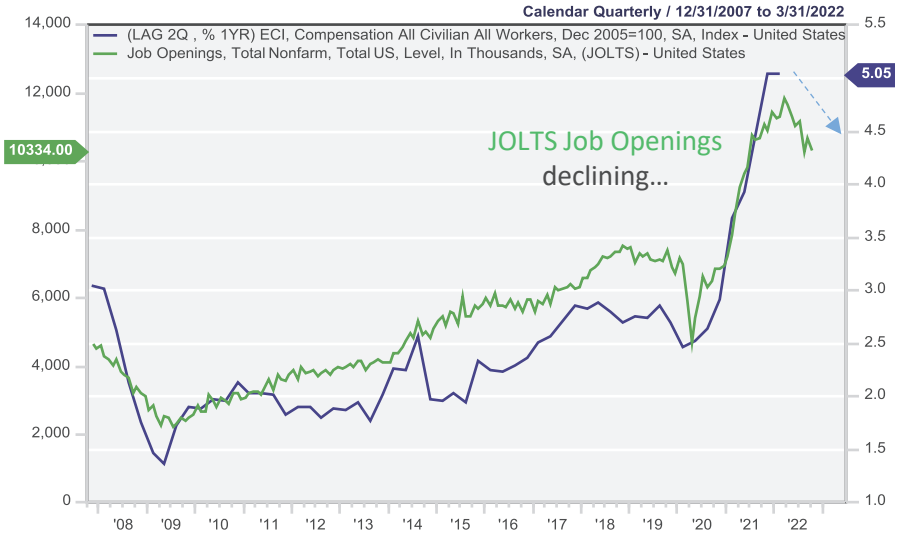
Source: FactSet, RJ Equity Portfolio & Technical Strategy

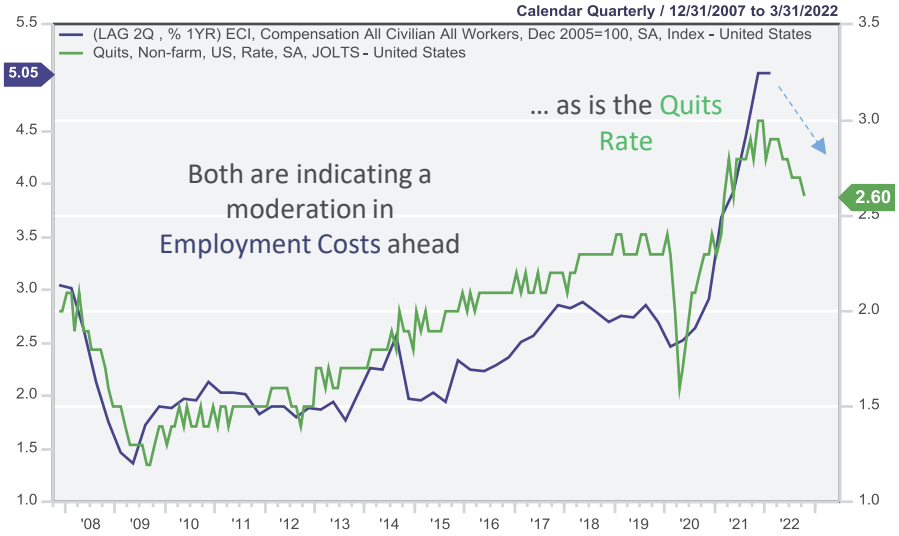
MACRO: US

A very important piece of the inflation equation is employment costs, given they make up the vast majority of corporate costs in the services sector (where inflation has been particularly high). The Employment Cost index is at a very elevated 5.0%, putting pressure on the services sector to offset these costs with price increases. While wage growth remains too high and may take time to move considerably lower, this week's JOLTS data showed a continued decline in Job Openings and the Quits Rate. These are both leading indicators for employment costs and suggest that wage growth should moderate as people feel less comfortable quitting their job and finding a new one. The degree of inflation moderation ahead will also play a large part in whether employment has to deteriorate or if the hit comes primarily out of elevated job openings, with obvious effects on economic growth.

Event	Period	Actual	Consensus	Surprise	Prior
Dallas Fed Index	NOV	-14.4	-21.5	7.1	-19.4
S&P/Case-Shiller comp.20 HPI M/M	SEP	-1.2%	-1.1%	-0.07%	-1.3%
S&P/Case-Shiller comp.20 HPI Y/Y	SEP	10.4%	10.6%	-0.22%	13.1%
Consumer Confidence	NOV	100.2	99.9	0.25	102.2
ADP Employment Survey SA	NOV	127.0K	199.0K	-72.0K	239.0K
GDP Chain Price SAAR Q/Q (Second Preliminary)	Q3	4.3%	4.1%	0.20%	4.1%
GDP Chain Price SA Y/Y (Second Preliminary)	Q3	7.1%	7.0%	0.10%	7.0%
GDP SAAR Q/Q (Second Preliminary)	Q3	2.9%	2.6%	0.30%	2.6%
GDP SA Y/Y (Second Preliminary)	Q3	1.9%	1.8%	0.10%	1.8%
Wholesale Inventories SA M/M (Preliminary)	OCT	0.80%	0.55%	0.25%	0.60%
Chicago PMI SA	NOV	37.2	47.0	-9.8	45.2
JOLTS Job Openings	OCT	10,334K	10,363K	-28.5K	10,687K
Pending Home Sales Index SAAR	OCT	77.1	78.0	-0.90	80.8
Pending Home Sales M/M	OCT	-4.6%	-5.0%	0.40%	-8.7%
Continuing Jobless Claims SA	11/19	1,608K	1,568K	40.0K	1,551K
Initial Claims SA	11/26	225.0K	240.0K	-15.0K	241.0K
Core PCE Deflator M/M	OCT	0.22%	0.30%	-0.08%	0.46%
Core PCE Deflator Y/Y	OCT	5.0%	5.0%	-0.02%	5.2%
PCE Deflator SA M/M	OCT	0.34%	0.40%	-0.06%	0.34%
PCE Deflator Y/Y	OCT	6.0%	6.0%	0.02%	6.3%
Personal Consumption Expenditure SA M/M	OCT	0.80%	0.70%	0.10%	0.63%
Personal Income SA M/M	OCT	0.70%	0.40%	0.30%	0.40%
Markit PMI Manufacturing SA (Final)	NOV	47.7	47.6	0.10	47.6
Construction Spending SA M/M	OCT	-0.30%	-0.25%	-0.05%	0.13%
ISM Manufacturing SA	NOV	49.0	49.8	-0.80	50.2

Source: FactSet, Raymond James Equity Portfolio & Technical Strategy

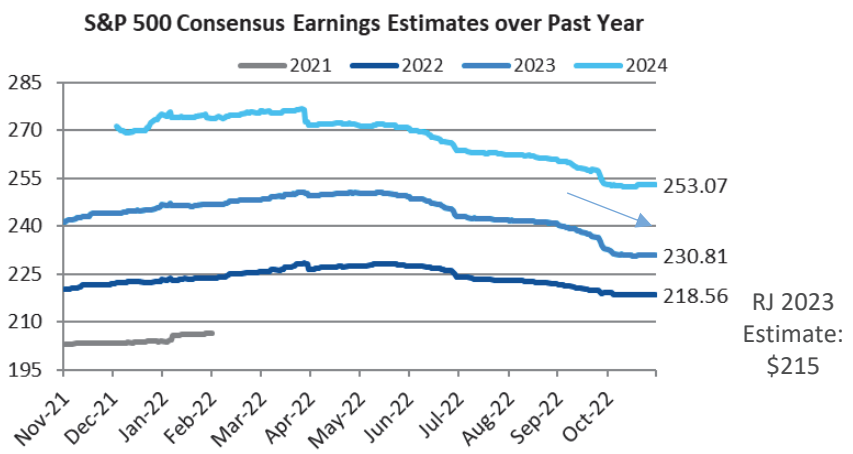


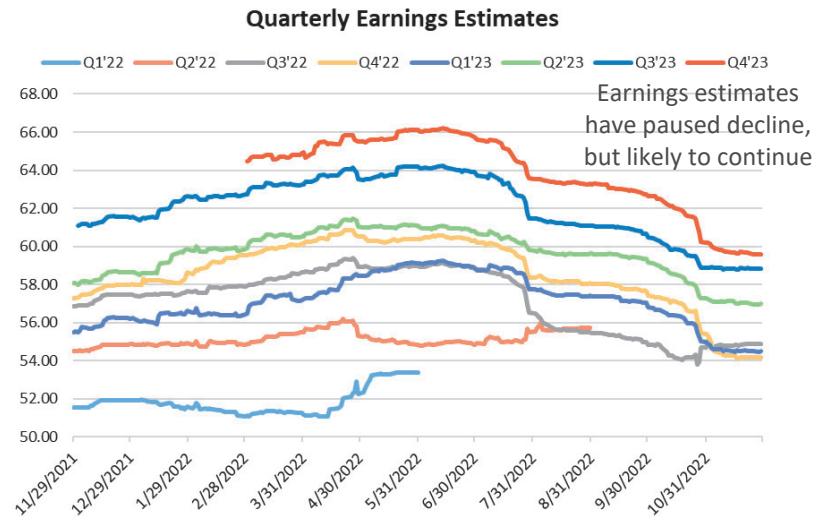


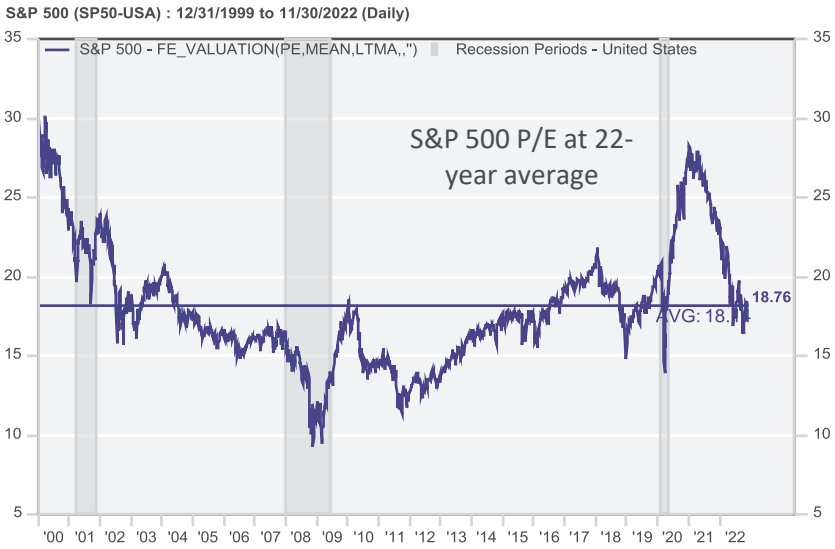
FUNDAMENTALS

Earnings estimates accelerated their decline during Q3 earnings season, as companies reduced their fundamental outlooks due to uncertainty and the economic slowdown. While this negative estimate revision trend has paused of late, we expect it to continue lower over the next year as swift Fed tightening works with a lag on the economy. Consumer purchasing power is being diminished due to high inflation, and company pricing power is declining as a result. Sales growth is likely to slow, particularly in recession, and still elevated employment costs are likely to weigh on margins. That said, we do expect a mild recession as supply has been hard-pressed to meet demand this cycle (lack of widespread excesses on balance sheets) and banks are well-capitalized. Moreover, we expect inflationary pressures to moderate over the coming year.

However, the market will bottom well ahead of earnings. The S&P 500 recently bottomed at a P/E of 16.5x and is currently at 18.8x in the rally (more balanced risk/reward in our view). P/E multiples can expand considerably in recessionary bear markets, however we expect volatility to continue with the Fed still tightening, easing a long way off, and the inflation outlook very uncertain. We, therefore, view the risk/reward as more attractive in the pullback periods.



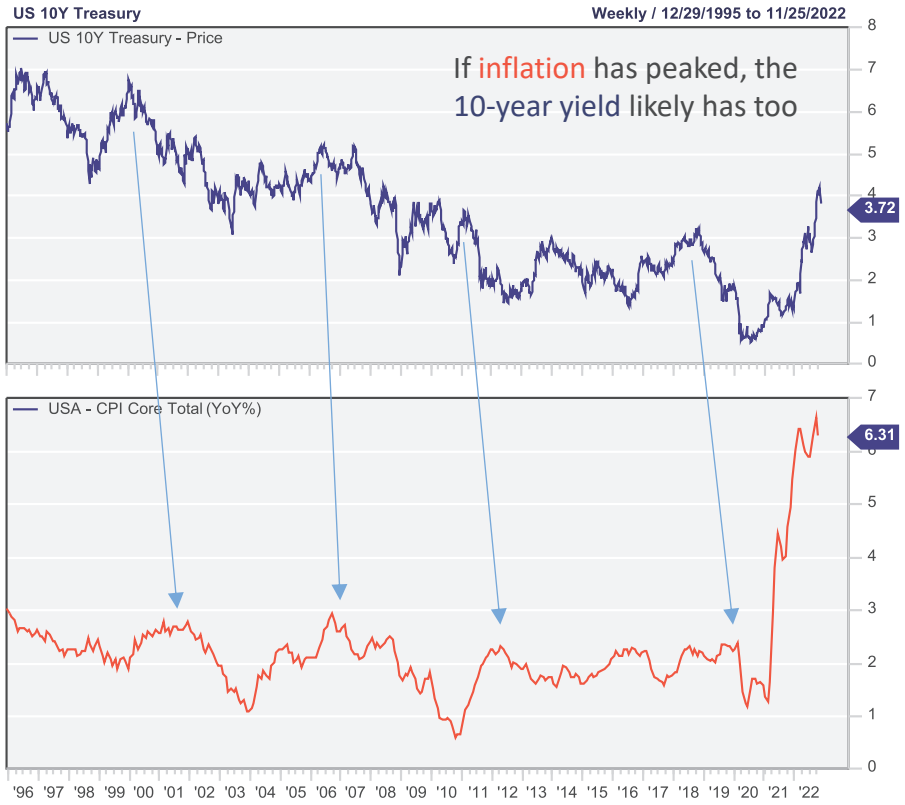


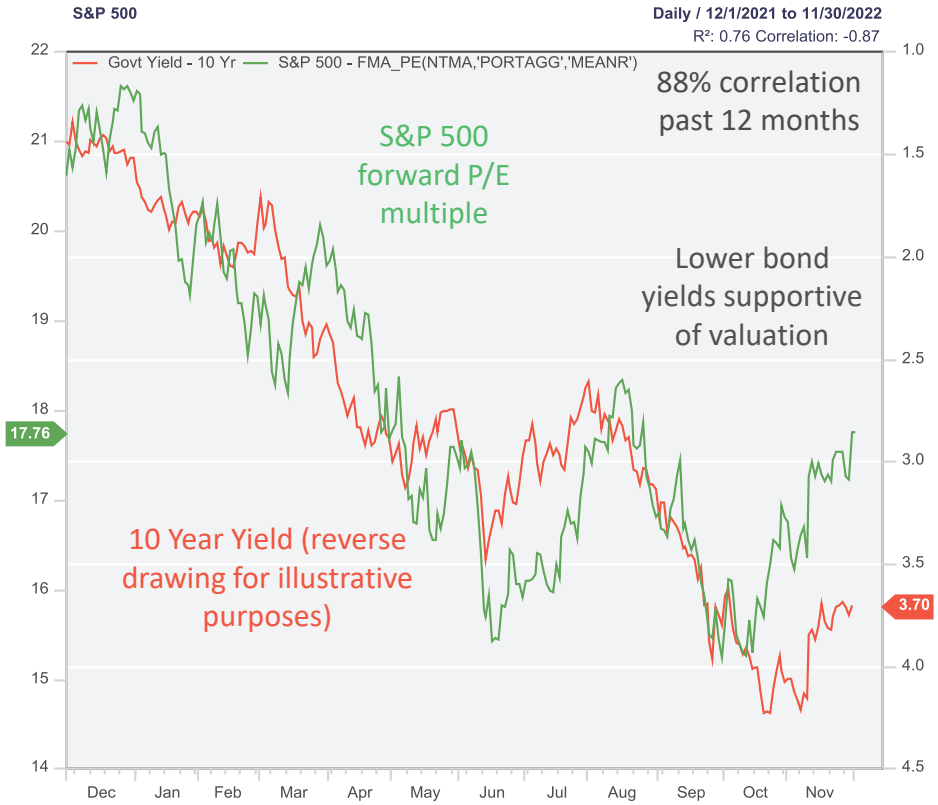


Source: FactSet, Raymond James Equity Portfolio & Technical Strategy

BOND YIELDS AND VALUATION

To show how intertwined inflation is to equity markets, the charts below show the relationship between core inflation, bond yields, and the S&P 500 P/E. For the past several decades, bond yields have peaked prior to inflation but we believe it to be more reactive this time due to inflation being so high (the stakes are high) and various hiccups in the inflation trajectory over the past year (i.e. Covid variants, Russia/Ukraine war, China lockdowns). We do believe that core inflation has likely peaked; and if this proves true, the US 10-year yield may have peaked and the S&P 500 P/E may have bottomed. This would provide a more supportive backdrop fundamentally for equity markets. Of course, the path of inflation remains uncertain and expectations are fluid. Moreover, in looking at the correlation between bond yields and the S&P 500 P/E, the current rally has likely gotten a little ahead of itself.





Source: FactSet, Raymond James Equity Portfolio & Technical Strategy

TECHNICAL: S&P 500

Source: FactSet, Raymond James Equity Portfolio & Technical Strategy

Yesterday's market reaction to Fed Chair Powell's speech saw the S&P 500 close above its 200-day moving average for the first time in 8 months. The index is now very close to testing the downtrend line, which comes in at ~4125.

Seasonality is often supportive this time of year, but we do view the market as overbought in the short-term (following a ~17% rally from the lows on 10/13). With resistance just overhead and our expectations for market choppiness to continue, we maintain our overall stance to refrain from chasing the rally periods and to build exposure in the weak periods.

If the S&P 500 consolidates its recent rally, we view initial support at 3910 followed by the 3800 area (50-day moving average).

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