January 9th, 2023

Weekly Market Guide

A new year marks a new beginning, but for now the story remains the same for equity markets. Rapid Fed tightening in order to fight high inflation in 2022 will work with a lag on the economy in 2023. This is already showing up in some economic indicators, such as housing where mortgage applications are at 25-year lows. Additionally, banks are tightening lending standards, CEO confidence is low, some layoffs/hiring freezes are being announced (particularly in the Tech sector), and leading economic indicators are negative. We believe the odds are high that a recession occurs in 2023, but we do expect it to be mild.

The big R-word can be scary and it is human nature to recall some of your most recent experiences. However, we view the current environment as far different than the 2000 dotcom bubble and 2008 financial crisis (two of the worst market drawdowns in history). A unique characteristic of the current cycle (coming out of the Covid shutdown) is that supply has been very hard-pressed to meet demand. Inventories are low, and we do not see widespread excess on balance sheets that can often plague economic downturns. Banks are also well-capitalized (much has changed since the credit crisis), and importantly we do believe inflation is set to come down (but take time) over the coming year which will ease financial strains.

This lends itself to a recessionary bear market likely more similar to historical averages, which have seen S&P 500 contractions of -33% over 13 months. We have already experienced a -25% drawdown over 12 months, and believe that this bear market is in its late stages- although sometimes bear markets end with that last capitulation selloff. Regardless of potential downside or volatility in the coming months, the long-term risk/reward skews heavily in investors' favor. And we remind investors to not lose sight of the bull market opportunity on the other side of the current weak trend. Bull markets can last 4-5 years and appreciate 152% on average. We do believe that equities will be climbing by year-end 2023, despite lower earnings, due to multiple expansion (as stocks discount the future)- and use a probability-weighted S&P target of 4365.

Over the coming months, investor focus will likely shift from inflation concerns toward economic damage. We believe a lot of negative news has already been priced in and see underlying technical improvement over the past several months. However, the S&P 500 still remains in a downtrend for now. Volatility is likely to persist, and the bottoming process and recovery may be elongated in this environment. With this in mind, we recommend being patient and pragmatic with positioning- use the weak periods as opportunity (with a long-term perspective) and refrain from chasing the rally periods.

Best wishes for a healthy and prosperous 2023!

Equity Market Indices	Price Return Year to Date	Price Return 12 Months
Dow Jones Industrial Avg	0.4%	-9.6%
S&P 500	0.4%	-19.6%
S&P 500 (Equal-Weight)	1.5%	-12.6%
NASDAQ Composite	-0.1%	-33.1%
Russell 2000	0.6%	-21.9%
MSCI All-Cap World	0.9%	-19.4%
MSCI Developed Markets	1.9%	-16.0%
MSCI Emerging Markets	1.9%	-21.1%
NYSE Alerian MLP	-1.0%	14.9%
MSCI U.S. REIT	1.9%	-25.7%

S&P 500 Sectors	Price Return Year to Date	Sector Weighting
Real Estate	2.6%	2.8%
Communication Svcs.	2.5%	7.4%
Financials	2.0%	11.9%
Materials	1.6%	2.8%
Industrials	1.1%	8.7%
Utilities	0.9%	3.2%
Consumer Discretionary	0.8%	9.8%
S&P 500	***0.4%***	-
Consumer Staples	0.1%	7.2%
Health Care	0.0%	15.8%
Information Technology	-0.8%	25.5%
Energy	-3.6%	5.0%

Source: FactSet, RJ Equity Portfolio & Technical Strategy

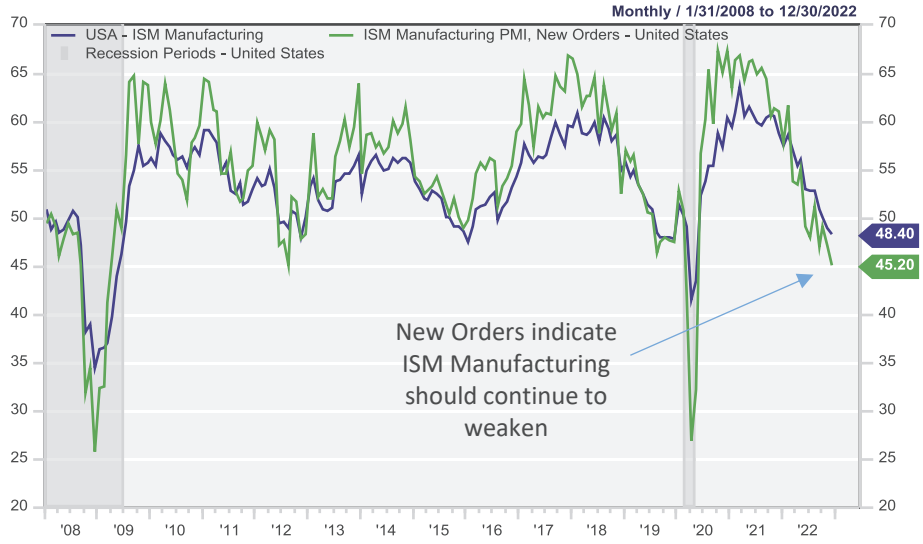
MACRO: US

December ISM Manufacturing continued to contract (down to 48.4), and New Orders down to 45.2 indicate that the manufacturing backdrop should continue to weaken ahead. (More on this discussed on page 4).

An important catalyst for equity markets is coming tomorrow morning with the December jobs report. Investors have become fairly comfortable with goods inflation, which has declined significantly over recent months. However, core services inflation remains elevated, which is being contributed to in part by the tight labor market. Employers are still increasing wages at a high rate to attract and retain employees, which is pressuring them to raise prices in order to maintain profitability. We believe this dynamic will correct itself over the coming year (as economic weakness ensues), but will also take some time. The next reading on nonfarm payrolls, the unemployment rate, and wage growth comes tomorrow morning- and is a hot topic for the Fed and investors. (Continued on next page)

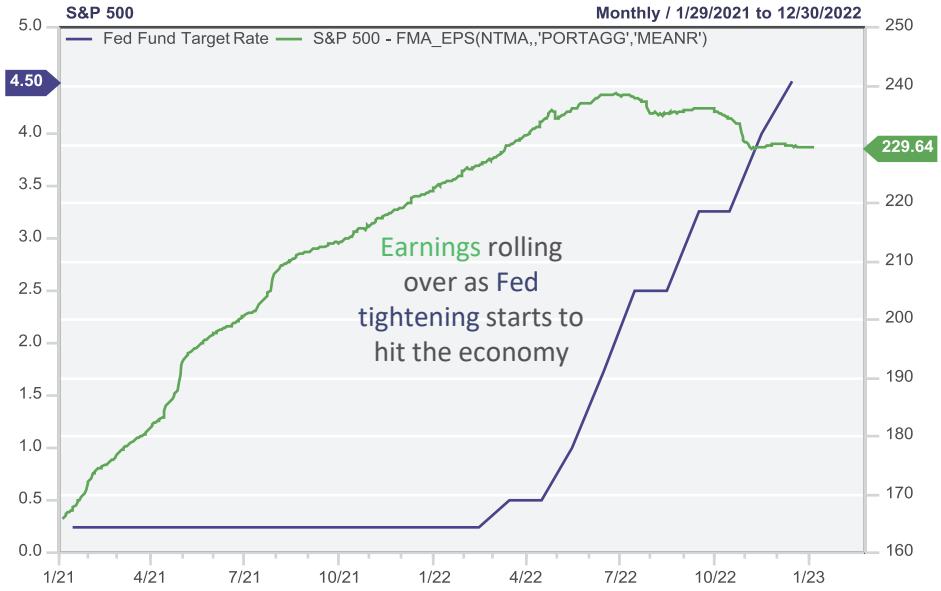
Event	Period	Actual	Consensus	Prior
Chicago PMI SA	DEC	44.9	40.0	37.2
Markit PMI Manufacturing SA (Final)	DEC	46.2	46.2	46.2
Construction Spending SA M/M	NOV	0.20%	-0.40%	-0.24%
ISM Manufacturing SA	DEC	48.4	48.5	49.0
JOLTS Job Openings	NOV	10,458K	10,000K	10,512K
BEA Total Light Vehicle Sales	DEC	13.3M	14.1M	14.2M
ADP Employment Survey SA	DEC	235.0K	145.0K	182.0K
Continuing Jobless Claims SA	12/24	1,694K	1,716K	1,718K
Initial Claims SA	12/31	204.0K	230.0K	223.0K
Trade Balance SA	NOV	-$61.5B	-$72.0B	-$77.8B
PMI Composite SA (Final)	DEC	45.0	44.6	44.6
Markit PMI Services SA (Final)	DEC	44.7	44.4	44.4

Source: FactSet, Gibbs Capital Management

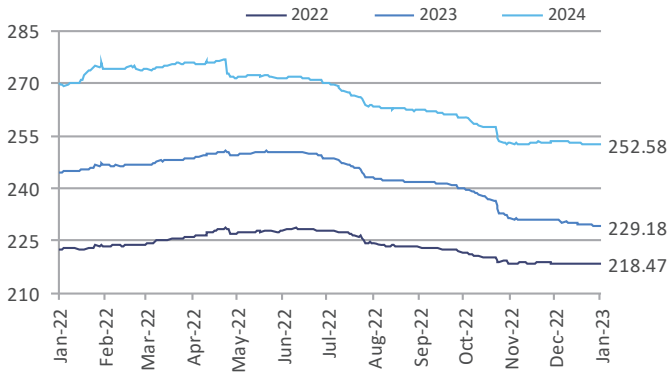


FUNDAMENTALS

As Fed tightening works with a lag on the economy, we expect lower economic growth and earnings ahead. Bottom-up earnings estimates of $229 for 2023 are still too high in our view. Our base case earnings estimate is $215. We are not convinced that a mild recession is fully priced in at this point, but we do believe a lot of negative news already has been. Bear markets can sometimes end with a capitulation selloff where valuations briefly reach depressed levels (i.e. 14-15x in 2018 trade war and 2020 Covid shutdown respectively), but a 16.5x P/E at the recent lows is already compressed 41% from the peak P/E in 2021 (in line with 43-45% P/E compressions in the severe dotcom bubble and financial crisis). Once investors can gain clarity on the inflation and economic outlook, P/E multiples will be able to expand despite lower earnings. On average in recessions, earnings bottom 8-9 months after recession end, while valuations bottom 2-6 months prior to recession end.

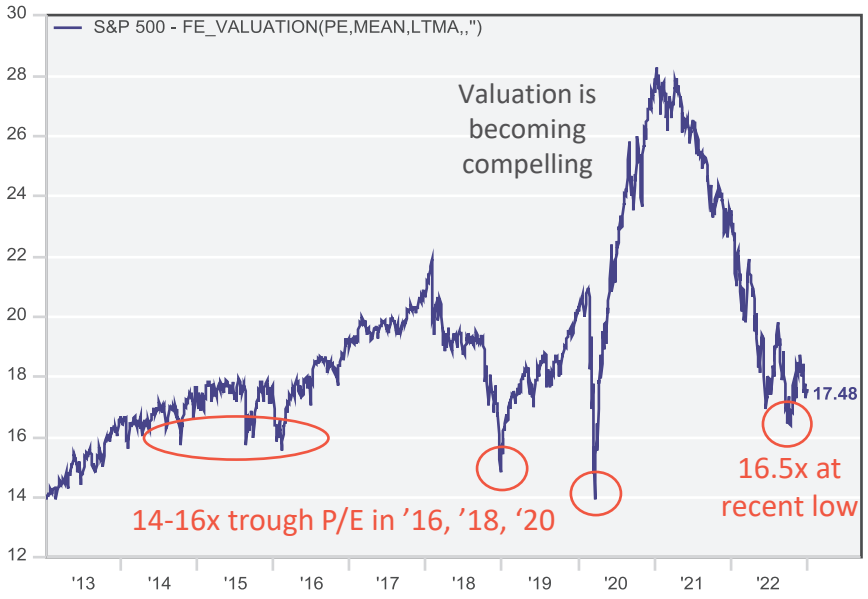


S&P 500 Consensus Earnings Estimates over Past Year



EPS Growth Estimates	
2022	5.8%
2023	4.9%
2024	10.2%

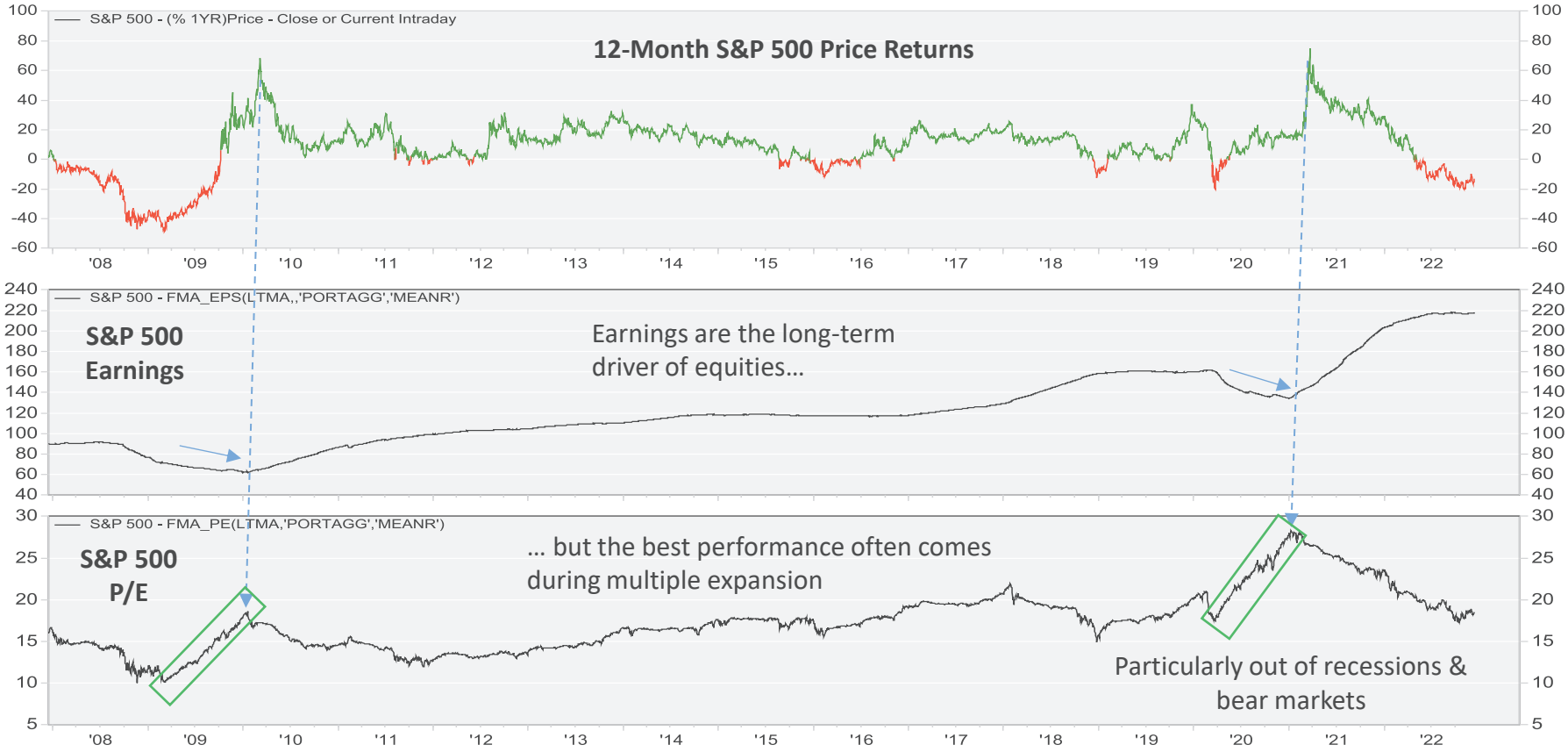
S&P 500 (SP50-USA) : 01/04/2013 to 01/05/2023 (Daily)



Source: FactSet, Gibbs Capital Management

VALUATION

As you can see in the last two recessions, the best 12-month price returns actually occurred prior to earnings bottoming due to multiple expansion. Stocks discount the future and often bottom when the headlines and sentiment are at their worst. We are not convinced that equities are ready for durable upside yet, but a lot of negative news has been priced in already. The S&P 500 has contracted -25% over 12 months vs. recessionary bear markets dropping -33% over 13 months on average historically. While volatility is expected to continue, we are also likely in the late stages of this bear market- and want to keep an eye on the bull market opportunity ahead of us. Thus, we recommend accumulating favored stocks in the weak periods as risk/reward improves.



Source: FactSet, Gibbs Capital Management

TECHNICAL: S&P 500

Source: FactSet, Gibbs Capital Management

Over the second half of 2022, some underlying technical positives have emerged that indicate the market may be attempting to turn out of its downtrend. For example:

- The S&P 500 has held its 200-week moving average and 50% retracement of its post-Covid advance (so far)
- Investor sentiment has reached depressed levels
- Net positioning is very negative
- The equity put/call ratio spiked
- High yield CDS spreads have receded
- The percentage of stocks above their 50-day moving average reached >90% twice.

These are typically things you see near lows. But ultimately, we need to see the series of lower highs and lower lows come to an end. It is also very common to have sharp counter-trend rallies in recessionary bear markets. For example, the 2000 and 2008 recessions saw multiple 20+% rallies before the lows were in.

Overall, we expect at least more time left in this bear market and believe the S&P 500 could be set for a 3700-4300 range over the next several months. Thus, we do not feel the need to chase the rally periods, and recommend using the weak periods as opportunity to accumulate favored stocks.

In the short-term, watch the 21DMA for potential resistance (currently at 3890) and then the downtrend line (currently at 4059). The next area of support is around the 3700-area followed by ~3518.

VALUE vs. GROWTH

Value continues to be our favored area over Growth. Despite lower interest rates and a lower US dollar, Growth stocks continue to underperform. In fact, Growth relative strength pushed to new lows this week, while Value relative strength pushed to new highs. Value has been a fairly consistent outperformer over the past 6 months, and this will consolidate at some point. However, following significant underperformance over the past 15 years, Value may also have a runway to longer-term outperformance.

Source: FactSet, Gibbs Capital Management (M23-90177)

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