February 13th, 2023

Weekly Market Guide

Equities have staged an impressive rally to begin 2023- S&P 500 +7.2%, Nasdaq Composite +13.8%, and Russell 2000 +10.3%. Along the way, the S&P 500 has broken through multiple technical resistance levels, including the defined downtrend that capped rallies in 2022. This is igniting investor optimism over a potential "soft-landing" scenario, and there are reasons for some optimism- i.e. good dataflow in the US recently, China reopening (end of zero-Covid policy), warmer winter pushing natural gas prices significantly lower, and Europe's economy holding up. We also cannot ignore the positive technical developments taking shape throughout the equity market, as the technicals often move ahead of the fundamentals. But after the recent surge in equities, we recommend exercising some patience- a V-bottom remains unlikely in our view.

An interesting development following last Friday's January jobs report has been the bounce in bond yields and US dollar. The 2-year yield acts as a gauge of Fed expectations and jumped from 4.08% to 4.46% in just two days. The reason for the move was the strength of the jobs report, which showed a 517k payroll increase in January- pushing the unemployment rate to a new low of 3.4%. The strong labor market is good for the economy but bad for the Fed, as wage growth (in a tight jobs market) may take longer to moderate and ease inflationary pressures. In other words, the report reduces the likelihood of Fed cuts coming soon. One week ago, market-implied Fed expectations reflected one more rate hike (~4.9% peak rate) before three cuts by January 2024. This has shifted to current expectations of now two more rate hikes (~5.1% peak rate) followed by two cuts by January 2024. This latest shift is closer to our base case expectation that the Fed is likely to hike-and-hold at ~5% through 2023, avoiding the stop-and-go policy that plagued the 1970s stagflationary period.

The 2-year yield and US dollar have both been important influences on equities over the past year, so their bounces are notable-and we will need to monitor them closely in order to assess the path forward for equity markets. Just as their declines since October have supported higher equities (and valuation expansion), a continuation of their recent bounce would likely weigh on multiples. In fact, there is a small disconnect emerging in equity valuations vs. bond yields recently- there has been a strong inverse relationship between the two over the past couple of years, with the most recent divergence suggesting equities may be getting a bit ahead of themselves in the short-term.

Overall, we believe the market is trying to turn, and we do expect equities to be higher over the next 12 months. But there are also a lot of headwinds still out there that can rear their head at any time. Therefore, we want to be adding exposure (as needed) to favored stocks, but also want to exercise some patience and act with pragmatism in doing so. Our short-term bias is for a sideways grind (or consolidation), as the market digests its recent strength to overbought conditions.

Equity Market Indices	Price Return Year to Date	Price Return 12 Months
Dow Jones Industrial Avg	2.4%	-4.3%
S&P 500	7.2%	-8.9%
S&P 500 (Equal-Weight)	7.4%	-3.4%
NASDAQ Composite	13.8%	-16.1%
Russell 2000	10.3%	-5.0%
MSCI All-Cap World	7.6%	-9.8%
MSCI Developed Markets	7.9%	-7.2%
MSCI Emerging Markets	6.7%	-16.3%
NYSE Alerian MLP	5.2%	12.4%
MSCI U.S. REIT	10.4%	-11.7%

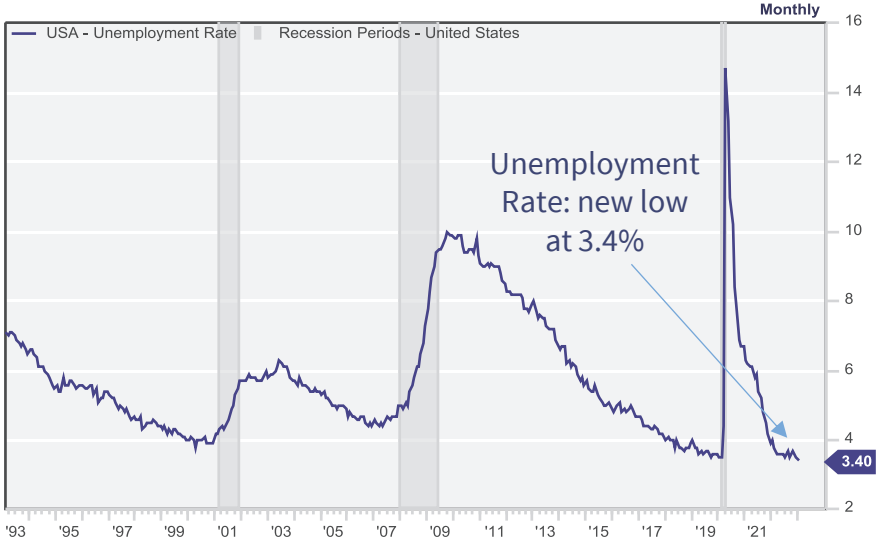
S&P 500 Sectors	Price Return Year to Date	Sector Weighting
Communication Svcs.	17.1%	8.0%
Consumer Discretionary	16.1%	10.6%
Information Technology	13.9%	27.3%
Real Estate	9.4%	2.8%
Financials	7.3%	11.7%
S&P 500	***7.2%***	-
Materials	6.7%	2.7%
Industrials	4.1%	8.3%
Energy	-0.2%	4.9%
Consumer Staples	-2.7%	6.5%
Health Care	-2.7%	14.4%
Utilities	-4.7%	2.8%

Source: FactSet, RJ Equity Portfolio & Technical Strategy

MACRO: US

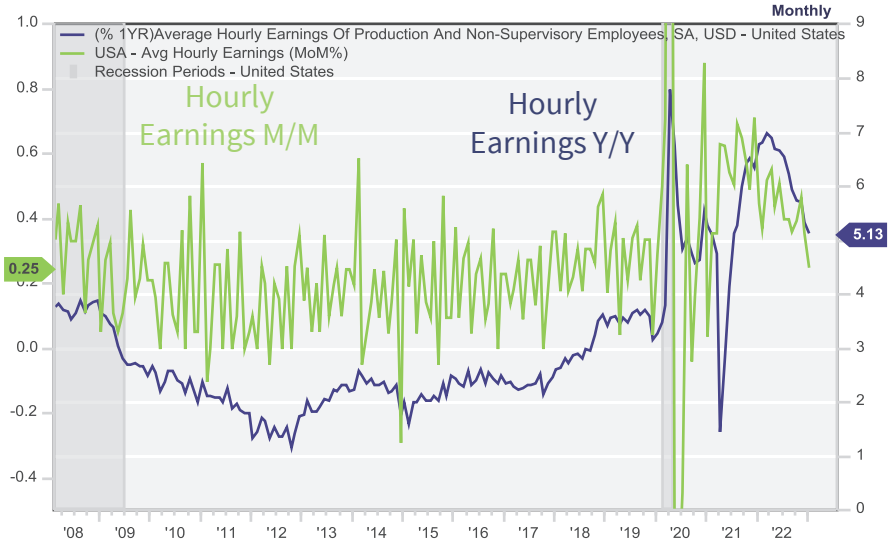
Last Friday's January jobs report was very strong, showing a 517k increase in nonfarm payrolls (well above estimates of 185k). This pushed the unemployment rate to a new low of 3.4%, supporting the potential of a "soft-landing" scenario that employment may not have to deteriorate significantly. A strong jobs market is good for the economy, but bad for the Fed. For example, the tight jobs market may result in wage growth taking longer to moderate and ease inflationary pressures.

The result has been an increase in Fed expectations, reducing the likelihood of Fed cuts coming soon. One week ago, market-implied Fed expectations reflected one more rate hike (~4.9% peak rate) before three cuts by January 2024. This has shifted to current expectations of now two more rate hikes (~5.1% peak rate) followed by two cuts by January 2024. This latest shift is closer to our base case expectation that the Fed is likely to hike-and-hold at ~5% through 2023, avoiding the stop-and-go policy that plagued the 1970s stagflationary period.



Event	Period	Actual	Consensus	Prior
Hourly Earnings SA M/M (Preliminary)	JAN	0.30%	0.30%	0.40%
Hourly Earnings Y/Y (Preliminary)	JAN	4.4%	4.3%	4.8%
Nonfarm Payrolls SA	JAN	517.0K	185.0K	260.0K
Unemployment Rate	JAN	3.4%	3.6%	3.5%
PMI Composite SA (Final)	JAN	46.8	46.6	46.6
Markit PMI Services SA (Final)	JAN	46.8	46.6	46.6
ISM Services PMI SA	JAN	55.2	50.3	49.2
Trade Balance SA	DEC	-$67.4B	-$68.5B	-$61.0B
Consumer Credit SA	DEC	$11.6B	$25.2B	$33.1B
Wholesale Inventories SA M/M (Final)	DEC	0.10%	0.10%	0.10%
Continuing Jobless Claims SA	01/28	1,688K	1,660K	1,650K
Initial Claims SA	02/04	196.0K	190.0K	183.0K

Source: FactSet



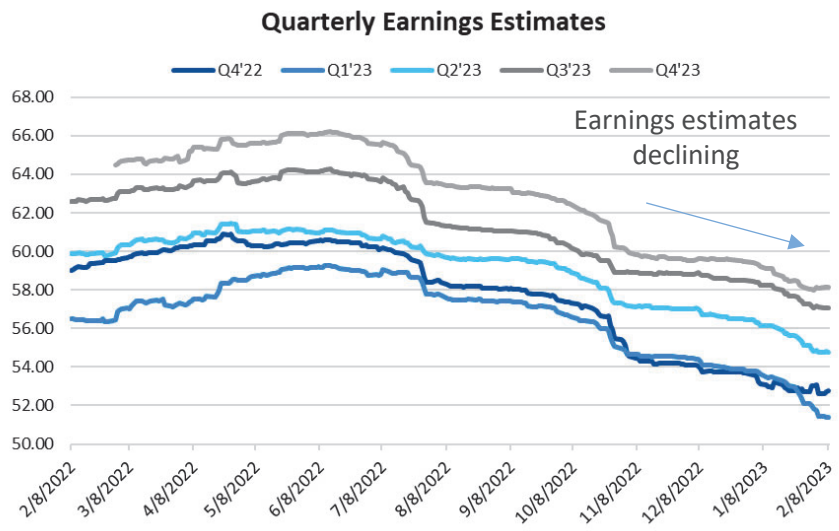
FUNDAMENTALS

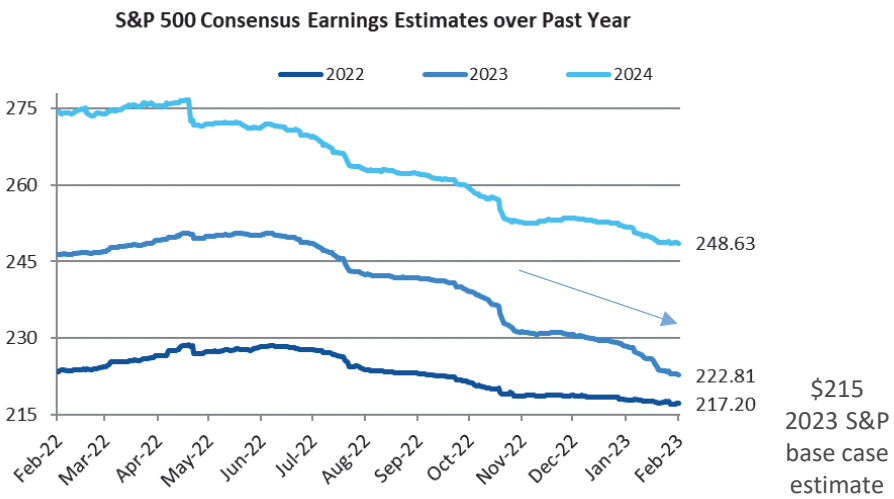
The majority of Q4 earnings season is behind us with over 70% of the S&P 500's market cap having already reported. Results have been roughly in-line with downwardly revised estimates. For example, Q4 estimates have been revised 14% lower since last June and are being reported with an aggregate surprise of 0.8%. This is well below the historic average EPS surprise of 5.4%.

Additionally, forward guidance continues to contract. Q1'23 estimates have been revised -4.5% lower since the year began, and Q2-Q4 2023 estimates have moved -2-3% lower- bringing 2023 expected earnings growth down to just 2.6% (2.8% lower than estimates when the year began). We continue to believe that forward estimates are too high. Sales growth is likely to be slow with the economy, and margin estimates are declining with elevated costs. We use a $215 base case S&P 500 earnings estimate for 2023 vs. current bottom-up consensus of $222.81.

Despite the gloomy earnings outlook, stocks have reacted favorably through earnings season with an average 3-day price reaction of 0.8% (though more mixed at the individual stock level- roughly half are trading higher and the other half lower on results). Good economic dataflow to begin the year, in conjunction with spurred fear-of-missing-out trading, are impacting performance.

Over time, we expect stocks to climb despite weak earnings, as investors gain clarity on inflation, Fed policy, and the economy- but that clarity (for sustainably higher prices) is likely to take more time in our view.





Source: FactSet

TECHNICAL: S&P 500

Source: FactSet

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We cannot ignore the positive technical developments taking shape throughout the equity market, as the technicals often move ahead of the fundamentals. But after the recent surge in equities, we recommend exercising some patience- a V-bottom remains unlikely in our view.

Short-term stochastics are at overbought levels, and we view ~4200 and ~4300 as technical resistance levels near current prices. On the downside, we view support as 3967 (50 DMA) and ~3800. We are currently using a fair value range as 3700-4300.

Overall, we believe the market is trying to turn, and we do expect equities to be higher over the next 12 months. But there are also a lot of headwinds still out there that can rear their head at any time. Therefore, we want to be adding exposure (as needed) to favored stocks, but also want to exercise some patience and act with pragmatism in doing so.

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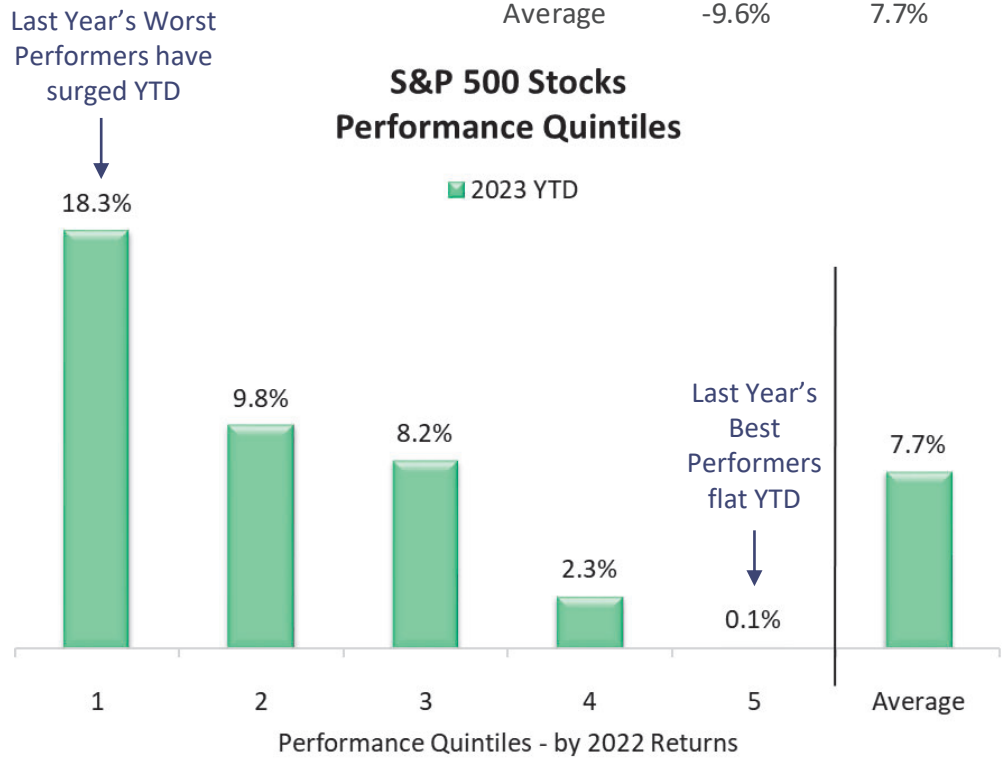
BIG MEAN REVERSION IN PERFORMANCE TO BEGIN 2023

Performance to begin 2023 has been a sharp mean reversion from performance last year. For example, the worst-performing stocks last year (Quintile 1: -44% average 2022 return) are up 18.3% on average to begin this year. Conversely, the best-performing stocks last year (Quintile 5: 32% average 2022 return) are flat so far in 2023. This relationship of flipped performance is fairly consistent across industry groups. While these higher-beta areas reflect where we believe opportunity lies in a recovery scenario, many stocks are also at overbought levels in the short-term. We generally recommend exercising some patience at current levels and accumulating as the trends evolve over time.

Performance Quintile	Average Return 2022	2023 YTD
1	-44.4%	18.3%
2	-24.5%	9.8%
3	-12.3%	8.2%
4	1.2%	2.3%
5	32.0%	0.1%
Average	-9.6%	7.7%

S&P 500 Industry Group	2022	2023 YTD
Automobiles & Components	-60.7%	51.3%
Semiconductors & Semiconductor Equipment	-36.9%	22.5%
Media & Entertainment	-44.1%	20.0%
Technology Hardware & Equipment	-26.3%	14.4%
Consumer Services	-15.9%	11.1%
Banks	-21.6%	10.5%
Retailing	-34.8%	10.1%
Software & Services	-27.0%	10.1%
Real Estate	-28.4%	9.4%
Transportation	-19.6%	8.2%
S&P 500	***-19.4%***	***7.2%***
Consumer Durables & Apparel	-30.5%	7.2%
Diversified Financials	-12.6%	7.0%
Materials	-14.1%	6.7%
Food & Staples Retailing	-11.6%	3.6%
Capital Goods	-2.0%	3.4%
Telecommunications Services	-11.3%	2.9%
Insurance	8.1%	2.7%
Commercial & Professional Services	-10.6%	0.9%
Energy	59.0%	-0.2%
Health Care Equipment & Services	-7.7%	-1.5%
Pharmaceuticals Biotechnology & Life Sciences	-0.3%	-3.6%
Food Beverage & Tobacco	5.6%	-3.8%
Utilities	-1.4%	-4.7%
Household & Personal Products	-11.5%	-5.8%

Source: FactSet



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