February 20th, 2023

Weekly Market Guide

Equity markets have experienced a strong start to the year- the average S&P 500 stock is up ~8% YTD with outperformance coming from the higher-beta, harder-hit areas in last year's decline. This is significant, as technical improvements often come well ahead of the fundamentals out of bear markets.

On one hand, the technical positives are becoming difficult to ignore. For example, the S&P 500 held its 200-week moving average at the October lows (a good level of long-term support). Investor sentiment and net positioning reached depressed levels, and selling conviction decreased at the October lows vs. June lows. Additionally, the S&P 500 staged impressive breadth thrusts in the advance and broke above its 12-month downtrend with a risk-on tone. These are characteristics often consistent with a market attempting to turn out of bear market lows. *We do view equities as overbought in the short-term and due some consolidation.*

On the other hand, we also believe that a glide path higher (V-bottom) is unlikely at this point. 2023 will be heavily influenced by the degree of inflation moderation, central bank policy, and ultimately the level of economic weakness inflicted (in order to bring inflation down). This week's stickier-than-expected CPI and PPI reports support our view that the path to inflation normalizing is unlikely to be smooth. Core CPI and core PPI rose 0.4% and 0.5% respectively- both likely to keep the Fed uneasy and more restrictive. To be sure, we do believe the Fed will be successful in bringing inflation down, but this process will also take some time.

Market-implied Fed expectations have shifted toward a hike-and-hold Fed strategy over the past two weeks, rather than optimism for a dovish pivot in the back half of this year- and this is resulting in higher bond yields. The US 2-year yield is back up to 4.67% (near cycle highs from early November), and the US 10-year yield has risen to 3.85% (from 3.40% two weeks ago). This is a headwind to equities in our view, as P/E multiples have held a strong inverse correlation to bond yields over the past two years. Moreover, earnings estimates continue to get revised lower- and we expect this trend to continue as Fed tightening (which remains ongoing) works with a lag on economic growth.

The net result is a bottoming process and recovery that are likely elongated- with normal back-and-forth trading along the way. We believe that stocks will be higher over the next 12 months as investors gain clarity on inflation, Fed policy, and their impacts on economic growth. Multiple expansion will drive upside despite weak earnings growth (as stocks discount the future). However, that clarity needed for sustained appreciation is also likely to take some time. And with equities short-term overbought in our view, we recommend exercising some patience at current levels- using weakness as opportunity to accumulate favored stocks for the longer-term.

Equity Market Indices	Price Return Year to Date	Price Return 12 Months
Dow Jones Industrial Avg	3.0%	-2.5%
S&P 500	8.0%	-7.2%
S&P 500 (Equal-Weight)	8.2%	-2.0%
NASDAQ Composite	15.3%	-14.6%
Russell 2000	11.3%	-5.6%
MSCI All-Cap World	7.8%	-9.1%
MSCI Developed Markets	7.5%	-7.2%
MSCI Emerging Markets	5.1%	-18.2%
NYSE Alerian MLP	7.0%	14.9%
MSCI U.S. REIT	10.0%	-11.3%

S&P 500 Sectors	Price Return Year to Date	Sector Weighting
Consumer Discretionary	18.8%	10.8%
Information Technology	15.6%	27.6%
Communication Svcs.	15.4%	7.8%
Real Estate	8.6%	2.7%
S&P 500	***8.0%***	-
Financials	7.2%	11.6%
Materials	6.8%	2.7%
Industrials	5.2%	8.4%
Energy	0.5%	4.9%
Consumer Staples	-1.7%	6.6%
Health Care	-2.9%	14.3%
Utilities	-3.4%	2.8%

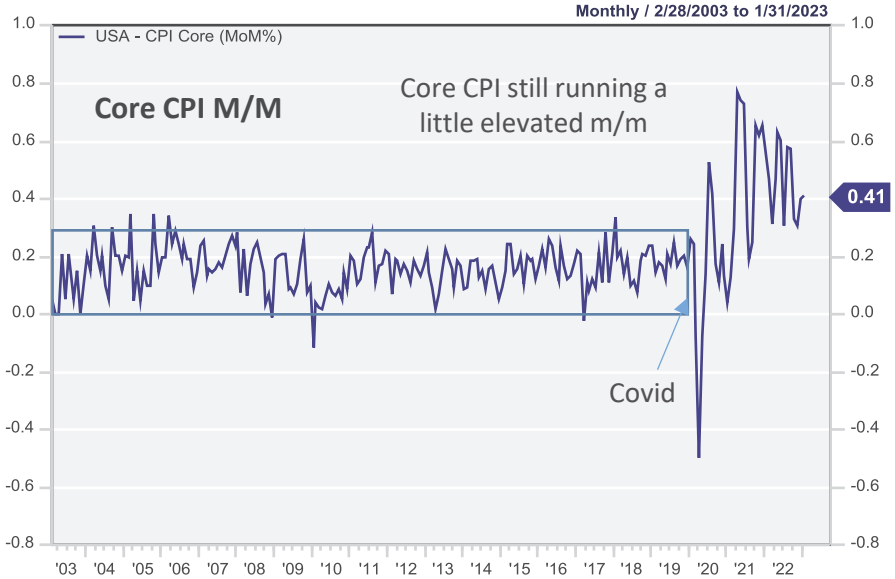
Source: FactSet

MACRO: US

Event	Period	Actual	Consensus	Prior
Michigan Sentiment NSA (Preliminary)	FEB	66.4	65.0	64.9
Treasury Budget NSA	JAN	-$38.8B	$110.0B	-$85.0B
NFIB Small Business Index	JAN	90.3	-	89.8
CPI ex-Food & Energy SA M/M	JAN	0.40%	0.40%	0.40%
CPI ex-Food & Energy NSA Y/Y	JAN	5.6%	5.5%	5.7%
CPI SA M/M	JAN	0.50%	0.50%	0.10%
CPI NSA Y/Y	JAN	6.4%	6.2%	6.5%
Hourly Earnings SA M/M (Final)	JAN	0.30%	-0.20%	0.30%
Hourly Earnings Y/Y (Final)	JAN	4.4%	-	4.4%
Empire State Index SA	FEB	-5.8	-20.0	-32.9
Retail sales Ex AutoFuel M/M	JAN	2.6%	0.45%	-0.44%
Retail Sales ex-Auto SA M/M	JAN	2.3%	0.70%	-0.90%
Retail Sales SA M/M	JAN	3.0%	1.7%	-1.1%
Industrial Production SA M/M	JAN	0.0%	0.50%	-1.0%
Business Inventories SA M/M	DEC	0.30%	0.30%	0.30%
NAHB Housing Market Index SA	FEB	42.0	36.0	35.0
Building Permits SAAR (Preliminary)	JAN	1,339K	1,350K	1,337K
Continuing Jobless Claims SA	02/04	1,696K	1,688K	1,680K
Housing Starts M/M	JAN	-4.5%	-1.5%	-3.4%
Housing Starts SAAR	JAN	1,309K	1,358K	1,371K
Initial Claims SA	02/11	194.0K	200.0K	195.0K
PPI ex-Food & Energy SA M/M	JAN	0.50%	0.30%	0.30%
PPI ex-Food & Energy NSA Y/Y	JAN	5.4%	4.9%	5.8%
PPI SA M/M	JAN	0.70%	0.40%	-0.20%
PPI NSA Y/Y	JAN	6.0%	5.4%	6.5%

Source: FactSet

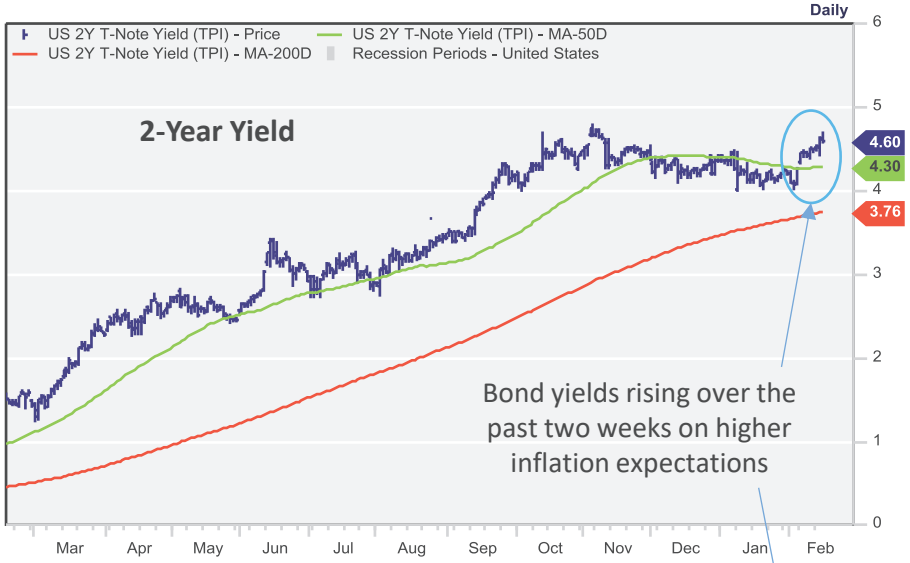
We believe that inflation has peaked- however the Fed's objective is to not only bring inflation down, but also keep it there. January core CPI rose 0.4% m/m and core PPI rose 0.5% m/m. These are still too high to bring inflation sustainably down to a 2-2.5% target level. The issue remains core services inflation, which appears "sticky" and is being supported by a still tight labor market (resulting in elevated wage growth). We do believe that these pressures will ease over the course of the year, but the path is unlikely to be easy or smooth. The latest economic data should provide some unease for the Fed, resulting in more restrictive policy. Consequently, over the past two weeks, the market's expected peak fed funds rate has increased from 4.88% to 5.24%- now baking in another 2-3 more rate hikes (vs 1 previously) with decreased chances of rate cuts in the second half of the year. **This hike-and-hold strategy is more in-line with our base case view- that inflation moderation will take time and the Fed will be reluctant to ease too quickly (avoiding the stop-and-go policy that plagued economic growth in the 1970s).**



INTEREST RATES AND VALUATION

Higher inflation expectations over the past couple of weeks, resulting in higher odds of tighter Fed policy, are pushing bond yields higher. The US 2-year yield is back up to 4.67% (near cycle highs from early November), and the US 10-year yield has risen to 3.85% (from 3.40% two weeks ago). This should act as a headwind to equities in our view, as **P/E multiples have held a strong inverse correlation to bond yields over the past two years**. So far, this relationship has broken somewhat with equities rallying despite higher bond yields. However, the moves do give us some caution at short-term levels. And if bond yields continue to rise, the market rally has likely gotten a little ahead of itself.

Source: FactSet

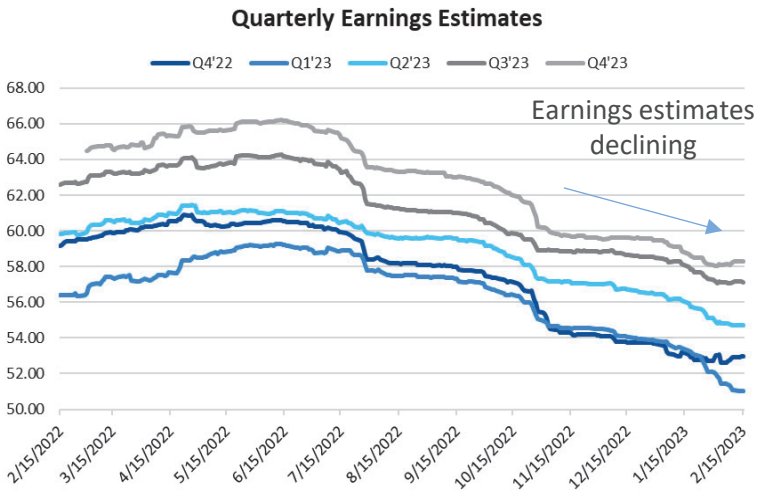


Bond yields rising over the past two weeks on higher inflation expectations

FUNDAMENTALS

Q4 earnings season is approaching an end, as 80% of the S&P 500's market cap has reported up to this point. Over the next week, we will hear from a number of retailers. Results have been roughly in line with downwardly revised estimates. For example, Q4 estimates were revised 14% lower since last June and results are beating them by an aggregate 1.2% below the 5.4% 15-year average). Additionally, forward guidance continues to contract. Q1 and Q2 estimates have been revised lower by -5.2% and -3.2% respectively since the year began. Q3 and Q4 estimates are down roughly 2% over the same period, but have shown some stabilization lately. We will continue to watch those late year trends, but we expect them to resume their downward revisions as the year progresses. **Our 2023 S&P earnings estimate of $215 remains below bottom-up consensus estimates of $222**.

Despite weakening earnings, the average price performance through earnings season has been good (0.8% average 3-day price reaction). Relative earnings estimate revision trends remain a significant influence on relative performance. Communication Services have been a recent standout with respect to estimate revisions, particularly given their drastic underperformance last year.



	% Q4 Est. EPS Growth		% EPS	% Companies	# of Companies Reporting			Est. Chg Since 1/1/2023			Avg 1D Price	3-Day	YTD	2022 EPS	2023 EPS	P/E	
S&P 500 Sector	Y/Y	Q/Q	Surprise	w/ Beats	Positive	Inline	Negative	Q4'22	2022	2023	Reaction	Reaction	Return	Growth	Growth	2022	2023
S&P 500	**-3.6**	**-3.6**	**1.2**	**69**	**256**	**19**	**97**	**-1.3%**	**-0.5%**	**-3.1%**	**0.7%**	**0.8%**	**7.28**	**5.2%**	**2.3%**	**19.09**	**18.65**
Consumer Staples	-1.0	-5.1	3.4	75	18	1	5	2.3%	0.1%	0.3%	1.4%	1.7%	-2.13	2.6%	3.9%	21.31	20.51
Communication Services	-24.4	4.1	-4.2	52	11	1	9	-5.1%	-1.9%	0.0%	0.2%	-0.1%	14.46	-18.2%	12.3%	18.58	16.54
Utilities	5.5	-35.4	1.6	60	6	1	3	-0.3%	0.3%	-0.3%	-1.2%	-1.1%	-4.00	1.6%	6.8%	19.42	18.18
Real Estate	5.7	-4.4	2.4	65	11	1	5	0.7%	0.1%	-1.0%	0.1%	0.7%	8.62	10.5%	1.5%	18.33	18.06
Industrials	40.3	4.9	-1.2	66	39	4	16	-2.0%	-0.3%	-3.1%	1.1%	0.1%	4.51	29.8%	11.5%	21.90	19.64
Financials	-12.7	4.9	0.7	64	41	2	21	-6.9%	-2.0%	-3.2%	0.6%	0.2%	6.43	-16.6%	13.3%	14.83	13.09
Information Technology	-9.0	8.1	0.6	78	47	4	9	0.0%	-0.4%	-3.3%	1.0%	2.0%	14.55	4.0%	0.8%	24.27	24.08
Materials	-21.1	-12.0	6.2	61	14	2	7	5.2%	0.9%	-3.5%	2.2%	3.2%	6.49	6.2%	-15.5%	14.73	17.43
Energy	61.5	-19.5	1.8	58	7	0	5	-2.8%	-0.6%	-3.9%	0.2%	0.4%	0.41	155.2%	-16.9%	8.55	10.29
Health Care	-4.9	-8.2	5.7	77	37	2	9	4.4%	1.3%	-4.3%	0.5%	0.3%	-3.45	5.1%	-9.0%	16.23	17.83
Consumer Discretionary	-19.9	-13.2	0.8	74	25	1	8	-3.5%	-2.5%	-6.3%	-0.5%	-2.4%	17.97	-13.3%	29.1%	34.77	26.94

Source: FactSet

TECHNICAL: S&P 500

Source: FactSet

Equity markets have experienced a strong start to the year- the average S&P 500 stock is up ~8% YTD with outperformance coming from the higher-beta, harder-hit areas in last year's decline. This is significant, as technical improvements often come well ahead of the fundamentals out of bear markets.

The technical positives are stacking up and becoming difficult to ignore. For example, the S&P 500 held its 200-week moving average at the October lows (a good level of long-term support). Investor sentiment and net positioning reached depressed levels, and selling conviction decreased at the October lows vs. June lows. Additionally, the S&P 500 staged impressive breadth thrusts in the advance and broke above its 12-month downtrend with a risk-on tone. These are data points often consistent with a market attempting to turn out of bear market lows.

That said, **we do view equities as overbought in the short-term**. MACD appears to be crossing over, which may be indication of some due consolidation in the short-term. We recommend exercising some patience at current levels, but would use weakness as opportunity to accumulate favored stocks for the longer-term.

We see short-term resistance at ~4200 and ~4300, while short-term support resides at 3975 (50 DMA), 3944 (200 DMA), and ~3918 (uptrend line), followed by ~3800 and ~3700.

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