March 13th, 2023

Weekly Market Guide

Narrative shift, after narrative shift- that is the road ahead. Good economic data and better-than-expected inflationary readings in January led to investor talk of a soft-landing (and even "no-landing") with a resulting surge higher in equities. Of course, this was then followed by hotter inflation readings in February, pumping the brakes on investor enthusiasm over the past month. Expected Fed rate hikes have moved up significantly over this time frame with the market now implying 67% odds of a 50bp hike at the March 22nd FOMC meeting (and a total of 5 hikes in 2023 to reach a peak rate of 5.6%).

Due to uncertainty and the stakes being so high on inflation, emotional sentiment swings are likely to continue for the market as investors digest the incoming dataflow. The next measures to watch include the February jobs report tomorrow morning, followed by February CPI next Tuesday. This incoming data will be important for the Fed, and accordingly will be highly influential on market moves. But just as January optimism was unjustified, the current adjustment may be too far in the other direction. In the coming weeks and months, we expect the shifting narrative to continue- and it is why we believe that equities may trade between a potential 3700-4300 range.

In periods of high uncertainty and volatility, it is easy for long-term investors to lose focus and become increasingly short-term thinking. But a lot of these market fluctuations are noise for the long-term investor. In fact, some positives can be gained in the recent move. Following Fed Chair Powell's testimony this week, higher rate expectations coincided with lower inflation expectations- reflecting Powell's message that the Fed remains committed to bringing inflation lower (and keeping it there). Accordingly, 5- and 10-year inflation expectations pulled back and sit within the Fed's targeted 2-2.5% range. This is a big deal for long-term potential values, as equities typically trade at their highest valuations when inflation is in that 2-3% "sweet spot." **Just as the Fed is willing to take some short-term pain for long-term gain, we believe that long-term investors should too.**

In the short-term, our bias is for some caution ahead of the incoming data. The S&P 500 is near the midpoint of our expected 3700-4300 potential range and breaking below support today, as concerns increase on the economy. Additionally, the 2-year Treasury yield, TIPS yield, and US dollar are trending higher, which have been negative influences on equities over the past year.

In sum: First we need to need to conquer inflation, and then assess how much damage will be inflicted on the economy. Until we get a degree of clarity on inflation, the odds are low that the market is able to trade back to new highs. However, technical characteristics over recent months also indicate that October may have been the bear market lows. This lends itself to a bottoming and recovery process that are likely more elongated this cycle. Expect volatility to persist in the short-term, but don't lose focus on the long-term. We recommend using the drawdown periods as opportunity to accumulate favored areas within a long-term perspective.

Equity Market Indices	Price Return Year to Date	Price Return 12 Months
Dow Jones Industrial Avg	-1.1%	0.5%
S&P 500	4.0%	-4.3%
S&P 500 (Equal-Weight)	3.6%	-1.0%
NASDAQ Composite	10.6%	-9.5%
Russell 2000	6.7%	-4.3%
MSCI All-Cap World	4.4%	-3.5%
MSCI Developed Markets	5.8%	4.0%
MSCI Emerging Markets	2.3%	-10.8%
NYSE Alerian MLP	4.5%	8.4%
MSCI U.S. REIT	5.1%	-15.5%

S&P 500 Sectors	Price Return Year to Date	Sector Weighting
Information Technology	12.5%	27.9%
Communication Svcs.	11.1%	7.8%
Consumer Discretionary	10.3%	10.4%
Materials	5.2%	2.8%
S&P 500	***4.0%***	-
Industrials	3.9%	8.6%
Real Estate	3.0%	2.7%
Financials	1.8%	11.4%
Consumer Staples	-3.5%	6.7%
Energy	-3.8%	4.8%
Utilities	-7.0%	2.9%
Health Care	-7.3%	14.2%

Source: FactSet

MACRO: US

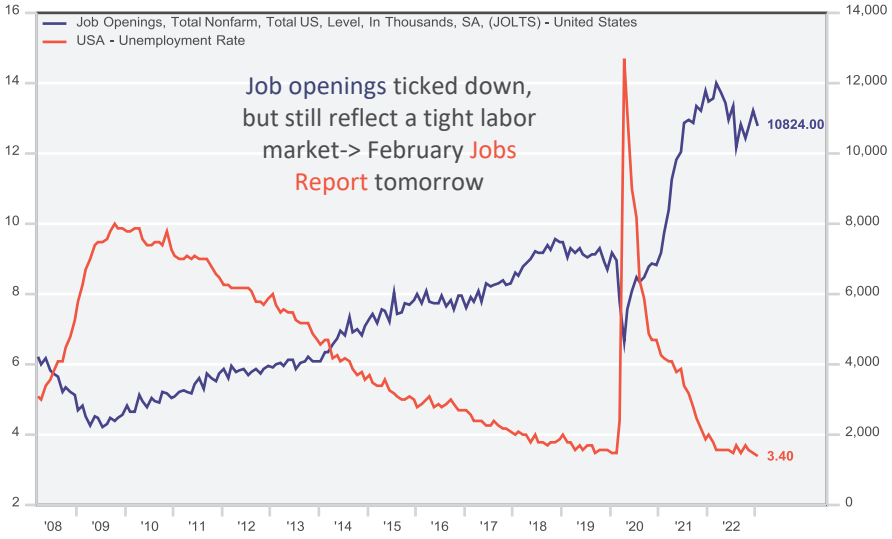
JOLTS Job Openings ticked lower, but remain elevated overall. There are still roughly 11M job openings vs. 6M unemployed. This tight labor market is contributing to high wage growth, which is contributing to services inflation and making the Fed's job tougher.

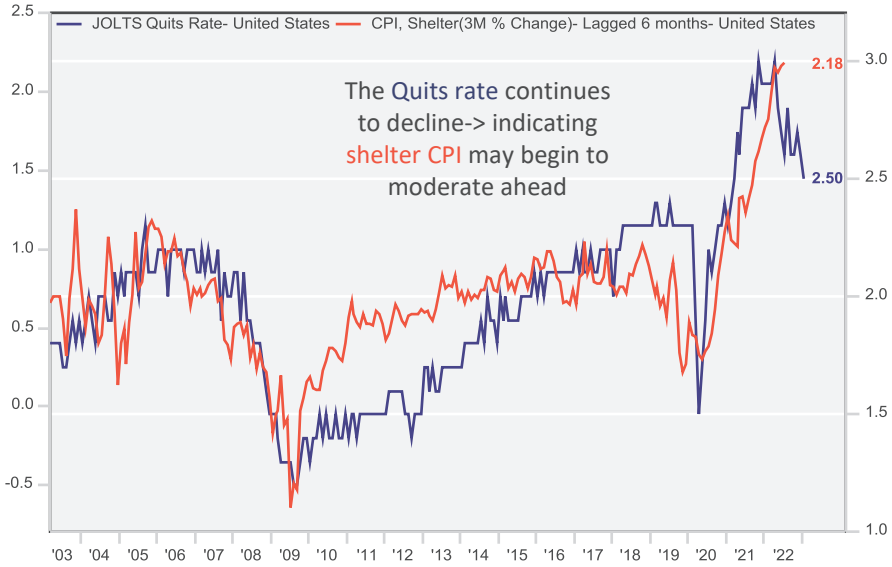
On the positive side- Within the JOLTS report, the Quits rate continued to decline. A high Quits rate indicates that workers feel comfortable finding another job. The decreasing Quits rate is a nice development, indicating that workers are now not feeling so comfortable. This has been a good leading indicator on Shelter CPI historically (one of the stickier areas of inflation), suggesting that shelter CPI should be set to moderate over the next 6 months.

While some of the soft economic readings indicate inflationary pressures should improve over the coming months, investors need to see it in the hard data. Tomorrow's jobs report and next Tuesday's CPI report will be very important for the Fed and markets.

Event	Period	Actual	Consensus	Prior
PMI Composite SA (Final)	FEB	50.1	50.2	50.2
Markit PMI Services SA (Final)	FEB	50.6	50.5	50.5
ISM Services PMI SA	FEB	55.1	54.5	55.2
Durable Orders ex-Transportation SA M/M (Final)	JAN	0.76%	-	0.70%
Durable Orders SA M/M (Final)	JAN	-4.5%	-4.5%	-4.5%
Factory Orders SA M/M	JAN	-1.6%	-2.0%	1.7%
Wholesale Inventories SA M/M (Final)	JAN	-0.40%	-0.40%	-0.40%
Consumer Credit SA	JAN	$14.8B	$27.0B	$10.7B
ADP Employment Survey SA	FEB	242.0K	196.0K	119.0K
Trade Balance SA	JAN	-$68.3B	-$69.0B	-$67.2B
JOLTS Job Openings	JAN	10,824K	10,580K	11,234K
Continuing Jobless Claims SA	02/25	1,718K	1,651K	1,649K
Initial Claims SA	03/04	211.0K	196.0K	190.0K

Source: FactSet





SHIFTING NARRATIVE

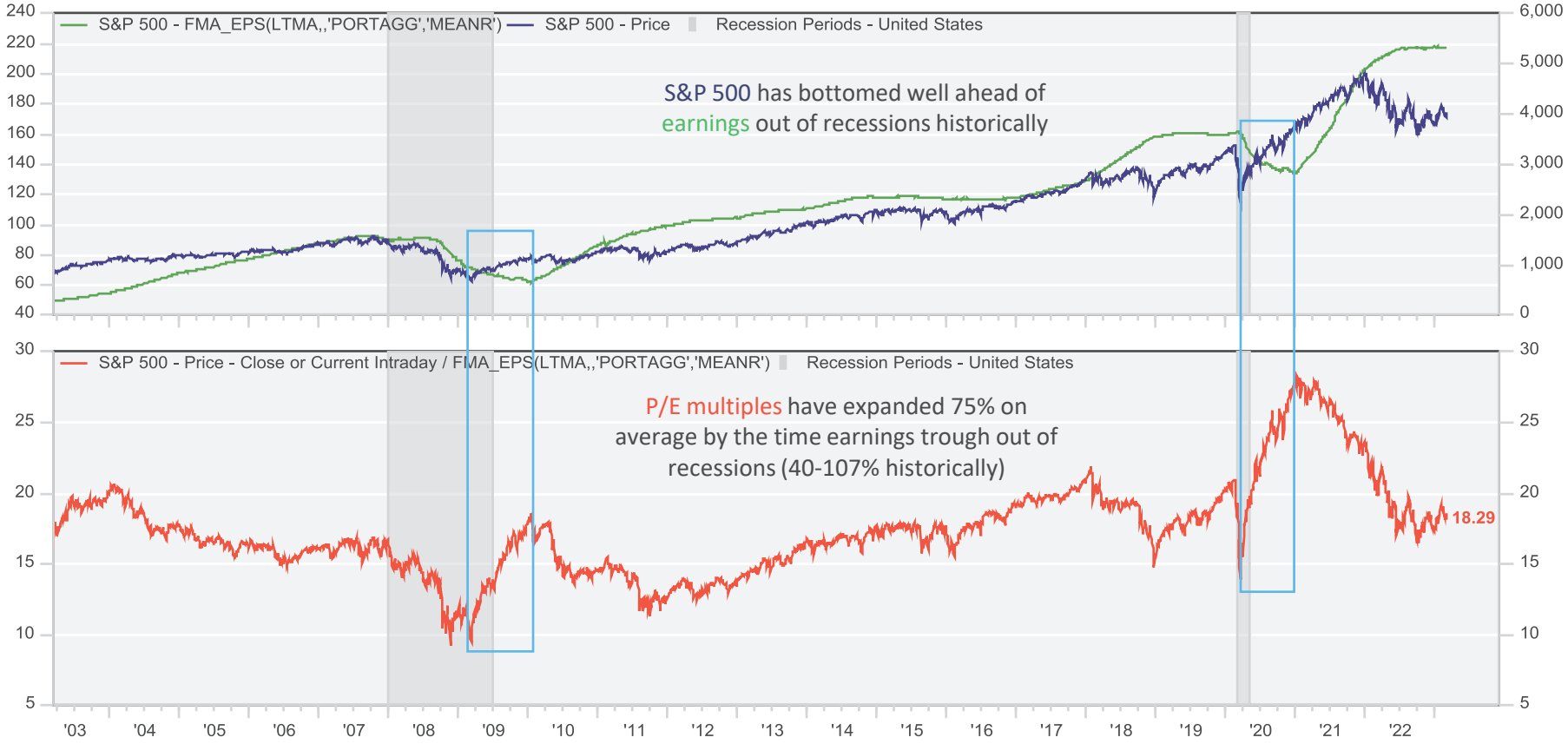
Narrative shift, after narrative shift- that is the road ahead. Good economic data and better-than-expected inflationary readings saw bond yields and the US dollar decline to begin the year- leading to investor talk of a soft-landing (and even "no landing") which corresponded with a surge higher in equities. Of course, a reality check then followed as hotter inflationary readings in February reversed these trends. The 2-year Treasury yield broke out to new highs, the US dollar has climbed, and the S&P 500 has pulled back.

Due to uncertainty and the stakes being so high on inflation, emotional sentiment swings are likely to continue for the market as investors digest the incoming dataflow. This incoming data will be important for the Fed, and accordingly will be highly influential on market moves. But just as January's optimism was unjustified, the current adjustment may be too far in the other direction. In the coming weeks and months, we expect the shifting narrative to continue- and it is why we believe that equities could trade between a 3700-4300 range.

Source: FactSet

FUNDAMENTALS

As Fed tightening works with a lag on the economy, we expect economic and earnings weakness ahead. However, it is important to remember that earnings have bottomed 8-9 months after recessions on average historically, whereas markets have bottomed 2-6 months prior to recession. P/E multiples have expanded 75% on average by the time earnings trough out of recessionary bear markets- and we believe that P/E expansion will drive positive returns over the next 12 months. However, durable upside will take clarity on inflation (and then the economy), which will take time. This lends itself to a bottoming and recovery process that are likely more elongated this cycle.



Source: FactSet

TECHNICAL: S&P 500

Source: FactSet

The S&P 500 is breaking below support today (both its 200 DMA and the short-term uptrend in place since October). Though, we do recommend giving a 1-2 day time filter to see if the breakdown holds or is quickly reversed.

Nonetheless, this breakdown is occurring as concerns increase toward the economy and comes with the S&P 500 near the midpoint of our expected 3700-4300 potential range

In the short-term, our bias is for some caution ahead of the incoming economic data. The 2-year Treasury yield is trending higher- and likely will eventually get to the peak Fed rate or higher. Along with upward trends in the TIPS yield and US dollar, this is weighing on equities.

We recommend long-term investors be patient and pragmatic when putting cash to work, using the drawdown periods as opportunity to accumulate favored areas within a long-term perspective.

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