March 27th, 2023

Weekly Market Guide

As bank contagion fears subsided, equities rallied over the past week. The banking industry will cut back on lending even more in the aftermath, raising the odds of economic contraction ahead. **But a silver lining is that inflation decreases in recessions, so the tightening in financial markets may bring the Fed closer to where they want to get.**

At yesterday's FOMC meeting, Fed Chair Powell noted that dynamic in finding a balance to monetary policy. As expected, the Fed raised rates by 25 basis points to a 4.75-5% target range and left its year-end fed funds projection at 5.1%- implying only one more hike. The Committee also altered its language from "ongoing increases" to "some additional policy firming may be appropriate." This leaves policy flexible and dependent on the incoming data pertaining to inflation, the economy, and market behavior. **The upshot is that the market will also remain highly sensitive to the incoming data flow.**

In the short-term, we expect range-bound trading (will stick with our ~3500-4100 potential S&P 500 range for now). We get news daily, weekly, and monthly on the variables impacting markets (i.e. inflation, Fed policy, and economy). The economic normalization process (from excessive easing in Covid to excessive tightening post-Covid) is likely to be lumpy with confusing data along the way. And given investor uncertainty on its path and the stakes being so high, we expect sentiment swings to occur. There will be excited periods where stocks rally and disappointed periods where they pull back. Until inflation is down, it will be difficult for stocks to move sustainably higher. For example, the Fed may be emboldened to act tighter with inflation high in good markets. On the flip side, the Fed is also at the stage where it will ease if economic concerns intensify, supporting bad markets.

This lends itself to being patient and pragmatic in deploying marginal cash balances. Use the drawdown periods as opportunity to accumulate, and refrain from chasing the rally periods. If fully invested, stay diversified and can shift positioning from conservative areas toward more risk-on areas as the trends evolve (and further information is gained on inflation, the Fed, and economy). We remind you that this bear market is almost 15 months long at this point, it will bottom (may already have), bottoms can happen rapidly, and the best returns always come after the worst returns.

Equity Market Indices	Price Return Year to Date	Price Return 12 Months
Dow Jones Industrial Avg	-3.4%	-8.0%
S&P 500	2.5%	-12.7%
S&P 500 (Equal-Weight)	-2.4%	-12.3%
NASDAQ Composite	11.5%	-17.3%
Russell 2000	-1.9%	-17.3%
MSCI All-Cap World	2.9%	-12.0%
MSCI Developed Markets	4.8%	-6.1%
MSCI Emerging Markets	0.5%	-15.0%
NYSE Alerian MLP	-1.9%	5.1%
MSCI U.S. REIT	-5.6%	-26.1%

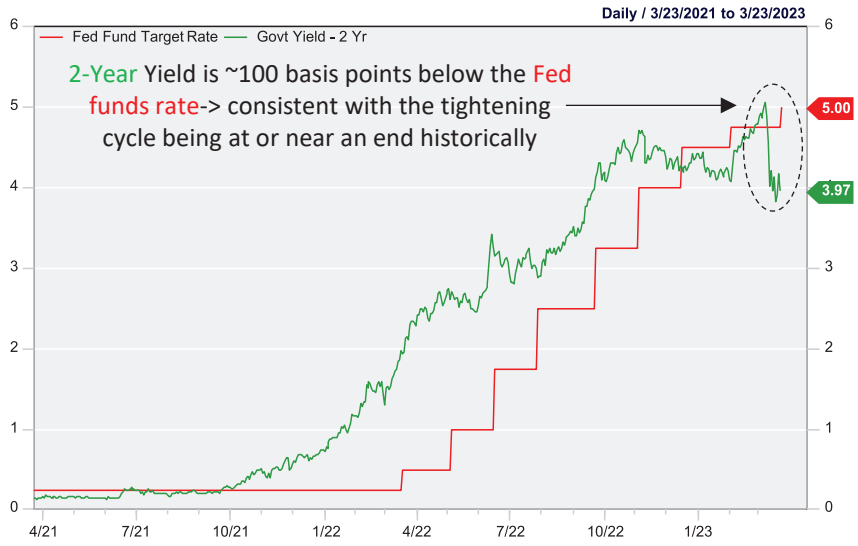
S&P 500 Sectors	Price Return Year to Date	Sector Weighting
Communication Svcs.	16.0%	8.2%
Information Technology	15.3%	25.8%
Consumer Discretionary	10.1%	10.1%
S&P 500	***2.5%***	-
Industrials	-1.4%	8.7%
Materials	-1.8%	2.6%
Consumer Staples	-3.4%	7.3%
Real Estate	-5.7%	2.4%
Health Care	-7.4%	14.4%
Utilities	-8.8%	2.8%
Financials	-8.8%	13.1%
Energy	-10.1%	4.6%

Source: FactSet

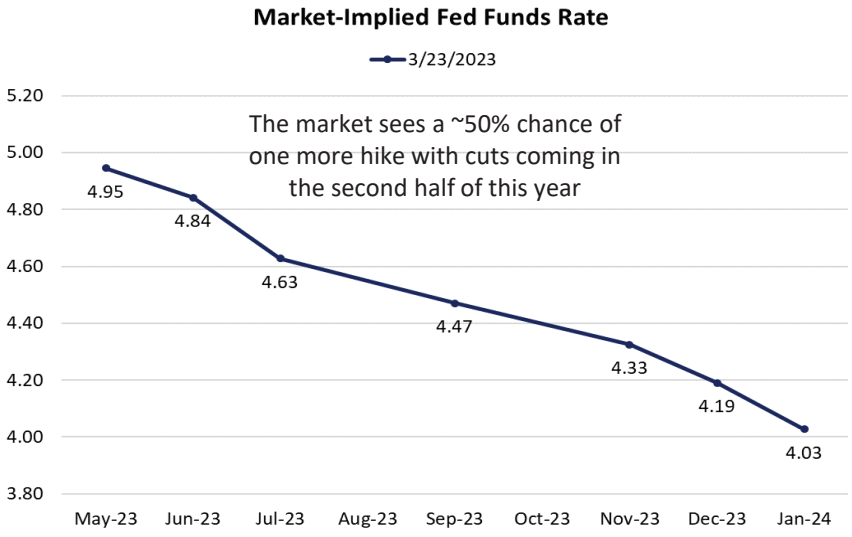
MACRO: US

Banking fears have been tempered over the past week, as policy makers did their part to restore some confidence in the sector. Importantly, the issues stem from liquidity, which is much easier to solve than credit worthiness (i.e. widespread defaults). In the aftermath, bank lending is likely to be cut back even further- raising the odds of economic contraction ahead.

But a silver lining is that tightening by financial markets gets the Fed closer to where they need to be. The situation remains fluid, but the market believes the rate hike cycle is at or near an end- with a 50% chance of one more hike in May, followed by cuts coming not far behind. Historically, when the 2-year yield has dropped 100 basis points below the Fed funds rate (as it is now), the tightening cycle is at or very near an end. The Fed has likely done enough in swift tightening over the past year, which will work with a lag on the economy. The upshot is the Fed's high dependency on incoming data will also leave the market highly sensitive, supporting our range-bound view for now.



Event	Period	Actual	Consensus	Prior
Capacity Utilization NSA	FEB	78.0%	78.4%	78.0%
Industrial Production SA M/M	FEB	0.0%	0.40%	0.30%
Leading Indicators SA M/M	FEB	-0.30%	-0.20%	-0.30%
Existing Home Sales SAAR	FEB	4,580K	4,200K	4,000K
Fed Funds Target Upper Bound	-	5.00%	5.00%	4.75%
Building Permits SAAR (Final)	FEB	1,550K	-	1,524K
Current Account SA	Q4	-$206.8B	-$213.2B	-$219.0B
Chicago Fed National Activity Index	FEB	-0.19	0.06	0.23
Continuing Jobless Claims SA	03/11	1,694K	1,690K	1,680K
Initial Claims SA	03/18	191.0K	195.0K	192.0K
New Home Sales SAAR	FEB	640.0K	645.0K	633.0K
Kansas City Fed Manufacturing Index	MAR	0.0	-5.0	0.0

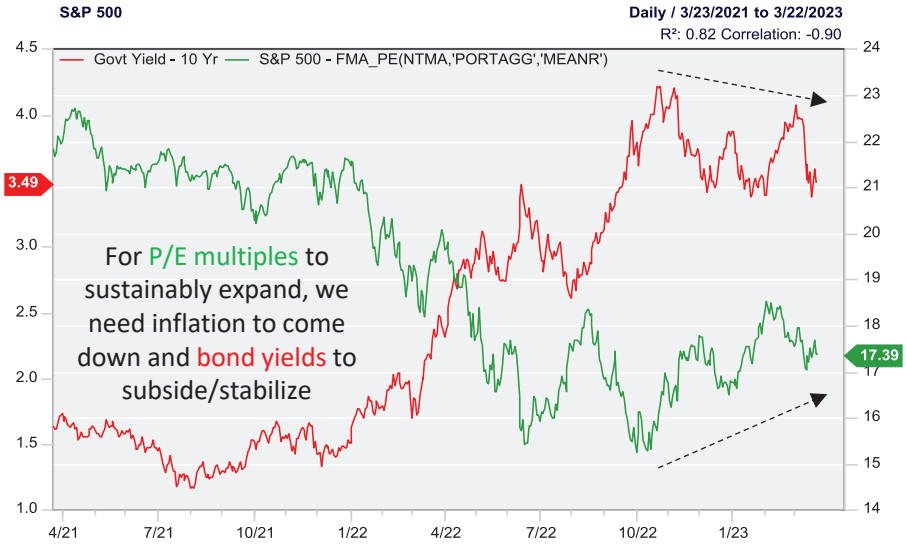


Source: FactSet

FUNDAMENTALS

Q1 earnings season begins in three weeks on 4/14 with several of the big banks. This will be of particular focus given the recent volatility in that area. S&P 500 earnings estimates overall have flattened out of late, however this is similar to the past couple of quarters which saw earnings estimates resume their downtrend as results came out. We still view estimates as too high, given our expectations of a mild economic recession, and use $215 as our 2023 base case S&P 500 earnings estimate.

As a reminder, stocks discount the future. Earnings typically bottom well after a recession ends, while markets bottom prior to recession ends. Durable market upside will take a degree of clarity on inflation, Fed policy, and the economy in our view. For P/E multiples to sustainably expand, we need inflation to come down and bond yields to subside/stabilize. We believe this will occur, and that P/E multiple expansion will drive positive equity market returns over the next 12 months.



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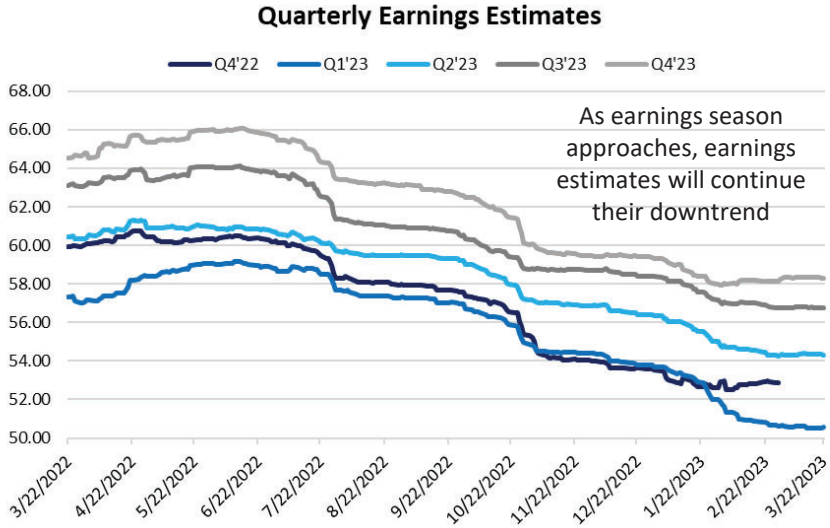

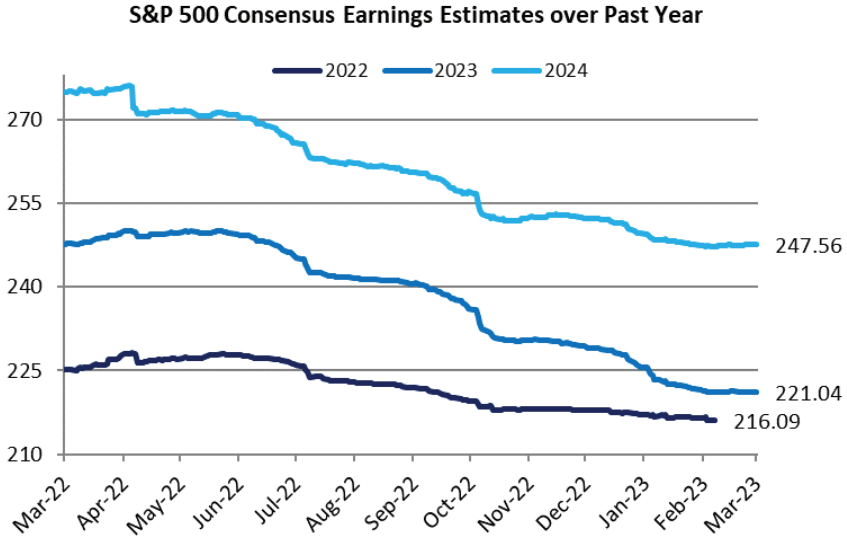

TECHNICAL: S&P 500

Source: FactSet

The S&P 500 quickly regaining its prior level after collapsing on bank issues is a positive- and significant downtrend support (from last year) holds for now. If it can continue to hold, the uptrend since October lows remains intact.

The surprising rally for stocks occurred as the government sent a message that deposits are safe, and the market shifted toward belief that the Fed will begin to loosen soon.

In the short-term, we expect range-bound trading (will stick with our ~3500-4100 potential S&P 500 range for now).

Although prices moved above the 4000 area of resistance intraday, weakness into the close finished below resistance. Investors will want to watch the 3800 area closely for support, as a break below damages the technical picture and opens the door for a move down to 3698.

CREDIT DEFAULT SWAPS

Credit markets remain a good indicator for underlying equity market trends. High yield CDS spreads spiked higher on the banking volatility last week but have pulled back below December levels this week as some bank confidence has been restored. This indicates that the S&P 500 may not have to undercut its December levels (~3765). We also note a positive divergence in yesterday's market pullback, as credit default swaps (CDS) narrowed despite equity weakness. In our view, odds are the lows are in- even if a recession occurs (one that is not severe, as we expect). If the banking situation gets a lot worse and a deeper recession comes into play, the S&P 500 may have to retest the October lows.

Source: Bloomberg

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