Weekly Market Guide

After flirting with a breakout above resistance at 4200 (a level that has capped the index this year), the S&P 500 has pulled back slightly in recent days. With plenty of headwinds (i.e. debt ceiling negotiations, inflation, Fed policy, economic concerns) playing out in front of us, along with very narrow market leadership since March, choppiness is still the highest likelihood. **We continue to believe that sustained market upside is going to be difficult without inflation much lower than it is currently.**

The reason is because as we get better-than-expected economic data (like recently), it likely emboldens the Fed to be tighter with monetary policy. This will act with a lag on economic growth in the future and put upward pressure on interest rates- all of which should act as a headwind to equities. So the path ahead likely stays volatile with potential range-bound trading as the narrative shifts over time. The playbook remains to not chase with marginal cash balances, and to use the drawdown periods as longer-term opportunity.

Through the noise of the past couple weeks, interest rates have crept higher (to their highest level since banking fears were spurred in early March). Bond yields have held a strong inverse correlation to equities (in particular Technology stocks) over the past couple of years. And we believe this relationship is likely to result in some air being taken out of the Tech heavyweights. Participation has gotten increasingly narrow, and we note a small number of mega-cap Tech stocks have now accounted for roughly all of the S&P 500's performance year-to-date. Ideally, we would see some rotation back into some of the more beaten-up, economic-sensitive areas if a pullback transpires.

Mixed signals are everywhere, and the Fed's messaging is playing a large part. On the one hand, the Fed wants to end high inflation- and market expectations have risen to ~50/50 odds of a 25bps hike by the end of July. On the other hand, the Committee is also publicly forecasting a recession in late 2023, influencing market expectations for cut(s) by year-end. The Fed would like to hike and hold for a prolonged period, but have also shown their willingness to support significant economic concern (i.e. bank liquidity issues). **This balancing act supports our rangebound view for now. But ultimately, the Fed is sacrificing short-term pain for long-term gain. Long-run inflation expectations are anchored and at levels that support elevated market valuations in the outlook.**

In sum: Expect back-and-forth trading to continue (and short-run risk/reward is likely skewed toward the downside), but we view weakness as long-term opportunity.

Equity Market Indices	Price Return Year to Date	Price Return 12 Months
Dow Jones Industrial Avg	-0.3%	3.7%
S&P 500	8.0%	4.3%
S&P 500 (Equal-Weight)	0.0%	-1.1%
NASDAQ Composite	20.0%	8.9%
Russell 2000	1.5%	-0.3%
MSCI All-Cap World	7.6%	3.1%
MSCI Developed Markets	9.0%	5.7%
MSCI Emerging Markets	2.3%	-5.4%
NYSE Alerian MLP	4.1%	7.4%
MSCI U.S. REIT	-1.2%	-12.7%

S&P 500 Sectors	Price Return Year to Date	Sector Weighting
Communication Svcs.	30.3%	8.7%
Information Technology	25.7%	26.7%
Consumer Discretionary	16.5%	10.1%
S&P 500	***8.0%***	-
Industrials	0.1%	8.4%
Consumer Staples	-0.8%	7.1%
Materials	-1.0%	2.5%
Real Estate	-3.1%	2.4%
Health Care	-4.6%	14.1%
Financials	-6.0%	12.8%
Utilities	-7.1%	2.7%
Energy	-8.8%	4.4%

Source: FactSet

FED EXPECTATIONS

Mixed signals are everywhere, and the Fed's messaging is playing a large part. On the one hand, the Fed wants to end high inflation- and market expectations have risen to ~50/50 odds of a 25bps hike by the end of July. On the other hand, the Committee is also publicly forecasting a recession in late 2023, influencing market expectations for cut(s) by year-end.

The Fed would like to hike and hold for a prolonged period, but have also shown their willingness to support significant economic concern (i.e. bank liquidity issues). This balancing act supports our rangebound view for now. But ultimately, the Fed is sacrificing short-term pain for long-term gain. Importantly, long-run inflation expectations are anchored and at levels that support elevated market valuations in the outlook.

Upcoming economic data that will factor into Fed expectations ahead of the 6/14 FOMC Meeting include: 5/26 April Core PCE (Fed's favored inflation measure), 5/31 April JOLTS Job Openings, 6/1 May ISM Manufacturing (6/5 Services), 6/2 May Jobs report, 6/13 May CI, 6/14 May PPI, banking stress (ongoing), debt ceiling negotiations (ongoing).

Event	Period	Actual	Consensus	Surprise	Prior
Continuing Jobless Claims SA	05/06	1,799K	1,829K	-30.0K	1,807K
Initial Claims SA	05/13	242.0K	255.0K	-13.0K	264.0K
Philadelphia Fed Index SA	MAY	-10.4	-18.5	8.1	-31.3
Existing Home Sales SAAR	APR	4,280K	4,300K	-20.0K	4,430K
Leading Indicators SA M/M	APR	-0.60%	-0.50%	-0.10%	-1.2%
Building Permits SAAR (Final)	APR	1,417K	-	-	1,416K
PMI Composite SA (Preliminary)	MAY	54.5	51.7	2.8	53.4
Markit PMI Manufacturing SA (Preliminary)	MAY	48.5	50.0	-1.5	50.2
Markit PMI Services SA (Preliminary)	MAY	55.1	52.6	2.5	53.6
New Home Sales SAAR	APR	683.0K	660.0K	23.0K	656.0K
Richmond Fed Index	MAY	-15.0	-9.0	-6.0	-10.0

Mixed signals everywhere you look

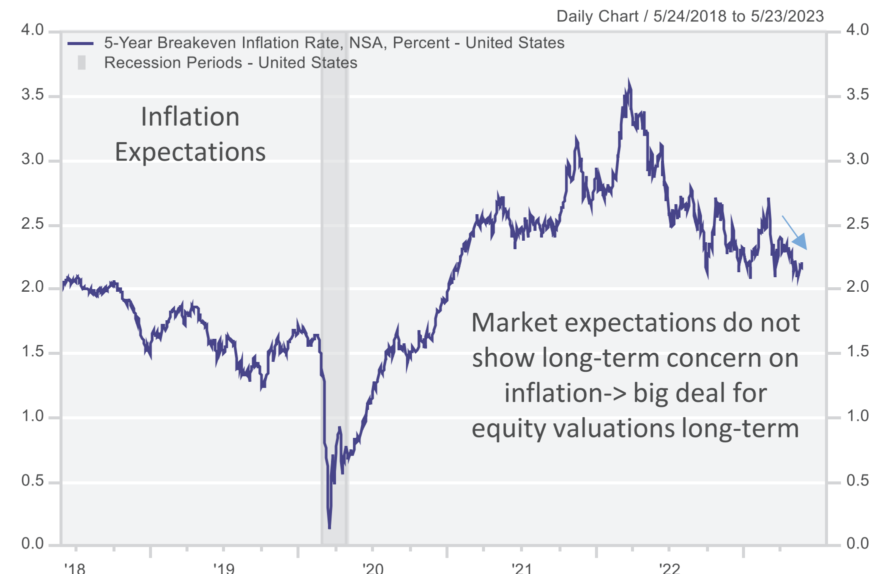
Market puts ~50/50 odds of a hike by July, followed by cut(s) by year-end

Region: United States » | Instrument: Fed Funds Futures »

Target Rate 5.25 | Pricing Date 05/23/2023

Effective Rate 5.08 | Cur. Imp. O/N Rate 5.081

Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M.
06/14/2023	+0.312	+31.2%	+0.078	5.159	0.250
07/26/2023	+0.526	+21.5%	+0.132	5.213	0.250
09/20/2023	+0.181	-34.5%	+0.045	5.126	0.250
11/01/2023	-0.518	-69.9%	-0.129	4.952	0.250
12/13/2023	-1.326	-80.8%	-0.331	4.750	0.250
01/31/2024	-2.084	-75.8%	-0.521	4.560	0.250

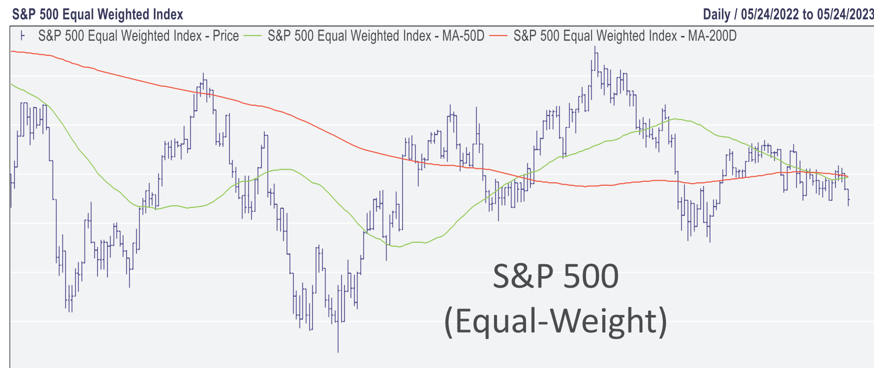


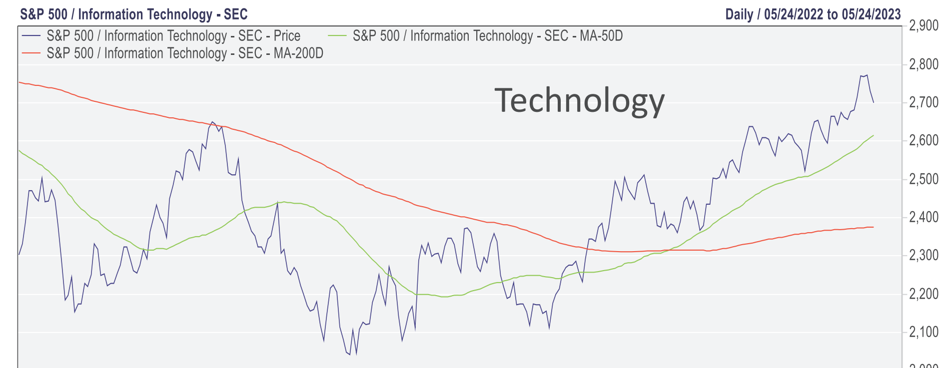
Source: FactSet, Bloomberg

"AVERAGE STOCK" AND TECH APPEAR TO BE IN TWO DIFFERENT MARKETS

Market participation continues to be very narrow with performance being dominated by the Technology heavyweights. For example, the equally-weighted S&P 500 index is exactly flat year-to-date, whereas the S&P 500 is up 8%. Roughly all of the index's return can be attributed to just 7 Tech-oriented stocks (which make up ~20% of the S&P 500's market cap). This is not an ideal technical backdrop, as healthy bull market moves are often fueled by broad-based participation.

S&P 500	Name	Weight 1/1/2023	YTD Return	Estimated Contribution
AAPL	Apple Inc.	6.0%	32.4%	1.951%
MSFT	Microsoft Corporation	5.5%	32.0%	1.774%
NVDA	NVIDIA Corporation	1.1%	110.0%	1.242%
META	Meta Platforms Inc. Class A	0.8%	105.0%	0.881%
AMZN	Amazon.com, Inc.	2.3%	36.9%	0.852%
GOOGL	Alphabet Inc. Class A	1.6%	38.9%	0.636%
GOOG	Alphabet Inc. Class C	1.5%	38.9%	0.567%
TSLA	Tesla, Inc.	1.0%	50.8%	0.521%

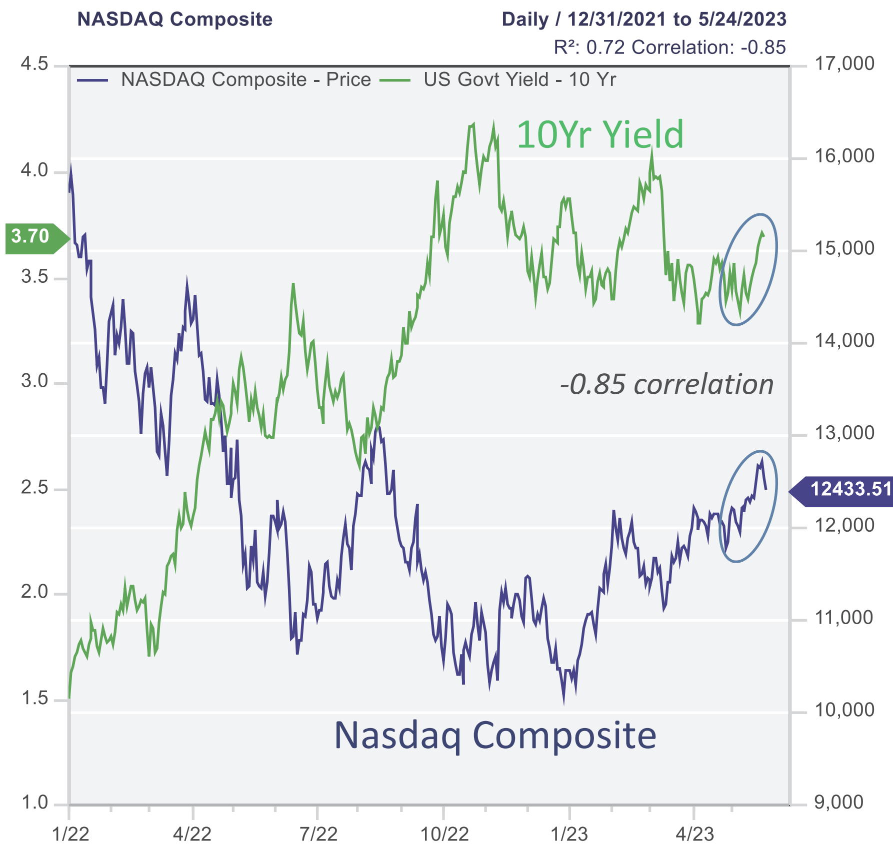


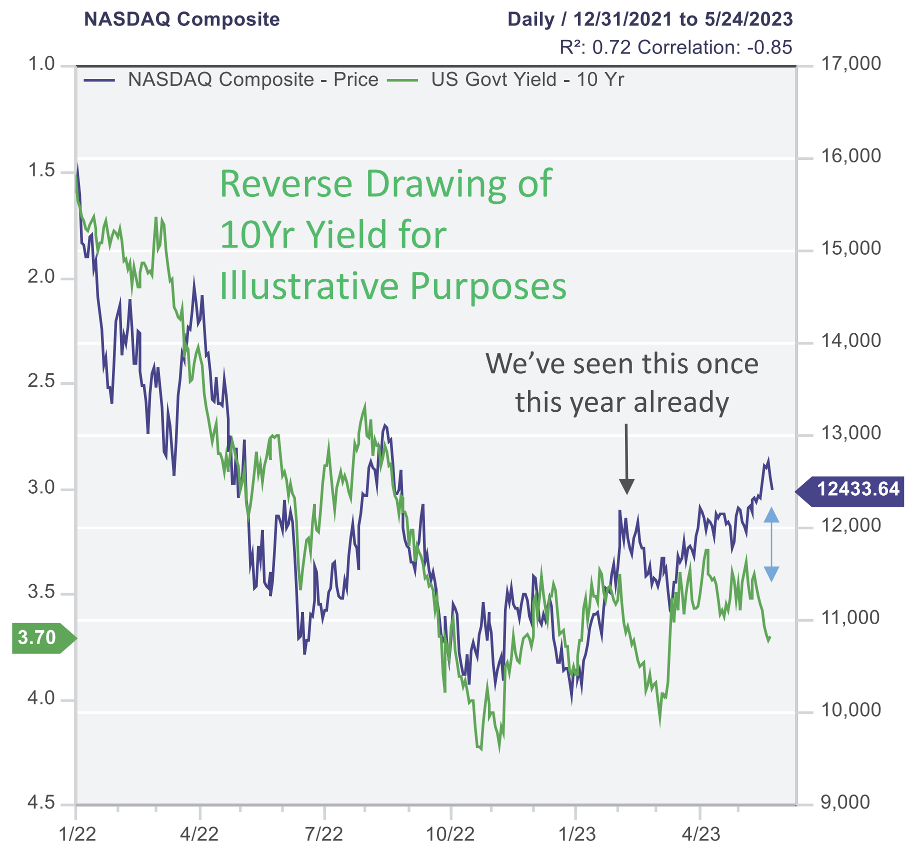


Source: FactSet

NASDAQ COMPOSITE vs. 10-YEAR YIELDS

Bond yields have held a strong inverse correlation to equities (in particular Technology stocks) over the past couple of years. So the recent rise in yields, in conjunction with higher Technology-oriented stocks, comes at odds. We have seen this divergence once before this year, and it ultimately led to some give-back in Tech stocks. With Tech getting extended in the short-term, we believe this relationship is likely to result in some air being taken out of the Technology space. Ideally, we would see some rotation back into some of the more beaten-up, economic-sensitive areas if this transpires.



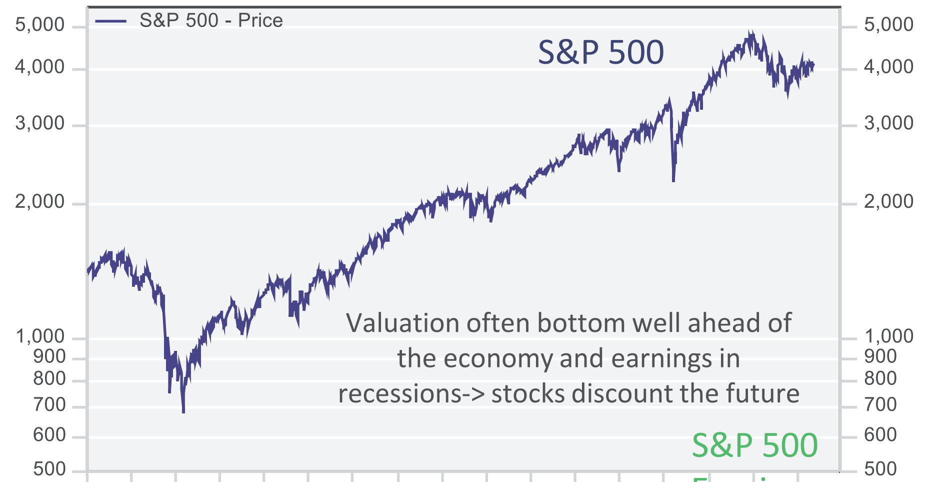


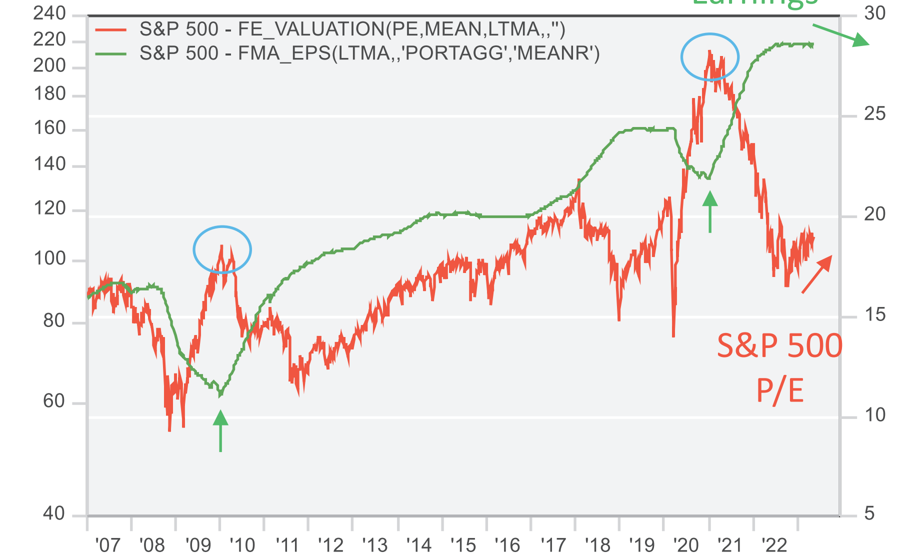
Source: FactSet

BOND YIELDS AND VALUATION

Bond yields have also played a significant influence on S&P 500 P/E multiples over the past two years (90% inverse correlation). So the recent rise in bond yields likely puts some downward pressure on multiples in the short-term. This is a big deal, as multiple expansion is typically what drives market returns out of recessionary bear markets. As you can see (bottom right chart), by the time earnings trough, P/E multiples are usually significantly higher and equities well off their lows as investors discount the future earnings recovery. Over the next 12 months, we believe multiples and markets will be higher as investors gain further clarity on inflation and the economy (how much damage was done). But we do not believe we are at that glide-path higher phase yet, and bond yields offer some indication on short-term trends. For now, back-and-forth trading is our expectation.

S&P 500 (SP50-USA) : 12/29/2006 to 05/23/2023 (Weekly)





Source: FactSet (M23-206282)

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