July 17th, 2023

Weekly Market Guide

The recent wave of market momentum continues, as equities pushed to year-to-date highs today. Positively, there has been wider participation of late- with many of the lagging areas driving performance (rather than just a handful of Tech heavyweights). Better-than-expected economic data is supporting the recent strength. For example, today's CPI report showed core inflation rise at just 0.2% m/m in June- the lowest monthly rate in over two years and a level that would bring inflation down to the Fed's 2-2.5% target should it continue.

The economy has undoubtedly held up much better than expectations this year, which is leading to increasingly more talk of a non-recessionary/soft-landing scenario. In our view, the timeline for economic contraction has been pushed out, and unique characteristics exiting Covid have been supportive. For example, the labor market remains undersupplied, and enormous stimulus has provided financial cushion through the economic normalization process thus far. But while the timing has been delayed, odds are still in favor of a mild recession occurring within the next 6-12 months in our opinion.

The result is a tug-of-war between economic indicators and market momentum for investment decisions. To be sure, we maintain a positive outlook overall and believe that equities will reach their prior highs (~4800 on the S&P 500) by the end of next year.

Reasons for equity market optimism over the next 12+ months include:

- The bear market started 18 months ago (and was -27% at the October lows)- recessionary bear markets have lasted 13 months and contracted 33% on average historically. They have also reached prior highs in 23 months on average, which would line up with late 2024 this cycle.
- Leading indicators on inflation suggest it should come down ahead, and long-term inflation expectations are anchored near 2.2% (2-2.5% is ideal for market valuations).
- Inflation coming down and/or employment weakness will allow a Fed pivot, and equities will begin pricing in the eventual economic recovery.

However, there are also reasons for some caution over the interim:

- The economy holding up better-than-expected may result in "sticky" inflation. The Fed is determined to bring down inflation and keep it there (wants to avoid stop-and-go policy and a prolonged period of high inflation).
- The Fed is still hiking, and rates are likely to remain higher-for-longer. This will work with a lag on economic growth ahead.
- Central bank tightening is putting upward pressure on interest rates globally- this is a headwind for equity valuations.
- We don't believe a mild recession has been fully priced in, if for no other reason, due to increasingly more talk of no recession over the airwaves.

Net: We recommend a positive bias overall, but expect choppy periods over the coming months. Be reasonable in portfolio positioning and timing.

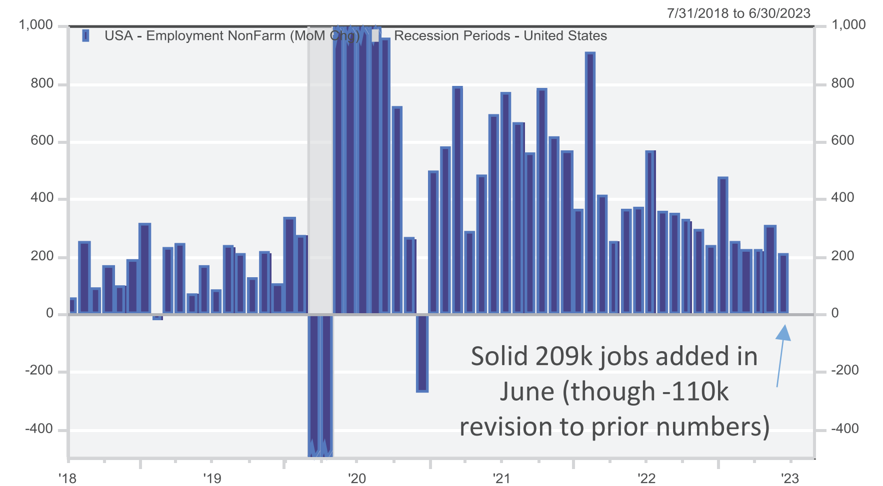
Equity Market Indices	Price Return Year to Date	Price Return 12 Months
Dow Jones Industrial Avg	3.4%	9.9%
S&P 500	15.6%	15.2%
S&P 500 (Equal-Weight)	7.2%	11.6%
NASDAQ Composite	31.5%	21.0%
Russell 2000	8.6%	10.5%
MSCI All-Cap World	12.4%	13.3%
MSCI Developed Markets	8.4%	15.2%
MSCI Emerging Markets	4.0%	1.4%
NYSE Alerian MLP	7.3%	21.7%
MSCI U.S. REIT	5.4%	-2.8%

S&P 500 Sectors	Price Return Year to Date	Sector Weighting
Information Technology	40.2%	28.0%
Communication Svcs.	35.3%	8.4%
Consumer Discretionary	33.2%	10.7%
S&P 500	***15.6%***	-
Industrials	10.9%	8.6%
Materials	5.5%	2.5%
Real Estate	3.3%	2.4%
Financials	-0.4%	12.6%
Consumer Staples	-1.0%	6.6%
Health Care	-4.4%	13.2%
Energy	-5.1%	4.2%
Utilities	-6.6%	2.6%

Source: FactSet

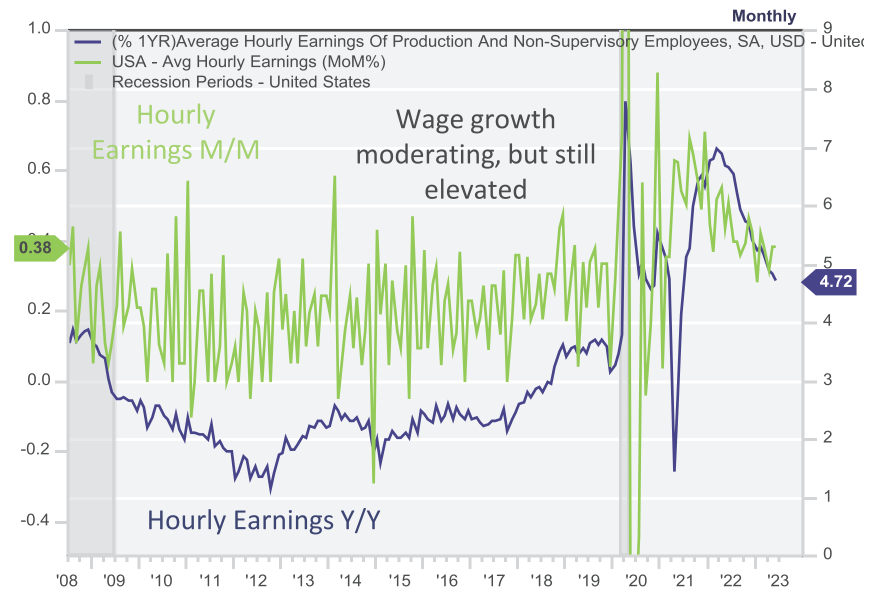
MACRO: US

Last Friday's jobs report was solid, showing 209k jobs were added in June (though -110k were revised out of prior numbers). Wage growth rose by 0.38% m/m, which brought the y/y reading down to 4.72%. While wage growth is moderating, it is still too elevated for the Fed's liking. The main issue at play is undersupply in the labor market. There are currently, 161M employed workers and 9.8M job openings, which still outweighs the 167M in the labor force. This labor imbalance will continue to put upward pressure on wage growth, which in turn will put upward pressure on inflation. We believe that the labor environment will eventually normalize and dampen wage growth and inflation- but for now, the data is unlikely to alter the Fed's thinking. A 25bp hike at the July 26th FOMC meeting appears to be a go, and incoming data will influence the path afterward. The consensus expectation is July may be the last hike, with the Fed then electing to hold before multiple cuts in 2024.



Event	Period	Actual	Consensus	Surprise	Prior
BEA Total Light Vehicle Sales (Preliminary)	JUN	15.7M	15.4M	0.33M	15.1M
ADP Employment Survey SA	JUN	497.0K	245.0K	252.0K	267.0K
Continuing Jobless Claims SA	06/24	1,720K	1,725K	-5.0K	1,733K
Initial Claims SA	07/01	248.0K	246.0K	2.0K	236.0K
Trade Balance SA	MAY	-$69.0B	-$69.3B	$0.32B	-$74.4B
PMI Composite SA (Final)	JUN	53.2	-	-	53.0
Markit PMI Services SA (Final)	JUN	54.4	54.1	0.30	54.1
ISM Services PMI SA	JUN	53.9	51.0	2.9	50.3
JOLTS Job Openings	MAY	9,824K	9,900K	-76.0K	10,320K
Nonfarm Payrolls SA	JUN	209.0K	215.0K	-6.0K	306.0K
Unemployment Rate	JUN	3.6%	3.6%	0.0%	3.7%
Wholesale Inventories SA M/M (Final)	MAY	0.0%	-0.10%	0.10%	-0.10%
Consumer Credit SA	MAY	$7.2B	$20.5B	-$13.3B	$20.3B
NFIB Small Business Index	JUN	91.0	-	-	89.4
CPI ex-Food & Energy SA M/M	JUN	0.20%	0.30%	-0.10%	0.40%
CPI ex-Food & Energy NSA Y/Y	JUN	4.8%	5.0%	-0.20%	5.3%
CPI SA M/M	JUN	0.20%	0.30%	-0.10%	0.10%
CPI NSA Y/Y	JUN	3.0%	3.1%	-0.10%	4.0%
Hourly Earnings SA M/M (Final)	JUN	0.40%	0.40%	-0.0%	0.40%
Hourly Earnings Y/Y (Final)	JUN	4.4%	4.4%	-0.0%	4.4%

Source: FactSet



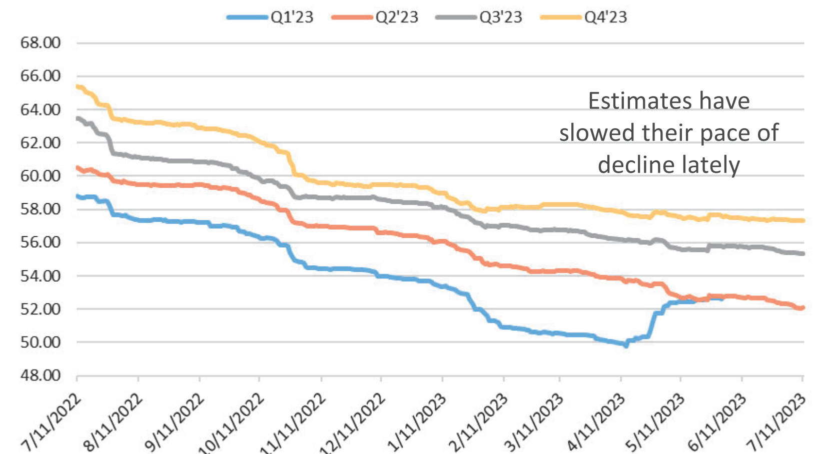
Q2 EARNINGS SEASON

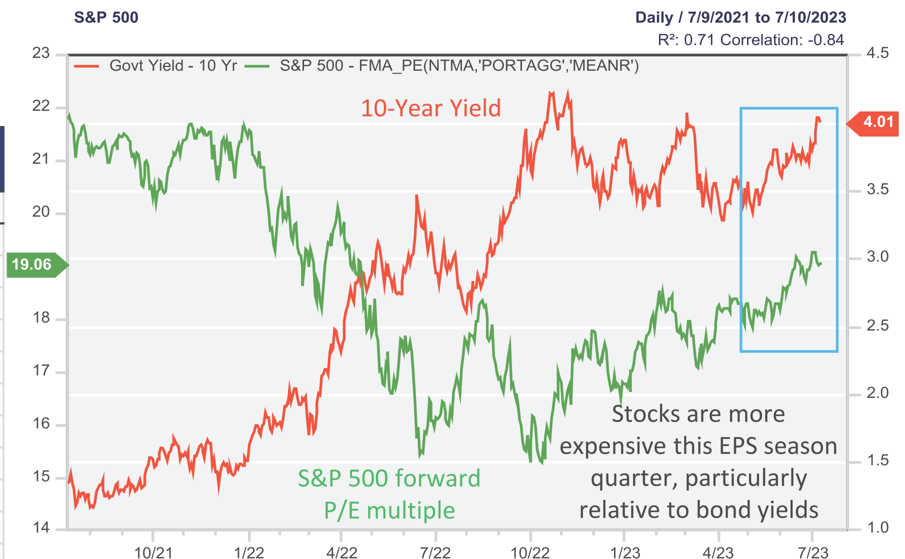
Q2 earnings season unofficially kicks off on Friday with several major banks. We believe the *bar is higher* going into earnings season this time around vs. Q1. Economic concerns were heightened in the lead up to last quarter's results, following a string of weak quarters and ongoing bank liquidity issues. Positive surprises then buoyed equity markets for the up-move that has transpired in recent months.

With increasingly more talk of a "soft landing" in the lead up to Q2 results, earnings revision trends have slowed their pace of decline. Additionally, valuations have extended despite the rise in bond yields (decoupling from their inverse correlation over the past couple years). For these reasons, we doubt Q2 provides the same upside surprise as Q1, given the higher bar for equities.

We will be listening to company results and outlooks, in addition to monitoring market reactions and earnings revision trends (which have been a key influence on underlying market performance).

S&P 500 Sector	% Q2 Est. EPS Growth Y/Y	% Q2 Est. EPS Growth Q/Q	Est. Chg Since Year End Q2'23	Est. Chg Since Year End 2023	Est. Chg Since Year End 2024	YTD Return
S&P 500	**-6.4**	**-1.1**	**-7.6%**	**-4.7%**	**-3.0%**	**16.34**
Communication Services	17.7	12.4	4.5%	3.8%	6.2%	36.80
Industrials	8.1	16.9	-1.0%	-0.2%	0.2%	10.64
Real Estate	5.1	3.9	-2.2%	-1.4%	-1.7%	3.32
Information Technology	-3.8	-2.9	-4.4%	-3.6%	-2.1%	41.37
Utilities	-3.9	-6.8	-5.9%	-1.3%	-1.0%	-5.30
Consumer Staples	1.3	1.0	-6.5%	-2.1%	-1.7%	-0.54
Consumer Discretionary	31.8	15.2	-8.0%	-6.4%	-8.3%	34.20
Financials	2.3	-7.5	-11.3%	-9.2%	-9.6%	0.39
Health Care	-16.7	-5.1	-11.3%	-5.4%	-4.2%	-4.36
Materials	-31.4	3.4	-13.2%	-7.6%	-5.7%	6.82
Energy	-46.8	-20.0	-23.3%	-16.1%	-4.7%	-4.59





Source: FactSet

TECHNICAL: S&P 500

Source: FactSet

The recent wave of market momentum continues, as equities push to year-to-date highs today. Positively, there has been wider participation of late with many of the lagging areas driving performance (rather than just a handful of Tech heavyweights). Better-than-expected economic data is supporting the recent strength.

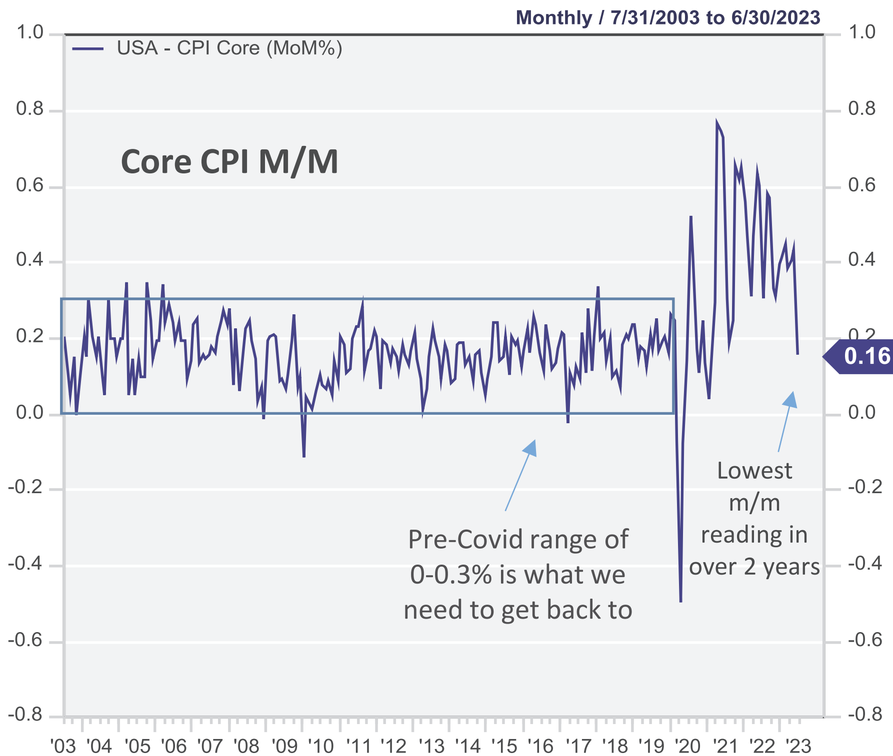
The index continues to ride above its 20-day moving average after breaking above ~4200 resistance in early June. The upward-trending 20 DMA will be the first level of support to monitor on downside (currently 4407).

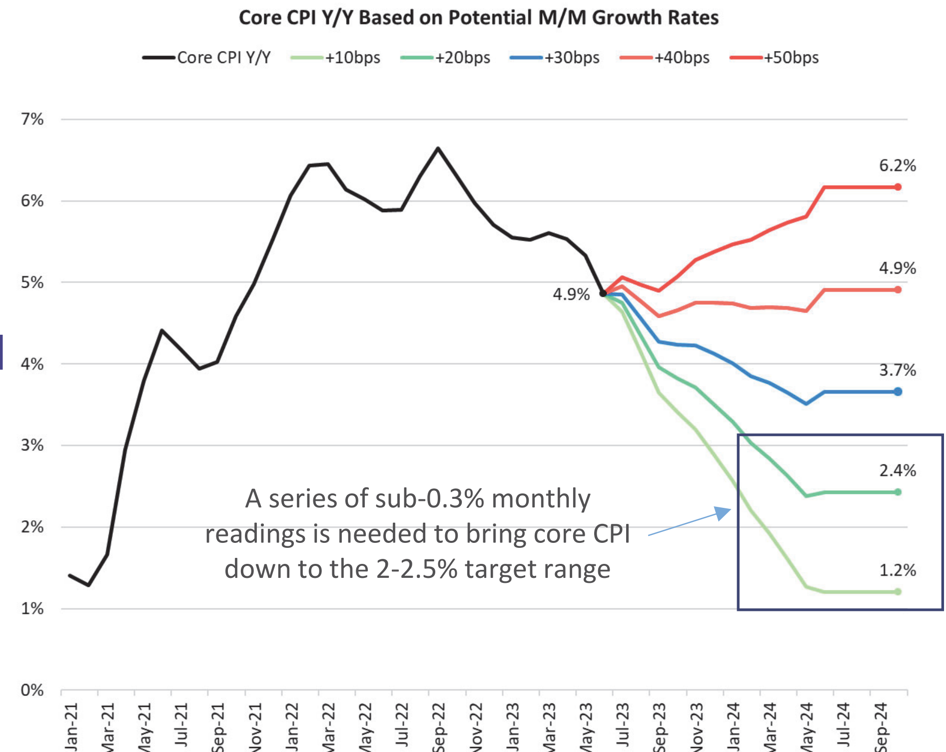
MACD is close to rolling over and stochastics are at overbought levels, so we do want to be mindful that a consolidation or pullback could develop soon. Earnings season, which begins later this week, will be an important catalyst to monitor. But for now, momentum remains upward.

Given the positive upside momentum, absent any major negative news, odds suggest that the index holds above obvious support levels during a pullback.
Potential support:
20-DMA: 4407
50-DMA: 4270
200-DMA: 4022

CORE CPI: GOOD STEP IN THE RIGHT DIRECTION

Today's inflation report showed core CPI rise at just 0.16% m/m in June. This was the lowest reading in over two years and is what investors have been waiting to see for awhile now. Base effects should bring the elevated 4.9% core CPI reading down over the next year, but the monthly readings will determine how quickly that occurs. In order to bring core CPI down to the Fed's target range of 2-2.5%, we will need to see monthly readings persist in the 0-0.3% range (which was the norm pre-Covid). So, today's report was a good step in the right direction. But one month does not make a trend. This is unlikely to change the Fed's stance yet. The Committee is determined to bring inflation down and keep it there (avoiding potential stop-and-go policy or a prolonged period of high inflation like that which plagued the economy and financial markets through the 1970s).





Source: FactSet

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