November 20th, 2023

Weekly Market Guide

Another big week for equities has the S&P 500 +10% from its recent lows on 10/27. The catalyst has been economic data supporting a potential end to the Fed's rate hike cycle, which has coincided with sharply lower bond yields (relieving pressure on stock valuations).

Inflation Moderation- Yesterday's October CPI report showed core CPI rise 0.2% m/m (below estimates of 0.3%). This was the 5th month in a row that core inflation grew in the 0.1-0.3% range (a range that was the norm prior to Covid). The average growth rate over the last five months has been 0.23%... If that 0.2% m/m pace can continue, core CPI y/y could reach 2.6% by next May and 2.4% by this time next year. That is where the Fed wants core CPI (2-2.5% target range) and is why investors cheered the data yesterday. Moreover, today's October PPI (producer prices) provided further evidence that inflation is coming down.

Fed Expectations- Economic data over recent weeks has shown inflation moderating, the undersupplied labor market normalizing, and consumer spending softening/weakening. We believe the Fed is in "wait and see" mode, as they have done a lot up to this point and the full effects of their rapid tightening work with a lag on the economy. However, at the same time, they do not want the market front-running potential Fed actions too quickly relative to the economic data, which would run the risk of unwinding some of the progress made on inflation. For example, sharply lower bond yields and stocks ripping higher are inflationary, which is what they are still battling. So, while they are likely on hold for now, the Fed is also likely to talk tough with stocks rallying and bond yields declining. The Fed will remain committed to bringing inflation lower and keeping it there (until employment cracks).

Strong Response From Oversold Conditions- We noted the internal strength two weeks ago from oversold levels (back-to-back days of 7.5x and 5x advancers vs decliners), which coincided with the November FOMC announcement, October jobs report, and lower bond yields. Yesterday's rally exhibited another breadth thrust, as advancers vs. decliners reached 10x. The cluster of strength beneath the surface is an encouraging signal that the worst of the recent drawdown may be behind us. Now, there is still work to do. Over half of stocks are below their 200 DMA and will need to rebuild their trends. Additionally, economic volatility appears to be picking up, and the Fed is unlikely to make sustainable market strength easy (as it battles inflation).

In sum- The Fed is likely on hold for now, but its tone will be tough with bond yields moving lower and stocks moving higher. Technically, we are encouraged by the internal strength exhibited from oversold conditions- raising the odds that the worst of this drawdown may be behind us. And we remain positive on equities over the next 12 months, as this bear market approaches two years in length with the average stock's valuation on the lower end of its long-term range. The market may be in for a grind, but we would use weakness as opportunity.

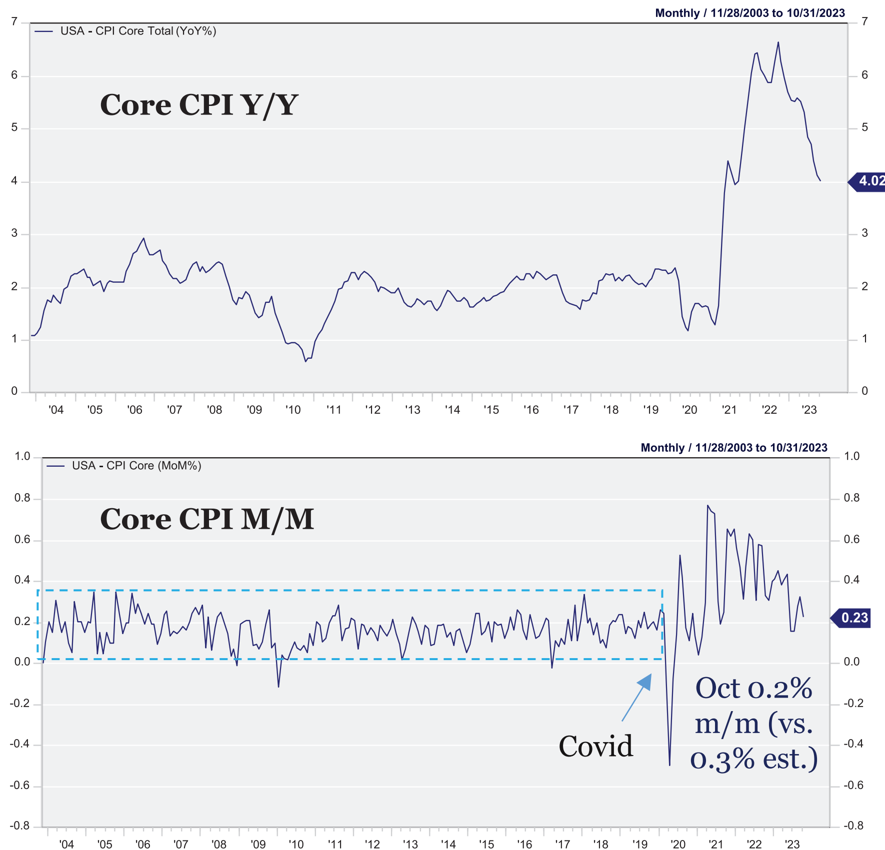
Equity Market Indices	Price Return Year to Date	Price Return 12 Months
Dow Jones Industrial Avg	5.1%	3.8%
S&P 500	17.1%	13.6%
S&P 500 (Equal-Weight)	2.1%	0.0%
NASDAQ Composite	34.7%	25.9%
Russell 2000	2.1%	-3.4%
MSCI All-Cap World	12.3%	10.6%
MSCI Developed Markets	6.4%	8.0%
MSCI Emerging Markets	0.3%	2.1%
NYSE Alerian MLP	15.0%	11.8%
MSCI U.S. REIT	-2.4%	-4.5%

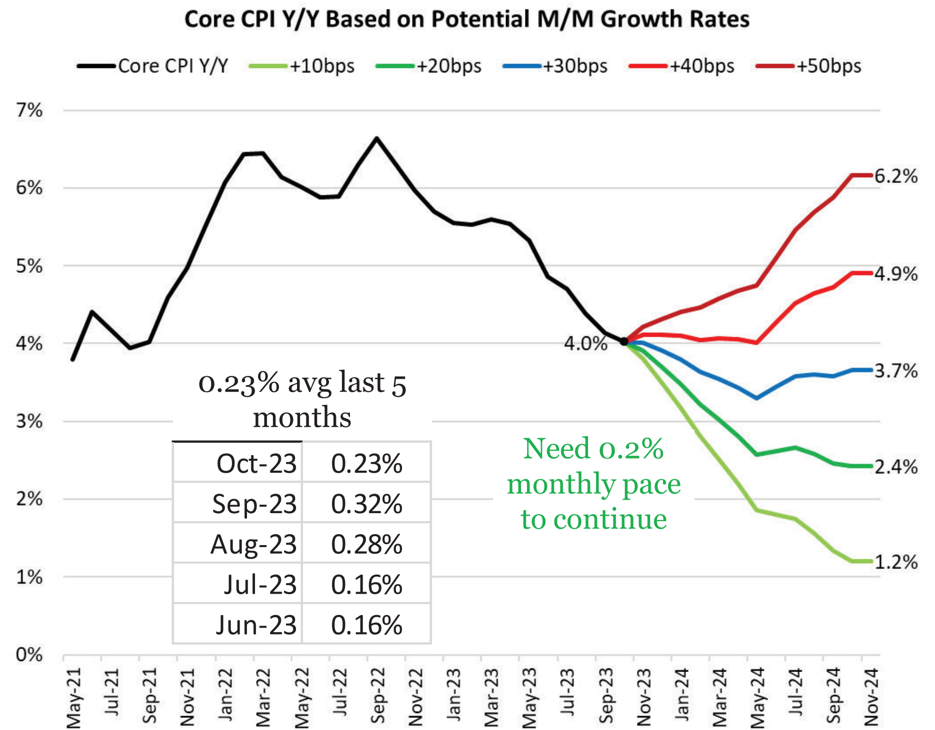
S&P 500 Sectors	Price Return Year to Date	Sector Weighting
Information Technology	49.0%	29.2%
Communication Svcs.	47.3%	8.8%
Consumer Discretionary	32.0%	10.8%
S&P 500	***17.1%***	-
Industrials	6.4%	8.3%
Materials	2.2%	2.4%
Financials	0.6%	12.7%
Real Estate	-3.4%	2.2%
Energy	-3.9%	4.2%
Consumer Staples	-5.4%	6.3%
Health Care	-6.1%	12.6%
Utilities	-12.5%	2.4%

Source: FactSet

October CPI- Better Than Estimates

Yesterday's October CPI report showed core CPI rise 0.2% m/m (below estimates of 0.3%). This was the 5th month in a row that core inflation grew in the 0.1-0.3% range (a range that was the norm prior to Covid). The average growth rate over the last five months has been 0.23%... If that 0.2% m/m pace can continue, core CPI y/y could reach 2.6% by next May and 2.4% by this time next year. That is where the Fed wants core CPI (2-2.5% target range) and is why investors cheered the data yesterday. Moreover, today's October PPI (producer prices) provided further evidence that inflation is coming down.





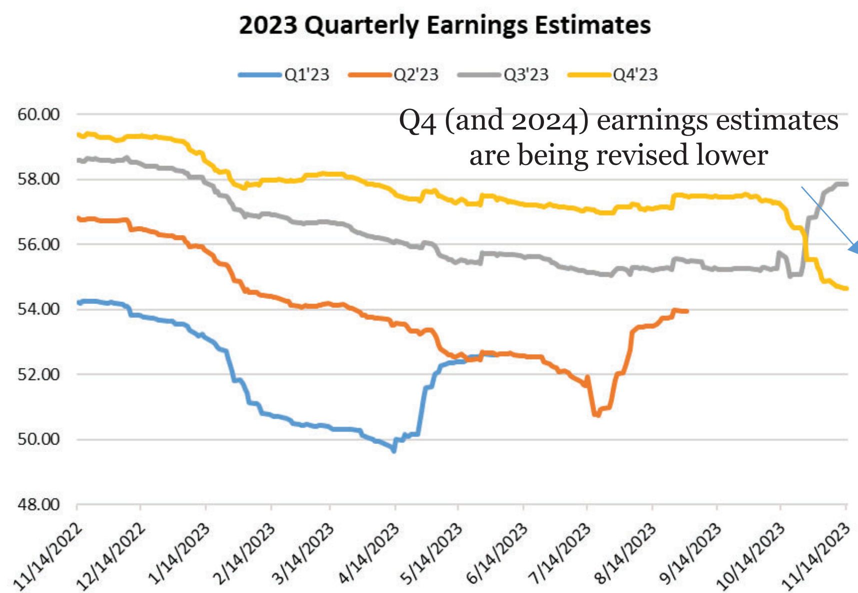
Oct-23	0.23%
Sep-23	0.32%
Aug-23	0.28%
Jul-23	0.16%
Jun-23	0.16%

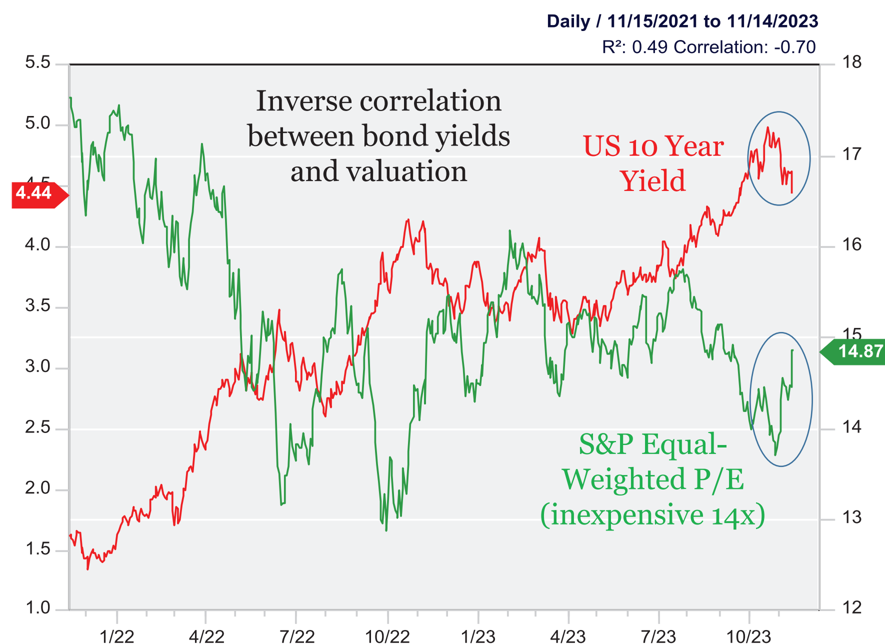
Source: FactSet

S&P 500 Fundamentals

Q3 earnings season is approaching an end, as 92% of S&P 500 companies have reported up to this point. Results have been good with 79% of companies beating earnings estimates by an aggregate 7.3% (above long-term averages). However, stock reactions have not been as impressive with "misses" being punished much more than "beats" have been rewarded. Some of this has to do with the market being in a drawdown during the bulk of reporting season, but forward guidance and earnings estimates have also declined- reflective of a softening economic environment.

We expect the lagged effects of rapid Fed tightening to weigh on economic activity ahead- and believe earnings will weaken. However, the market is a forward-looking mechanism; and a lot of negativity has been discounted already. The current bear market is now over 22 months in length, and the average stock's valuation is on the lower end of its long-term range. Importantly, valuations bottom well ahead of the fundamentals in recessions, and it is normal for higher valuations to drive market performance (as investors discount an eventual economic recovery). While the market may remain in a grind for now, we believe that multiple expansion will result in higher prices over the next 12 months (despite lower earnings). Accordingly, we recommend using weakness as opportunity.





Source: FactSet (M23-339315)

Fed Expectations & Bond Yields Driving Equity Markets

The S&P 500 decisively broke out of its 3-month downtrend, ending the series of lower highs and lower lows in place since July. The catalyst has been economic data supporting a potential end to the Fed's rate hike cycle, which has coincided with sharply lower bond yields (relieving pressure on stock valuations).

Technically, we are encouraged by the internal strength exhibited from oversold conditions- raising the odds that the worst of this drawdown may be behind us. Now, there is still work to do. Over half of stocks are below their 200 DMA and will need to rebuild their trends. Additionally, economic volatility appears to be picking up, and the Fed is unlikely to make sustainable market strength easy (as it battles inflation). The market may be in for a grind, but we would use weakness as opportunity.

Source: FactSet

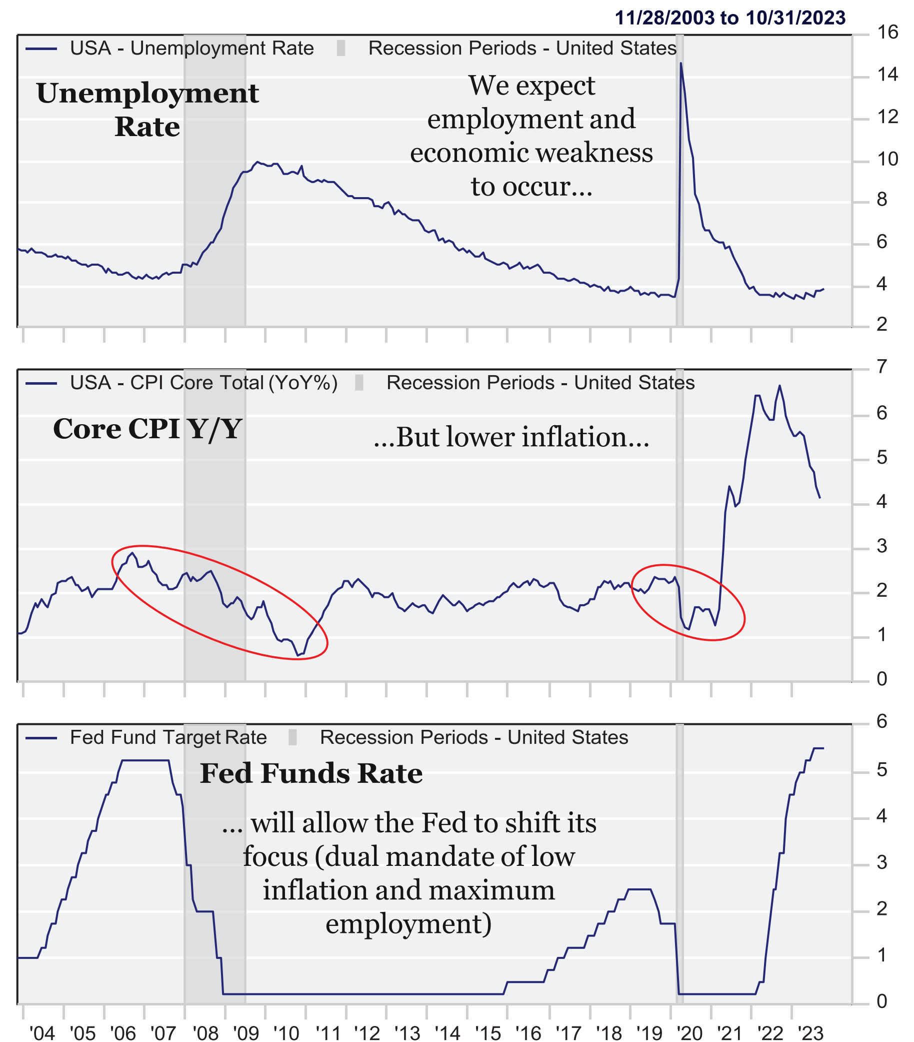
Fed Expectations- On Hold, But Tone Will Be Tough

Economic data over recent weeks has shown inflation moderating, the undersupplied labor market normalizing, and consumer spending softening/weakening. We believe the Fed is in "wait and see" mode, as they have done a lot up to this point and the full effects of their rapid tightening work with a lag on the economy. However, at the same time, they do not want the market front-running potential Fed actions too quickly relative to the economic data, which would run the risk of unwinding some of the progress made on inflation. For example, sharply lower bond yields and stocks ripping higher are inflationary, which is what they are still battling. So, while they are likely on hold for now, the Fed is also likely to talk tough with stocks rallying and bond yields declining. The Fed will remain committed to bringing inflation lower and keeping it there (until employment cracks).

Bond market pricing in an end to the rate hike cycle, and the next move being cuts in 2H 2024

Region: United States »		Instrument: Fed Funds Futures »	
Target Rate	5.50	Pricing Date	11/15/2023
Effective Rate	5.33	Cur. Imp. O/N Rate	5.333

Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M.
12/13/2023	+0.000	+0.0%	+0.000	5.333	0.250
01/31/2024	+0.000	+0.0%	+0.000	5.333	0.250
03/20/2024	-0.261	-26.1%	-0.065	5.267	0.250
05/01/2024	-0.695	-43.4%	-0.174	5.159	0.250
06/12/2024	-1.252	-55.7%	-0.313	5.020	0.250
07/31/2024	-1.810	-55.8%	-0.452	4.880	0.250
09/18/2024	-2.427	-61.8%	-0.607	4.726	0.250
11/07/2024	-2.994	-56.6%	-0.748	4.584	0.250
12/18/2024	-3.558	-56.4%	-0.889	4.443	0.250
01/29/2025	-4.080	-52.2%	-1.020	4.313	0.250



Source: Bloomberg, FactSet

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