KRILOGY

Week in Review

Equity Markets:
The S&P ended the week down just over 1% as investors' concerns around aggressiveness in rate hikes and Fed balance sheet reduction has been renewed. Small caps and growth stocks lagged compared to peers. The NASDAQ finished the week in the red by almost 4%. Defensive sectors led the way this week with strong performance in health care, utilities, and consumer staples.

Market participation was low this week, as noted by T. Rowe Price traders. Volume across the market was down as it appears investors are waiting on the sidelines for earnings season to ramp up before taking heavy action.

Fixed Income Markets:
The yield curve inversion was short-lived as the 10-year treasury yield rallied to end the week at 2.71% and the 2-year yield settled at 2.5%. Some portions of the yield curve, however, remain inverted as the 3-year to 7-year bond yields remain above the 10-year. The more closely watched segments of the curve, which include the 3-month and the 2-year relative to the 10-year, actually steepened last week.

The 3-month Treasury bill and 10-year Treasury spread is considered to be a better leading indicator for recessions because it has historically produced fewer false signals, according to FactSet. That spread currently stands at just over 2%.

Economic:
The labor market continues to tighten as continuing jobless claims fell to 166,000. This is the lowest figure since 1968. The services PMI came in lower than expected, but still indicates expansion with a reading of 58.3.

The minutes from March's FOMC meeting garnered the most attention this week. The first numbers were released regarding the Fed's balance sheet reduction. The Fed is prepared to reduce the balance sheet by as much as $95B per month. This is higher than the consensus expectation of $80B prior to the meeting. The minutes also showed that a 50-basis point (0.50%) rate hike in their next meeting in May is a legitimate possibility.

Looking Ahead

Equity Markets:
Earnings season kicks off this week, led by major banks. Q1 earnings growth is expected to be 4.5%, according to FactSet. If estimates hold true, it would mark the first time in two years earnings growth did not exceed 10%. Slowing earnings growth does not necessarily mean the environment for equities is negative. The market/economic cycle ebbs and flows. The expansion is not linear and as long as the trend is still heading up, it is positive. It is also important to note that earnings numbers are being compared to stronger growth periods. Earnings numbers are starting to roll out from the time when the economy was heavily affected by the pandemic, making the comps more difficult.

We believe the market still has strength to power forward and that it is right to expect sector/asset class leadership change. Additionally, the current environment does not lend itself to excessive risk-taking, as we are no longer in an expansionary monetary policy period. It is appropriate for investors to review their desired risk levels and ensure they have an investment strategy that matches. Having a properly allocated portfolio allows investors to endure bouts of volatility.

Fixed Income Markets:
The Fed's shift in policy stance has been swift. The about-face to what appears to be a very aggressive tightening policy will likely lead to more volatility across the markets. Fed governors who spoke last week made it very clear that the Fed is fully committed to battling inflation. If the Fed were to raise rates by 50 basis points at their next meeting, it would be the first time in over 20 years breaking from the traditional 25 basis point increase.

The futures markets are predicting that by the end of the year the fed funds target rate will hit 2.50%-2.75%. Currently, it stands at 0.25%-0.50%. We believe that if this occurs, a sustaining yield curve inversion is a real possibility. A yield curve inversion has not been a perfect predictor. This is a time to assess the risks in a portfolio and ensure there is a comfortable amount of risk being taken.

Economic:
There will be a host of key data points released this week, many pertaining to the March inflation picture. We will see the most recent numbers for the CPI, Producer Price Index (PPI) and the Import Price Index. The March retail sales report and preliminary University of Michigan Consumer Sentiment Index will likely garner attention along with the inflation numbers.

See following page for important disclosures

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