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WEEKLY MARKET RECAP | January 23, 2023

Week in Review

Equity Markets:

The S&P 500 ended the week down slightly, 0.7%. This snapped a three-week winning streak to start the new year. In a shift from the recent style trend, growth outperformed value. The NASDAQ finished the week up 0.6% and the Dow finished down 2.7%. Weakening economic numbers, subpar earnings releases, and the political landscape with the debt ceiling contributed to the volatility last week.

11% of S&P 500 companies have reported earnings. 67% have beaten earnings expectations while 64% have beaten revenue expectations, according to FactSet. Both of these are below their respective five- and 10-year averages. The Q4 blended earnings growth rate, which combines reported earnings with analyst estimates for companies that haven't reported, is -4.6%. If this trend continues it will be the worst quarter for S&P 500 earnings since Q3 of 2020 which saw earnings decline 5.7%. Despite weaker earnings numbers, valuations have come down slightly. According to FactSet, the forward Price-to-Earnings sits at 17x. This is below the five-year average of 18.5x, and slightly lower than the 10-year average of 17x.

Fixed Income Markets:

The bond market was little changed for the week. The 10-year treasury ended the week with a yield of 3.48%. The yield curve remains severely inverted. The 2s/10s spread sits at -0.66%. The three-month Treasury Bill finished the week with a yield of 4.66%. Currently, the three-month bill and 10-year inversion is -1.24%. According to data from the Federal Reserve Bank of St. Louis, this is the largest inversion this part of the yield curve has seen in 40 years.

The markets heard from members of the Fed this week. More members have supported a further slowing of the pace of rate hikes. The markets have priced in the probability of a 25-basis-point hike at the next meeting at 99.8%, according to the Fed Funds futures market.

Economic:

The housing market continued to cool with an 11th straight month of existing home sales declining 1.5% in December. Despite the lower sales numbers, the median home price was up 2.3% from a year ago. We would anticipate this number to level off as we move into the comparable period last year when the Fed's rate hikes started to push mortgage rates higher.

Headline PPI dropped 0.5% in December, much more than the Dow Jones estimate of 0.1%. A sharp drop in energy prices was a major contributor to the negative number. Core PPI, which excludes food and energy, increased by 0.1% in December.

Looking Ahead

Equity Markets:

With the majority of major banks reporting last week, earnings season will begin to ramp up this week. We will see an array of sectors represented but the majority of the focus will likely be on the technology sector. Earnings estimates have continued to come down, and are starting to extend further into 2023. According to FactSet, Q1 and Q2 analysts' estimates have turned negative. The Q1 earnings decline is expected to be -1.1%, This is much lower than the 5.9% earnings growth expected on September 30th, 2022.

Economic news and earnings estimates have begun their descent. The environment is pointing to an expected economic downturn at some point this year, which was likely priced in during the ~28% drawdown last year. The impacts of the slowdown should be mild because of the strong starting point of the economy going into the Fed rate hikes. Historically, the market has started its recovery as economic data and earnings are still searching for their trough. In the midst of the noise, the market looks forward and begins its march higher toward the recovery on the horizon. This is why we believe investors should stay committed to their thoughtfully developed plan. Diversification across sectors should reward investors as numbers trough and the recovery begins. Cyclical sectors have historically rewarded patient investors.

Fixed Income Markets:

The steep rate hikes in 2022 are starting to show their impact with a very cooled-off housing market, layoffs increasing, and inflation continuing its way down. The Fed has expressed its commitment to tamp out inflation completely and will not pull up short. This means there are more rate hikes to come. In our opinion, the majority, if not all, of the damage in the bond market has already occurred by the historical rate-hiking pace in 2022.

The bond market has recovered some of the losses it suffered in 2022, and we believe this year should be positive for the bond market. Given where the yield curve finished in 2022, we're set up for the potential negative correlation we have historically witnessed from treasuries in the event we do enter a recession.

Economic:

This week will be a busy one for economic data. The Conference Board's Leading Economic Index (LEI) will start the week off. This index is likely to be a closely watched reading going forward. Historically, the LEI has been a reliable indicator of a recession in the near-to-intermediate term. The first of three readings on Q4 GDP will be released. The final University of Michigan Consumer Sentiment Index will be a good follow-up to last week's retail sales numbers. S&P Global will release January's preliminary data on Manufacturing and Services activity.

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