Week in Review

Equity Markets:

The markets rebounded from their first weekly decline of the new year. Growth outpaced the broader markets with the NASDAQ ending the week up 4.3% while the S&P 500 finished in the green by 2.5%. The S&P is up 6% so far in 2023, rallying with the broader markets. We are roughly 15% below the all-time high set over a year ago so there is still work to be done.

29% of S&P 500 companies have reported earnings thus far. 69% have beaten earnings expectations and 60% have beaten revenue expectations, according to data collected by FactSet. Both are below their respective five & 10-year averages. The blended earnings growth rate, which combines actual reported earnings and analyst expectations, is -5% so far for the quarter. The USD appears to have had a major impact on corporations that derive the majority of their revenues overseas, according to data by FactSet. Companies with over 50% of their revenues outside of the U.S. are experiencing earnings declines of 7.3%, while companies that generate at least 50% of their revenues domestically have experienced earnings declines of 3.5%. In Q4 the USD rallied to multi-decade highs but has since softened meaningfully. The currency impacts on earnings for Q1 2023 are likely to be less severe if the dollar weakness remains.

Fixed Income Markets:

Treasury yields traded in a tight range for the majority of the week and the 10-year finished with the week yielding 3.52%. After a rally at the turn of the new year, the fixed-income markets have been in a stall pattern waiting for the next rate decision.

The bond market was little changed following the PCE report that came in at expectations. Year-to-date, the aggregate bond index is up 3.3%.

Economic:

Inflation continued to cool. Headline PCE met expectations at 5% year over year, while the core number came in at 4.4%. PCE has a heavy influence on Fed policy and the reading last week should be seen as a step in the right direction by the Fed. The Leading Economic Index fell for the 10th straight month. The University of Michigan Consumer Sentiment Index was revised higher to 64.9 as the expectations component jumped in the final reading. The housing market surprised to the upside with pending home sales increasing 2.5% in December while expectations for a 1% decline was the consensus estimate. The housing market is slowing but these numbers could indicate a troughing process.

Looking Ahead

Equity Markets:

Nearly a third of the way through earnings season it appears the historical pace of rate hikes by the Fed is starting to have an impact. Consumer demand started to weaken in Q4, which is historically a strong period. We are approaching the end of rate hikes and inflation is easing. Now, market fundamentals are likely to be the driving force behind stock market moves. The drawdown in 2022 priced in a mild recession. As a discounting mechanism, the markets were anticipating a slowing economy and weaker than expected earnings from companies due to the actions taken by the Fed. We are still on the side of a mild recession and not worse, mainly due to the strong starting position we entered 2022. The labor market was at historical strength, corporate balance sheets were historically solid, and profit margins remained near historic highs. This means there is room to falter without necessarily causing severe damage to the stock market.

Earnings revisions and guidance are overwhelmingly coming in negative, all while economic data continues to soften. Long-term investors should keep in mind that the stock market historically bottoms prior to the worst of news coming in. Volatility will likely remain and should present opportunities for long-term investors to obtain assets at discounted prices. Systematic rebalancing should also benefit from the volatility that is likely to continue. It's possible a retest of the current low of 3,491 may still occur, but the commitment to a thoughtfully developed investment plan to achieve an individual's goals should help in blocking out the noise of the market in the short term.

Fixed Income Markets:

All eyes will be on the Fed decision that will be announced Wednesday following its two-day policy meeting. The markets have priced in a 25-basis point increase. This would be the second meeting in a row of reduced hikes if market expectations are correct. We believe the pace of hikes holds little importance at this stage of the rate hiking cycle. The majority of the policy work has already occurred. The terminal Fed funds rate expectations have yet to come down significantly. The Fed has indicated a terminal rate in the 5.1% range, with the markets slightly lower. We anticipate the Fed reaching the terminal rate in the first half of the year and when compared to 2022, that increase is a very small percentage move.

Economic:

It will be a busy week for economic data that could add fuel to the market alongside the FOMC meeting. The JOLTS report and initial jobless claims will be closely watched following the string of layoff announcements this month. ISM will release its manufacturing and services PMI and we will also get a regional reading out of Dallas.

**** *See Important Disclosures on following page*

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