Week in Review

Equity Markets:

The S&P 500 ended the week slightly in the red, down 0.3%. The market saw elevated intraday volatility for the majority of the week as new economic numbers came in. The market is working through slowing earnings and a Fed that is likely to stay restrictive for longer, all while the labor market remains historically tight and expected GDP growth (despite being revised lower) remains positive for the year.

82% of S&P 500 companies have reported earnings so far. 68% have beaten earnings expectations and 65% have beaten revenue expectations[1]. The forward P/E sits at 18x, below the five-year average of 18.5x but above the 10-year average of 17.2x[1]. The recent multiple expansion has come from both factors of the equation; earnings estimates being moved down and the year-to-date rally in the markets.

Fixed Income Markets:

Hotter-than-expected jobs numbers and inflation reports over the past two weeks have pushed rates higher. The 10-year Treasury yield briefly rose to 3.92% on Friday before ending the day at 3.82%. After seeing a steep decline in yields year-to-date, as low as 3.32%, we have moved into the range that we began the year with. The yield curve remains steeply inverted. The 1-year Treasury finished the week yielding 5%. This is the first time in roughly 20 years this maturity has been over 5%.

The bond market's outlook for the future Fed Fund's Rate has increased dramatically. Fed Fund's Futures contracts are now implying at least two more 25 basis point rate hikes, and the probability of a third one in June increased to 53% last week[2]. The odds of the Fed increasing the pace to 50 basis points have also increased. To begin the year the bond market had priced in a maximum of two rate increases and then cuts toward the back end of the year. Currently, rate cuts are off of the table according to the futures market.

Economic:

Inflation reports came in slightly hotter than expected. January's CPI had a smaller decline than economists' estimates and the PPI number rose more than expected to 6%. Core CPI remains persistent, increasing 5.6% year-over-year. Retail sales surprised and rose 3% in January which topped the Dow Jones estimate of a 1.9% increase. The Leading Economic Index declined for the tenth straight month. The index declined 0.3% in January matching Bloomberg consensus estimates. Consumer expectations, yield curve, ISM new orders, and credit conditions were the negative contributors, offsetting the positives of the job claims and stock prices.

Looking Ahead

Equity Markets:

Analysts' consensus estimates for 2023 S&P 500 earnings is 222.85[3]. Downward earnings revisions have picked up steam this year. Individual companies are also lowering expectations. So far, 82 S&P 500 companies have made EPS preannouncements for the first quarter of 2023[4]. 65 have issued negative guidance while only 17 have issued positive guidance. The equity markets have been able to shrug off the changes in the fixed-income market and persistent inflation reports. We expect to see volatility tick up as the earnings outlook moves down.

Growth continues to outpace Value this year. We believe investors should remain disciplined when it comes to diversification. If we do see a deterioration in the economy and earnings, broad diversification (not only style but market cap and geographic) should serve investors well in the long run. Volatility has been muted relative to 2022, and the likelihood of it re-emerging is increasing with the economic and monetary policy outlook for the remainder of the year. Systematic rebalancing should assist in reducing the volatility and purchasing assets at suppressed prices which can present attractive long-term buying opportunities.

Fixed Income Markets:

In the past couple of weeks, the bond market has shifted the path it believes the Fed is going to take. Now, the bond market sees the terminal range at 5.25-5.5%. The markets and the Fed have come closer together regarding their outlook. We still believe the 10-year has reached its cyclical peak. The futures market moving upward is likely to contribute to heightened volatility. We believe this will cause the yield curve to become more inverted; rate hikes have more of an impact on the short end of the curve.

For fixed-income investors, the current structure remains an attractive opportunity. Current yields are at levels that were rare in the last cycle.

Economic:

S&P Global will release February's Preliminary Manufacturing and Services PMI. The second GDP estimate for Q4 2022 will be released Thursday. On Friday, the Fed's preferred inflation gauge, PCE will be released. We will also see numbers for new and existing homes, as well as the final reading of the University of Michigan Consumer Sentiment Index.

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

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Sources:

1)FactSet:
https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_021723.pdf

2)CME Group
https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html

3)Yardeni Research
https://www.yardeni.com/pub/yriearningsforecast.pdf

4)Lipper Alpha/Refintiv
https://lipperalpha.refinitiv.com/wp-content/uploads/2023/02/TRPR_82221_685.pdf

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