Week in Review

Equity Markets:

The rally slowed last week and the S&P 500 declined 1.1%. Higher rates and subpar earnings hit growth stocks more heavily. The NASDAQ declined 2.4%. Roughly 70% of S&P 500 companies have reported earnings. Thus far, 69% of companies have posted a positive earnings surprise and 63% have beaten revenue expectations according to data compiled by FactSet[1].

These numbers are below their respective five- and 10-year averages[1]. The blended earnings growth rate for Q4 2022 is -4.9%. On December 31, estimates had earnings declining 3.3%. The restrictive policy actions taken by the Fed last year and the inflationary environment appear to be having an impact on corporate earnings.

Fixed Income Markets:

The Treasury market saw a slight sell-off last week. The 10-year yield increased by 0.2%, ending the week at 3.74%. The yield curve remains steeply inverted. The 2's/10's spread finished the week at -0.76%. There is inversion throughout maturities on the yield curve and it is just over seven months from the initial inversion in July of last year.

The move to higher yields followed commentary from members of the Fed, including Chairman Powell. Chairman Powell has not wavered in his commitment to defeating inflation and he continues to point to the strong labor market as to why there remains more work to do. He acknowledged many of the softening data points in the goods segment, but policymakers still have concerns that inflation in the services segment needs more restrictive policy action.

Economic:

February's Preliminary University of Michigan's Consumer Sentiment Index rose more than expected to 66.4. A rise in the current conditions outpaced a slight decline in the expectations portion of the index. The consumer has remained resilient despite a multi-decade high in inflation. Mortgage activity has ticked up so far this year. The MBA Mortgage Application Index has risen four out of the five weeks in 2023. The index increased by 7.4% according to the release last week[2]. Mortgage rates remain drastically higher than a year ago, but it appears the stabilization in the rate has homebuyers less concerned. The housing market has significantly cooled over the past year, but the recent data could be indicating a bottoming process in the market.

Looking Ahead

Equity Markets:

We are entering the final stages of Q4 2022 earnings reports, and we are starting to look to the next couple of quarters. Analysts are actively decreasing their expectations for Q1 and Q2 2023 earnings. The market spent the majority of 2022 reacting to policy actions and economic readings. Little focus was placed on the fundamentals of the market. Now, we are seeing the fundamentals of the market begin to soften.

Historically, the market bottoms before the depth of the negative reports. Over the last four earnings downgrade cycles, data collected by Natixis shows that the S&P troughs roughly halfway through the earnings revisions[3]. We believe that we are in the heart of these revisions and investors remain focused on the long-term. The S&P 500 is still 15% below its all-time high of 4,818. For investors who can withstand the volatility that will likely continue over the next couple of quarters, the market presents attractive long-term growth opportunities. Systematic rebalancing can give investors the opportunity to purchase assets at discounted prices if volatility remains elevated as the earnings outlook deteriorates.

Fixed Income Markets:

The inflation reports set to be released this week have the potential to cause volatility in the fixed-income markets. We still believe we have seen the cycle high in the rate structure and have a positive view of the fixed income market. Short-term volatility could push rates near the 4% level. The majority of the damage to the bond market occurred last year in our opinion. Bond investors are now being rewarded with a sufficient return, unlike the period of the last 10-plus years.

We also believe investors should stay focused on high-quality bonds. Last week, the Fed Funds Rate inverted with corporate bond yields[4]. This spread turning negative indicates that investors are not sufficiently being rewarded for taking on credit risk, in our opinion. High-quality bonds are providing an asymmetric risk/reward profile at the current moment.

Economic:

We are set for a busy week with economic reports. The inflationary picture for January will begin to form with the CPI, PPI, and Import Price Index likely to dominate the headlines. Regional economic activity will be released from the Philly and New York Fed. An important index we have noted in past recaps, the Leading Economic Index, will be released on Friday.

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

Sources:

1)FactSet:
https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_021023.pdf

2)Economy.com:
https://www.economy.com/economicview/indicator/usa_mbamort/F0CC5C74-9B9F-4E20-B4D4-B22EE7B6240D/United-States-MBA-Mortgage-Applications-Survey

3)Natixis Investment Management, FactSet, Portfolio Analysis & Consulting

4)Federal Reserve Bank of St. Louis:
https://fred.stlouisfed.org/series/AAAFF

Important Disclosures: