Week in Review

Equity Markets:

The S&P 500 saw its worst weekly performance this year, ending down 2.7%. The driving forces were macro-related and were reminiscent of last year. Following a higher-than-expected PCE report on Friday, the markets were deep in the red and finished the final trading session down over 1%.

Q4 earnings season is coming to a close with 94% of S&P 500 companies having reported. So far, 68% have exceeded earnings estimates and 66% have beaten revenue estimates[1]. The blended earnings growth rate stands at -4.8% which is worse than the anticipated -3.3% heading into the quarter. Earnings outlooks have continued to be ratcheted down and the likelihood of this continuing is high. 76 S&P 500 companies have issued negative EPS guidance for the first quarter of 2023. The inflationary environment and interest hikes are starting to show up in corporate earnings and we expect to see this continuing due to the lag effect of monetary policy.

Fixed Income Markets:

The bond market ended the week slightly negative. The 10-year treasury yield rose slightly to 3.95%. The bond market has had a slight disconnect in the outlook on monetary policy over the past few months. The Fed has remained consistent, but the bond market had priced in a better outcome. In January, the markets believed that the Fed was going to raise rates twice in 2023 and were expecting cuts in the back half of the year[2]. Currently, four hikes have been priced in and the probability of a rate cut is near 0%.

Economic:

The PCE report showed that inflation is still prevalent in the economy and surprised to the upside. It rose 0.6% month-over-month and 5.4% from last year. Both exceeded estimates of 0.2% and 5%. There was a swift drop in inflation in 2022 but the Fed's battle will not be linear. Driving inflation back to target will likely see bouts of choppiness. Core PCE, the preferred gauge by the Fed, also came in higher than expected, increasing 4.7% from January of 2022. The University of Michigan Consumer Sentiment Index was revised higher to 67 from the preliminary number of 66.4. Despite the stickiness of inflation, the consumer remains resilient. The housing market seems to have stabilized and the deterioration has slowed. New home sales in January increased 7.2% from December and were modestly down 0.7% from one year ago.

Looking Ahead

Equity Markets:

The strong start to the new year was a welcomed reprieve following a historically bad year in 2022. Investor sentiment was extremely negative, and part of the recovery is likely due to the reversal of sentiment. The markets may have gotten ahead of themselves and were too optimistic last month. It is important for investors to remember the challenging environment that still lies ahead. We are not in the clear yet and volatility will likely remain elevated for some time to come. As long-term investors, we attempt to ignore the peaks and valleys and keep sight of the full journey.

Thus far, 2023 has been a good example of commitment to a long-term investment strategy. January saw an S&P 500 rally of 6.18%. This followed a tough December, and the shift was nearly impossible to predict. The same is also true for February. Year to date, the S&P remains in the green and an investor who lacks conviction regarding their long-term goals would have missed the strong January returns. We believe that a thoughtfully constructed diversified portfolio which matches your risk appetite is crucial in this current environment. Weakness may still be ahead, but an investor with conviction regarding their long-term investment goals should not worry. Short-term bouts of weakness are long-term investors' opportunities.

Fixed Income Markets:

After the 10-year treasury peaked in October near 4.25%, yields retreated below 3.5% in quick order. The fight against inflation is likely to be long, and not always easy. The Fed is consistent in its messaging of "higher for longer". Until inflation approaches its target, we are not likely to see an easing occur. This does not necessarily mean 1970's/80's absolute rate levels, but an easy monetary environment is a thing of the past.

Our view remains that the 10-year yield is likely to stay range bound between 3-4% until the Fed pivots. This also means that we believe we have likely seen peak interest rates in the current cycle. As bonds sell off, we believe fixed-income investors have opportunities to lock in attractive long-term returns. The current yields on treasury securities are at levels the market did not see in the prior cycle.

Economic:

We will receive data that will encompass the broader economy this week. January housing data will finish up with the pending homes sales report on Monday. Economic activity will be released from the ISM Manufacturing and Services Index. Regional data will also be released from Chicago, Dallas, and Richmond. The Conference Board will release its Consumer Confidence Index as well.

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

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