Week in Review

Equity Markets:

The S&P 500 recovered some of the losses from the week prior, ending the week positive by 1.9%. After starting the week in the red, the market rallied despite the surge in yields. This earnings season has been less than stellar, but last week saw a few major S&P companies have very good reports. Salesforce and Broadcom specifically, helped stabilize the market before the rally on Friday. The second month of the year ended down 2.6% for the S&P 500, giving back some of the 6.2% gain from January.

Q4 earnings season is nearly complete with 99% of S&P 500 companies having reported[1]. 69% have reported positive earnings surprises and 65% have beaten revenue expectations[1], according to data collected by FactSet. Earnings results have significantly underperformed when compared to their five- and 10-year averages of 77% and 73%. Eyes have already turned to Q1 earnings which has also received steep downward revisions. 105 S&P 500 companies have issued guidance for Q1 earnings. 81 have issued negative guidance while only 24 reported positive guidance[1]. Data from Refinitiv is showing a Q1 earnings decline of 4.5%[2]. This is a significant downward revision from the 1.4% growth that was expected on January 1st.

Fixed Income Markets:

Yields saw elevated volatility last week with the 10-year Treasury yield trading in a fairly wide range of 20 basis points. The yield moved from an intraweek low of 3.90% on Monday to the week high of 4.09% on Tuesday before finishing the week flat from the prior week at 3.96%.

Economic:

The ISM Services Index came in at 55.1, remaining in expansion territory. A similar theme from the final S&P Global U.S. Services PMI was reported. The final reading saw a slight upward revision to 50.6 from the preliminary 50.5. Both numbers indicate the services sector is in expansion territory. Pending home sales increased 8.1% month-over-month according to the National Association of Realtors. This reprieve, however, is likely to be short lived with the recent spike in interest rates.

Looking Ahead

Equity Markets:

Even when faced with a surge in yields mid-week, the market was able to stabilize and end the week higher. We anticipate that this trend will continue as we see more rate hikes and potentially hotter inflation reports. Volatility should be expected as this data comes in, but we believe fundamentals will be the major input for a sustainable market trend.

The S&P 500 remains 17.2% below its peak from January 3rd of 2022. Earnings have continued to come down which has resulted in a slight uptick in the market multiple. The forward P/E sits at 17.9 assuming 225 for 2023 earnings[3]. Currently, the market is not overly valued or undervalued. In our opinion, earnings will need to come in better than expected for the market to see a sustainable rally. Earnings revisions are still occurring, and we believe this surprise is not likely to occur in Q1 earnings but in increases later in the year. This does not mean the markets will not experience times of strength, but we believe it is prudent for investors to be patient, as this not the time to for excess risk taking.

We are positive on the markets while noting more volatility likely remains, so strict adherence to your asset allocation targets should be top of mind. As long-term investors, we see the market as attractive on a multi-year basis. The road to a new upward path may remain bumpy until we come out on the other side of the rate hikes and earnings revisions.

Fixed Income Markets:

Chairman Powell will be speaking to congress on Tuesday and investors will be watching closely for any insight into potential policy going forward. Fixed-income investors should be prepared for weeks like last week as more rate hikes are certain to occur. We believe actions like last week (short term spikes before settling down) are likely to occur around policy events, jobs, or inflation. We still believe we have seen the peak of the rate cycle but have not fully counted out the potential to test those levels at some point. The current rate structure provides fixed-income investors a sufficient return that was missing in the last cycle. If a prolonged breakdown in the equity markets occurs, the negative correlation benefit of high-quality bonds is relatively attractive.

Economic:

The labor market will dominate the economic reports for this week. On Wednesday, the JOLTS report and the ADP National Employment report will get the labor reports started, followed by unemployment claims on Thursday. Numbers on jobs and unemployment will be released on Friday by the U.S. Bureau of Labor Statistics. Tuesday, we will have a release on consumer credit. This area has started to show weakness over the past few months as the inflationary environment has remained elevated.

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

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

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3)Yardeni Research, Inc.
https://www.yardeni.com/pub/stockmktperatio.pdf