Week in Review

Equity Markets:

The S&P 500 finished the week with a modest return of 0.3%. The NASDAQ finished the week up 2.52% and widened the spread for growth outperformance relative to value for the year. Large Cap Growth has outperformed Large Cap Value by a 22% year-to-date[1]. Growth is up 21.3% while value is in the red by 0.7%. Much of the outperformance has been dominated by a handful of names, and the jet fuel behind much of the recent rally is the "AI Arms Race".

First Quarter earnings are nearly complete with 97% of S&P 500 companies having already reported. 78% of companies have beaten earnings expectations and 76% have beaten revenue expectations[2]. Earnings have come in better than expected; at the beginning of the quarter analysts were expecting a decline in earnings of 6.7%, but the decline has been much less so far at 2.1%.

Fixed Income Markets:

Treasury yields continued their push higher as debt ceiling negotiations slowed. The 10-Yr Treasury finished the week with a yield of 3.8%. The 1-Yr Treasury continued its multi-decade push higher and finished the week yielding 5.24%. This is the highest yield for this maturity since the fall of 2000[3].

The force that has been behind the recent ascent in rates may be coming to a conclusion. Over the weekend, the administration and members of the Republican Party reached an agreement on the debt ceiling. The last step is to have Congress vote on the deal, and the fear of a US default will be a thing of the past.

Economic:

The Fed's preferred inflation gauge came in slightly higher than expected. The Personal Consumption Expenditures Price Index rose 4.4% year-over-year and the core reading, which excludes food and energy, rose 4.7%. Both of these numbers were 0.1% higher than economists' estimates. The University of Michigan Consumer Sentiment Index came in at 59.2, above the forecast of 57.9. Despite the upside surprise, the index hit a six-month low as the long-term expectations portion of the survey dropped significantly[4]. The second, of three, first-quarter GDP estimates showed the economy grew at an annual rate of 1.3%. This reading improved on the first estimate of 1.1%. Broad expansion in spending helped push the reading higher.

Looking Ahead

Equity Markets:

Earnings have been much better than feared. Earnings have still declined year-over-year which means, broadly, corporations are still not seeing growth. Analysts may have discounted earnings too quickly and the slower growth appears to have just been pushed out. Full-year 2023 earnings have not seen only slight revisions upward despite the surprise in the first quarter. At the start of the first-quarter earnings season, expectations were for 1.2% growth in 2023. Today, this number sits at 1.5%[5].

Market participation (breadth) is hitting extreme lows[6]. This means that the market is being propped up by a handful of names. This can be seen in the wide performance spread between value and growth. Mega-Cap Tech has dominated so far this year while essentially the rest of the market has been left behind. This is a time when investors must remain diligent and committed to their long-term investment plan. Having a few names with large outperformance can become tempting to chase. But, as last year showed, style reversals can occur at any point and the performance margin can swing back the other way. Systematic rebalancing can be beneficial when this occurs. Trimming some of the large outperformers while wading into the underperformers can keep your portfolio properly diversified and positioned to capture the style reversal when it occurs.

Fixed Income Markets:

Last week's PCE report rattled the Fed Fund's Futures market. At the beginning of the week, futures had priced in a 72% probability for a Fed pause but following the report the market has priced in a 66% probability of another 25-basis point rate hike[7]. Following the release of the FOMC meeting minutes and hearing from members of the Fed since their most recent meeting has shown there is some disagreement on the future of rate increases. One thing is clear though, if the end of rate hikes has not come already it is very close to the end.

We still believe the 4.25% yield on the 10-Yr from last October is the cycle high and the majority of the damage in the fixed-income markets occurred last year following the intense pace of hikes. We may see bouts of heightened volatility around the interest rate decisions but believe that rates will ultimately settle in the 3.25% range in the next 6-12 months. We see opportunities for fixed-income-oriented investors in the current structure. A suitable return can be found now that the "income" component has returned to the fixed-income market.

Economic:

The economic calendar this week will have a heavy focus on the labor market. The JOLTS report will be released on Wednesday and to end the week, monthly unemployment and job creation data will be released. The headline will be the ultimate vote on the new debt ceiling deal, which is scheduled to take place on Wednesday, as of now.

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

Sources:

1)JP Morgan
https://am.jpmorgan.com/content/dam/jpm-am-aem/americas/us/en/insights/market-insights/wmr/weekly_market_recap.pdf

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