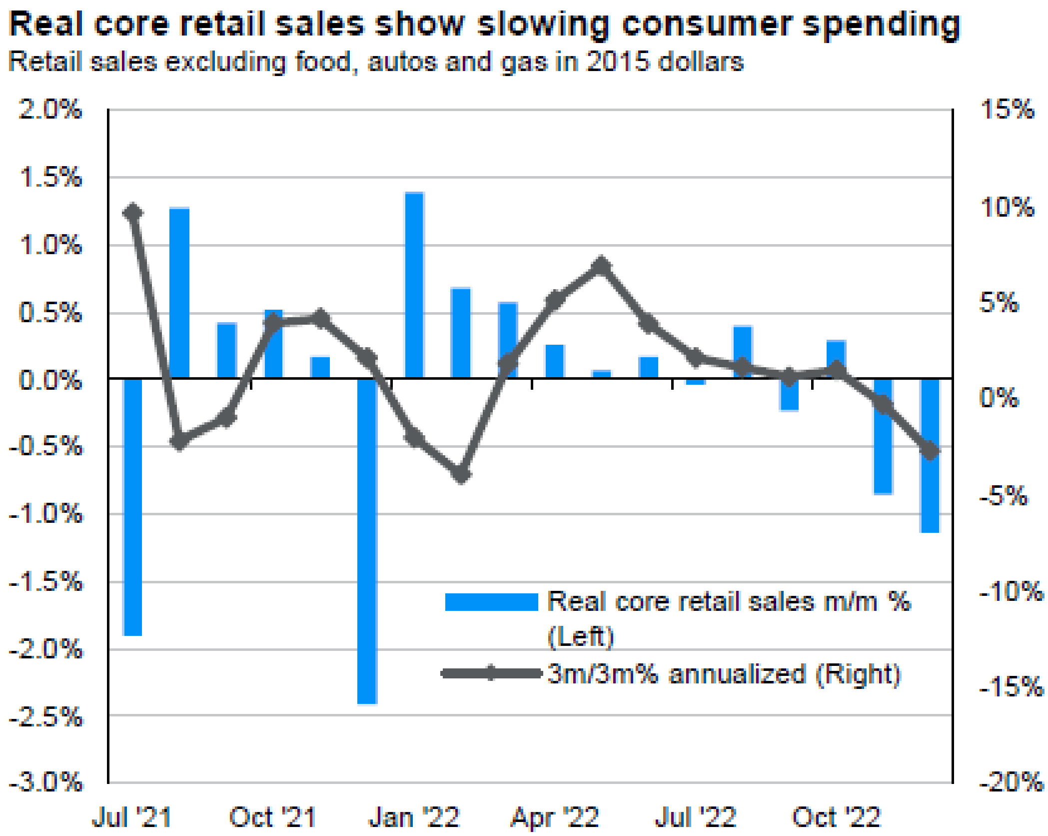
Monday, January 23, 2023

Good morning:

After a positive start to the year in equity markets, based partly on declining inflation numbers, stocks turned negative midweek on the heels of weaker manufacturing and consumer data. The ongoing U.S. debt ceiling issue, along with mixed earnings results also contributed to renewed investor apprehension. By week's end, the Dow led major averages lower by -2.66%. The S&P 500 fared better posting -0.65%, while the NASDAQ bucked the trend and posted a gain of 0.55% for the holiday-shortened trading week.

For the past several months, bulls on Wall Street have been counterintuitively hoping for weaker economic news. The logic being that any signs of a softer economy would prompt the Fed to consider halting its rate hiking campaign sooner. However, now that several major tech and financial companies have announced broad layoffs, housing starts are declining, and consumer spending is starting to slow, the reality of a lower GDP and perhaps a recession seems inevitable. As results from the Q4 holiday shopping season are reported over the next couple weeks by key retailers, investors will likely have further evidence of the more cautionary level of holiday spending from consumers.



Source: JP Morgan Asset Management

If the Fed is looking to tamp down inflation that was partially set ablaze by pent-up demand from consumers awash with cash, then why would a modest decline in spending be seen as surprising or even bad? It boils down to whether the stock price declines in this bear market adequately reflect the earnings decline that is likely to unfold in the coming year. As this chart illustrates, forecasts for future S&P 500 earnings per share have been moving lower as analysts expect lower corporate profits. However, if such earnings declines turn out to be less than expected or shorter in duration, as would be the case in a so-called "soft landing," equity prices could recover far sooner than many expect.

Source: Bloomberg

As we move further into 2023, we continue to expect higher levels of volatility in both directions. Historically, markets have been forward-looking and can start to recover up to six months before the end of an economic downturn. Despite some very positive trading sessions so far this year, we are not convinced that equities have seen their ultimate bottom in this cycle. Today's strong opening of between 1-2+% in major stock indices is reestablishing some positive momentum and cautionary optimism as investors await further economic and earnings reports later in the week.

After the unprecedented steps taken during the pandemic to both fight the spread of COVID-19, as well as financially support workers, businesses, and the economy, it should not be a surprise that we had many unexpected, or at least unavoidable consequences. Our economy is still feeling the reverberations as we strive to return to more familiar levels of pre-pandemic normalcy. Additional time and distance should help.

Have a great week!

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The Dow Jones Industrial Average (DJIA), commonly known as “The Dow” is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal.

S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market. An investment cannot be made directly in a market index.

The NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market.

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