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Weekly Market Guide

The month of February was a reality check for investors following January's surge higher on "soft landing" optimism, as sticky inflationary readings over the past several weeks resulted in higher rate expectations, rising bond yields, and lower equities. It is a reminder that the path ahead will be a lumpy process and that the market is not ready to sprint back to new highs. We expect choppy trading over the coming weeks and months, as investors digest the economic dataflow- and sentiment swings may occur due to elevated uncertainty on inflation, Fed policy, and ultimately economic growth. That said, we do remain positive on equities over the next 12 months and view the recent pullback as opportunity to accumulate favored areas within a longer-term perspective.

Fed rate hike expectations have moved substantially higher as a result of the recent "sticky" inflation readings. For example, the market-implied peak Fed funds rate is now 5.46% by September vs. an expected peak just one month ago of 4.88% by June. This shift in expectations is pushing bond yields higher- the 2-year yield is up to 4.95% (cycle highs) and the 10-year yield is up to 4.06% (approaching October highs of 4.23%)- which is a headwind to equity valuations.

But just as the "goldilocks" market view was unjustified, this current adjustment in the other direction may be misguided as well. The highest odds are that the normalization process (from pandemic/record stimulus) will create confusing data along the way with upside runs and pullbacks to follow for equities. Until we get some clarity regarding inflation and then the economy, a market run to new all-time highs is a low probability. But the amount of technical positives over recent months also suggest that the lows of this bear market may be in. **Hence, the pullback can be accumulated with a percentage of cash set aside and earmarked for equities.**

- **Don't overthink Growth vs. Value**- stay with diversity. If the economy does not rollover, Value may continue to lead. If the economy softens to the point to drive rates down, Growth may lead (on a relative basis).
- **Mid-caps** have some of the best price momentum. **Small-caps** are holding up and likely justify at least an equal weight. Risk of economic weakness (they suffer more) holds us back from being too bullish or overweight.
- **Global**- although it is tough to square with potential economic weakness ahead, the technical price momentum is difficult to ignore (despite it being driven by dollar weakness). The result is an equal weighting in-line with long-term targets- potential economic weakness keeps us from being overweight. Emerging Markets are interesting with China reopening (and pulling back).
- **Bonds**- 10-year yield nearing top of near-term range?

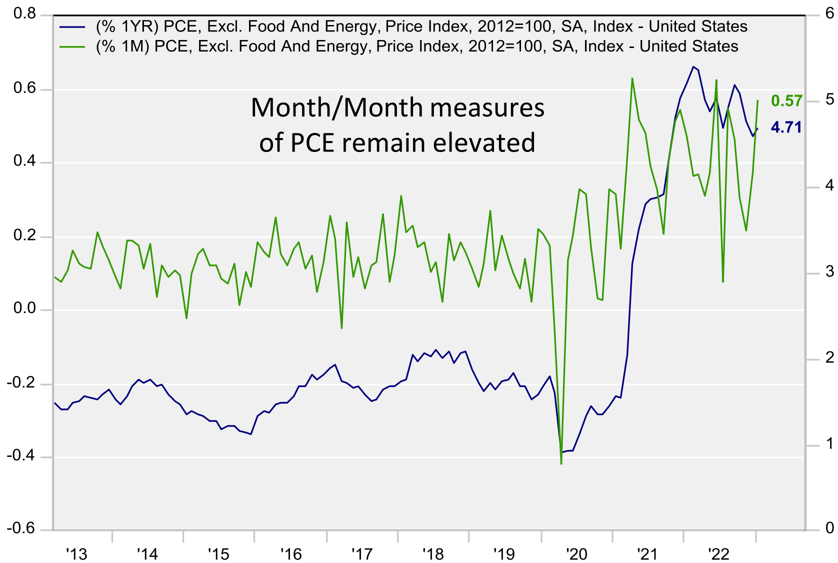
Equity Market Indices	Price Return Year to Date	Price Return 12 Months
Dow Jones Industrial Avg	-1.5%	-1.9%
S&P 500	2.9%	-8.2%
S&P 500 (Equal-Weight)	3.3%	-3.3%
NASDAQ Composite	8.7%	-15.9%
Russell 2000	7.8%	-5.5%
MSCI All-Cap World	3.9%	-8.7%
MSCI Developed Markets	5.7%	-3.9%
MSCI Emerging Markets	2.9%	-16.3%
NYSE Alerian MLP	3.3%	9.1%
MSCI U.S. REIT	3.7%	-15.6%

S&P 500 Sectors	Price Return Year to Date	Sector Weighting
Consumer Discretionary	10.9%	10.6%
Information Technology	8.7%	27.2%
Communication Svcs.	8.2%	7.7%
Materials	5.9%	2.8%
Financials	3.7%	11.8%
S&P 500	***2.9%***	-
Industrials	2.8%	8.6%
Real Estate	1.6%	2.7%
Energy	-3.3%	4.9%
Consumer Staples	-4.2%	6.7%
Health Care	-6.8%	14.4%
Utilities	-9.9%	2.8%

Source: FactSet

MACRO: US

The Fed's favored measure of inflation- PCE (Personal Consumption Expenditures)- came in high and ahead of expectations for January. Core PCE rose 0.57% m/m (vs 0.4% est.) and 4.7% y/y (vs 4.3%). This is the latest in a number of "sticky" inflationary readings over the past month and is a reminder that the process of inflation normalization is unlikely to be quick or smooth. **We do believe that the Fed will be successful in bringing inflation down over the next year, but clear and convincing progress is also likely to take time and come with economic weakness.** February ISM Manufacturing points to that weakness, coming in at 47.7 (below the 50-breakeven point for growth). New orders also came in at a weak 47.0, though that was a jump from January's 42.5 low. For now, we view it as a counter-trend bounce- and believe that Fed tightening will act with a lag on the economy ahead.



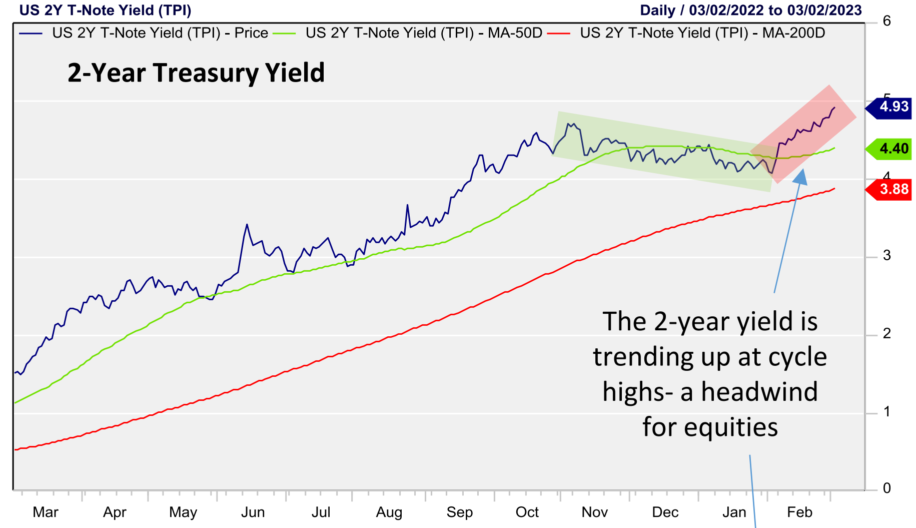
Source: FactSet

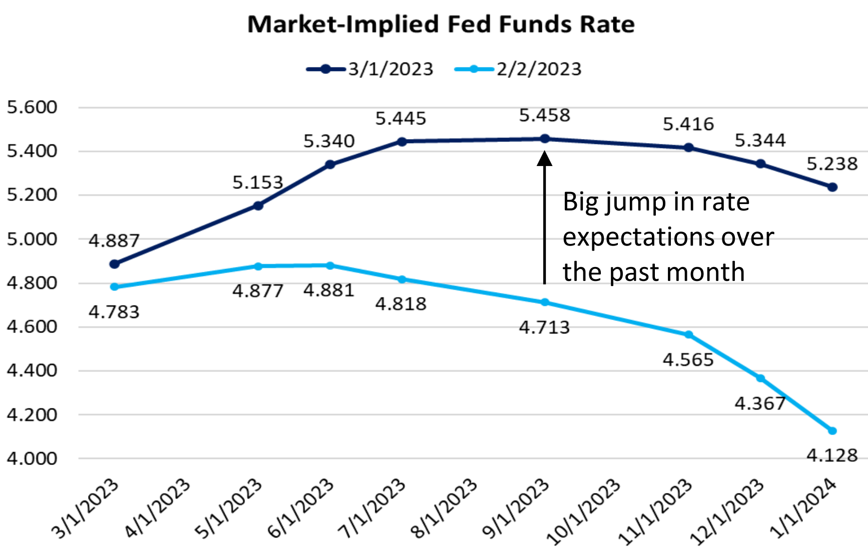
US Economic Data This Week:

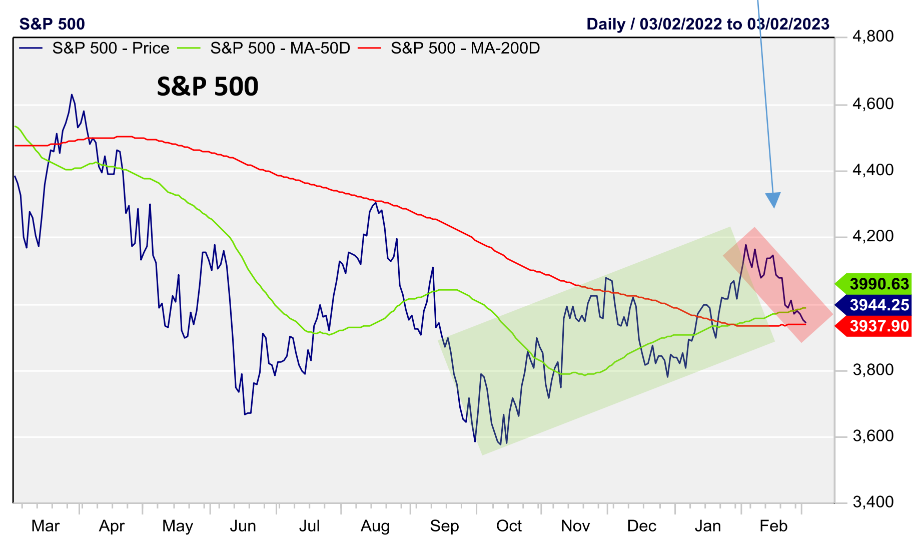
Event	Period	Actual	Consensus	Prior
BEA Domestic Auto Sales SAAR (Final)	JAN	2.2M	-	2.2M
BEA Domestic Light Truck Sales SAAR (Final)	JAN	10.2M	-	10.2M
BEA Total Light Vehicle Sales (Final)	JAN	15.7M	15.5M	15.7M
Building Permits SAAR (Final)	JAN	1,339K	1,339K	1,339K
Core PCE Deflator M/M	JAN	0.57%	0.40%	0.37%
Core PCE Deflator Y/Y	JAN	4.7%	4.3%	4.6%
PCE Deflator SA M/M	JAN	0.62%	0.50%	0.20%
PCE Deflator Y/Y	JAN	5.4%	4.9%	5.3%
Personal Consumption Expenditure SA M/M	JAN	1.8%	1.1%	-0.10%
Personal Income SA M/M	JAN	0.60%	0.90%	0.30%
Michigan Sentiment NSA (Final)	FEB	67.0	66.4	66.4
New Home Sales SAAR	JAN	670.0K	620.0K	625.0K
Durable Orders ex-Transportation SA M/M (Preliminary)	JAN	0.70%	-0.10%	-0.40%
Durable Orders SA M/M (Preliminary)	JAN	-4.5%	-3.7%	5.1%
Pending Home Sales Index SAAR	JAN	82.5	77.9	76.3
Pending Home Sales M/M	JAN	8.1%	0.90%	1.1%
Dallas Fed Index	FEB	-13.5	-9.0	-8.4
Wholesale Inventories SA M/M (Preliminary)	JAN	-0.40%	0.10%	0.08%
S&P/Case-Shiller comp.20 HPI M/M	DEC	-0.50%	-0.50%	-0.52%
S&P/Case-Shiller comp.20 HPI Y/Y	DEC	4.6%	4.6%	6.8%
Chicago PMI SA	FEB	43.6	45.4	44.3
Consumer Confidence	FEB	102.9	108.5	106.0
Richmond Fed Index	FEB	-16.0	-4.5	-11.0
Markit PMI Manufacturing SA (Final)	FEB	47.3	47.8	47.8
Construction Spending SA M/M	JAN	-0.10%	0.20%	-0.69%
ISM Manufacturing SA	FEB	47.7	47.8	47.4
Continuing Jobless Claims SA	02/18	1,655K	1,675K	1,660K
Initial Claims SA	02/25	190.0K	197.0K	192.0K
Unit Labor Costs SAAR Q/Q (Final)	Q4	3.2%	1.6%	-
Productivity SAAR Q/Q (Final)	Q4	1.7%	2.5%	3.0%

THE FED, BOND YIELDS, AND EQUITIES

Fed rate hike expectations have moved substantially higher as a result of the recent “sticky” inflation readings- and this shift in expectations is pushing bond yields higher. **Just as the decline in bond yields from October through January was a tailwind to equities, the steady increase in bond yields of late is now a headwind. But just as the “goldilocks” market view was unjustified, this current adjustment in the other direction may be misguided as well**. The highest odds are that the normalization process (from pandemic/record stimulus) will create confusing data along the way with upside runs and pullbacks to follow for equities. Until we get some clarity regarding inflation and then the economy, a market run to new all-time highs is a low probability. But the amount of technical positives over recent months also suggest that the lows of this bear market may be in. **Hence, the pullback can be accumulated with a percentage of cash set aside and earmarked for equities.**





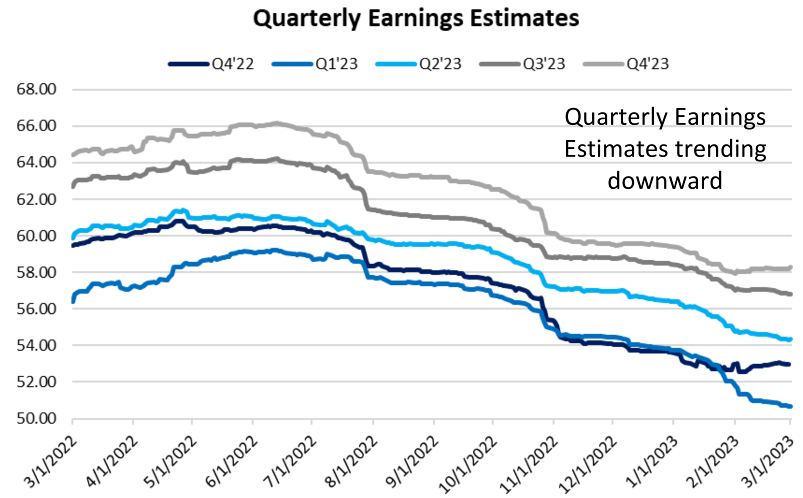


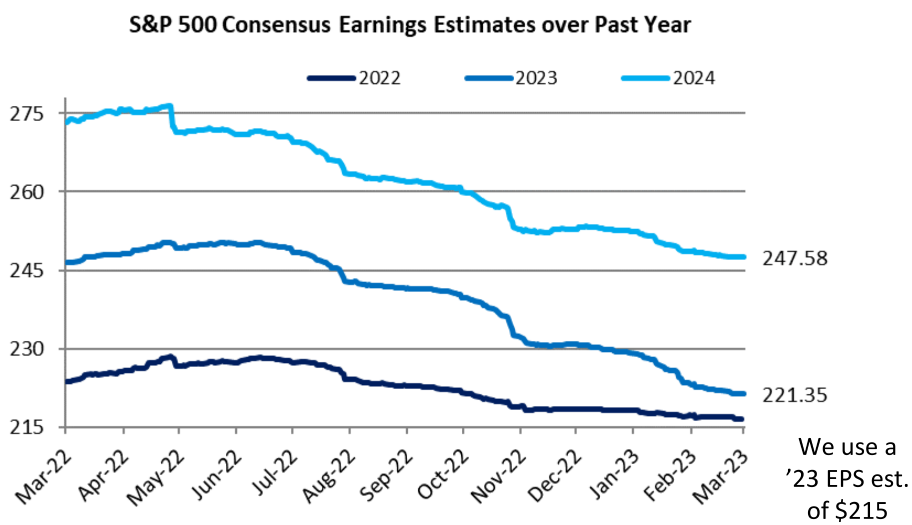
Source: FactSet

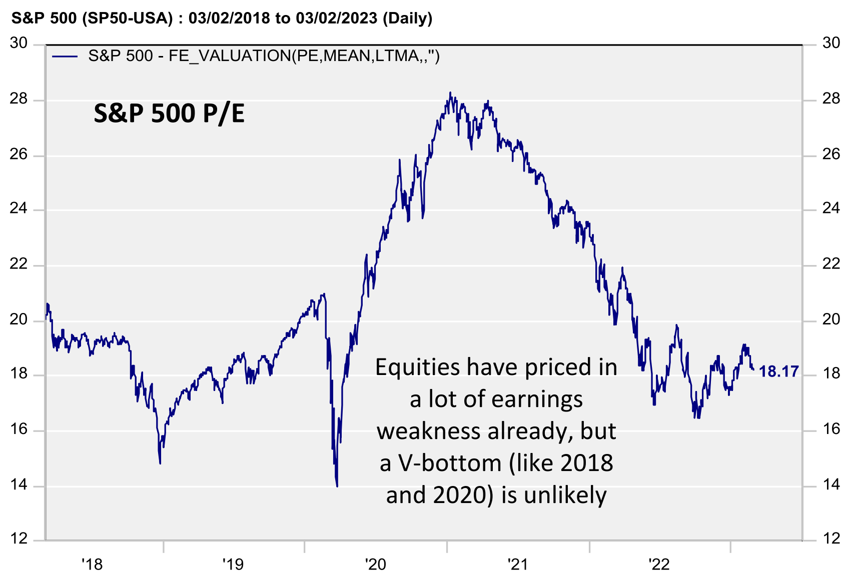
FUNDAMENTALS

Forward earnings estimates continued to decline throughout Q4 earnings season, in particular Q1'23 and Q2'23 estimates, as companies guided towards economic uncertainty and weakness. **We believe that forward estimates will keep trending lower** and use a 2023 year-end earnings estimate of $215 (with risks to the downside given our expectations for a mild recession).

Stocks have discounted a lot of earnings weakness already in our view, but we are not convinced that a mild recession has been fully priced in. We also do not have the luxury of a Fed coming to the rescue as they did coming out of the market lows in 2018 (trade war) and 2020 (Covid shutdown), due to their fight against high inflation. The result is a bottoming and recovery process that are likely more elongated this cycle. As investors gain clarity on inflation, Fed policy, and ultimately the economy, we expect multiples to climb higher and drive positive returns. But that clarity will also take time.







Source: FactSet

TECHNICAL: S&P 500

Source: FactSet

S&P 500 is trying to hold major support (50-DMA, 200-DMA, former down-trend resistance).

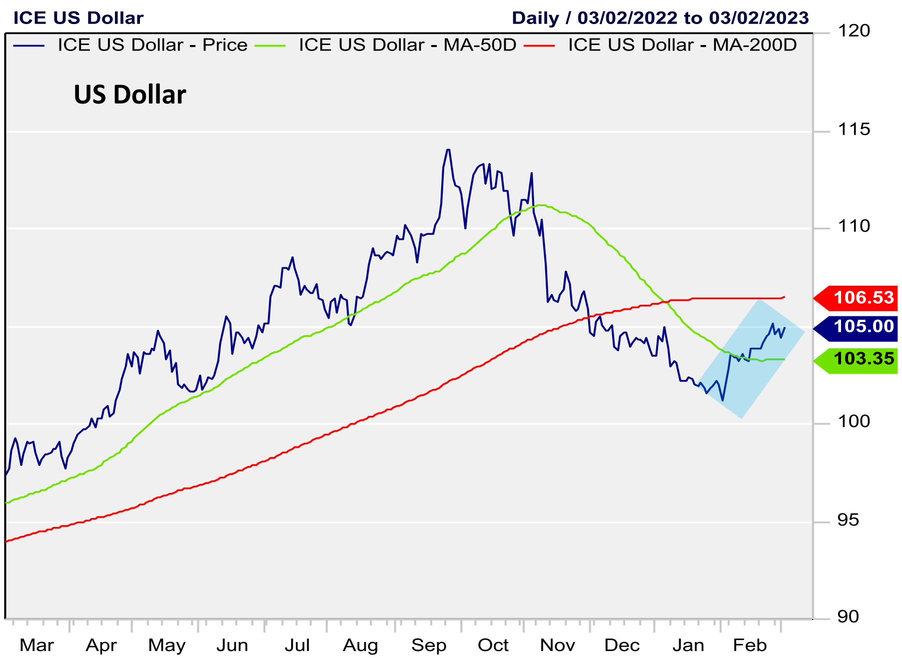
With the market oversold, a modest bounce may develop.

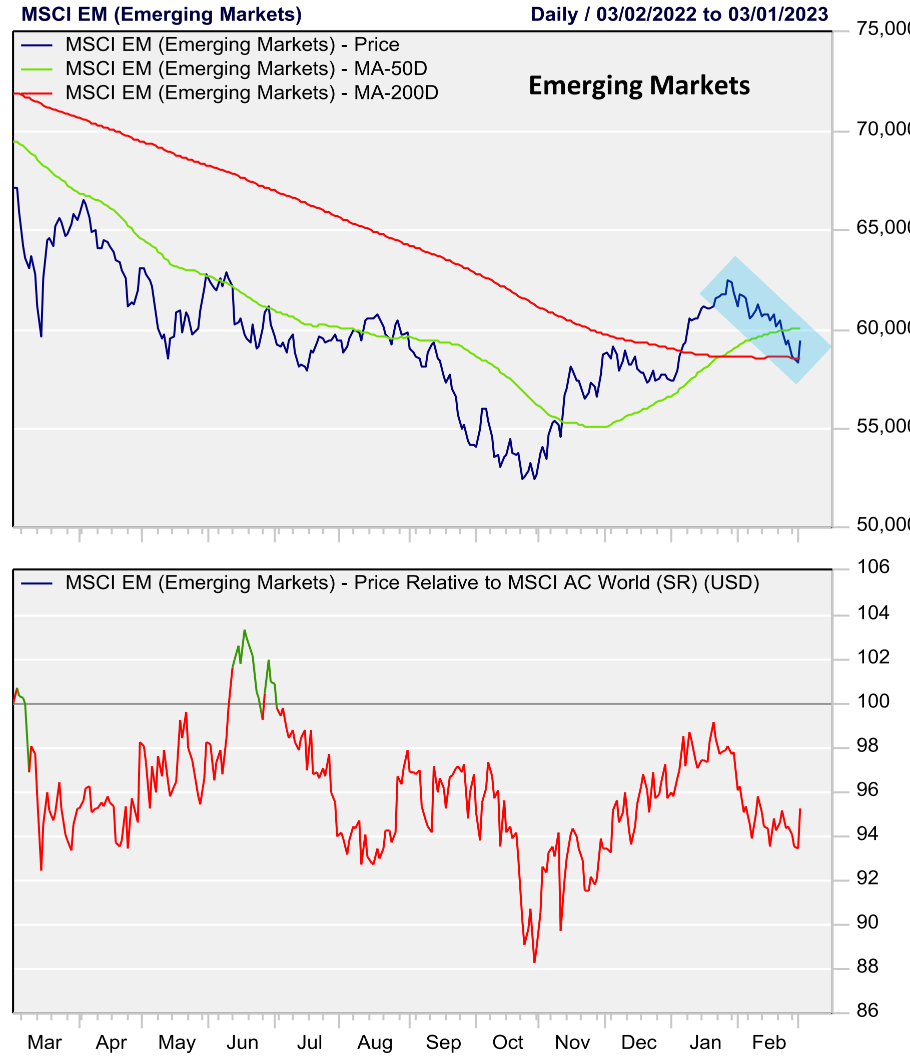
Over the next three weeks (JOLTs Job Openings and Jobs Report next week, CPI the following, FOMC the next), we may get data to push a break-down (limited to near 3700-3800 or a bounce to retest the recent 4200 high).

Our bias is for a bounce. Long-term investors should not over think it and put some cash to work in here.

GLOBAL MARKETS AND US DOLLAR

Global markets have appreciated considerably from their October lows, a byproduct of the US dollar decline- these moves have consolidated in recent weeks. Our bias is that the dollar has likely peaked but may become more range-bound in the coming months. This should reduce the headwind to global equities, and draws our attention with areas like Emerging Markets still 26% off their highs. Although it is tough to square with potential economic weakness ahead, the technical price momentum is difficult to ignore. Emerging markets also may fare slightly better on the world scale with the reopening of China possibly helping the yuan and Chinese equities (largest EM weighting). **If the US dollar fails at resistance (200 DMA), we recommend accumulating positions in China and EM**.

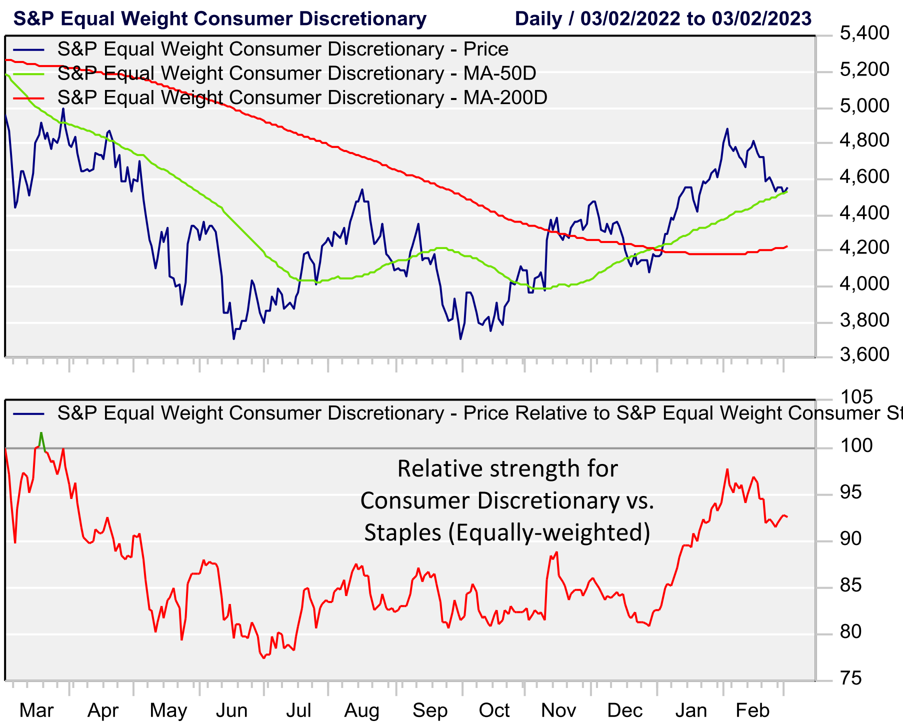


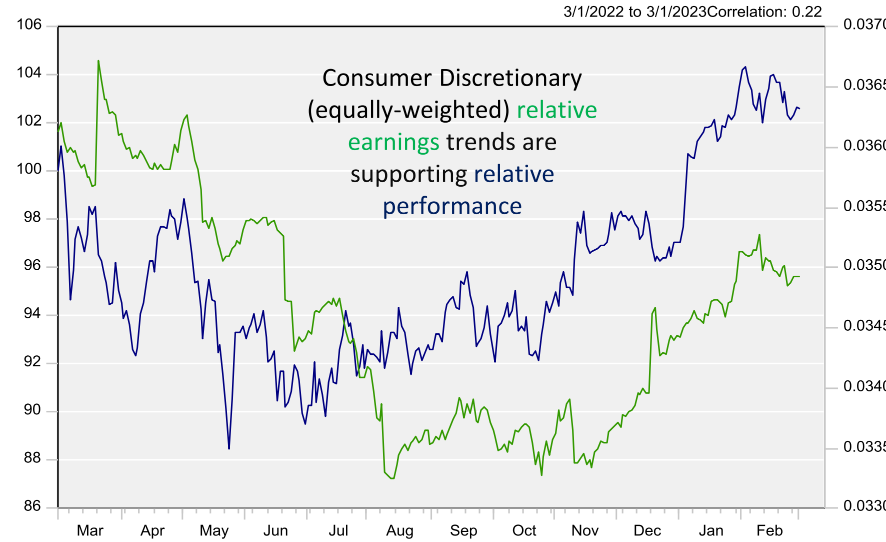


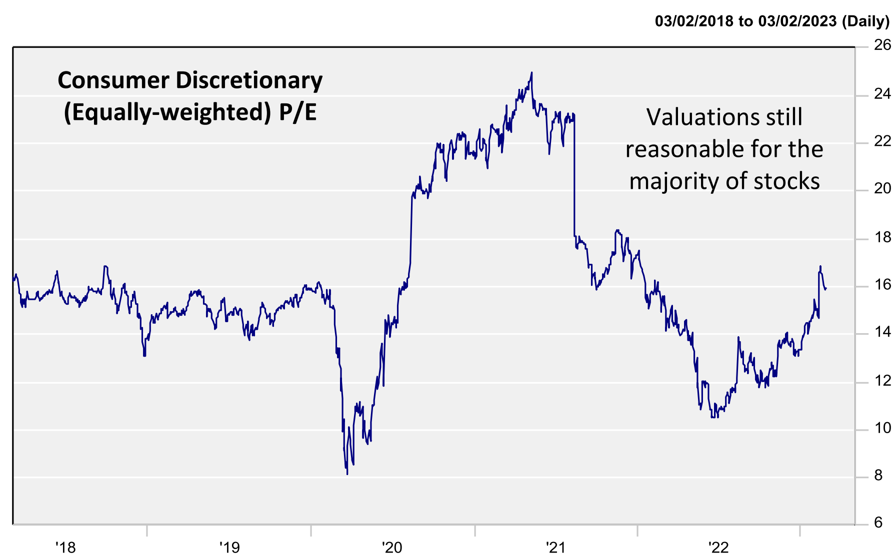
Source: FactSet

CONSUMER DISCRETIONARY

Relative earnings trends for the average Consumer Discretionary stock have been improving since November, supporting improved relative performance (vs the S&P 500) and a relative strength breakout vs. Consumer Staples. This bodes well for performance trends. Valuations have lifted from very depressed levels but are still reasonable (in line with pre-pandemic for the average stock). **With the group pulling back to support at its 50 DMA, we recommend increasing exposure** (Overweight sector view with a focus on the equally-weighted index).



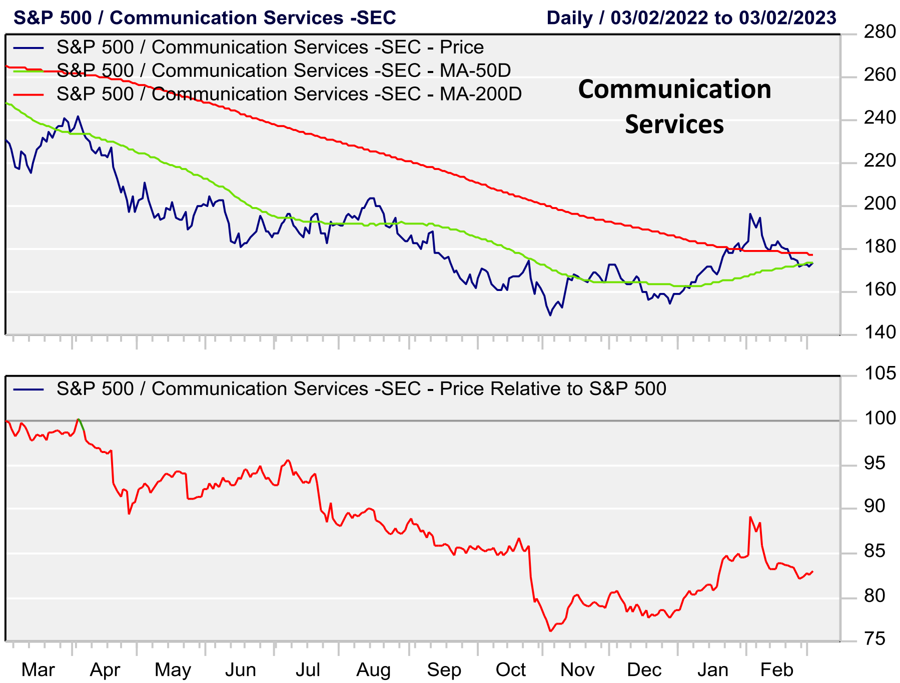


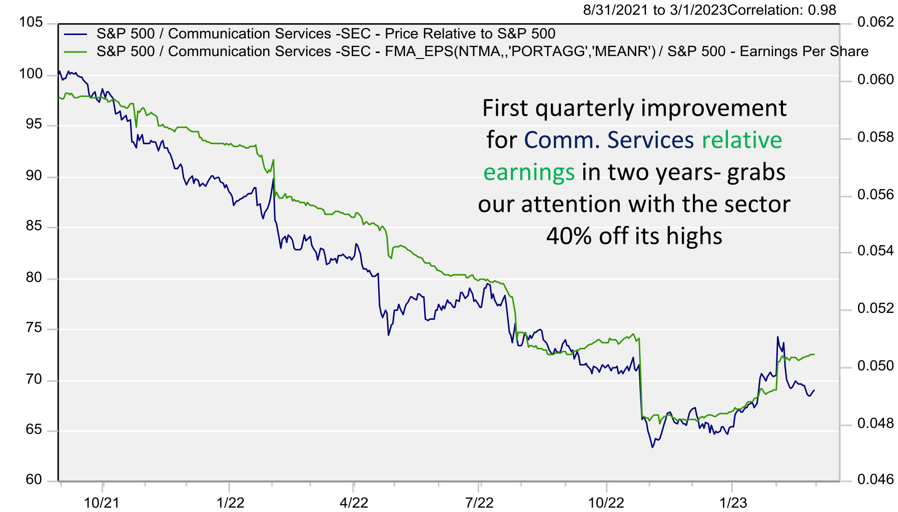


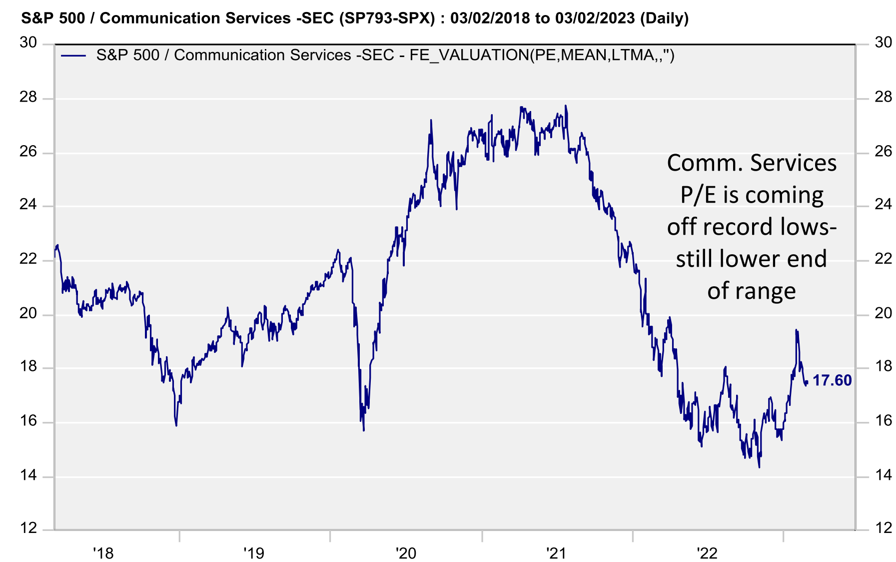
Source: FactSet

COMMUNICATION SERVICES

We upgraded Communication Services to Overweight (from Equal Weight) in our Sector Analysis published this week (link here for further info). **Valuation is coming from record lows and being accompanied by improved estimate revision trends**. Many of the most prominent names in the sector saw their earnings estimates tick higher in Q4 earnings season, resulting in the first relative earnings improvement for the sector in two years. *There has been a 98% correlation between Comm. Services relative earnings and relative strength trends over the past two years*. We believe this provides a more supportive backdrop for performance and **with the sector still 40% off its highs, we recommend an increase in exposure**.







Source: FactSet

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The **Dow Jones Industrial Average (DJIA)** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market.

The **MSCI World All Cap Index** captures large, mid, small and micro-cap representation across 23 Developed Markets (DM) countries. With 11,732 constituents, the index is comprehensive, covering approximately 99% of the free float-adjusted market capitalization in each country.

The **MSCI EAFE (Europe, Australasia, and Far East)** is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 21 developed nations.

The **MSCI Emerging Markets Index** is designed to measure equity market performance in 23 emerging market countries. The index's three largest industries are materials, energy, and banks.

The **Russell 2000** index is an index measuring the performance of approximately 2,000 smallest-cap American companies in the Russell 3000 Index, which is made up of 3,000 of the largest U.S. stocks.

The **NYSE Alerian MLP** is the leading gauge of energy infrastructure Master Limited Partnerships (MLPs). The capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities, is disseminated real-time on a price-return basis (AMZ) and on a total-return basis (AMZX).

The **Barclays Intermediate Government/Credit Bond** index measures the performance of U.S. Dollar denominated U.S. Treasuries, government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than one year and less than ten years.

The **Euro Stoxx 50 Index** is a market capitalization weighted stock index of 50 large, blue-chip European companies operating within Eurozone nations. Components are selected from the Euro STOXX Index which includes large-, mid- and small-cap stocks in the Eurozone.

The **China CSI 300** is a capitalization-weighted stock market index designed to replicate the performance of top 300 stocks traded in the Shanghai and Shenzhen stock exchanges. It had a sub-indexes CSI 100 Index and CSI 200 Index.

The **S&P 500 Futures** is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The **DJIA Futures** is a stock market index futures contract traded on the Chicago Mercantile Exchange`s Globex electronic trading platform. Dow Futures is based off the Dow 30 stock index.

The **Nasdaq 100 Futures** is a modified capitalization-weighted index of the 100 largest and most active non-financial domestic and international companies listed on the NASDAQ.

Europe: DAX (Deutscher Aktienindex (German stock index)) is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange.

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