February 27, 2023

Weekly Viewpoint

Market Falls Amid Shifting Fed Expectations

Performance for Week Ending 2.24.2023

The Dow Jones Industrial Average (Dow) finished off 2.99%, the Wilshire 5000 Total Market Index℠ (Wilshire 5000℠) lost 2.77%, the Standard & Poor's 500 Index (S&P 500) dropped 2.67% and the Nasdaq Composite Index (NASDAQ) shed 3.33%. Sector breadth was negative with 10 of the 11 S&P sector groups closing lower. The Consumer Discretionary sector (-4.44%) was the worst performer followed by Communication Services (-4.37%) and the Real Estate sector (-3.78%). On the upside the Energy sector (+0.17%) bucked the trend.

Index*	Closing Price 2/24/2023	Percentage Change for Week Ending 2/24/2023	Year-to-Date Percentage Change Through 2/24/2023
Dow	32816.92	-2.99%	-1.00%
Wilshire 5000	39690.74	-2.77%	+4.25%
S&P 500	3970.04	-2.67%	+3.40%
Nasdaq	11394.94	-3.33%	+8.87%

Market Observations: 2/20/23 – 2/24/23

The S&P 500 finished lower for a third straight week as a backup in bond yields weighed on stock prices. After gaining almost 17% off the mid-October lows stocks have hit a rough patch in recent weeks. It appears the markets have entered a period of price discovery, where investors are trying to gauge what is currently priced into the market, and what is likely to come to fruition in the quarters ahead.

Still More Work to Do: The jobs market has been strong with the unemployment rate at a 53-year low, the monthly retail sales jumped by 3% last month suggesting the US consumer remains on firm footing, and inflation, while still retreating, remains at stubbornly high levels. All of these factors suggests that the Fed still has more work to do to cool the economy. The bond market seems to be agreeing, with the yield on the 2-year Treasury—which is a proxy for changes in monetary policy—up by about 70 basis points since the start of February. Fed funds futures are currently locking in 25-basis point hikes at both the March and May meetings and are signaling better than a coin toss chance of an additional 25 basis point hike at the June meeting. The terminal rate (i.e., the level that the Fed is expected to stop raising rates) now stands at a range of 5.25 -5.5%. That's a big change from where we were at the start of the month when the terminal rate was at 4.9% and futures were actually discounting two rate cuts by the end of the year. That's no longer the case.

FOMC Meeting Minutes: The meeting minutes from the late-January/early February FOMC meeting were released last week. While a lot of new data (Payrolls, CPI, etc.) has been released since the meeting, making the minutes somewhat stale, there were some key takeaways. The minutes signaled that potentially more than two non-voting FOMC participants thought that a half-point hike (vs. the quarter point hike that was delivered) was appropriate at the meeting. The meeting language stated that "a few" participants, not a couple, favored a higher hike, a signal that at least one more person is in the Loretta Mester/Jim Bullard camp, both of whom have publicly stated that they would have supported a 50-basis-point move had they voted. The minutes also said upside risks to inflation remained a key factor driving policy, and a number of them noted that an "insufficiently restrictive" policy stance could stall recent disinflation.

In other Fed news, speaking on CNBC, St. Louis Fed President James Bullard said he thinks the U.S. economy is more resilient than many investors have thought. "I think markets have overpriced a recession in the second half of 2022 and overpriced a recession in the first half of 2023 and maybe they are overpricing the chances of a recession in the second half of 2023," Bullard said. He noted that the Chinese economy was coming back from COVID lockdowns, and the European economy is stronger than expected. "It kind of seems like the U.S. economy might be more resilient than markets thought, let's say, six to eight weeks ago," he said. Bullard said his peak rate continues to be 5.38% (or within a range of 5.25 -- 5.5%).

Fourth Quarter Earnings: Q4 earnings season continues to wind down and while reported results have been lackluster, they have been no worse than feared. As of Friday 468, members of the S&P 500 have reported results with just over 68% surprising to the upside. Aggregate earnings growth for the group is down 3.1% from a year ago, essentially in line with the forecasted 3.3% decline at the start of earnings season. On the sector level, the strongest growth has come from the Energy, Industrials, and Consumer Discretionary sectors, whereas, Materials and Communication Services have delivered the weakest results.

The Week Ahead: Key data reports will revolve around consumer and manufacturing activity. Reports of interest include the Conference Board's consumer confidence index on Tuesday. The report will be important to assess whether US consumers will continue to support economic growth amid downward revisions in Q4 consumer spending as well as cautious guidance from retailers Walmart and Home Depot. On the manufacturing side, the ISM Manufacturing Index and a host of regional central bank manufacturing indices will be watched closely. On the earnings front, investors will find out whether cautious spending continues to be a theme this week as a set of retailers release earnings, including Target (Tuesday), Lowe's (Wednesday) and Costco (Thursday). The Fed speaking calendar will be busy with a half dozen speeches scattered throughout the week.

Definitions

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Wilshire 5000 Total Market IndexSM represents the broadest index for the U.S. equity market, measuring the performance of all U.S. equity securities with readily available price data. The index is comprised of virtually every stock that: the firm's headquarters are based in the U.S.; the stock is actively traded on a U.S. exchange; the stock has widely available pricing information (this disqualifies bulletin board or over-the-counter stocks). The index is market cap weighted, meaning that the firms with the highest market value account for a larger portion of the index.

Standard and Poor's 500 Index 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 Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.