March 13, 2023

Weekly Viewpoint

CPI Report Could be Key in the 25 vs. 50 Basis Point Debate

Performance for Week Ending 3.102023

The Dow Jones Industrial Average (Dow) finished off 4.44%, the Wilshire 5000 Total Market Index[SM] (Wilshire 5000[SM]) lost 5.12%, the Standard & Poor's 500 Index (S&P 500) fell 4.55% and the Nasdaq Composite Index (NASDAQ) shed 4.71%. Sector breadth was negative with all 11 of the S&P sector groups closing the week lower. The Financials sector (-8.50%) was the worst performer followed by Materials (-7.64%) and Real Estate (-7.0%).

Index*	Closing Price 3/10/2023	Percentage Change for Week Ending 3/10/2023	Year-to-Date Percentage Change Through 3/10/2023
Dow	31909.64	-4.44%	-3.73%
Wilshire 5000	38379.18	-5.12%	+0.80%
S&P 500	3861.59	-4.55%	+0.58%
Nasdaq	11138.89	-4.71%	+6.42%

Market Observations: 3/6/23 – 3/10/23

The S&P 500 finished the week sharply lower, suffering its worst weekly performance since the start of the year. Driving the weakness was hawkish commentary from Fed Chair Powell who opened the door to a more rapid pace of rate hikes to battle elevated levels of inflation. The losses deepened as the week progressed after federal regulators closed tech-focused lender Silicon Valley Bank (SVB), the biggest U.S. bank failure since 2008. While the collapse of SVB seemed to raise worries of another "Lehman moment" and stoked fears of bank sector contagion, this situation seemed to be very different. In many ways, this was just a good old-fashioned run on the bank following signs the company's bond portfolio was suffering due to the Fed's rate hiking program. Not to downplay the seriousness of the event, but historically we know that the Fed has often raised rates until "something breaks," and the fall of Silicon Valley Bank and fears of bank sector contagion could be enough in the near term for the Fed to slow the pace of rate hikes. A look at Bloomberg's World Interest Rate Probability Tool shows the probability of a 50-basis-point rate hike at the March meeting is at around a 30% probability, down sharply from the 71% probability on Wednesday following Chairman Powell's testimony on Capitol Hill.

Powell Indicators Higher for Longer: Last week, Fed Chair Powell presented the semiannual Monetary Policy Report to the Senate Banking Committee on Tuesday and to the House Financial Services Committee on Wednesday. The key takeaway from his prepared remarks was his openness to larger rate hikes, saying that, "we would be prepared to increase the pace of rate hikes" if the data indicated. Powell also pointed to a higher terminal rate as well, saying that "the ultimate level of interest rates is likely to be higher than previously anticipated." The comments were not well received by the equity markets as they appeared to be somewhat of a pivot for the Fed and may suggest a return to 50-basis-point moves. Recent commentary from Fed officials have been suggesting that they wanted to move cautiously and assess the cumulative impact of what they'd delivered so far. That message was interpreted as they would proceed at a 25bps pace until they stopped. With the Fed moving into their pre-FOMC blackout period, the 25 v. 50 basis point debate remains front and center.

Labor Market Cools but Still too Hot: On Friday, the Labor Department reported that nonfarm payrolls rose 311k in February, down from 504k in January, but well above the consensus estimate of 225k. The unemployment rate rose to 3.6% from 3.4% in the prior month. Wage growth during the month showed signs of slowing with average hourly earnings rising 0.2% month/month, the smallest increase since February 2022. On a year-over-year basis, average hourly earnings increased from 4.4% to 4.6%, reflecting an unusual pause in wage growth in February 2022. While other measures of wages have also been showing signs of easing wage pressures, annual wage growth remains well above the roughly 3.5% the Fed likely sees as consistent with its 2% inflation target. While there are growing signs the labor market is beginning to cool, recent readings suggest that the Fed still has some work to do.

Technicals Breakdown: The selling pressure last week resulted in a considerable amount of technical damage, with the S&P 500 falling through its 200-day moving average (3940) and its uptrend line of the October 12 lows. The break above the 200-DMA back in January was considered a favorable development and a sign that the downtrend over the course of 2022 had been reversed. The markets will likely be put in the penalty box in the near-term with the potential for a downside test of the 3800-support level. Below 3800, the 200 WEEK moving average comes into play (3725). The 200-week trendline is where the market stop falling back in October of last year.

The Week Ahead: With Fed officials now in their traditional 10-day blackout period ahead of next Wednesday's FOMC meeting, all eyes will be on Tuesday's Consumer Price Index (CPI) report. Given the upside surprise in the January report, this week's data will be an important indicator to suggest whether it was a blip in a disinflationary trend or evidence of more persistent-than-expected inflation. It will also be instrumental to market expectations heading into the March 22 Fed meeting, particularly after Chair Powell's hawkish testimony last week led investors to price in a growing chance of a 50bps move. Other data reports on interest include more information on the US consumer from the retail sales data (Wednesday) and the University of Michigan's sentiment report (Friday). The retail sales release will be closely watched given last month's beat but otherwise cautious guidance from key US retailers. Another useful signal may come from FedEx's and Dollar General's earnings due Thursday. Aside from the consumer-focused data, investors will also get more insight into the production side of the economy with the PPI (Wednesday), industrial production (Friday) and several regional Fed gauges released throughout next 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.