I would like to share my views on what transpired last week, it was by far the biggest week of this short year and probably one of the biggest weeks we have seen since the beginning of the Federal Reserve's rate-hike campaign to stamp out inflation. As we mentioned in our note to investors on 12/27/22, this market will be driven by economic data to start off 2023 and last week is when we got a ton of it.

So what was it that moved the markets?

1) Earnings
2) Economic Data
3) The Federal Reserve's interest rate hike and follow up statement/press conference

Lets dig a little deeper.

So far, according to Factset, the blended earnings growth rate for Q4 S&P 500 EPS currently stands at (5.3%). This compares to the (3.2%) expected at the end of the quarter. The blended revenue growth rate is 4.3%. Of the 50% of S&P 500 companies that have reported for Q4, 70% have beaten consensus EPS expectations, below the one-year average of 75% and the five-year average of 77%. In addition, 61% have surpassed consensus sales expectations, below the one-year average of 73% and the five-year average of 69%. In aggregate, companies are reporting earnings that are 0.6% above expectations, below the 4.5% one-year average surprise rate and the five-year average of 8.6%. In aggregate, companies are reporting sales that are 1.1% above expectations, below the 2.8% one-year positive rate and the five-year average of 1.9%. Translation, in our opinion: earnings are clearly slowing down.

On the economic data front, we saw a sharp slowdown in Unit Labor Costs (something the Fed watches closely as it's tied to wage inflation) but that was off set on Friday by an unexpected strong jobs report showing a decline in the unemployment rate to 3.4%. Not only did the economy add 517,000 jobs in the previous month but the previous months were adjusted higher! Why is this a negative? Because one of the biggest problems the economy has faced is a dysfunctional labor market where there aren't enough workers to fill the jobs needed which leads primarily to wage inflation which then reverberates to the rest of the economy through higher prices. This is one of the key factors, if not at this point the most important factor, to get the Fed to stop it's rate hike campaign to break the back of inflation. Finally, ISM Manufacturing PMI (measures the performance of the manufacturing sector) fell to 47.4 (under 50 indicates contraction in the manufacturing sector) and new orders dropped to 42.5 – both readings are the lowest since the Financial Crisis (excluding Covid) in 2009. So, as you can see, some conflicting data here.

Finally, the Federal Reserve raised rates, as expected, by .25%. What changed this time was the "tone" of Fed Chairman Powell's press conference where, for the first time since 2021, the Central Bank indicated they might become less hawkish in the future (meaning a pause in raising rates) which sent the markets higher on Wednesday and Thursday. Now the big question for the markets will be are there only 1 or 2 .25% rate hikes left. If so, a HUGE weight will be lifted off of the market and finally allow us some breathing room to the upside. It is these expectations that have been responsible for the markets trending higher in 2023.

Turning to the stock market, the market “technicals” are improving quite a bit. The S&P 500’s 50 day moving average has crossed above its 200 day moving average, according to Factset, and more and more companies are trading at 20 day highs. According to Stansberry Research: *The S&P 500 just hit a triple bullish indicator (a positive return during the Santa Claus rally, the first five trading days of January, and the entire month of January) that's led to positive returns for the rest of the year 90% of the time throughout history.* Why does this matter? Because in 2022 the market simply could not get any momentum. Every time it did, we would end up rolling over and going to new lows. Buying the dip ended up costing money. In the last 4-8 weeks, that trend seems to be reversing and in a significant way in some cases. While this does not signal an all-clear, there are real signs of stabilization and reason to believe this rally could be the start of something more sustainable.

Add it all up and there are reasons to be optimistic on more fronts than we have seen in quite a long time for this market. That doesn’t mean there won’t be scares, pullbacks and bad headlines but clearly the path is getting more smooth.

Thank you for your time and attention to our update. We welcome any comments or questions. Enjoy your week.

Regards,

Tim

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Sources:
FactSet [1]

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