ECONOMIC & MARKET INSIGHTS

An Execute Summary for February 2023

The January rally in equities, while welcomed by investors, did not set the stock markets up for very attractive forward returns so the February pullback was not surprising. Valuation measures based on forecasted earnings are somewhat above average and are elevated for this late stage in the economic cycle when valuation levels typically approach lower points. So far, the level of earnings surprise for the fourth quarter has been typical with roughly half of companies beating expectations. With the U.S. economy and consumer spending holding up better than expected, corporate earnings may surprise on the upside in the near-term.

Equity and bond market volatility has subsided but remains well above historical averages. While the guidance of the Fed will continue to be attentively monitored by investors, there are other concerns. The U.S. debt ceiling, which is controlled by Congress, is likely to be a source of volatility until it is resolved. Heightened tensions between the U.S. and China and the ongoing Russia-Ukraine war are potential sources of global instability. Going forward, investors face an investment regime marked by higher inflation, interest rates, and volatility that is likely to extend much longer than had been anticipated a few weeks ago. In this scenario, it is imperative to think about portfolio positioning with a forward view. Elevated volatility makes high quality assets with reliable cash flows more attractive.

Recent economic data has been unexpectedly robust. U.S. GDP growth in the fourth quarter of last year was an annualized 2.9%. The consumer has remained resilient, supported by a strong labor market and surplus savings remaining from the COVID fiscal stimulus. The January jobs report took economists and investors by surprise. Despite the prominent media coverage of technology sector layoffs, 517,000 new jobs in January and a drop in the unemployment rate to 3.4% indicate the labor market remains stronger than the Fed would like. One area that has demonstrated weakness is housing where a recent uptick in mortgage rates is squeezing affordability into the important spring selling season. While buyers remain more discerning, supply also remains tight, which can spark competition for in demand properties.

The Federal Reserve has been following through on its policy guidance. As expected, the Fed announced a 0.25% hike in February leaving the policy rate in the 4.50%-4.75% range. Although Fed Chair Powell's January press conference had a favorable tone for investors suggesting that the Fed was seeing clear signs that inflation was trending lower, more recent comments have been more hawkish. The downward trajectory of inflation will be hard to maintain. The prices of goods such as cars and smartphones have sharply pulled back as pandemic-related supply side disruptions cleared up but are likely to stabilize and inflation in the services sector remains entrenched. In aggregate, the data suggests the Federal Reserve has more work to do and additional rate hikes are likely coming. The bond markets now expect three more rate hikes of 0.25% with the Fed funds rate reaching 5.5%.

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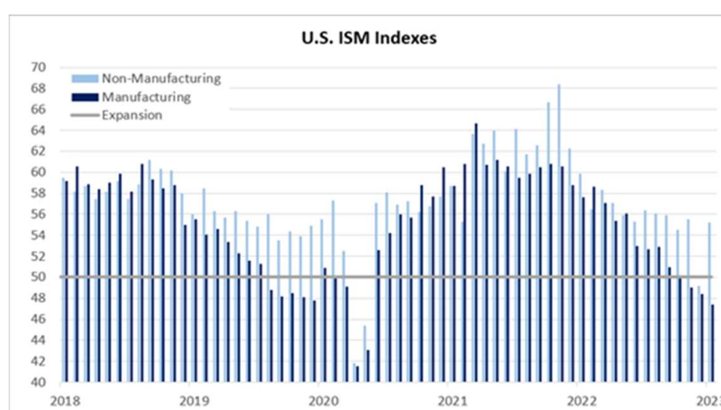

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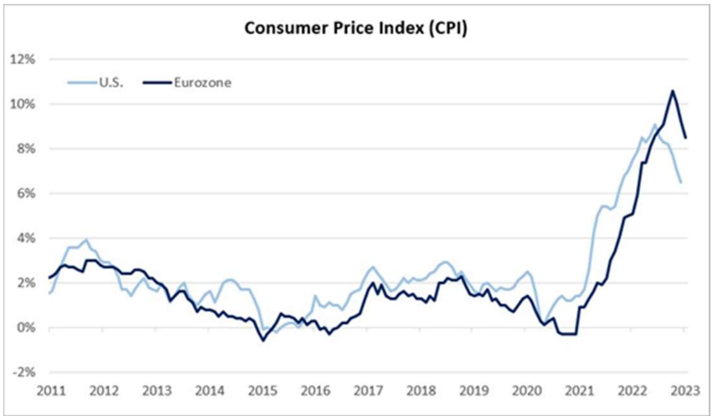
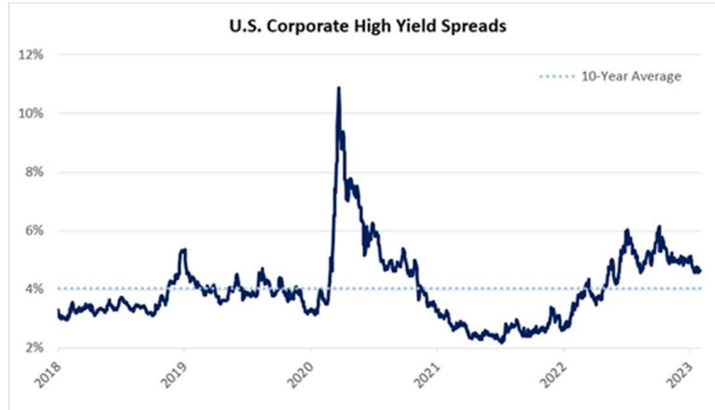


U.S. Bureau of Labor Statistics



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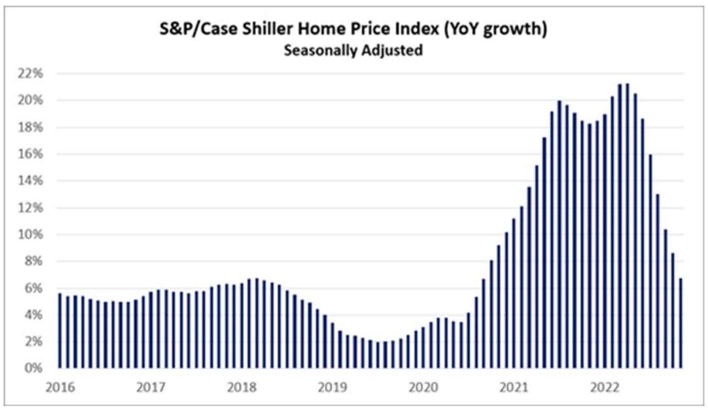

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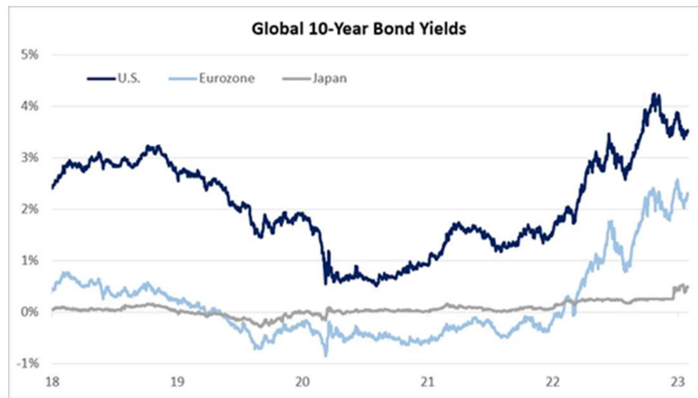

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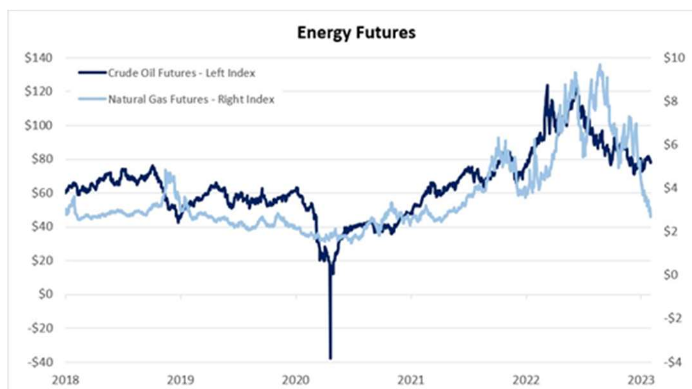

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