STIFEL

2023 FIRST QUARTER MARKET THOUGHTS

The beginning of 2023 is bringing equity returns few predicted, buoyed by good fourth quarter earnings reports. In fact, with 404 companies reporting, S&P 500 earnings are running at $54.30, which is above estimates of $52.85. Among companies reporting, 68.6% have exceeded expectations while 25.5% have fallen short.[1] With the Federal Reserve raising interest rates aggressively last year, the bar was lowered when many analysts tempered their company earnings expectations, but I believe $54 in earnings for the quarter is respectable.

Although no one can predict market performance with any certainty, S&P 500 earnings could reach $220.00 for the year if current trends continue, which, at a level of 4,100, would put the index at an 18.6 multiple.

However, one valuation indicator that I question is the relationship between the earnings yield and six-month treasury. The earnings yield is the opposite of the P/E multiple; it's the current earnings divided by the price of, in this case, the S&P 500.

A recent Bloomberg article put it like this, "Specifically the six-month treasury bill currently yields a hair below 5%, the highest since 2007. Meanwhile, the S&P 500 earnings yield clocks in at 5.08%. The gap between them is the slimmest advantage that stocks have held since 2001."[2]

With recent Consumer Price Index (CPI) and Producer Price Index (PPI) readings showing that inflation is still high, the Federal Reserve may have to continue raising interest rates and hope that, as time passes, prior hikes combined with a potential future increase in March (and perhaps June) finally makes a significant impact on inflation. With the goal of slowing down wage growth and increasing unemployment to fight inflation, I believe that continued economic growth may be tough.

One of my favorite quotes from analyst Byron Wien in his 2023 forecast is, "The Federal Reserve remains in a tug-of-war with inflation, so it puts the word 'pivot' on the shelf alongside the word 'transitory.'"[3] In other words, a "pause" in rate hikes may be a ways off.

Given all of this information, depending upon your investment criteria, a more conservative approach could be prudent going into the late spring and summer months while we wait for the Fed's medicine to hopefully kick in.

It also goes with one of our three tenets: Don't fight the Fed. Remember, the Fed is tightening monetary policy across the board. It's not only raising interest rates, but it's also stopped its bond-buying program, also known as quantitative easing. Instead, it's unwinding its balance sheet in what you could call it quantitative tightening. I feel there may be a storm of our own making on the horizon; in my opinion, I don't believe that we can add so much stimulus and not expect an equally sharp retreat when it's taken away.

For the coming months, be ready to batten down the hatches and look for potentially better values later in the year.

As always, I appreciate the trust you've placed in me as your financial advisor and look forward to continuing our relationship for years to come.

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[1] Confluence Investment, market letter, 2/17/2023

[2] Bloomberg Markets, 2/15/2023

[3] Byron Wien and Joe Zidle: The 10 surprises of 2023, Blackstone, 1/5/2023

Past performance is no guarantee of future results, and no one can predict the markets with any certainty. The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market. Index returns include the reinvestment of dividends but do not include adjustments for brokerage, custodian, and advisory fees. Indices are unmanaged and are not available for direct investment.