James K. Noble CFP® CLU®

What's in this week's Report:

- What's Making Stocks So Resilient (And Is It A Bullish Signal?)
- Weekly Market Preview: Will Powell be hawkish and will jobs data stay hot?
- Weekly Economic Cheat Sheet: All about employment (JOLTS, ADP, and Jobs Report on Friday).
- Technical Update: S&P 500 Value vs. Growth Debate
- Disinflation On, Disinflation Off

Futures are little changed following a quiet weekend and as investors look ahead to an important week of catalysts (Powell speeches and employment reports).

China released updated growth expectations for 2023 of "around 5%" and that's slightly under estimates and was a mild disappointment.

Economic data was solid overnight as Euro Zone Retail Sales (1.0% vs. (E) 0.3%) and UK Construction PMI (54.6 vs. (E) 49.1) both beat estimates.

Today expect digestion of last week's rally as there are no material economic reports or Fed speak, as markets look ahead to Powell's testimony tomorrow.

Market	Level	Change	% Change
S&P 500 Futures	4,061.00	11.25	0.27%
U.S. Dollar (DXY)	104.4660	-0.0550	-0.05%
Gold	1,856.90	2.30	0.12%
WTI	78.62	-1.06	-1.33%
10 Year	3.917%	-0.046	-1.17%

March 6, 2023

Planning Corner

News outlets have been focused on the dramatic investor stampede into fixed deferred annuities. According to the insurance industry non-for profit LIMRA. In 2022, fixed-rate deferred annuities totaled $112.1 billion, more than double (111%) the sales in 2021. This is 38% above the previous annual high of $80.8 billion set in 2002. Fixed indexed annuity (FIA) sales also had a record quarter and year. For the year, FIA sales were $79.4 billion, up 25% from 2021, and 8% higher than the record set in 2019.

In order to best understand this investor trend, it is important to note that a fixed deferred annuity is a contract to provide a stated interest rate for a specific period, and the principal is guaranteed by the insurance company.

Higher interest rates have heightened investor interest (pun intended) and sagging stock values have driven investors to safety. Check to see if this option makes sense for a portion of your portfolio and call today!

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Stocks

Stocks recovered from early week losses driven by hawkish money flows in reaction to hot inflation data to end the week higher as investors embraced some dovish Fed comments from Thursday afternoon. The S&P 500 rallied 1.90% on the week and is now up 5.37% YTD.

Economic data was in focus to start the week last Monday as strong details to an otherwise disappointing Durable Goods report, and a shocking 8.1% m/m rise in the January Pending Home Sales Index (E: 1.1%) saw stocks retrace early gains in morning trade. Treasury Secretary Yellen struck an encouraging tone when discussing inflation in the afternoon, helping stocks bounce modestly but it proved unsustainable, and stocks ended near the lows with the S&P 500 up just 0.31%.

Stocks posted declines on Tuesday as hot inflation data in Europe (Spain and France's CPI reports) sparked hawkish money flows that a modest dip in consumer inflation expectations within the U.S. Consumer Confidence report were unable to counteract. Then a sizeable $1.5B market-on-close imbalance saw the S&P 500 close the day on session lows, down 0.30%.

The first trading day of March was volatile on Wednesday as another hot inflation print in Europe (Germany this time) offset early optimism about a strong Chinese Manufacturing PMI. Then the ISM Manufacturing Index hit the wires with a soft headline and unexpectedly hot Price subindex and stocks and bonds both came for sale as a part of a broad hawkish reaction from markets. Chances of a 6% terminal fed funds rate were introduced in rates markets and stocks churned lower over the course of the day with the S&P falling 0.47%.

Stocks were initially lower on Thursday thanks to more hot inflation data in both the U.S. and Europe as Eurozone HICP and domestic Unit Labor Costs both topped estimates, the latter, meaningfully so. With stocks becoming near-term oversold and testing a key technical support level in morning trade, the Fed's Bostic's comments about being "firmly in the 25-bps hike camp" for the next meeting saw stocks begin to squeeze higher. The S&P 500 gained 0.76% on the day.

On Friday, a much-lower-than-expected Eurozone PPI report helped further ease some of the hawkish money flows from earlier in the week, which saw stocks gap higher at the open, extending Thursday's gains. Then the ISM Services Index was released a half hour into the New York session, and while the headline was largely as expected the Prices Index importantly declined from January, further easing inflation worries. That data point sparked a pullback in bond yields and the dollar, which helped stocks power higher. The S&P 500 gained 1.61%.

What's Making Stocks So Resilient (And Is That A Bullish Signal?)

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Stocks rallied late last week to snap a three-week losing streak, as dovish commentary helped to offset hot inflation and growth data, and the resilience of the stock market simply must be admired.

Consider that on February 1, the 2-year Treasury yield hit 4.11%, and just over a month later (and a short month, at that) it hit a multi-decade high of 4.90%! That's nearly an 80-bps move in four weeks.

Similarly, Fed rate hike expectations surged. Following the February 1 FOMC decision, fed fund futures priced in a terminal (or peak) rate of less than 4.875% and a year-end fed funds rate of less than 4.30%. This week, those numbers hit 5.625% and 5.375%, respectively—basically 100 bps of expected additional rate hikes.

Meanwhile, disinflation didn't just slow, it reversed in several global inflation readings while economic data has been consistently better than expected (especially in the labor market and service sector, the two areas the Fed is targeting). Yet, despite all of that negative news, which last year would have sent the S&P 500 into quasi-freefall, the S&P 500 is down less than 5% from the peak on February 2. Whether you're a bull or bear, that's pretty resilient price action!

The question is why are stocks so resilient? I believe the answer lies in an old market adage: "Stocks don't discount the same information twice." The Fed walloped the markets in 2022 with rate hike shocks, but after sustaining that beating for 12 months, the truth is that the worst is behind stocks from a rate hike standpoint. Sure, fed funds could possibly go as high as 6%, but that's only about 150 bps of additional tightening from here, as opposed to the 450 we've already been through.

Put simply, the 2022 market was about rate hikes, and regardless of whether we get another 50 bps or 150 bps of tightening, the bottom line is we're closer to an end than a beginning. So, does that mean I'm suddenly turning materially bullish on the market? No, it does not, and here's why.

This year is going to be all about economic growth, and if that rolls over, so will this market. Stocks may have proven themselves resilient to more than previously expected rate hikes, but I remain concerned they will not be immune to the impact of these rates hikes. Put more plainly, stocks may have discounted higher rates, but they have not discounted the recession that higher rates might unleash upon the economy.

In the week ahead, we are going to provide a historical overview of what happened to markets once the Fed does stop rate hikes. The prevailing sentiment on Wall Street is that once that's done, stocks can sustainably rally. However, history begs to differ.

To be clear, I'm enjoying this resilient market, but I want to make sure I don't confuse the market's ability to withstand last year's headwind with an invincibility towards what could be this year's headwind (falling growth).

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Economic Data (What You Need to Know in Plain English)

Need to Know Econ from Last Week

Economic data last week showed resilient growth and resilient inflation, and that pressured markets and pushed global bond yields higher early last week.

Inflation data was the key market influence last week, and it wasn't good, especially in Europe. French, Spanish, German and Eurozone inflation metrics all rose more than expected, and several posted increases from the previous month (including Germany where HICP rose to 9.3% y/y vs. (E) 9.0%). We and others have said that continued disinflation (a slowing of inflation pressures) is needed for stocks to rally, and last week we didn't just get a slowing of disinflation, we got a reversal!

The inflation data in the U.S. wasn't quite as bad as it was in the EU, but it wasn't far off. The Prices index in the March ISM Manufacturing PMI rose to 51 from 44.5, while Unit Labor Costs (a broad measure of wage and benefit costs to employers) handily beat expectations, rising 3.2% vs. (E) 1.4%. Neither number will automatically make the Fed want to hike rates more than previously expected, but they both help to further reduce any hope of a near-term pause.

For now, the market is clearly betting this is a one-off statistical bounce back (otherwise stocks and bonds would be lower) and disinflation will ultimately resume. But the stakes on being right on that bet are very high, so the inflation data will remain critically important going forward.

Turning to economic growth, data showed a resilient U.S. economy (and the global economy). The March ISM Manufacturing PMI rose to 47.7 vs. (E) 48.0, still in contraction territory but only barely so. New Orders, meanwhile, rose to 47 from 42.5 (again, still in contraction territory but a solid bounce back). The picture was similar for the Services PMI, which was essentially from February (55.1) and above the market's expectation (E: 54.5). New Orders rose to 62.6, signaling strong future growth, and Prices Paid fell slightly to 65.6 from 67.8, but that's still much too high (it needs to be in the mid-to-lower 50s). Durable goods, meanwhile, were also better than it seemed, as the most important index in the report, New Orders for Non-Defense Capital Goods ex-Aircraft, rose 0.8% vs. (E) -0.1%. That tells us that business spending and investment is not contracting materially, despite headlines about layoffs and caution from management.

For stocks and bonds to sustainably rally, we need to see 1) Disinflation reengage and accelerate and 2) Growth remain stable, but not be too strong or suddenly fall off a cliff. Last week we saw neither, as economic data was resilient, while inflation bounced back. If that continues it'll weigh more on stocks and bonds.

Important Economic Data This Week

Fed Chair Powell gives his semi-annual testimony on monetary policy to Congress on Tuesday and Wednesday, and that obviously has the potential to move markets. But barring a surprise from Powell,

employment will be in focus this week and the most important number this week is Friday's jobs report. For markets to rally they will need to see 1) A negative revision to the blow out January jobs report and 2) A job adds number that comes in under the expectation.

But Friday's jobs report isn't the only important labor market report this week. JOLTS (Job Openings and Labor Turnover Survey) comes out Wednesday, as does the ADP jobs report. JOLTS bounced back above 11 million last month, and the Fed will absolutely want to see that number drop considerably before becoming confident the labor market is returning to better balance. So, a lower-than-expected JOLTS number will be positive.

Finally, we get weekly jobless claims on Thursday, and they remain far too low for the Fed to be confident there's any healthy deterioration in the labor market. We'll want to see claims move steadily higher over the coming weeks, towards the mid-200k, while any decline will be yet another signal that the labor market remains very tight.

Bottom line, employment data is very important for this market, and if we need proof of that we just have to look at the January jobs report (out February 6) because that hot jobs report started this month-long pullback in stocks. Now, this week, the jobs data will either make that pullback worse, or provide welcomed evidence of deterioration in the labor market, because that has to happen if the Fed is going to pause anytime soon.

Special Reports and Editorial

Technical Update: S&P 500 Value vs. Growth Debate

The Value vs. Growth Debate

There has been a lot of discussion about the Value vs. Growth investment styles since the start of the year as there was a flurry of investment into growth names after 2022's dismal performance. And while growth is handily outperforming so far this year with a gain of over 8% compared to value, which is effectively flat YTD, it is still too early to declare an end to the value over growth trade. The main reason is due to relative strength, or the trend of each style against the S&P 500 itself.

Looking first at growth, the downtrend against the S&P has been broken, but we have not yet seen a meaningful new high in growth relative to the S&P 500. Furthermore, value has not made a meaningful new low versus the S&P 500, leaving the outlook more neutral on the two styles. And with the adage "the trend is your friend" in mind, it could be detrimental to jump out of value and into growth before there is definitive evidence that a reversal favoring growth has occurred.

Disinflation On, Disinflation Off

Over the years, we and others have often referred to the markets as being "Risk On/Risk Off." Risk On referred to when good news results in investors embracing risk and pushing stocks, foreign currencies, and

corporate debt higher. Risk Off meant the opposite, meaning stocks fall and bonds and the dollar rally. However, since the start of 2023, that dynamic has shifted from Risk On/Risk Off to "Disinflation On/Disinflation Off."

For background, it's important to understand exactly what disinflation is. Disinflation is a decline in inflation. So, inflation is still positive, but the increases are getting smaller (CPI going from 9% to 6% is disinflation). That's not to be confused with deflation, which is outright negative inflation (CPI posting negative year-over-year readings).

For most of 2022, markets were driven by rising interest rates (following the dramatic Fed rate hikes). Those rising rates pressured the stock market multiple, sent recession fears higher, and weighed on stocks while decades-high inflation hammered bonds.

In December the Fed reduced rate hikes from 75 bps to 50 bps and signaled that the pace of rate hikes would slow further. Markets took that to mean the end of rate hikes would soon come into sight.

That belief led to the current Disinflation On/Disinflation Off market, because when disinflation is on, markets expect an imminent end to Fed rate hikes, and when disinflation is off, markets price in more Fed rate hikes.

Consider that in January, Disinflation On ruled markets. Inflation statistics came in under expectations and were declining from previous months and economic data implied growth was clearly slowing. That led to markets believing the Fed was close to ending its rate hike campaign.

That, in turn, led to the following market moves: Stocks rallied broadly with tech/growth/small caps handily outperforming. Bonds rallied broadly, with longer-dated Treasuries and investment grade debt outperforming. Foreign markets also outperformed.

In February, the script was flipped. Inflation data came in hotter than expectations and growth data implied the economy was not really slowing. As a result, we saw Disinflation Off. That, in turn, led to the following market moves: Stocks down broadly, but value and defensive sectors (utilities/consumer staples/healthcare) outperformed. Bonds dropped broadly with longer-dated Treasuries leading the way lower while investment grade debt lagged.

These two markets are 180 degree turns from one another: Disinflation On, Disinflation Off. But as the market has become more fixated on this Disinflation On/Off dynamic, it's started to show up in daily trading as well, as evidenced yesterday.

Case-Shiller Home Price Index was lower than estimates (sign of disinflation) while the Chicago PMI dropped sharply (soft economic data) and the net result was a mild "disinflation bid" in stocks as tech/growth/small caps outperformed. Bottom line, we should expect markets to continue to trade in this Disinflation On/Off mode for the foreseeable future, and until such time as we know definitively 1) A recession is coming (or not) or 2) The Fed signals it truly is done hiking rates.

For now, we expect more wavering between the Disinflation On/Off but tactically we'd continue to go favor

defensives and value given our concerns about economic growth, and also longer-dated Treasury yields (which is more of a Disinflation On trade and offer some additional upside exposure if my caution is unwarranted).

Finally, the focus on disinflation isn't going away anytime soon, and understanding what the data means in relation to disinflation will be key in getting the next leg of this market right (whether it's higher, or lower). We'll be watching for you.

Economic Breaker Panel: February Update

The message from this month's Economic Breaker Panel is remarkably clear: The economy is *not* yet showing any serious signs of slowing despite tighter financial conditions. And given this data, the market is right in thinking the Fed will hike rates more than previously expected. Simply put, this month's Breaker Panel implies the Fed has not yet hiked rates enough to cool the economy and take pressure off rising inflation.

This has practical implications, because if the data in the Breaker Panel remains consistent, then it will make higher yields more sustainable (meaning higher rates for longer), and that would equate to a consistent headwind on stocks. Put differently, many in the market assume that rates will only stay this high for a small period of time. However, if the Breaker Panel is right, it implies that rates may stay this high, and higher, for a long time, something that is *not* priced into stocks with the S&P 500 at 4,000.

Over the past several months, and despite increasing pressure from rising rates and clear warnings of future economic growth from the yield curve, economic data has remained broadly buoyant. That implies the Fed simply hasn't hiked enough to cool the economy yet and until we begin to see clear signs of weakening in the Breaker Panel (i.e. numerous breakers being "tripped") we'll continue to be skeptical of any ideas of imminent Fed pivots or pauses, and instead continue to brace for high, or higher, bond yields.

Macro Indicators**: 10s-2s, Real Interest Rates.** For these two indicators, we're looking for outright inversion of the 10s-2s spread and positive real interest rates as conditions that would "trip" the economic breaker and serve as a warning. *Update:* These two macroeconomic indicators continue to show financial conditions are a headwind on growth. Real interest rates remained near recent, multi-year highs above 2% while 10s-2s hit from multi-decade lows nearly -90 bps following the hot jobs report. However, these warnings have not yet shown up in the economy. Some are taking that as a sign of "it's different this time," but it just reminds us of the lessons from '00 and '07, which were that slowdowns can take far longer to appear than most think possible (including macroeconomic analysts). **Takeaway: Both Breakers Tripped.**

Economic Indicators**: Light Truck Sales, 12-Month Total Vehicle Miles Traveled, Avg. Work Week, Jobless Claims, Building Permits, New Orders for Non-Defense Capital Goods Ex Aircraft.** For these economic indicators, we're looking for multi-month declines to imply a rollover of the economic trend, or for 12-month total vehicle miles traveled a year-over-year decline. *Update:* Outside of real estate-related industries, economic data remains resilient, and most metrics got stronger in December and January. The economic indicators in the Breaker Panel give us a diversified look at the economy, and there simply aren't any material,

consistent and compelling signs of weakness in the hard data. **Takeaway: One Breaker Tripped (Building Permits).**

Market-Based Indicators**: Brent Crude & Copper.** "Dr. Copper" and crude oil can act as coincident or leading indicators of economic activity, and multi-month lows in both would "trip" this market-based indicator. To trip these market-based breakers, we'd need to see multi-month lows in both Brent crude and copper. *Update:* Copper and oil are in the middle of the past few months' trading ranges, and while neither are rallying hard (implying rising expectations for global growth) neither are falling sharply to multi-month lows, either. As such, both remain mostly rangebound and neither are giving materially negative, or positive signals. **Takeaway: No Breaker Tripped.**

The bottom line in the Breaker Panel is clear: Growth is not materially slowing, as the economy proves remarkably resilient to rate hikes (so far). Practically, that strengthens the case for higher-for-longer rates, an idea that has pressured stocks since the January jobs report (and will continue to be a headwind on stocks (as it's been for over a year now). For markets to sustainably rally, we need to see 1) Stable data (not too good, not too bad) and 2) The Fed meaningfully signal the end is near. Right now, neither is happening (data is too good, and the Fed isn't even pretending the end is near).

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Quote of the week:

"Whatever the mind of man can conceive and believe it can achieve."

- Napoleon Hill

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