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What's in this week's Report:

- Moment of Truth: Does the Fed Signal a Pause?
- Weekly Market Preview: Important New Insight into the Hard vs. Soft Landing Debate
- Weekly Economic Cheat Sheet: ISM Manufacturing Today, Services Wednesday, Jobs Report Friday (It's a Very Busy and Important Week)
- Hard Landing vs. Soft Landing Scorecard

Futures are little changed as markets digest the FRC seizure and asset sale to JPM and look ahead to this week's FOMC decision and important economic data.

First Republic (FRC) failed over the weekend and was seized by the FDIC. Assets were then sold to JPM who will effectively absorb the bank. FRC's failure was widely expected, and as such it's not a new negative on markets.

Economically, the Chinese April manufacturing PMI missed expectations and fell back below 50 (49.2 vs. (E) 51.4.).

Today there is only one notable economic report, the April ISM Manufacturing PMI (E: 46.8), and markets will want to see stability in the data (so no further declines).

On the banks, again FRC's failure was priced in last week, so it's not a new negative on markets. The key now is seeing if any other regional banks with large uninsured deposits come under pressure, so as we said last week, we'll be watching WAL, CMA, and ZION over the coming days.

Market	Level	Change	% Change
S&P 500 Futures	4,187.00	-1.25	-0.03%
U.S. Dollar (DXY)	101.6690	0.0100	0.01%
Gold	2,012.60	13.50	0.68%
WTI	75.14	-1.64	-2.14%
10 Year	3.473%	0.021	0.61%

May 1, 2023

Planning Corner

Retirement is about more than just the dollars and cents of income, expenses, and taxes. The value of family and shared experiences is essential to a healthy lifestyle in retirement.

Escaping a stressful job or toxic work environment can be good for both your mental and physical health.

For some, the term retirement takes on new meaning as they transition from permanent full-time employment to a new part-time work lifestyle that we like to call the "hybrid" retirement.

This lifestyle can facilitate multiple retirement goals such as deferring Social Security benefits to age 70, maximizing lifetime income and spousal benefits. Many part-time opportunities offer health insurance which can defer the enrollment in Medicare Part B, effectively saving thousands of dollars per year.

If you are struggling with the idea of stopping work entirely then it might suit you to consider a hybrid retirement. Call today to discuss you can transition to retirement!

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Stocks

Last Week (Needed Context as We Start a New Week)

Stocks were volatile last week as solid big-tech earnings later in the week helped offset the recently increasing worries about a looming recession. The S&P 500 ended the week with a gain of 0.87% and is now up 8.59% YTD.

Stocks started last week little changed as looming tech earnings saw the S&P 500 close essentially flat on Monday, but volatility picked up meaningfully on Tuesday as FRC shares plummeted to record lows on disappointing earnings and lack of any corporate guidance. There were also several negative debt ceiling headlines and soft earnings from UPS and PKG both further weighed on sentiment. The S&P 500 fell 1.58% on the session.

The selling continued Wednesday as FRC hit yet another set of new lows although the losses were partially offset by strong earnings from MSFT and GOOGL as well as an EIA report that showed strong consumer demand for gasoline. The S&P 500 fell to fresh April lows but held technical support at 4,050, ending down 0.38%.

Money flows reversed in a big way Thursday amid a resurgence in soft-landing hopes given more strong big-tech earnings (META delivered a very solid Q1 earnings report and the stock ripped higher) and mostly market favorable economic data between resilient jobless claims and better-than-expected details to the Q1 GDP report. The melt-up rally was notably thin and appeared to be more the function of a sellers' strike/short covering than any real money stepping in to add long exposure. Nonetheless, the S&P gained an impressive 1.96%.

On Friday, stocks opened little changed as traders digested a largely as-expected headline and Core PCE Price Index release in the premarket. Earnings, meanwhile, were mixed as cautious guidance from AMZN about their cloud computing division was largely offset by strong quarterly results from INTC and CVX. But absent any materially negative news, stocks drifted higher Friday morning. The market pulled back briefly in midmorning after CNBC reported that FRC is likely headed to FDIC receivership, but the broader banking sector largely held up and maintained morning gains. Stocks recovered to new session highs into the lunch hour and the S&P 500 ended with a solid 0.83% gain.

Moment of Truth: Will the Fed Announce the Pause?

Ever since mid-March, when SVB and SBNY failed, markets have taken the additional headwind on the economy from regional bank stress to validate the following Fed script: Hike 25 bps in May, but announce a pause in rate hikes. Then, in late summer, as growth slows and inflation falls, the Fed announces a "pivot" towards less-hawkish policy, and rate cuts occur in the fourth quarter.

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This expected path for Fed policy has not only propelled the S&P 500 to the very top of the "reasonable" valuation spectrum and produced solid returns YTD, but it also has allowed markets to "look past" economic data and earnings guidance that is sending very mixed signals about whether this economy is headed for a soft or hard landing.

Now, it's time for the Fed to meet the market's "hike/pause/pivot/cut" expectation. If they do, then that will 1) Solidify the YTD gains and 2) Opens the possibility of an extended rally if the economic data points to a soft landing (up to 4,300 or perhaps above).

If they do not meet that expectation, then the stock market is "over its skis," and it opens the possibility of a potentially sharp and painful drop (easily 5%) as 1) The market multiple will fall given the risk of additional rate hikes, and 2) The chances of a hard landing will rise as the Fed puts continued pressure on growth via higher rates.

Our full FOMC Preview in Tuesday's report will pinpoint the key phrase that will signal that "pause" or not, but it's more likely than not the Fed does signal a pause. However, if that occurs, while it could fuel a near-term rally, don't confuse that with a signal that downside risks to the market have been removed. In the end, what will decide whether the S&P 500 sees 4,600 or 3,600 first is whether we get a hard landing or soft landing, and as such once the Fed has signaled its intentions, focus needs to shift back to data (and ours absolutely will, because that's the key to the medium-term trend in this market).

Tactically, the market remains resilient, and sentiment remains very negative, so we continue to want to maintain long exposure. However, we still prefer defensive/low-vol positioning, because our main medium-term fear is that hard landing, and minimizing and avoiding the fallout from that possibility (which could easily be 10%-20% drop). We prefer large-cap exposure with a tactical focus on high free cash flow companies and defensive sectors until such time as the economic outlook becomes clearer (and when a hard landing isn't such a big risk).

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

Need-to-Know Economic Data from Last Week

Economic data pointed to mixed growth and sticky inflation, but neither number was bad enough to shake the market's "hike/pause/pivot/cut" expectation for the Fed, and as such the data didn't materially weigh on markets last week (that would change this week if the data shows sticky inflation and mixed growth).

Starting with last week's inflation reports, they were all higher than expected. The Employment Cost Index, which is the best comprehensive measure of gains and benefits (think total employee compensation) rose 1.2% vs. (E) 1.1% while the fourth-quarter reading was revised slightly higher to 1.1% from 1.0%. The March Core PCE Price Index met expectations at 4.6%, but the February data was revised higher to 4.7% y/y as was the headline PCE Price Index, which rose to 5.1% y/y. Finally, in the advance Q1 GDP report, the Core PCE Price Index for the first quarter rose at a 4.9% annualized rate, hotter than expected.

None of these inflation metrics were terrible, but none of them declined, either, and if core inflation remains stickier than expected then this week's 25-bps rate hike will not be the last one—and that will invalidate the "hike/pause/pivot/cut" script, and it'll weigh on stocks.

Turning to growth, the headlines from the two notable reports last week were deceiving, as the Durable Goods headline was strong but the report was actually soft, while the Q1 GDP headline was soft but the details were strong. Starting with Durable Goods, the key metric in this report is New Orders for Non-Defense Capital Goods es-Aircraft (NDCGXA) and that metric missed estimates (-0.4% vs. (E) 0.2%) and saw a big, negative revision to the February data (to -0.7% from -0.2%). With the revisions, NDCGXA suddenly dropped to levels last seen in June, and that implies that businesses are starting to restrain spending and investment, which is an economic negative.

Looking at GDP, the headline missed estimates (Q1 GDP rose 1.1% vs. (E) 2.0%), but that was mostly because of a big inventory adjustment (not the result of a sudden drop in consumer or business spending). This is exactly why we look at "Final Sales of Domestic Product" and "Final Sales to Domestic Purchasers," because it looks at consumer spending and business performance and ignores inventory adjustments, and both of those readings were strong at 3.4% and 3.2%, respectively. Bottom line, there was nothing in the Q1 GDP report to imply consumer spending slowed dramatically in the quarter, and that's a general positive.

Bottom line on growth, as we said last week the data is extremely conflicted, with some reports pointing to sudden weakness, and other reports implying strength. That's typical of economies that are approaching a transition from growth to contraction (or contraction to growth), and this mixed data continues to have us weary that the economy is going to slow in the coming months.

Important Economic Data This Week

This is a very important week for markets because by Friday's open, we'll know: 1) If the Fed hikes 25 bps and is pausing, 2) If growth is rebounding or rolling over, and 3) If the labor market is moving closer towards the "balance" the Fed needs to feel confident wage inflation won't be a problem. And with the S&P 500 above 4,100, the answers to those questions need to be: 1) Yes, the Fed is pausing, 2) Growth is stable or rebounding (and not rolling over) and 3) There is moderate deterioration in the labor markets).

From an indicator and event standpoint, the key event this week is Wednesday's FOMC meeting. Beyond the expected 25-bps rate hike, the market wants to know if the Fed will formally signal a pause via a language change in the statement.

The second most important event this week is Friday's jobs report, because the labor market remains incredibly resilient, and it's hard to envision the Fed pivoting or cutting (assuming they do pause) if unemployment is under 3% and the economy is still adding hundreds of thousands of jobs every month. Markets need to see moderation in the jobs data to reinforce rate cut expectations later in 2022.

The third most important event this week is the ISM PMIs, as we get the manufacturing PMI today and the

services PMI on Wednesday. The regional surveys have shown mixed results so far in April, but the bottom line is if the services PMI drops below 50 (and the manufacturing survey stays solidly below 50) then that will increase "hard landing" concerns, and as we know, that's the one worry consistently pressuring markets.

The "hike/pause/pivot/cut" narrative combined with expectations for a soft landing have powered the S&P 500 to current levels, and as long as those expectations are met this week, the rally can hold and even continue. However, if those expectations are not met this week, then the disappointment could be intense, and a 5%-ish air pocket in the S&P 500 shouldn't shock anyone if 1) The Fed signals more rate hikes are likely, 2) The ISM PMIs both fall below 50 and 3) The jobs number comes in "Too Hot," because that will imply a stagflation environment with no Fed relief, and at 4,100, the S&P 500 is much too high for that environment.

Special Reports and Editorial

Hard Landing vs. Soft Landing Scorecard

The hard landing vs. soft landing debate is one of the most important debates in the market right now, as the answer to that question likely determines whether the next 10% in stocks is higher, or lower. Yet despite that importance, I haven't seen any sort of comprehensive "scoreboard" on which outcome is more likely, so I've put one together so that we have a measure of hard vs. soft landing.

Like all things *Sevens Report* related, I want to keep it succinct, so I'm not listing a lot of economic data points. Instead, I've included the "big three" data points from each month (job adds, ISM Manufacturing PMI and ISM Services PMI), along with a measure of consumer spending (because consumer spending is 2/3rd of the economy and if it slows, the economy will slow), a measure of business spending (because business spending is a solid part of the economy), and the most timely measure of unemployment (because that will deteriorate before the monthly jobs report).

To help determine if the "Scoreboard" is pointing more towards a hard or soft landing, I decided to compare the most-recent data to the readings one month ago and three months ago. The reason for that is simple: Hard landings don't happen gradually, they happen suddenly. Soft landings do happen gradually. So, comparing activity to a year ago isn't helpful in determining if we're getting a hard landing, or not. Activity can be down over a year ago, but those declines don't automatically mean a hard landing. Conversely, if activity is off sharply from three months ago (or a month ago) that does imply something has changed and the economy is quickly losing momentum (a hard landing).

Given this analysis, the conclusion is remarkably clear: **If we look at the scoreboard, soft landing is currently more likely than a hard landing.** Here's why.

Of the "Big Three" monthly economic reports, only one is flashing hard landing. Of the three most-important monthly economic reports, only one, the ISM Manufacturing PMI, is pointing towards a hard landing. The PMI is solidly in contraction territory (below 50) and down from one and three months ago.

Conversely, the ISM Services PMI is down moderately from one month and three months ago, but it's not yet

in contraction territory. So, those declines are signaling a soft landing more than a hard landing (at least for now).

Finally, the monthly jobs data is down from previous very high levels, but job adds are still above 200k and that's not a number that implies hard landing. Bottom line, two of the big three monthly economic reports are signaling soft landing. *What signals hard landing going forward? ISM Manufacturing PMI declining further, ISM Services PMI dropping below 50 in the next month of two, and job adds dropping below 150k starting next month.*

There are few signs that U.S. consumer spending is materially slowing. Retail sales, which is the most comprehensive measure of consumer spending each month, is higher than it was three months ago, and while it's off recent highs, it's not giving the type of signal that would imply a hard landing is upon us. But even beyond the macro-economic data, earnings commentary does not imply we are seeing a material collapse of consumer spending. Now, this shouldn't be a shock, because consumer spending only substantially slows when unemployment rises, and that's not happened yet. Bottom line is consumer spending may be slowing, but it's not imploding like we would expect in a hard landing (at least not yet). *What signals a hard landing? Retail sales rolls over and begins to drop sharply, falling to multi-month lows within the next three months.*

Business spending is slowing, but it's not collapsing. New orders for non-defense capital goods excluding aircraft (NDCGXA) is the best metric we have for national business spending and investment, and it's essentially little changed from one month and three months ago. And that's largely backed up by earnings commentary so far. Yes, tech companies have warned on business tech spending, but we have to think about that in the context of the massive growth of the past few years. Beyond tech-related concerns, however, there's not a lot of evidence to imply business spending is falling off a cliff. **What Signals a Hard Landing? NDCGXA falling to multi-month lows in the next three months.**

Employment is deteriorating, but barely so. Employment is a lagging economic indicator, broadly speaking, which means it only deteriorates after the economy has slowed materially. But jobless claims is one of the most current employment indicators and that's why we watch it weekly and include in the Economic Breaker Panel. So far, there's been a mild increase in weekly claims as they are up over a one-month and three-month time frame, but the increase isn't enough to imply a hard landing. **What Signals a Hard Landing?** Claims moving above 300k within six weeks.

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Hard Landing vs. Soft Landing Scoreboard				
	Current	One Month Ago	Three Months Ago	Hard Landing/ Soft Landing
ISM Manufac-turing PMI	46.3	47.70	48.40	Hard Landing
ISM Services PMI	51.2	55.1	56.5	Soft Landing
Job Adds (Non-Farm Payrolls)	236k	326k	472k	Soft Landing
Retail Sales	$598.59B	$605.62B	$589.03B	Soft Landing
NDCGXA	$75.10B	$75.03B	$75.02B	Soft Landing
Jobless Claims	245k	230k	200k	Soft Landing

To be clear, today's analysis does not mean a hard landing won't happen. Remember, we focused last week on how all the Covid stimulus likely could delay any economic slowdown far longer than investors (or analysts) think possible. So, do not take this analysis as me saying a hard landing won't happen—I think a hard landing is still entirely possible in the coming months or quarters. But, so far, it is not happening. Yes, the economy is clearly slowing, but not at the pace yet that we'd consider a hard landing. And that's one of the reasons stocks have proven resilient, as we covered last week.

Going forward, this hard landing/soft landing debate will continue and remain critically important for the next material move in stocks, so we are going to keep this "Hard Landing vs. Soft Landing" scoreboard updated, so that we know, ahead of our competition, if a hard landing is more likely or the threat of it is removed, because either outcome will require adjustment in portfolios to protect against volatility, or seize opportunities.

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