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What's in this week's Report:

- The Fed Pivoted, So Now What?
- Weekly Market Preview: Will there be any debt ceiling progress, and does disinflation resume?
- Weekly Economic Cheat Sheet: CPI on Wednesday is the key report this week.
- What the Fed Means for Markets

Futures are slightly higher following a mostly quiet weekend of news as markets look ahead to Wednesday's CPI.

News was slightly positive on the debt ceiling over the weekend, as reports indicate the White House will try to negotiate a short-term debt ceiling extension (to the end of September). However, it remains uncertain if even this short-term deal can get done before the "X" date.

Economically, German Industrial Production missed estimates (-3.4% vs. (E) -1.5%) but that's not moving markets.

Today there are no notable economic reports but there is a potentially important release at 2:00 p.m. via the Bank Senior Loan Office Survey. Markets (and the Fed) are nervous the regional bank stress will curtail lending and put a bigger headwind on the economy. If the loan officer survey reflects that reality (a drop in bank lending) it could cause volatility as that would increase the chances of a potential hard landing.

Market	Level	Change	% Change
S&P 500 Futures	4,155.25	5.50	0.13%
U.S. Dollar (DXY)	101.1260	-0.0880	-0.09%
Gold	2,032.20	7.40	0.37%
WTI	73.04	1.70	2.38%
10 Year	3.494%	0.048	1.39%

May 8, 2023

Planning Corner

Following up on last week's topic of lifestyle transition through hybrid retirement involving part-time employment, this week we highlight one of the hidden benefits of remaining involved in the workforce.

A new Surgeon General Report titled *The U.S. Surgeon General's Advisory on the Healing Effects of Social Connection and Community* warns of the epidemic of loneliness and isolation. Remaining in the workforce provides social infrastructure to maintain social connections, providing opportunities for engagement and participation.

For some, their extended family, religious faith groups, or neighbors provide these opportunities. Each of us must cultivate our own "tribe" as we get on in years to provide healthful engagement.

Your retirement journey should be about more than the dollars and cents. You need people to share it with to make the journey worthy!

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Stocks

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

Stocks were volatile last week as investors parsed through more mixed earnings reports, mostly upbeat economic data, a largely as expected Fed decision, and more regional banking sector turmoil. The S&P 500 fell 0.80% on the week and is now up 7.73% YTD.

Markets began the week with quiet and mostly sideways trading on Monday as investors digested the news that FRC had failed over the weekend and the lender's assets were to be acquired by JPM. The ISM Manufacturing Index came in above estimates, which saw stocks edge higher, but a hot prices sub-index kept the market from gaining any upside momentum. The S&P fell 0.04%.

Stocks dropped on Tuesday as regional bank fears resurfaced as PACW and WAL shares plunged in morning trade. The weakness in banks stocks dragged bank indices to new 52-week lows and the S&P 500 ended with a loss of 1.16% on the session.

The looming FOMC decision and some relative stabilization in banks kept stocks little-changed ahead of the Fed on Wednesday. The S&P 500 hit a new session high on the back of a dovishly received FOMC statement but Powell pushed back on the idea of rate cuts, and that poured cold water on the rally. The S&P 500 ended the day down 0.70%.

The selloff continued Thursday as the sharp declines in regional bank shares dragged the broader market lower, simultaneously sending the VIX beyond the 20 mark for the first time since late March. The combination of still-hawkish central bank chatter and some stagflationary economic data didn't help sentiment either and the S&P 500 closed down another 0.72%.

Stocks rebounded Friday thanks to solid AAPL and SQ earnings and a jobs report that, when considering the revisions to the previous month's data, was mostly Goldilocks. The S&P 500 rallied hard and tested 4,150 in the afternoon before some hawkish comments from the Fed's Bullard saw the index pullback in the final hour to end just off session highs, but still with a very solid rally.

The Fed Pivoted, So What's Next?

Last week brought the fulfillment of multiple events the market had been watching, including the FOMC decision (the pause), key April economic data (hard landing/soft landing) and Q1 earnings (which are basically over). So, given what's happened, I want to step back and update the state of each event, and identify what happens next.

Fed Policy. *What Happened:* The Fed paused. *Market Impact:* Neutral. This was already priced in so it helps support stocks but won't push us materially higher. *What's Next:* Barring a jump in inflation, when does the pivot occur (sooner the better)?

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April Economic Data. *What Happened:* Data was generally "fine" and did not signal a hard landing (although it left the possibility for one intact). *Market Impact:* A hard landing remains the biggest potential negative for stocks, so the fact that data did not imply a hard landing helped stocks rally. *What's Next:* This week's CPI report, and then the May economic data (the hard landing vs. soft landing issue remains the biggest one for markets).

Earnings. *What Happened:* The Q1 earnings season was better than feared, with a high number of companies (more than 80%) beating estimates. *Market Impact:* Neutral. Earnings are helping to support stocks, but guidance wasn't great and earnings season won't push the S&P 500 higher. *What's Next:* Guidance was underwhelming and that will have to be increased for earnings to be a tailwind).

In sum, the events of last week largely came out "ok" for markets and imply that the March and April rally was valid, so that's a positive. However, it's important to realize that risks on the horizon didn't dissipate. Even after the Fed decision, Q1 earnings and April economic data, we don't know, for sure, if: 1) The Fed will actually cut rates this year (if not, that's a negative), 2) If earnings can hold up (Q1 results were good but guidance was not, that's a potential problem) and 3) The economy can maintain this soft-ish landing.

Bottom line, the events of May were "ok" and positive for stocks, but most of them were already priced in and they don't remove the possibility of future negatives. As such, we continue to think a cautious approach centered on large-cap defensives and tech, minimum-volatility ETFs and long-dated Treasuries remains the best way to maintain long exposure, but also account for the fact that none of the major issues that could cause a sharp market decline have been eliminated.

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

Need-to-Know Economic Data from Last Week

The Fed signaled the long-awaited pause in rate hikes last week amidst resilient economic and inflation data, and that helped to support stocks amidst mixed earnings and more regional bank stress, although the risk of a rebound in inflation, or a sudden loss of economic momentum, remain very real.

The FOMC decision was the most important event from last week, in that it confirmed the Fed is likely pausing rate hikes, and largely validated the first half of the "hike/pause/pivot/cut" expected Fed script. In fact, the FOMC statement was slightly more dovish than expected, in that the Fed largely eliminated any hawkish forward guidance (instead of just qualifying it) and noted that the regional bank stress will put additional pressure on the economy. Powell's press conference was a bit more mixed, as he cautioned that the FOMC didn't formally announce a "pause" (although they did, in effect) and, more negatively, he disavowed any thought of rate cuts (something the market expects late in the year). In aggregate, the FOMC decision was slightly dovish, but it only really confirmed what markets had priced in starting in March, namely that the regional banking stress would cause the Fed to hike once more, and pause, which is what they did. As such, it didn't spark an additional rally, although it helps solidify the YTD gains.

Turning to actual data, it was resilient last week, although inflation metrics were also firm. The jobs report was strong on the headline, with job adds at 253k vs. (E) 180k, the unemployment rate at 3.4% vs. (E) 3.6% and wages rising 0.5% m/m vs. (E) 0.3% m/m and 4.4% y/y vs. (E) 4.2% y/y. So, on its face, that number was very close to a "Too Hot" reading. But revisions matter, and the revisions to the February and March data were substantially negative. The February jobs data was revised lower by -78k jobs (from 326k to 248k) and the March data was revised lower by -71k (from 236k to 165k). Those revisions, which totaled -149k, helped to make this jobs number largely "Just Right" (at least for Friday) and implied the labor market is cooling, which is what the market wants to see.

Turning to the ISM Manufacturing and Services PMI, they provided similar messages to the jobs report: Activity is moderating, but inflation pressures were sticky. The April ISM Manufacturing PMI rose to 47.1 vs. (E) 46.8 and New Orders, the leading indicator in the report, slightly rose to 45.7 vs. (E) 45.5. On the service side, the April ISM Services PMI rose to 51.9 vs. (E) 51.8, while New Orders remained solid at 56.1. Bottom line, neither data point is very "strong" in an absolute sense, but they do imply moderation in activity, which increased soft landing hopes and pushed back on hard landing fears.

Inflation readings, however, were firm last week and while none of the data was alarming, if inflation metrics bounce back that will challenge the Fed pause assumption and pressure stocks. Both price indices in the ISM Manufacturing and Services PMI were buoyant, with the manufacturing price index rising to 53.2 vs. the previous 49.0 and the ISM services prices index little changed at 59.6 vs. (E) 59.9. Other metrics of inflation were similarly firm, with the aforementioned wages running hotter than expected, as did Unit Labor Costs.

Last week's Fed decision met an important market expectation, and while that's not enough to power stocks higher, it is enough to help reinforce current YTD gains. However, somewhat lost in that was the fact that inflation was stickier than expected and if inflation does not come down, there's risk that the Fed pause gets reversed, and that will weigh on stocks because markets are very much expecting, a decline in inflation and stable economic data. Any disappointment on either front would be a new headwind on stocks.

Important Economic Data This Week

Focus this week will be squarely on inflation, as Wednesday's CPI and Thursday's PPI are, by far, the most important economic reports this week. Put simply, disinflation (the decline in inflation) must continue. We need to see both headline and, more importantly, core CPI continue to drop from previous levels and, hopefully, come in solidly under expectations. Practically, that means headline inflation falls below 5% while Core CPI drops below 5.5% (and the closer to 5.0% the better) and the market needs to see this positive inflation data to help ease worries about a potential Fed pause reversal. Bottom line, the "hike/pause/pivot/cut" Fed script that's pushed stocks higher since March is based very much on the idea that inflation will drop further, and that needs to happen to further solidify these YTD gains.

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Special Reports and Editorial

What the Fed Means for Markets

The Fed met market expectations for the first half of the "hike/pause/pivot/cut" policy script, as the Fed hiked rates a final time and clearly signaled it is pausing further rate hikes (which for all intents and purposes means they are done with this hiking cycle, and the next move will be a cut, it's just a question of when).

Positively, that means the YTD gains should be better supported because they were driven by expectations for a Fed pause, and that's what occurred. Additionally, we can now stop wondering about "terminal rates," because we're there at 5.125%. The next subject of Fed speculation will be when the Fed signals a dovish pivot, which markets expect will happen sometime in the summer. The practical takeaway from the Fed decision is that the YTD gains will be better supported going forward. However the decision will not 1) Spur material upside nor 2) Eliminate the chance of a material pullback and here's why. It's all up to economic data now.

If the data hints at a soft landing (moderation in the labor market, stability in ISM PMIs, retail sales, durables goods, and a continued decline in inflation) then the Fed pause means the "soft landing" can propel stocks substantially higher, like it did when the Fed executed a "soft landing" in mid-2019 (where stocks rallied hard into year-end).

If data starts to hint at a hard landing, and this includes any additional headwinds from the regional banking crisis or the looming debt ceiling fight, then even with the Fed's pause stocks will drop sharply and for one simple reason: The Fed will have paused too late. To take an extreme example, if the economy rolls over hard starting in May (something I don't think will happen but for illustration purposes let's go with it) and the Fed were to cut rates in June (something that's not going to happen, but again you get my point), it would *still* be too late for the Fed to stave off a hard landing.

So, with the Fed no longer applying pressure to the economy via higher rates, it makes the economic growth (and the influences on economic growth) now the key to whether the S&P 500 sees 4,300 first, or 4,000 first, and it's the economic data that will tell us which way it's breaking.

Debt Ceiling Negotiations

It is my belief that in the near term, based on study of most recent debt showdowns, a brief market correction is likely necessary to bring additional urgency to the bargaining table for a resolution to emerge. As such, there is an asymmetrical risk to the downside due to the likely deadline related outcomes possible. It is unlikely that the U.S. ever defaults, but if that is the indicated outcome, then U.S. markets will be similarly impacted in the short term. However, the past occurrences indicate that these losses may be short lived as the U.S. equity market has proven to be previously resilient.

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