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What's in this week's Report:

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- A "Make or Break" Week for the Rally
- Where the Opportunity is in Stocks Right Now
- Weekly Market Preview: Will Data Confirm "Goldilocks" Optimism?
- Weekly Economic Cheat Sheet: CPI Tuesday, Fed Wednesday, Key Growth Data Thursday
- Market Multiple Table/Chart: June Update
- A Tale of Two Trades

Futures are slightly higher on momentum from last week's rally, as it was a very quiet weekend of actual news and investors are looking ahead to multiple important market catalysts this week.

Economically, the only notable number was Japanese PPI which rose 5.1% y/y vs. (E) 5.7% y/y in what is the latest sign of global disinflation.

Oil declined more than 2% overnight on over supply concerns as Russia is largely ignoring its production quota.

Today there are no notable economic reports nor any Fed speakers, so barring any major surprises markets should be relatively calm ahead of tomorrow's CPI report, Wednesday's FOMC decision and Thursday's important economic data.

Market	Level	Change	% Change
S&P 500 Futures	4,360.50	11.75	0.27%
U.S. Dollar (DXY)	103.4640	-0.0930	-0.09%
Gold	1,977.30	0.10	0.01%
WTI	68.04	-2.13	-3.04%
10 Year	3.715%	-0.029%	-0.78%

June 12, 2023

Planning Corner

Today's edition of the Planning Corner comes after a brief hiatus due to the passing of my mom at age 89 after a long journey of dementia and Alzheimer's which she faced with humor and flair, charming those around her until her body failed her.

The theme for this week is "It's time to get your act together, the whole world is on fire right now". Markets seem to be ambivalent to the weather, so it seems. The rest of us can't help but notice the dark haze in the sky and the acrid smell of smoke everywhere from Canadian wildfires over two thousand miles away. In April a wildfire engulfed watershed land around Echo Lake in West Milford, NJ, causing evacuations and threatening area homes and business in my community. Other wildfires around NJ have been in the news for months.

Planning for long-term care is like getting your house ready for a wildfire. It's essential to prepare well before the event occurs to protect your family, health, and welfare.

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Stocks

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

Stocks churned sideways for most of last week as traders assessed the outlook for future Fed policy amid multiple hawkish central bank surprises overseas before a late-week rally saw the broader market hit the highest levels since last August. The S&P 500 advanced 0.39% on the week and is now up 11.96% YTD.

Monday was quiet as the ISM Services PMI didn't materially alter the outlook for a hard or soft landing, nor impacted the expectation for a pause at this week's FOMC meeting.

Stocks rallied modestly on Tuesday thanks to an upgrade of global growth expectations from the World Bank and despite a surprise rate hike from the Reserve Bank of Australia. But the market gave those gains back Wednesday, as soft Chinese export data brought the optimism surrounding the World Bank's upgraded growth estimate into question. Then the Bank of Canada was the second central bank to deliver a hawkish surprise for the week and the S&P 500 fell 0.38%.

Stocks rebounded Thursday despite a pop in jobless claims, as that resulted in a decline in Treasury yields and a rally in super-cap tech. A sharp drop in oil prices on the back of rumors that the U.S. and Iran had struck a nuclear deal helped further ease inflation worries. The S&P 500 rose 0.62% to end at a new YTD high.

On Friday, the S&P 500 came within 3 points of the intraday high from last August, a key technical tipping point for the market, led by tech shares. But the market didn't have the momentum to breakout to new highs as traders maintained a degree of caution with this week's FOMC meeting in focus. The S&P 500 retreated in the afternoon to close with a modest gain of 0.11%, just below psychological resistance at 4,300, which was also below the August 2022 closing high of 4,305.

Stocks were resilient again last week and the S&P 500 broke above 4,300 for the first time since August 2022, not because macroeconomic news was good, but instead because news wasn't bad enough to make investors doubt that a Goldilocks' scenario of 1) Rapid disinflation, 2) End of central bank hawkishness and 3) Soft economic landing is the most likely outcome.

We know that because markets ignored evidence to the contrary. Data (ISM Services PMI and jobless claims) pointed to an economy losing momentum, two significant global central banks surprisingly hiked rates, and both cited sticky inflation for the surprise hikes! But none of that was enough to break the optimism in markets, as evidenced by the CNN Fear/Greed Index hitting "Greed" levels, and the AAII Investor Sentiment Index becoming the most bullish and least bearish since November 2021.

Looking forward, we know that can push the "market" higher: More of the same (evidence of accelerating disinflation, not hawkish Fed, solid economic data). Specifically this week, that looks like 1) CPI (and

especially Core CPI) solidly under expectations, 2) The Fed pausing rate hikes and markets not believing threats to hike in the future and 3) Solid economic data from Philly Fed, Empire Manufacturing, Retail Sales, Jobless Claims and Industrial Production.

But even if we get that outcome from the data and news, the broad "market" is facing a valuation constraint. At 4,300, the S&P 500 is now trading at a 19.4X multiple if we use the 2023 S&P 500 EPS estimate of $223, and a 17.4X multiple if we use the 2024 S&P 500 EPS estimate of $247. Those aren't "best case" scenario multiples, but they aren't that far off, either, and even with the bullish momentum currently helping stocks ignore any news that doesn't fit the bullish narrative, it's hard to see investors pushing the broad averages materially higher from here (perhaps 5% or so).

However, there is likely more potential upside in a continued compression of the performance spread between RSP and SPY, value and growth, small caps over large caps, and cyclical sectors and super-cap tech. **To that point, the S&P 500 was little changed last week, but value and small cap both rallied more than 1.0%, while the Nasdaq was flat and growth declined 0.11%. Point being, if you're looking to add long exposure here, we'd prefer to add it to the parts of the market that have been left behind in this recent rally, but that will benefit if the Goldilocks scenario of 1) Disinflation, 2) Not-hawkish Fed and 3) Solid growth continues throughout this week.**

More broadly, one can't help but admire that market's ability to elicit the most amount of "pain" from the most number of investors, and in the case of the market throughout 2023 that's meant stocks moving steadily higher despite, frankly, a lot of bad news. Regional bank crisis (not over), earnings declines (but not as bad as feared), clear softening of economic momentum (but not a hard landing) and more rate hikes than expected at the start of the year (the market expected one in 2023, then a pause) leading the pack. And it's the respect of the market's ability to do that very thing that kept me advocating staying long stocks (albeit in more defensive and lower-volatility sectors) rather than raising cash.

However, my experience through 2000-2003 and 2007-2008 continues to make me nervous. Investors operate in days, weeks, and months. Markets and economies operate in quarters and years. In both '00 and '07, warnings of a looming economic slowdown were wrong for over a year, with those risks all but dismissed by the time what everyone warned about actually showed up. I hope this time is different. I hope we do get Goldilocks and we're talking about new highs in the S&P 500 by year-end. But the reality of 1) High rates for longer, 2) A slowing economy, 3) Pressure on corporate profits, 4) Contracting lending and 5) Slowly rising unemployment can't be totally ignored, either. So, while we enjoy this resilient market, please keep in mind that under the surface, things aren't quite as good as the AAII Sentiment Index would imply.

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

Need-to-Know Economic Data from Last Week

There were only two notable economic reports last week and both implied a clearly slowing economy (and more towards a hard landing than soft) while two important central banks surprised with 25-bps rate hikes,

but stocks ignored those data points and events and extended the rally.

Starting with the data, the most important report last week was the ISM Services PMI, and it showed a slowing of activity and inflation. The headline reading fell to 50.3, which was the second lowest reading since the pandemic, while New Orders, the leading indicator in the report, dropped to 52.9 from 56.1. Prices also fell to a three-year low, declining to 56.2 from 59.6. Looking at the data unemotionally, this report implies the U.S. economy is indeed slowing, as the service portion of the economy has been the engine of growth for years and it is slowing. That slowing is causing prices to fall, but that's not "Immaculate Disinflation," and instead just a good, old-fashioned economic slowdown causing reduced demand and lower prices. Markets largely ignored the report as it wasn't damning enough to counter act the strong bullish momentum in stocks, but I do want to make clear that this report, which is basically the third most important economic report of the month, did point more towards a hard landing.

The other notable report last week was weekly jobless claims, which popped to the highest level since November 2021 at 261k vs. (E) 235k. Now, that also hints at a slowdown that's intensifying, but this data set has been so volatile lately (in part because of fraud in claims) that markets aren't taking the jump too seriously, yet, and as such it didn't really impact markets. But like the ISM Services PMI, I do want to make clear that this report does point more towards a hard landing. So, last week's economic and central bank news wasn't particularly positive, as the data pointed more towards a hard landing than a soft landing, and important global central banks signaled that rate hikes remain a possibility, and rate cuts remain far off.

Now, stocks didn't care as momentum is higher, a new "bull market" apparently started, and people are chasing. But I do want to make it clear that beyond the short term, last week's actual data wasn't positive.

<u>Important Economic Data This Week</u>

To say this week is busy would be an understatement because by Friday, we will learn 1) If the Fed is truly pausing rate hikes, 2) If disinflation is accelerating and 3) If economic growth is holding up so far in June, and the answers to those questions will determine if the S&P 500 can extend last week's gains or give them back.

The most important event this week is Wednesday's FOMC decision, and at this point a pause is widely expected (a hike would be a big surprise) and the key will be how forcefully the FOMC threatens to hike rates in the future (and how much the market believes them).

The second most important event this week could make that Fed rate hike more likely, because the May CPI report comes out on Tuesday and will be the first big inflation number since hopes of accelerating disinflation boosted stocks throughout May. Specifically, markets will want to see Core CPI fall much closer to, and ideally below, 5.0% y/y and that could help bolster the idea that disinflation has taken hold and it's just a matter of time until inflation is back under control (and it'd make a Fed pause all but guaranteed).

Finally, after CPI and the FOMC, we get a series of important economic reports on Thursday. First, we get the initial look at June economic activity via the Empire and Philly manufacturing indices, and markets will

want to see stability in the data (both are negative and if they get worse that will increase hard landing worries). Second, jobless claims will be of particular interest given the spike from last week, and markets will want to see that increase undone or at least partially reversed to ease any concern the labor market is weakening. Then, and just as important as the other two reports, May retail sales will be released. Markets will want to see stability in consumer spending because with manufacturing weak and government spending flat, consumer spending is the key to keeping this economic landing "soft." Here's why this data matters so much.

If CPI drops sharply and confirms accelerating disinflation, and the Fed pauses rate hikes and markets think they're done, and we get a run of bad economic reports on Thursday, then worries will bubble up that it's all too late, and that Fed has hiked too far, that inflation is dropping because growth is slowing, and that a hard landing is much more likely. Moreover, markets will think that the Fed's pause came too late and now they can't do anything to help the economy. That's the major worry for stocks right now, and that's why economic data this week is just as important as CPI and the FOMC decision.

Special Reports and Editorial

Market Multiple Table/Chart: June Update

Fundamentals clearly improved over the past month and the June Market Multiple Table reflects those changes in numerous ways and implies that the gains enjoyed in stocks and bonds are partially fundamentally driven. However, at the same time, the room for additional positive surprises is slim, and at this point a realistic "Best Case" scenario produces only a modest further rally, while any disappointment now could easily open a 10% "air pocket" in the market.

There were multiple changes to the June Market Multiple Table compared to the May edition, and all of them were the "Gets Better If" scenario. First, the debt ceiling has been removed as a market influence, and obviously that was resolved in the "Gets Better If" case, as there was a multi-year debt ceiling extension passed.

Second, the regional bank crisis, which in May was the second-biggest influence on markets, has been relegated to the least important active influence on markets as there have been no more regional bank failures and even some stabilization in the most "vulnerable" regional banks PACW, WAL, ZION and CMA. To be clear, I don't think this means there's an "All Clear" on regional banks, but the past month has seen at least some stabilization.

Finally, over the past month we've seen mostly stable economic data (or at least data that isn't screaming "hard landing") while there are anecdotal signs of a restart, and potential acceleration, of disinflation. I'm not saying either issue is resolved and there very much remains the risk of an economic hard landing and/or sticky inflation, but both issues saw some improvement over the past 30 days.

The net result of that is an increase in the market multiple for the current situation to 17.5X-18.5X from 17X-18X, and an increase in the "Gets Better If" Scenario to 18.5X-19.0X (from 17.5X to 18.5X) as that better

supports the current market valuation.

At this point, there isn't a lot of material upside if we get a near-perfect scenario. A 19X multiple on $240 2024 S&P 500 EPS (neither of which can be justified right now) results in 4,560 in the S&P 500, or about 7% from current levels. That's not a bad return by any stretch, but that really is an almost "perfect" macro scenario for a modest return.

Bottom line, the macro environment has improved but we're running out of fundamental positive catalysts and aggressively pricing in a near "best case" scenario, and that works unless there's some real disappointment, because it's a long way to fundamental support at these levels.

Current Situation: Mostly stable economic data, hints of an acceleration in disinflation, a likely Fed pause and regional bank stability. As mentioned, there was real, positive macroeconomic news over the month as the debt ceiling is behind us and regional banks are stable, quieting the two strongest potential macro surprises. Additionally, there was positive incremental movement on economic data (stable readings), inflation (hints of disinflation) and the Fed (clearly guiding towards a June pause). Now, none of those last three issues are determined yet and we could easily get disappointment in one or all three this month, but for now there's positive motion and that's helped to support the YTD rally in stocks.

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A Game of Multiples (Updated 6/5/2023)			
Market Influence	**Current Situation**	**Things Get Better If...**	**Things Get Worse If...**
Hard Landing vs. Soft Landing	May economic data continued to show a resilient economy and labor market, increasing hopes for a soft landing.	The solid data continues and major growth metrics remain stable or decline only slightly	Major economic readings suddenly turn lower and increase hard landing worries.
Inflation	Thanks to the price indices in the ISM PMIs, hope has risen for "Immaculate Disinflation," where inflation drops quickly and growth doesn't slow.	More inflation readings drop sharply, most importantly the CPI report (out June 13).	Core CPI remains elevated and does not decline, dashing the "Immaculate Disinflation" narrative and pressuring stocks.
Fed Policy Expectations	A Fed pause is still the consensus expectation, but it's not a done deal yet and a rate hike is still possible.	The Fed does not hike rates in June and confirms it's pausing hikes to monitor growth.	The Fed hikes rates 25 bps in June, dashing hopes of any near-term dovish pivot.
Regional Bank Stress	No regional banks have failed over the past month and we've seen some stabilization in vulnerable banks PACW, WAL, ZION and CMA.	No more regional banks fail and the crisis gradually recedes.	PACW, WAL, ZION, CMA or some other regional bank fails or is rescued, increasing contagion fears.
Expected 2023 S&P 500 EPS	**$225**	**$240**	**$215**
Multiple	17.5X-18.5X	18.5X-19X	15X-16X
S&P 500 Range	3,938-4,163	4,440-4,560	3,225-3,440
S&P 500 Target (Midpoint)	4,051	4,500	3,333
Change from today	**-5.2%**	**5.3%**	**-22%**

Things Get Better If: Data points more convincingly towards a soft landing, core inflation drops faster than expected, the Fed confirms the pause and there are no more regional bank failures. This environment would create a "sweet spot" for stocks and we should expect a break above 4,300 and maybe 4,400 in the S&P 500 as a soft landing would become more likely (increasing the market multiple), the regional bank crisis would fade as a potential risk, inflation would drop opening the door for Fed rate cuts, and the Fed would hint at a

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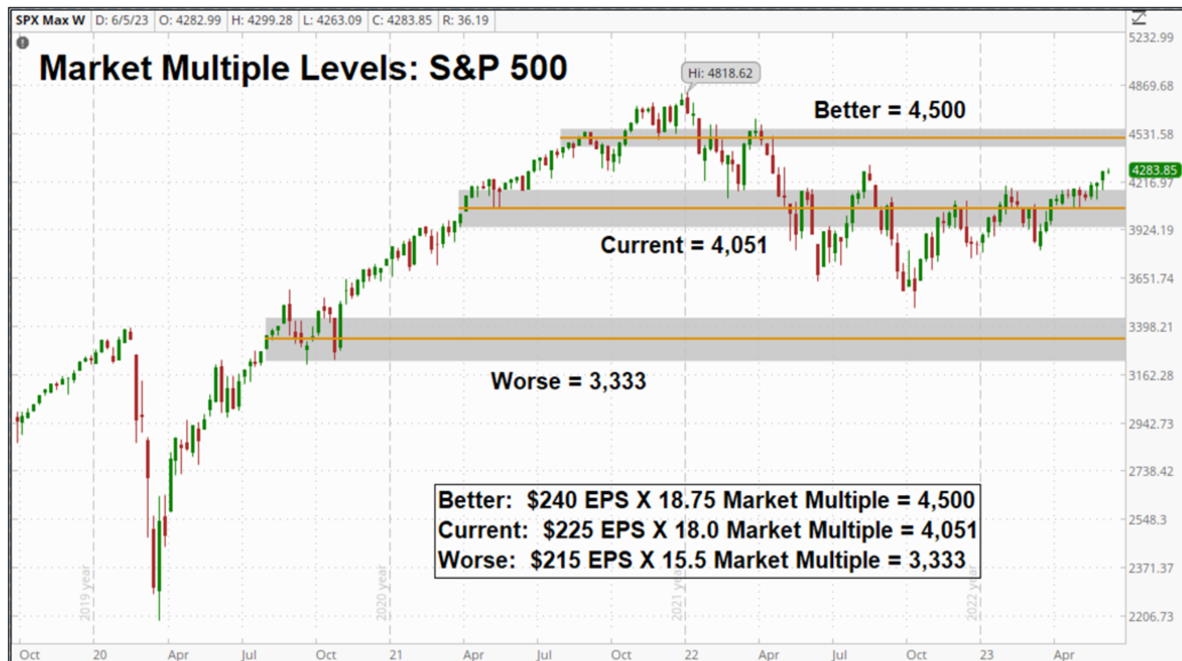
looming pivot. That would boost the market multiple above current levels, and a rally into the mid-4,000s should be expected.



Things Get Worse If: Economic data rolls over and points to a hard landing, core inflation remains sticky and doesn't drop much below 5.5%, the Fed hikes rates in June and PACW, WAL or another regional bank fails. This outcome isn't as remote as the price action in stocks would imply. Yes, there's been positive motion on economic data pointing towards a soft landing, inflation possibly declining more quickly, the Fed truly pausing and regional bank stability, but none of them are completely resolved and one bad major economic report, Fed decision or comment, or regional bank stock weakness would put a new headwind on this market. The problem is we're a long way from fundamental valuation if we get a hard landing, sticky inflation, still-hawkish Fed and/or regional bank stress. Any one of them could cause a 5% decline in stocks, but any two or more could create a 10%-20% decline, in a hurry.

Bottom line, the past month has seen real macro improvement as the gains in stocks are mostly appropriate. But at this point, the market is assuming a lot of positives, and if they all come true, there's not a ton more upside and there's material downside on any real disappointment. That's not a reason to lighten up on stocks, but it is context to be aware of amidst suddenly budding optimism in the market.

A Tale of Two Trades

For most of 2023 markets have basically been alternating between two cross asset trades, and that has been especially true over the past week. And understanding these two trades should help more tactically oriented investors outperform.

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Stepping back, we can call the two trades “Growth On/Growth Off.”

The Growth Off trade has been the dominant one for most of 2023, and the trade looks like this: Markets price in lackluster economic growth (not a recession but slow growth). Treasury yields and the dollar fall on the idea of a dovish Fed pivot and super-cap tech stocks (MSFT/AAPL/NVDA/GOOGL/etc.) lead markets higher, while the vast majority of sectors and stocks go nowhere or even decline.

The reason this is called the Growth Off trade is clear: The market prices in lackluster economic growth and maybe even recession. In that instance, “growth” will be scarce for most corporations, so investors stampeded to companies with 1) Higher margins and 2) Perceived inherent business growth, i.e. the tech sector and growth styles. Essentially, the fear of slow or no growth makes investors rush towards sectors that are seen as having inherent growth. This trade has dominated markets in 2023, with substantial outperformance from the tech and communications sectors, SPY over RSP and growth over value.

But in recent days, the Growth On trade that dominated recent years has made a comeback. The catalyst was the rising hopes for Immaculate Disinflation, whereby inflation falls but growth doesn’t slow or stall. It’s characterized by higher yields and a strong dollar, and diminished hopes for a dovish Fed pivot (although that’s perceived as “ok” because it’s not needed).

In this trade, which has driven markets mostly since last Thursday, the “market” does well, with the vast majority of sectors trading higher, led by cyclical sectors such as industrials, materials, energy, and financials. Super-cap tech, meanwhile, lags. The reason this is called the Growth On trade is also clear. If the economy is going to continue to grow, then investors don’t need to “hide” in tech stocks that are perceived to have inherent growth. Instead, investors can get the benefits of economic growth in other sectors that benefit more from it, like the aforementioned cyclical sectors. In this trade, the vast majority of stocks rise, value outperforms growth as investors rotate to sectors that benefit more directly from solid economic growth.

On Thursday, Friday, Tuesday, and Wednesday, the Growth On trade dominated on momentum from the solid economic data last week that pointed towards Immaculate Disinflation. But, on Monday and yesterday, the Growth Off trade dominated following disappointing economic data (the ISM Services PMI and the Weekly Jobless Claims).

We can expect this dynamic to continue during this transition period in the economy, where we are floating somewhere between slow growth and a potential recession, until such time as it becomes clearer which way we are headed. But understanding these two trades, which again are being driven by economic data, will remain important to understanding the market internals and, for more tactically active investors, finding ways to outperform.

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