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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **May 17, 2023**

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Last week's S&P 500 Index: -0.3%

Some positives, eventually

Key takeaways

- We continue to project an economic recession and lower 2023 earnings than the consensus forecast for the S&P 500 Index.
- But as it has been the case with every recession, the bad times eventually come to an end. We do think brighter skies should prevail as we move through next year.

As we are normally focused on the very near to nearer term in this weekly piece, some of our regular readers have commented that our recent tone has been negative and lacking a "brighter skies" theme at some point down the road. And as the S&P 500 Index continues to test resistance in the 4,180 – 4,200 area, we have been getting asked, "Is now the time to buy equities?"

Between summer and into autumn, yes, we believe we are looking at a rocky road as growth slows and an eventual recession starts as the Federal Reserve (Fed) keeps interest rates at or slightly higher than current levels over the balance of the year. This isn't new news for those familiar with our guidance. We believe that the stock market currently appears to be pricing in rising earnings and a Fed that is cutting rates quickly starting in September. We continue to disagree with that consensus projection, and we project an economic recession and lower 2023 earnings than the consensus forecast for the S&P 500 Index.

But as it has been the case in every recession, the bad times eventually come to an end. And we do think brighter skies should prevail as we move through next year. What gives us some level of confidence that next year is likely to be better than this year? Let's take a look at some of our reasons.

To begin, and of meaningful importance, inflation, based on our analysis, is likely to have fallen below 3% on a rolling 12-month basis. In fact, we look for the Consumer Price Index (CPI) to register full-year readings below that 3% level both this year and next. Remember, the Fed's goal is for inflation to average 2% over the long-term. Inflation spent most of the 10 years prior to the pandemic well below the 2% goal.

Therefore, we believe it is reasonable that the Fed would stop hiking rates in advance of inflation sinking below 3% if it feels the trend is going in that direction and with the desired magnitude. Note that monetary policy works with a lag. Many economists believe it can take between nine to 18 months for policy adjustments to fully impact growth. That means, in theory, rate hikes the Fed enacted since early last year are now taking a bite out of growth. We believe the Fed will be finished hiking rates soon and likely will then pause, holding rates at their peak.

If, as we expect, inflation falls below wage growth, consumers will have more buying power that can fuel additional spending. We believe the Fed will be cutting rates next year in response to a moderate recession. Taken together, we expect adding some buying power at somewhat lower rates should result in modest growth next year. Our analysis suggests a weaker dollar in 2024 should help in an effort to push global growth forward as commodity prices potentially benefit along with the earnings of multinationals based outside the U.S. We anticipate that a recovering global economy, easier monetary policies from central banks, and modest inflation may help spur potential buying opportunities in equities and commodities in 2024.

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Definitions

Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is unmanaged and not available for direct investment.

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