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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **June 14, 2023**

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Last week's S&P 500 Index: +0.4%

Time to get less defensive?

Key takeaways

- Investors are asking if now is the right time to move from a more defensive posture toward something more assertive that anticipates a further rally in stocks.
- We reiterate our stance: We do not want to chase this rally. We don't believe now is the time to get less defensive.

Our regular readers know that our recommended positioning since the first quarter of last year has been leaning more defensive. In other words, we have made an attempt to insulate portfolios from the economic slowdown that is currently ongoing. We also want to preserve capital. Our current analysis suggests investor caution should remain front and center. We do not think now is the time to be looking to add additional risk.

But our email inboxes have been jammed with questions in recent weeks asking if now is the right time to move from a more defensive posture toward something more assertive that anticipates a further rally in stocks. And while, yes, equities have run higher and we do forecast the S&P 500 Index trading at or near the 4,700 level by the end of next year, we believe the path the market takes between here and there is unlikely to be smooth. We believe the economy will continue to slow and should eventually slip into a recession as the Federal Reserve (Fed) keeps interest rates higher for longer. Even if the economy slows only to stall speed, we anticipate that earnings growth is going to be tough to come by and still a meaningful headwind for a nearer-term advance in stocks from current levels. We believe the next 6 to 12 months is likely to feature bouts of downside volatility and a bumpy ride.

In thinking further about the Fed, the Federal Open Market Committee (FOMC) will announce its latest rate decision today and could likely hold the federal funds target rate range steady in the 5% – 5.25% range. But that does not mean our U.S. central bankers are finished pushing interest rates higher, and we believe it is likely the Fed will emphasize that stance in the post-meeting statement as well as Chair Powell's press conference this afternoon. We know that inflation is still well above the Fed's stated long-term average target of 2%. And while our base case calls for the Consumer Price Index to be a touch below 3% by the end of this year, the Fed will likely continue to hike rates if inflation does not begin to come down more noticeably over the next handful of months. In our view, this is an equity market risk.

So, what do we believe investors should do now? Given the strong performance of the Information Technology sector over the last 12 months, we recommend trimming positions in this sector and moving those funds into what we view as more attractively priced sectors such as Energy, Health Care, and Materials. Technology valuations are no longer attractive based on our analysis, and an environment of higher-for-longer interest rates is also a negative for the sector. The fixed-income portion of our defensive portfolio guidance continues to call for parking funds in high-yielding short-term instruments such as Treasuries as well as locking in rates at the long end of the curve.

In summary, we do not want to chase this rally higher. We don't believe now is the time to get less defensive.

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Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility.

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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