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PRIVATE WEALTH

March Update

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Executive Summary

Will the Ides of March be a Turning Point for the Markets?

March should prove to be an exciting month for the markets as it will be data-heavy with employment and inflation updates set to be released around the Ides of March. The next employment report will be on Friday, March 10, followed by CPI data on March 14 and PPI and Retail sales data on March 15. Each of these datasets will "betray" what's happening with inflation – and we know that the Fed will be watching in the wings, anticipating its next move. Et tu, Mr. Powell?

As of this writing, the Bulls and Bears continue to play king-of-the-hill, looking to lay claim to the next direction of the market. This is why it's helpful for long-term investors to take a step back and consider the longer-term trend within the market. We have been making the case that equities remain in a secular bull market – meaning that equity markets will recover over time and be able to achieve new record all-time highs. So, we believe this bear market that we have been in has actually been a buying opportunity. We came to the belief that the lows of October 2022 were indeed the lows for this bear cycle. But – remember – as long as the Federal Reserve continues to raise rates, both stock and bond markets will remain volatile. We do believe that the Fed will be successful in fighting inflation – and we also believe that inflation has already peaked (it's just that the data will not move in a straight line).

You'll hear and read a lot about "sticky" inflation. This is the new buzzword that expresses the concerns of economists, regulators, and investors. It refers to the phenomenon when prices do not adjust quickly to changes in supply and demand. It means that inflation has become persistent, adding to the difficulty in controlling it.

Our investment philosophy recognizes that volatility always creates opportunities. We believe that the 60/40 asset allocation model is back and should be embraced in portfolios that should be positioned for the Bull to return. Yes, we could be wrong if the Fed needs to raise interest rates to 6%. That action would most likely derail a stock market rally and cause rates to continue to rise with 10-Treasury yields trending toward 5%. Should that happen, then it should be the last leg of the current Bear and a new cycle will begin.

Dow Jones Industrial Average – Secular Bull Trend Intact

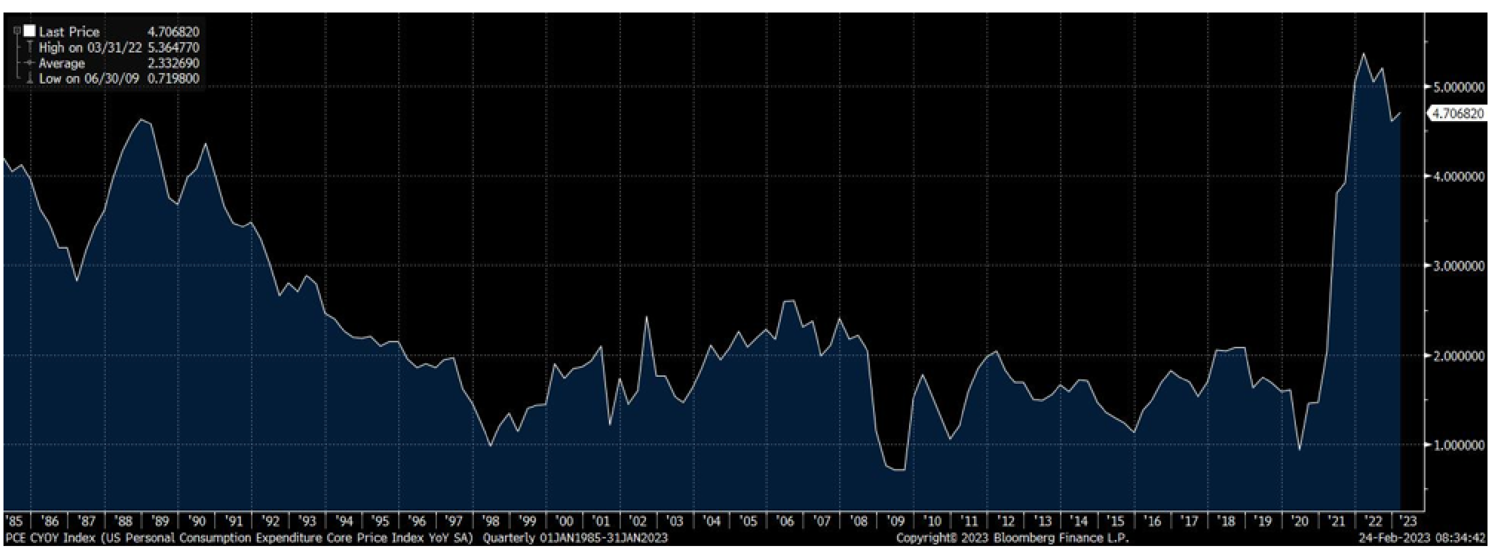
Source: StockCharts.com, February 24, 2023

Inflation Remains in Focus, Arguing for Higher Rates

Last month's PCE Core Price Deflator came in hotter (4.7%) than expected (4.3%) – and the data had already been revised the previous month higher to 4.6% from 4.4%. So, this report was in line with the trend we just saw with the overheated CPI and PPI numbers. Data does not trend in one straight line so occasional upticks in inflation should be expected. Because the Deflator is the Fed's favorite measure of inflation, this data will keep the Fed on the same course of raising interest rates as expected. The terminal rate is now expected to be 5.3%-5.5%. But examining the chart of PCE (below), it still looks like the data is peaking.

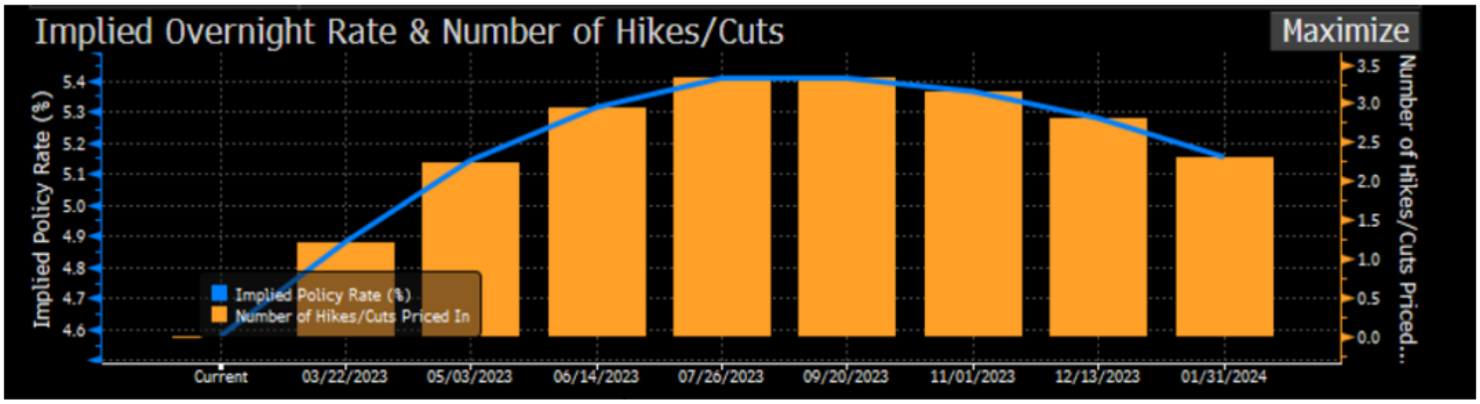
It's worth repeating: as long as interest rates are going up, markets will remain volatile.

Price Consumption Expenditure Core Price Deflator



Source: Bloomberg; February 24, 2023

Expected Rate Hikes and Cuts

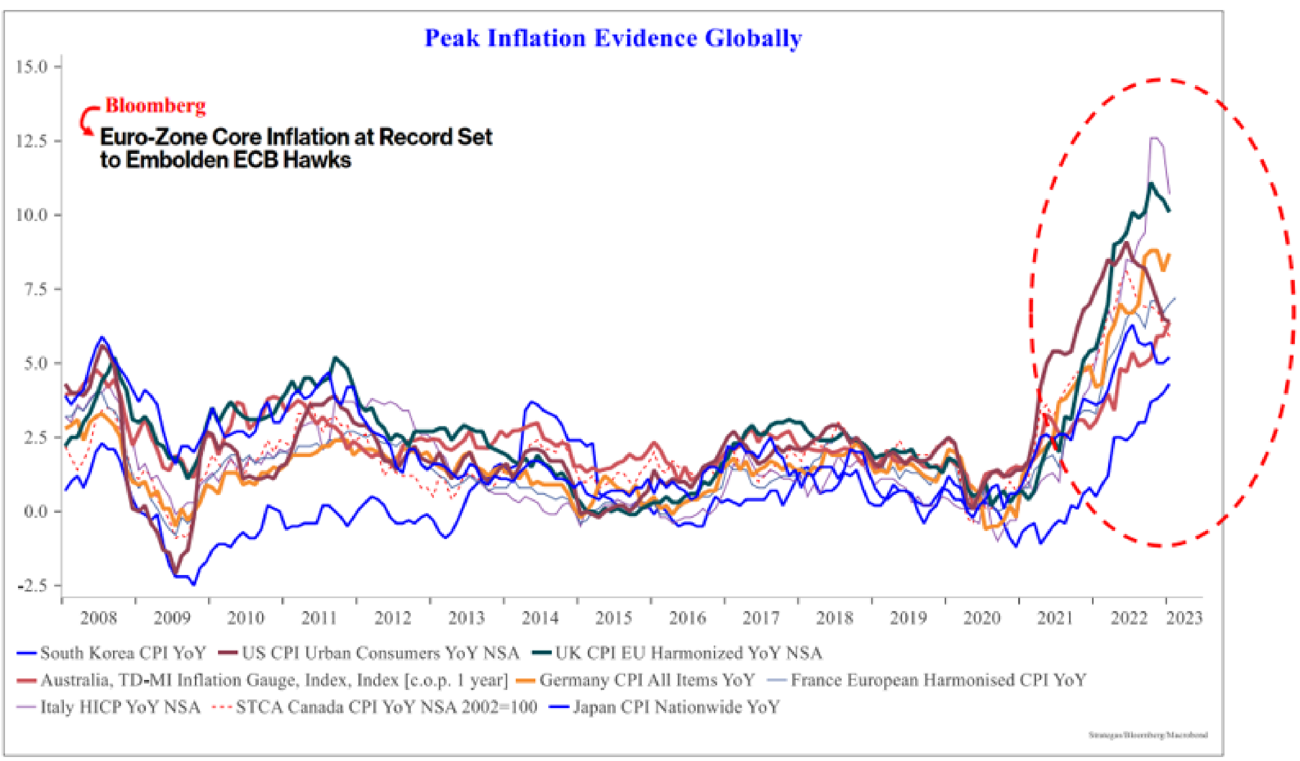


Source: Bloomberg; February 28, 2023

Global Inflation: Peaking or Sticky?

As noted above, there's a growing concern that inflation is getting "sticky" – that is, persistent. In most regions around the world, inflation appears to be peaking, but the fear is that it will not fall as quickly as the Central Banks would like – as recently seen in France and Spain where hot inflation data was just released for both countries. If inflation does become sticky, it should keep interest rates higher for longer. The U.S. was the first country to begin an aggressive tightening cycle, therefore what happens in the U.S. could be a leading indicator for the world.

Global CPI Appears to be Peaking Globally

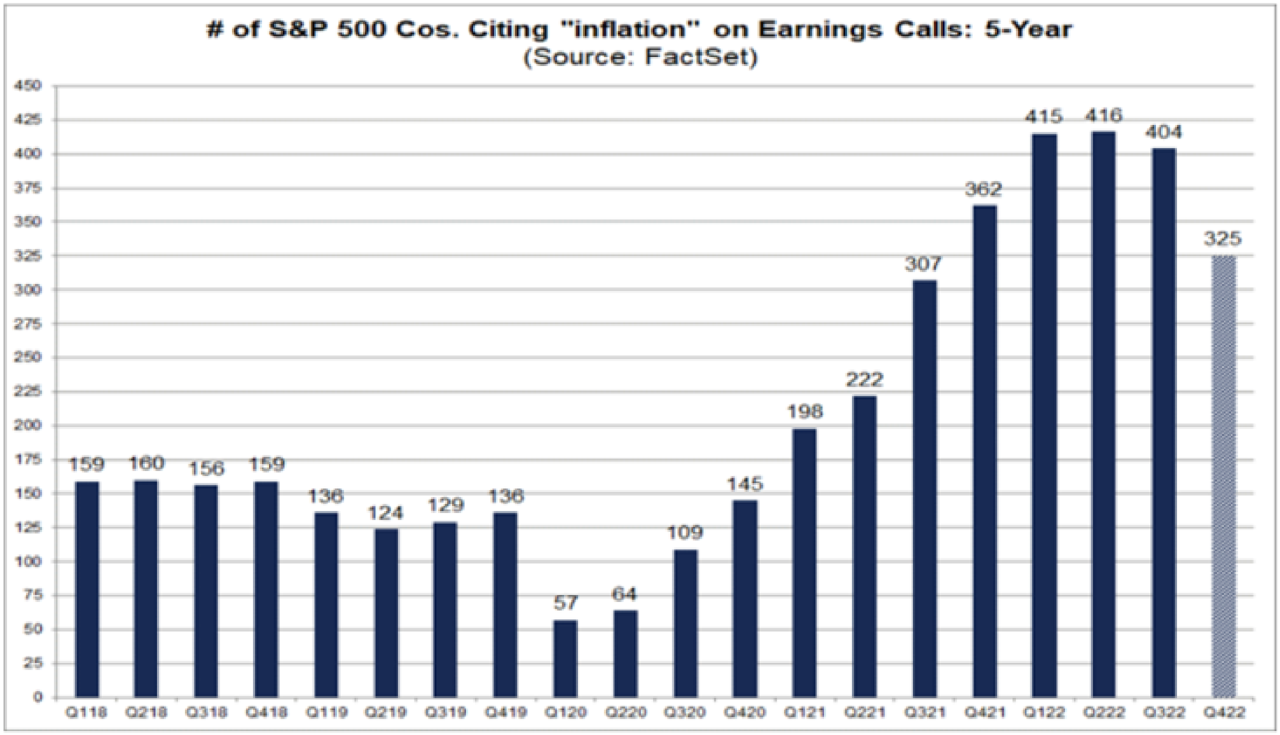


Source: Strategas, February 28, 2023

Peak in Inflation on Earnings Calls – A Good Sign

Speaking about inflation… it's interesting to measure when companies "speak about inflation." We took a look at recent earnings calls, and from Q2 to Q4 2022, companies mentioning inflation fell 22%. We believe this signals that companies believe that inflation has peaked or is near a peak.

S&P 500 Companies Citing "Inflation" on Earnings Calls



Source: FactSet, February 24, 2023

Job Market Still Strong (but Strong Like Bull?)

A good barometer for measuring the job market is the initial jobless claims that are reported weekly. Recent reports show claims running below 200,000 – an indication of a strong job market. The Fed would like a soft economic landing – one that doesn't squash the job market – but jobless claims below the 200,000 threshold means the Fed will continue to believe that inflation is a risk. We'll need claims to get above this key measure in order for the Fed to feel confident that it's succeeding in slowing down the economy – and by extension, inflation.

Initial Jobless Claims

Source: Bloomberg, March 4, 2023

St. Louis Fed GDP Nowcast has Moved Negative for 1Q23

What's a good indicator that the economy is slowing down? We like to check the Real GDP Nowcast model maintained by the St. Louis Federal Reserve. As of this writing, the number the model is forecasting for 1Q23 is currently negative 1.23%, down from negative 1.10% on Feb. 24. This model gets updated as economic data impacting the model is released. A slowing economy would be welcomed by the Fed. What we need to keep in mind is that the impact from changes to Monetary Policy typically lag by 12 to 18 months. March 17 is the one-year anniversary of the Federal Reserve beginning its tightening cycle of raising rates. Therefore, considering the expected lag, we should start seeing the impact.

St. Louis Federal Reserve Real GDP Nowcast

Source: St. Louis Federal Reserve, March, 3, 2023

History of Federal Reserve Rate Hikes in this Cycle)

FOMC Meeting Date	Rate Change (bps)	Federal Funds Rate
Jan 31 to Feb 1	+25	4.50% to 4.75%
Dec 14, 2022	+50	4.25% to 4.50%
Nov 2, 2022	+75	3.75% to 4.00%
Sept 21, 2022	+75	3.00% to 3.25%
July 27, 2022	+75	2.25% to 2.50%
June 16, 2022	+75	1.5% to 1.75%
May 5, 2022	+50	0.75% to 1.00%
March 17, 2022	+25	0.25% to 0.50%

Source: Forbes, February 1, 2023

S&P 500 Monthly Chart with Stochastic – Most Oversold Since 2008

We pointed out in our Year Ahead Outlook that the S&P 500 was on track to reach the most oversold reading since 2008-2009. Using the monthly stochastic price momentum indicator, the S&P 500 is now in this range. We also need to keep in mind there have been major corrections in the past five years. In 2018, the S&P 500 had a 20% pullback, followed by a correction in 2020 of over 30%, and in 2022, a drop of over 25%. Given the expected higher rates – and higher rates for longer – it is possible the market will trade in a range until we get a better picture of the last expected rate hike. But taking a big picture, longer-term view, now is a great time to be buying equities.

S&P 500 with Monthly Stochastic

Source: Bloomberg, February 25, 2023

S&P 500 Monthly Chart with Fibonacci Retracement Levels

Here we examine the monthly Fibonacci retracement levels based on the low of 2020 to the high in 2022. Markets can retrace up to 50% to 61.8% of a move and the S&P 500 has pulled back to the 61.8% level. The market has been trading in a tight range of 3815-4190. We expect the market to remain in this range until it can break one of the barriers -- either 4% to the downside or 5% on the upside. So, look for the market to trade in a 10% range until a trend is confirmed.

S&P 500 Index – Monthly

Source: Bloomberg, February 25, 2023

Nasdaq 100 Monthly Chart with Fibonacci Retracement Levels

The Nasdaq 100 has a similar pattern to the S&P 500 in terms of Fibonacci retracement levels. The Nasdaq had a 61.8% correction from the lows in 2020 and is in a trading range of 12980-11795 or 8% to the upside and 2% to the downside.

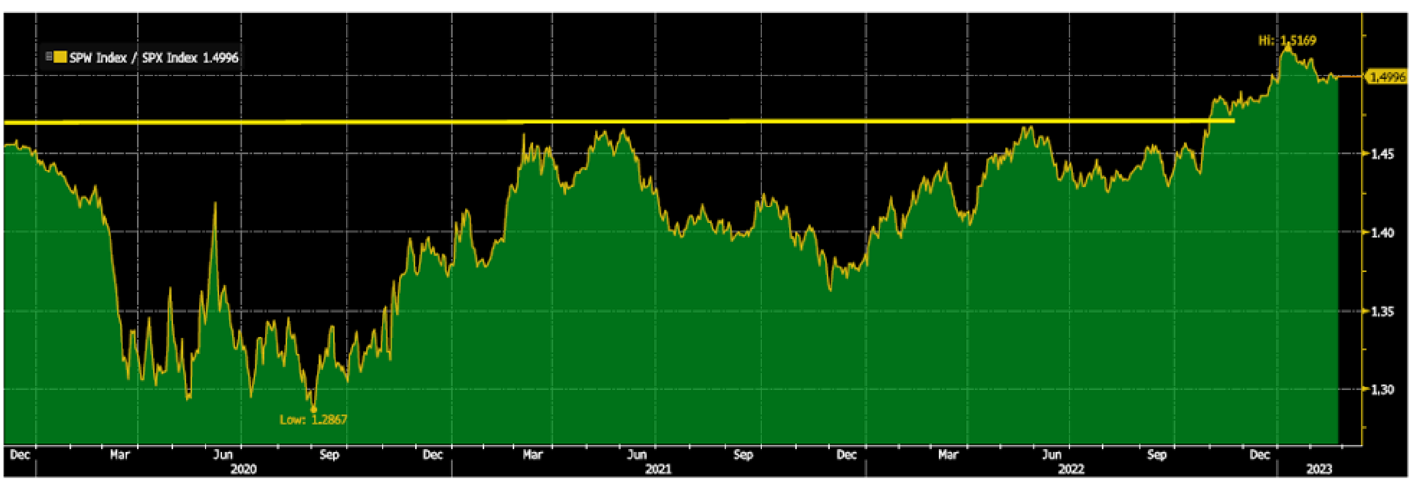
NASDAQ 100 – Monthly

Source: Bloomberg, February 25, 2023

S&P Equal-Weight is Outperforming the S&P 500 Index

Here is a relative chart of the S&P Equal-Weight Index to the S&P 500, which is a cap-weighted index. Equal-weight is a better representation of what is really happening in the market without a few stocks driving the direction and/or its performance. Equal-weight is performing better, which indicates that Mega Cap Tech may not maintain its recent outperformance.

S&P 500 Equal Weight vs. S&P 500 Index



Source: Bloomberg, February 25, 2023

Value Line Arithmetic Index

The Value Line Arithmetic Index is an equal-weighted index of approximately 1700 stocks. Note that the index is above both its 50-day and 200-day moving averages and is testing the April 2022 highs. This is one of the strongest indices in the market.

Value Line Arithmetic Index – Weekly

Source: Bloomberg, February 27, 2023

Russell 2000 Small Cap Index

We continue to favor small caps over large caps. Taking a look at the Russell 2000, the index remains in an uptrend and is consolidating within a range after the bear market correction. Small caps still trade at a deep discount to large caps, with their forward price-to-earnings ratio at 14x.

Russell 2000 Small Cap Index – Monthly

Source: Bloomberg, February 27, 2023

Breadth of the Market has Improved

The number of stocks advancing relative to those that are declining has increased, an improvement driven by the rally. But the market is at a crossroads, it will break either up or down to create the next trend line. To support a continued rally, we would like to see a breakout to the upside.

Bloomberg Cumulative Advance-Decline Line for NYSE Stocks

Source: Bloomberg, March 4, 2023

S&P 500 Underperforming the Rest of the World

The U.S. equity market, as measured by the S&P 500, looks to continue to underperform the rest of the world. This appears to be a good time to diversify portfolios with international markets.

S&P 500 relative to the MSCI Word (ex US)

Source: StockCharts.com, March 3, 2023

Playing Favorites: What We Currently Like

Cyclical Stocks Leading the Market Higher

Looking at cyclical large cap stocks versus defensive large cap stocks, we see that this rally is indeed being led by cyclical stocks. This tells us the market is pushing out a recession. This also gives us evidence that it is strongly likely that the low for the market was in October 2022.

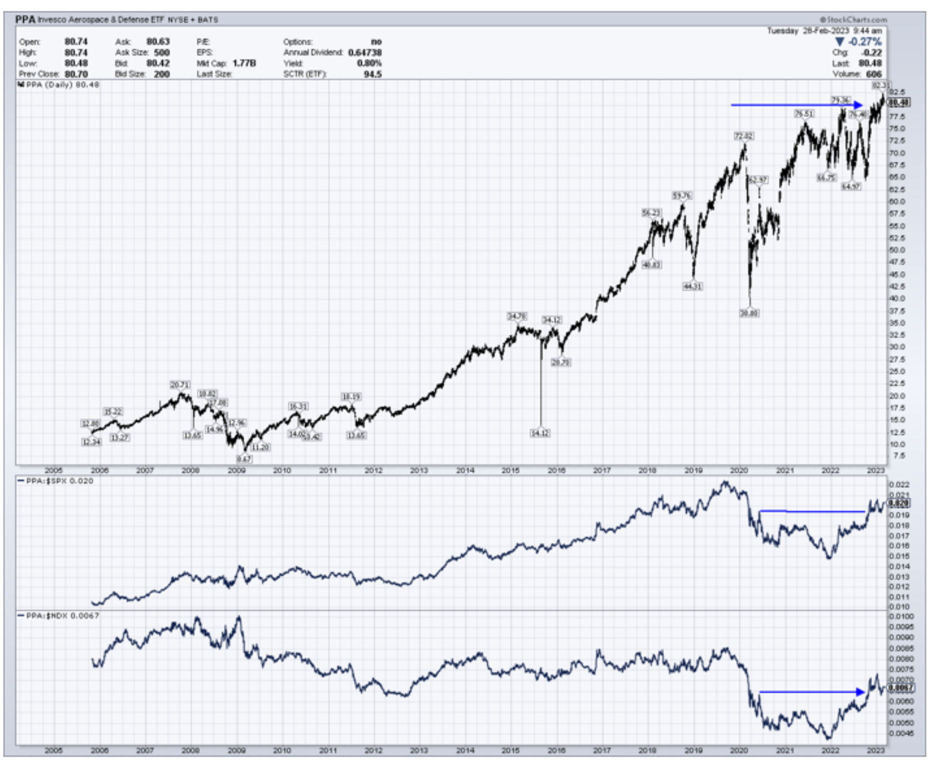
Cyclical Stocks Outperforming Defensive Stocks

Source: Bloomberg, March 3, 2023

Invesco Aerospace & Defense ETF (PPA)

The U.S. has committed $113 billion to the war in Ukraine and the global amount being sent to Ukraine is approximately $2 Trillion – a staggering amount. This commitment of capital generally benefits the Aerospace & Defense industry – one group that recently hit a record all-time high. Comparing PPA to the S&P 500 and Nasdaq 100 in the chart below shows this ETF is outperforming both indices.

Invesco Aerospace & Defense ETF (PPA)



Source: StockCharts.com, February 28, 2023

VanEck Semiconductor ETF (SMH)

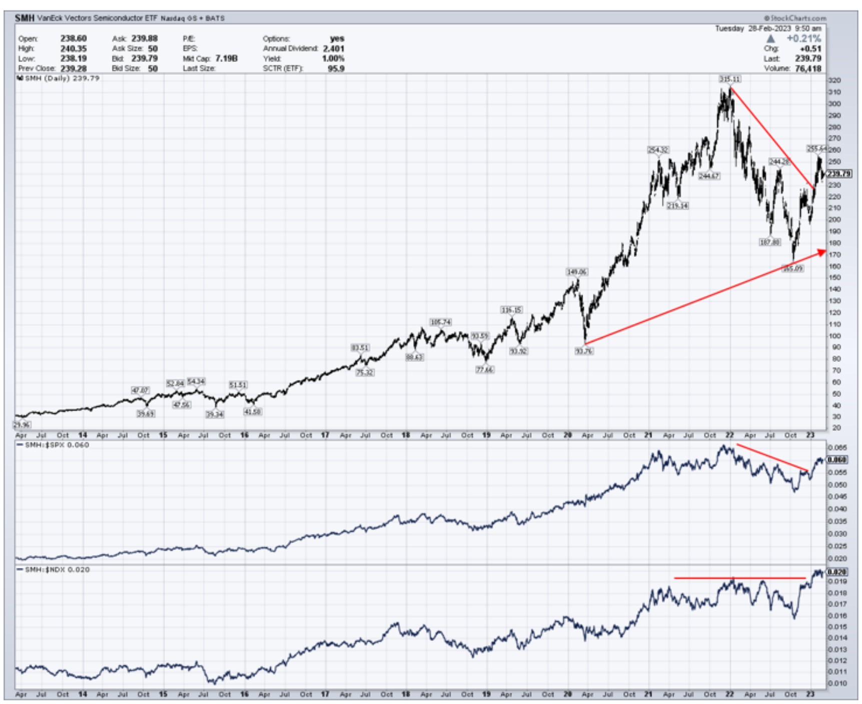
Nothing is hotter in Technology than A.I., and as artificial intelligence relies on chips, Semiconductor stocks remain our favored area in Tech. Chips are the brains of technology, and we expect them to remain in high demand. A.I. is just the next area of focus but chips for all forms of technology will be needed over the coming years.

Semiconductors are our favored area of technology. A driver for the sector is the Chips and Science Act from 2022 where the act establishes and provides funding for the Creating Helpful Incentives to Produce Semiconductors (CHIPS) for America Fund to carry out activities relating to the creation of incentives to produce semiconductors in the United States. This Act contributes $13 billion to R&D, $39 billion to construction and $24 billion to tax credits.

According to the Semiconductor Industry Association (SIA), the CHIPS Act has already sparked $200 billion in private investments for U.S. semiconductor production. The Act is expected to generate 28,000 new jobs. Here are some highlights of announcements spurred by the CHIPS Act:

- **Over 40 new semiconductor ecosystem projects announced across the U.S.,** including the construction of new semiconductor manufacturing facilities (fabs), expansions of existing sites, and facilities that supply the materials and equipment used in chip manufacturing
- **Over $200 billion in private investments announced across 16 states** to increase domestic manufacturing capacity
- **40,000 new high-quality jobs announced in the semiconductor ecosystem** as part of the new projects, which will support many more jobs throughout the broader U.S. economy

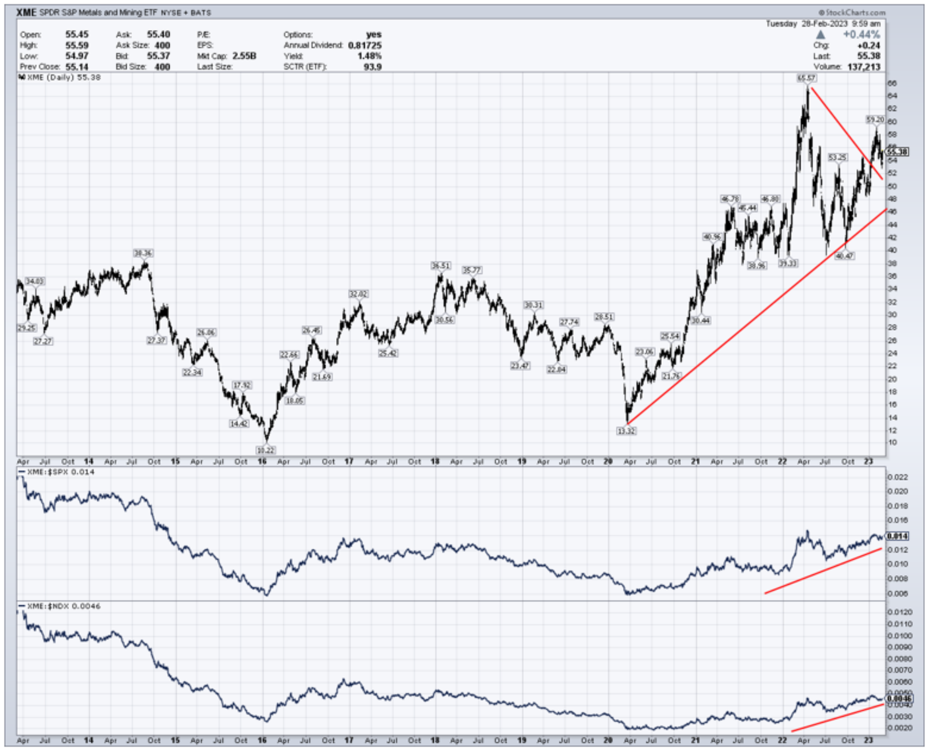
Semis remain strong relative to the S&P 500 and Nasdaq 100 as seen in the chart below.



Source: StockCharts.com, February 28, 2023

SPDR Metals & Mining ETF (XME)

Metals & Mining continue to be strong relative to the S&P 500 and Nasdaq 100 showing leadership in the market. Simple and to the point!



Source: StockCharts.com, February 28, 2023

S&P 500 Energy Sector

We remain bullish on Energy. The sector had a great performance last year and its gains are consolidating. Energy also hit its record high from 2014. Record highs generally take time to break. We still believe this sector has the ability to reach new record highs.

Be sure to read the important note on p. 14 under "Significant Change to Growth & Value Indices."

Source: StockCharts.com, February 28, 2023

WTI Crude Oil Holding Support near $75-72 – Positive for Energy

Source: StockCharts.com, March 3, 2023

SPDR Financial Sector ETF (XLF)

A sector that has seen good improvement is Financials. Insurance has been strong, but Banks are also holding up well. We have been neutral on this sector but are warming up to it. Financials, as a sector, is outperforming the Nasdaq 100, while moving in step with the S&P 500. Should the sector start to outperform the S&P 500, we would see that as a strong bullish sign for the market overall. Also, the Global Classification System (GICs) is making a significant change, taking payment stocks from the Technology sector and adding them to the Financial sector. These are names such as Visa (V), Mastercard (MA), PayPal Holdings (PYPL) Global Payments (GPN), Automatic Data Processing (ADP), and Paychex (PAYX). This is not a full list of changes.

The reclassification will add several growth stocks to the traditional value stocks in Financials. In total, $952 billion of market cap representing 10% of the Info Tech sector will move to Financials. Financials will represent 14% of the S&P 500 market cap (vs. 12% today). V, MA, and PYPL will be the three largest stocks affected.

SPDR Financial Sector ETF (XLF)

Source: StockCharts.com, February 28, 2023

Value Has a Leg Up on Growth

We still favor Value over Growth. Why? Let's go to the chart! Below, I have plotted the ratio of Value to Growth using two key technical indicators: the relative strength index (RSI) and the moving average convergence divergence (MACD). The ratio is holding the 200-day moving average and both RSI and MACD are pointing to Value as outperforming. Believe your eyes!

iShares Russell 1000 Value vs. iShares Russell 1000 Growth (IWD v IWF)

Source: StockCharts.com, February 28, 2023

Significant Change to Growth & Value Indices

In January, a major – significant! – change was made to the Growth and Value indices. Energy came out of Value and into Growth, that's a huge shift! Materials also moved into Growth. Technology was shifted the other way – and that's the biggest cut to Growth, but it actually represented only a modest add to Value. These changes may impact how these indices perform. Something we will most certainly be watching closely.

Pure Growth & Value Sector Weight Changes

Source: Bloomberg; February 27, 2023

10-Year Treasury Yield – Resisting and Testing

Yields have risen on the 10-year Treasury as inflation data has come in higher than expected. Resistance near 4% is being tested. If economic and inflation data come in stronger than expected, yields can push to test the October 2022 high of 4.3%. The risk here is that rates eventually push to 5%. We remain believers that rate hikes are getting near the end of the cycle. Rates should eventually fall to the 2.5% area. We remain buyers of Treasuries.

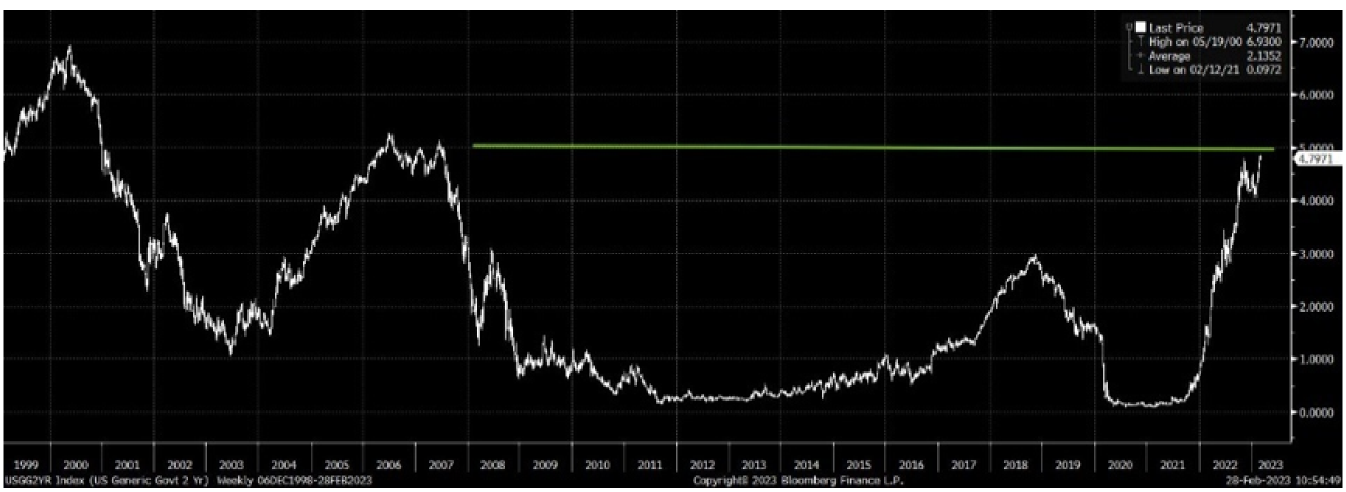
10-Year Treasury Yield

Source: Bloomberg; February 28, 2023

2-Year Treasury Yield Breaks to the Upside, Targeting 5%

Yields on the 2-year Treasury broke to the upside on stronger inflation data. The 2-year is catching up with the Fed and it's now looking to price at a 5% rate. This would put rates back to the levels last seen in 2007 and where there is resistance.

2-Year Treasury Yield



Source: Bloomberg; February 28, 2023

Bitcoin – In a Trading Range

What's the deal with Bitcoin? First, some background: Bitcoin was proposed in a white paper in 2008 by Satoshi Nakamoto, the pseudonym of a software developer. Bitcoin was designed as a decentralized, fully independent, digital, or virtual currency also known as a cryptocurrency. No institution controls the Bitcoin network, and it is not tied to a single country because transactions can be performed cryptographically without the need for a central issuing authority. Think of Bitcoin as a payment network – "internet money."

There is growing interest in Bitcoin (BTC). BTC is the most volatile asset I have ever experienced in my career – its swings of 80% on the upside and downside seem unprecedented. The long-term trend remains up and near-term is in a consolidating trading range with support between 22,000-20,000 and with resistance near the $25,000 area. Technical analysis suggests BTC would remain in a trading range for a period of time given the recent 80% decline and to eventually resume its uptrend. But this might take longer than investors would like. A solid break above $25,000 would indicate further gains.

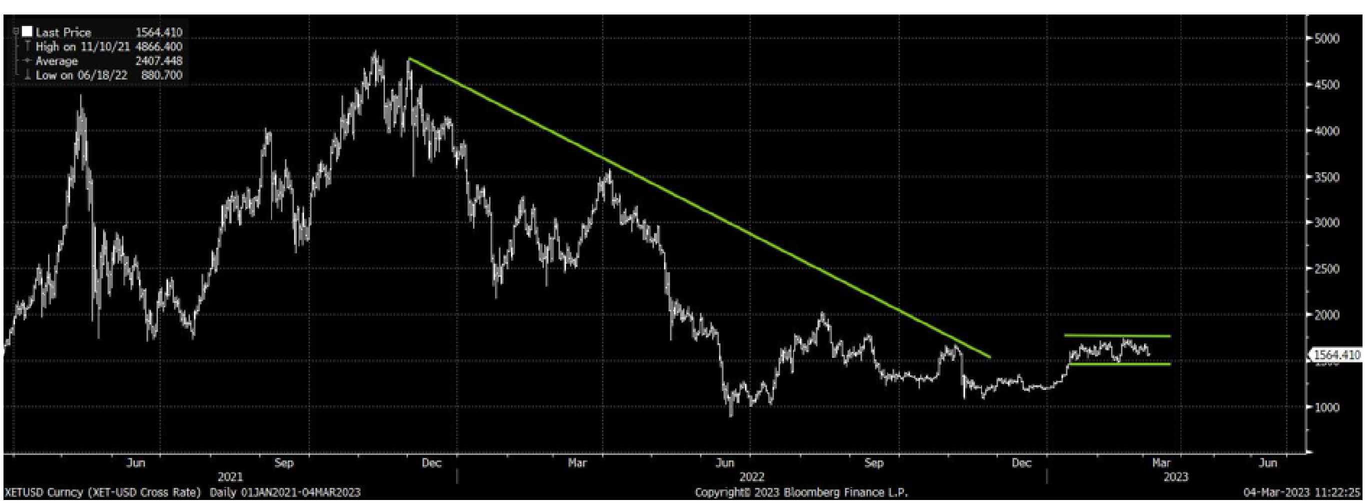
Bitcoin Daily Chart

Source: Bloomberg; February 28, 2023

Ethereum is Range-Bound

Ethereum (ETH) is an open source blockchain platform that supports smart contracts and enables decentralized applications. ETH is the native token for the network and is used to pay for transaction fees. Ethereum was first described in a white paper in 2013. Think of Ethereum as technology on the blockchain. This next generation of technology is known as Web 3 – the next generation of the internet. Web 3 will allow most users to be connected via a decentralized network and have access to their own data. Technical analysis suggests that ETH is likely to remain in a trading range $1742-$1463. One of these levels needs to break to determine the next move up or down. As long as ETH is a leader on the blockchain, it is possible that the uptrend resumes, but like BTC, it may take longer than investors will like.

Ethereum Daily Chart



Source: Bloomberg; February 28, 2023

Bitcoin Relative to Ethereum – In a Tight Trading Range

Although Bitcoin and Ethereum are very different cryptocurrencies, many investors compare them and trade them as a pair. As you can see from the chart below, they are in a very tight trading range with no leader.

Bitcoin Relative to Ethereum

Source: Bloomberg; March 3, 2023

Last Words

Lions May Roar, but No Slaughter of the Lambs This March

It's a waiting game – maybe a bumpy one – until mid-March when data released around the Ides will foretell our fortunes regarding inflation and therefore rates – whose movement will continue to drive behavior in both stock and bond markets. And that means continued volatility. In this environment, it's smart to diversify in fixed income, as rates appear to be getting closer to the end of the tightening cycle. Don't forget that the 60/40 model is back in favor, and rightly so.

Keep an eye on inflation – any stickiness can prove problematic for the markets. And with the one-year anniversary (March 17) of the first-rate hike in the current series of Fed actions, the impact of the traditional lag will start manifest.

The Fed meets next on March 21, and if the February data is hot, you can expect the Fed will roar again at the 50 bps level.

Taking a longer-term view, this is the best time since 2008-2009 to be purchasing equities!