The Weekly Market Update – 2/21/23: Updated 2023 Recession Watch

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,079.09	-0.28%	6.24%	6.24%	-9.67%	4,796.56	17.6%
Dow Jones Industrial Average	33,826.69	-0.13%	2.05%	2.05%	-3.72%	36,799.65	8.8%
NASDAQ Composite	11,787.27	0.59%	12.62%	12.62%	-17.22%	16,057.44	36.2%
Russell 2000	1,946.36	1.44%	10.51%	10.51%	-4.05%	2,442.74	25.5%
MSCI EAFE (USD)	2,087.04	0.08%	7.36%	7.36%	-6.09%	2,398.71	14.9%
MSCI Emerging Markets (USD)	999.42	-1.40%	4.50%	4.50%	-17.28%	1,444.93	44.6%
Bloomberg Commodity Index	106.53	-1.97%	-5.56%	-5.56%	-1.23%	237.95	123.4%
Barclays U.S. Aggregate Bond	89.64	-0.46%	0.85%	0.85%	-12.30%	112.07	25.0%

Source: FactSet

Consumer-facing economic data has exceeded economists' expectations (per FactSet) to begin 2023, making a near-term U.S. recession increasingly less likely. Despite this improving economic outlook, the S&P 500 equity index has traded lower for the past two weeks. According to the U.S. Bureau of Economic Analysis (BEA), the U.S. economy grew 2.1% in 2022, as measured by real gross domestic product (GDP), which is the value of inflation-adjusted goods and services produced. With evidence of weak consumer, business, and housing trends in late 2022, GDP estimates were cautious to begin 2023. As of 12/31/22, the FactSet consensus real GDP estimates for the year and first quarter of 2023 (1Q23) were +0.3% and -0.2%, respectively. This reflected an expectation of economic slowdown, but January data for jobs growth (Bureau of Labor Statistics, BLS), retail sales (U.S. Census Bureau), and jobs openings (BLS, December) came in above expectations. This did not paint a picture of a building recession (which is defined by the National Bureau of Economic Research as a significant decline in economic activity that is spread across the economy). In fact, on 2/17/23, the FactSet consensus estimates for 2023 and 1Q23 were higher, at +0.6% and +0.4%, respectively. In addition, an alternative GDP model from the Atlanta Federal Reserve Bank, GDPNow, which tracks GDP trends only from data already reported, as of 2/16/23, reflected 1Q23 GDP growing +2.5%. Consumer spending data in January tracked above levels in any quarter of 2022. Despite the positive data, the widely followed, large company S&P 500 index declined 2.4% since closing at 4,180 on 2/2/23 (its highest closing value of 2023 to-date). We attribute the weak market reaction to rising interest rates as U.S. Treasury yields surged in February, which not only can negatively affect equity valuations (higher interest rates lower the present value of future cash flows), but also will likely entice the Federal Reserve Bank (Fed) to keep short-term interest rates higher for longer to battle inflation. Our view is that the risk of a mild recession (a GDP percentage decline of less than 1%) remains, but near-term GDP (at least for 1Q23) is better than expected. The strong January consumer data (just one month) could slow or weaken in the months ahead and thus, bears are monitoring closely. We expect equity market volatility to continue as rallies will be met with skepticism, and we advocate for sector diversification and portfolio rebalancing.

The S&P 500 Energy sector dropped 6.7% in February through 2/17/23, more than erasing its January gain as eight of eleven macro sectors were lower in February. S&P Global and MSCI slot companies in one of eleven Global Industry Classification Standards (GICS) sectors; within the S&P 500 index, Energy is the eighth largest sector, comprising 4.9% of index market capitalization as of 2/16/23. While Energy outperformed all S&P 500 sectors in 2021 and 2022 as surging oil prices and post-pandemic demand drove large earnings gains, oil prices have pulled back since early November 2022, and earnings growth is expected to turn negative Y/Y in 2023 (-17% per FactSet). Sector weakness could also be caused by recession fears.

Following the President's Day holiday on 2/20/23, a short week will include earnings reports from several large retailers and an important consumer inflation report on Friday. With many retailers on a January fiscal year calendar, retailer earnings are late in the cycle. This will provide more data on consumer spending momentum and also provide information on January trends. The Fed's preferred consumer inflation report, the PCE price index (personal consumption expenditures), January data, is due Friday. FactSet consensus is for a Y/Y increase of 4.9%, down slightly from 5.0% in December.

James D. Ragan, CFA
Director of WM Research
(206) 389-4070
jragan@dadco.com

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