The Weekly Market Update – 3/6/23: Market Gains Reflect Positive Sentiment

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,045.64	1.90%	5.37%	5.37%	-7.51%	4,796.56	18.6%
Dow Jones Industrial Average	33,390.97	1.75%	0.74%	0.74%	-1.48%	36,799.65	10.2%
NASDAQ Composite	11,689.01	2.58%	11.68%	11.68%	-15.00%	16,057.44	37.4%
Russell 2000	1,928.26	2.00%	9.48%	9.48%	-5.85%	2,442.74	26.7%
MSCI EAFE (USD)	2,070.64	1.74%	6.52%	6.52%	-4.98%	2,398.71	15.8%
MSCI Emerging Markets (USD)	988.03	1.66%	3.31%	3.31%	-15.65%	1,444.93	46.2%
Bloomberg Commodity Index	108.31	2.62%	-3.98%	-3.98%	-5.45%	237.95	119.7%
Barclays U.S. Aggregate Bond	88.77	-0.01%	-0.13%	-0.13%	-11.98%	112.07	26.3%

Source: FactSet

Despite trading lower in February, major U.S. equity indices held on to year-to-date (YTD) gains, and also rallied to begin March as investor sentiment improved. The widely followed U.S. large-company S&P 500 index dropped -2.6% (price return, not including dividends) in February, but on the strength of gains in January, the index increased 3.4% for the two months through February. In addition, equities rallied to begin March, pushing the YTD gain to 5.4% through 3/3/23. We attribute 2023 equity market volatility to an ongoing investor debate regarding inflation, Federal Reserve Bank (Fed) interest rate policy, and U.S. economic growth. To begin the year, in our view, the prevailing outlook was that the Fed would soon pause its interest rate tightening policy (use its overnight bank lending fed funds interest rate target), and the U.S. economy would slow as interest rate increases in 2022 would begin to limit gains in employment, consumer spending, and business investment. In January, however, both employment (Bureau of Labor Statistics, BLS) and consumer spending (Bureau of Economic Analysis) exceeded expectations, and month-to-month inflation (BLS) was the highest level in three months. This led to a revised popular view that Fed interest rate hikes will continue, with higher interest rates likely in the short-term (possibly through June 2023) and then a Fed interest rate pause that could last for an extended period (into 2024). In February, the yield on the U.S. 10-year Treasury bond (widely used as a proxy for long-term U.S. interest rates) moved to 3.92% on 2/28/23, from 3.40% on 2/1/23. Over the same period, the 2-year Treasury yield (a proxy for short-term U.S. interest rates) moved to 4.80% from 4.11%, respectively. The increase in interest rates caused the February weakness in equities, in our view, as not only do higher interest rates reduce the present value of a company's future cash flows, they also reduce the relative attractiveness of some dividend-paying equities (as bonds have higher yields), and the higher rates can ultimately slow economic growth (due to the higher cost of credit). By 3/2/23, the 10-year Treasury yield moved to 4.08%, but retreated to a level of 3.96% as of early trading on 3/6/23. That modest decrease in interest rates from the recent peak has driven equity market gains to begin March, in our view, as investors appear to increasingly view a 2023 recession (a significant decrease in economic activity spread across the economy) as less likely. We agree that the potential for an early 2023 (i.e. first half of the year) recession has diminished, but we believe economic uncertainty is high as we move to late 2023 and early 2024.

Sector moves in February reveal equity investor positioning. Data providers S&P Global and MSCI place all S&P 500 constituents into one of eleven Global Industry Classification Standards (GICS), which are also weighted by market capitalization. In February, while the overall S&P 500 index declined -2.6%, 5 of the 11 sectors did better than that, led by Technology (+0.3%, the only positive sector for the month), Industrials (-1.2%), Consumer Discretionary (-2.3%), and Financials (-2.4%). Each of these sectors are considered "cyclicals," which are sectors that largely offer products and services that are somewhat discretionary and can prosper during periods of economic growth. This indicates that investors have discounted recession risk.

After much of January's economic data exceeded expectations, this week marks the beginning of February data releases. All eyes will be on Friday's BLS release of February jobs. Following the January jobs increase of 517 thousand (K), the highest in six months, the February FactSet consensus is for a 217K monthly increase. In addition, on 3/8/23, the BLS releases January jobs openings (JOLTS). The Fed would like to see both jobs and open jobs begin to slow.

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