



Market Commentary
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English Version

The Market's Opening Round

Get guidance on investments, and the major structural factors behind your clients' portfolios.

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Executive Summary

The Federal Reserve is telling the markets that although interest rates could be peaking, they could stay higher for longer. Individual companies are stating that they are experiencing real pressures on sales and earnings. Yet investors appear to be looking past this and pricing in a reduction in interest rates. At the end of the day, economic data will have the last word.

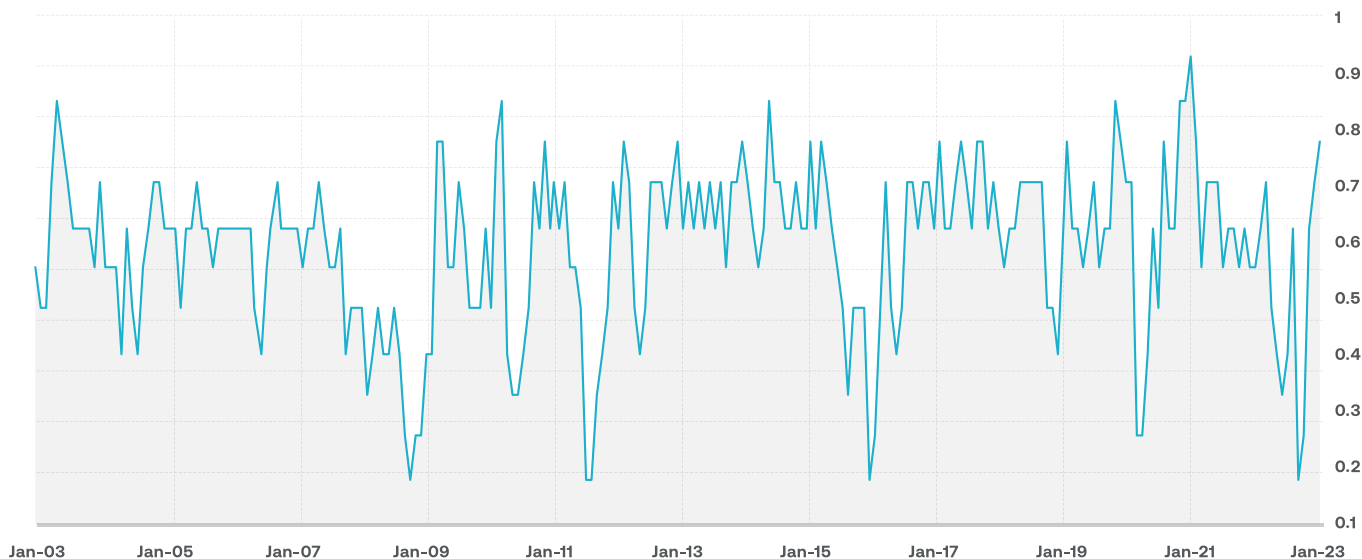
The Market's Opening Round

Global markets have seen an extraordinary beginning to the year. In the month of January, the S&P 500 Index gained 6.2% and the MSCI All Cap World Index rose 7.1%, yet both trailed the MSCI Emerging Markets Index, which led after being up 7.9%. As a side note, it is important to keep this relative outperformance in perspective as over the past 5 years the S&P 500 has risen by 56%, handily beating the ACWI index which was up 27%, as well as the Emerging Markets index, which was down 14%. Shifting our focus back to January, we have seen US Large Cap equities have one of their strongest starts to the year, dating back to the 1980s. At the same time, the powerful rally in US Small Cap stocks is approaching its peak from last August, from which it later retreated nearly 20% in the back half of 2022. **Given these strong rallies to start the year, we think that some caution is warranted ahead, as a near-term pullback in equities would not be unusual.**

In the quest for the elusive “Fed-pivot” investors appear victim to something known in behavioral finance as confirmation bias. This behavior is evident when individuals tend to focus only on information that supports their assumptions and dismiss that which does not. In the current context, the Federal Reserve has been telling markets that, although it might be almost done raising interest rates, these will likely

BI Market Pulse Index

Source: Bloomberg Intelligence



stay higher for longer. What the market is hearing, or wants to hear, is the Fed saying that it will start cutting rates soon. This expectation has led investors to try to get ahead of the Fed, driving risk appetite higher, to the point of near-extreme levels.

Bloomberg Intelligence publishes a chart called the BI Market Pulse Index, which we can see next. What this chart is telling us is that investor sentiment is reaching the high end of optimism levels seen over the past ten years – what Bloomberg Intelligence calls “manic territory”. The higher the data climbs on the chart, the higher the risk appetite being exhibited by the market. This high level of optimism is just another data point, along with the rallies and strong starts that we have seen this past month across different markets. But as we know, data points combine to form trends.

A good source of data that can shine some light as to where the market may be headed is the 2022, 4th quarter earnings season. As of February 3rd, 2023, half of the companies in the S&P 500 Index have reported 4th quarter earnings. Because of the nature

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of the reporting season, the Financials and Industrials sectors have seen a larger number of companies report. However, except for Consumer Discretionary, Real Estate, and Utilities, most sectors have seen at least half of their companies divulge numbers. As we can see on the next table, most companies reported a growth in 4th quarter sales, compared to the previous quarter, resulting in 5.12% average sales growth for the index. However, when we look at earnings, we can see that despite very strong growth numbers in some sectors, these were not enough to offset weakness in others. This dynamic dragged down the index’s earnings into negative territory, posting a

	% Reported	Sales GR	Earnings GR
S&P 500 Index	50%	5.12%	-3.06%
Energy	42%	15.45%	68.97%
Industrials	68%	10.40%	40.76%
Consumer Discret.	36%	14.00%	23.53%
Utilities	13%	19.13%	22.71%
Real Estate	23%	6.78%	11.97%
Health Care	48%	4.15%	-1.97%
Consumer Staples	50%	5.42%	-3.06%
Technology	49%	-3.84%	-12.41%
Financials	82%	3.53%	-13.91%
Communications	42%	-3.53%	-25.78%
Materials	52%	-8.57%	-41.70%

Source: Bloomberg, Insigneo Research

growth rate of -3.06%. At first glance, these numbers do not seem alarming, but when we take into consideration that in the 3rd quarter of last year, sales and earnings grew by 11.5% and 4.06%, respectively, we can see a more meaningful decline in earnings growth.

This pattern becomes even more evident when we study the data on a year-over-year basis. The next table shows a side-by-side comparison of the growth in earnings for the S&P 500 between two different time-periods: From February 2021 through February 2022, and from February 2022 through February 2023. As we can see on this table, earnings exploded from 2021 through 2022, rising over 52%. Looking at the following year though, we can see that although earnings growth was still positive, it was at a much lower rate of 6.95%.

Profit margins rebounded quickly in 2021 from the lows seen during the Covid-19 pandemic but appeared to peak in 2022. This rebound was in large part due to a reduction in the costs of capital, labor, and the production of goods after the pandemic. As we know, lower costs lead to higher margins. However, we are

Sector (BICS)	Feb 21-Feb 22 Earnings GR	Feb 22-Feb 23 Earnings GR
S&P 500 Index	52.29%	6.95%
Materials	88.26%	-8.03%
Industrials	99.56%	33.23%
Consumer Staples	12.64%	4.67%
Energy	N.M.	173.84%
Technology	37.47%	14.17%
Consumer Discretionary	72.36%	-1.53%
Communications	42.05%	-19.06%
Financials	68.18%	-20.26%
Health Care	30.41%	8.20%
Utilities	23.48%	12.10%
Real Estate	23.38%	16.64%

Source: Bloomberg, Insigneo Research

now in an environment where the reverse economic scenario is true. Higher interest rates have increased the cost of capital, while Inflation has driven labor and production costs higher. These undercurrents are putting pressure on margins and earnings growth. This dynamic is manifesting itself during the current earnings season, as seen on the first table.

Different sectors are experiencing various degrees of declines in sales, margins, and earnings. The same is true for companies within the sectors themselves. This trend has been particularly evident in Technology, Communications and Consumer Discretionary, as these sectors have seen different companies post different reports, while many are also trying to reduce expenses through measures such as layoffs. As of the end of January, companies in these sectors had announced almost 60,000 layoffs, with half of these coming from Amazon (18,000) Alphabet (12,000) and Microsoft (10,000) combined. Amazon reported margin pressures due to lower sales of its Cloud service AWS, while Apple saw its steepest sales decline in years, stemming from a weaker macroeconomic back drop, particularly in China. Microsoft saw its lowest revenue

growth numbers since 2016, driven by slower sales in its Azure Cloud business. Alphabet and Meta also saw pressure for revenues and earnings, although Alphabet's push into artificial intelligence and Meta's large stock buyback announcement were the focus of the releases. One common theme across these sectors was the relative lack of visibility in the outlooks for the current year because of macroeconomic uncertainty. Another noteworthy theme was increased expense controls and cost reductions across most companies. This is important because companies in these sectors are used to spending, sometimes overspending, in order to keep growing. A successful shift to capital discipline will be an important step in the right direction as these companies mature, separating the wheat from the chaff.

Sales and earnings pressures brought about by macroeconomic uncertainty have also been present in other sectors. McDonald's said it was experiencing operating margin pressures, while Kimberly Clark saw declining sales despite increases in unit prices to offset inflation. Automakers such as Tesla, GM and Ford are likely to experience declining margins as competition and price wars heat up. Industrial giants Boeing and Caterpillar saw increased costs

cut into profits. Even companies in the Energy sector like Chevron and Exxon Mobil saw revenues ratchet down, albeit from very high levels.

What is interesting is that, despite clear signs of slowing sales and earnings across the economy, large earnings misses, and negative outlooks, these stocks are not being heavily penalized. Perhaps investors are looking past 2023 and into 2024 and beyond. Going into this year, the market appeared to be pricing in a recession. Now, it appears to also be pricing in a reduction in interest rates in the second half of 2023. Many companies are telling us that they are seeing real headwinds on sales and profit margins, and the duration of these headwinds is unknown, as they hinge on an uncertain macro environment. The Fed is telling us that although rates might be peaking, they are likely to stay higher for longer. The stock market appears to have one message for company management teams and the Fed: "I don't believe you." In time, economic data will have the last word. In the meantime, we would not be surprised if we see a market pull back as expectations adjust to the data. This could even create an attractive entry point for investors looking to get exposure to the markets. The adage of "Don't fight the Fed" has rang true for many years and could prove to be right again this time. ■

House Views Matrix

	TACTICAL (UP TO 3 MONTHS)	CYCLICAL (UP TO 12 MONTHS)
US Equities¹	UNDERWEIGHT	UNDERWEIGHT
European Equities	NEUTRAL	OVERWEIGHT
Japanese Equities	OVERWEIGHT	OVERWEIGHT
Emerging Market Equities	OVERWEIGHT	OVERWEIGHT
Chinese Equities	OVERWEIGHT	OVERWEIGHT
US Treasuries²	NEUTRAL	NEUTRAL
Investment Grade Fixed Income	OVERWEIGHT	NEUTRAL
High Yield Fixed Income	OVERWEIGHT	NEUTRAL
Emerging Market Sovereign	OVERWEIGHT	OVERWEIGHT
US Dollar	NEUTRAL	UNDERWEIGHT
Energy³	OVERWEIGHT	OVERWEIGHT
Precious Metals	OVERWEIGHT	NEUTRAL
Cash	UNDERWEIGHT	NEUTRAL

¹ Relative to global equities in USD

² Relative to aggregate fixed income markets in USD

³ Relative to an overall commodity allocation

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