OBSERVATIONS: *Mixed macro data and small cap rally*

- Markets moved largely sideways last week with the S&P 500 Index gaining +.8% and the NASDAQ gaining +.3%, while small cap equities (Russell 2000 Index) gained about +1.5%.[1]
- The Small Business Optimism Index decreased 0.8 points in March to 90.1—marking the 15th consecutive month below the 49-year average of 98. Small business owners still indicate the labor market remains tight, and the vast majority of respondents expect worse business conditions over the next 6-months.[1]
- The Dodge Momentum Index—a leading indicator of non-residential construction by about 9 to 12 months tracked by the Dodge Construction Group—declined by -8.6% in March from February. The industry group expects further declines in the index this year as credit conditions tighten and the US economy weakens.[2]
- Inflation came in as expected in March, with headline CPI registering 5.0% year-over-year (YoY)—down from 6.0% YoY in February—and core-CPI (excluding food and energy) inching up to 5.6% YoY from February's 5.5% YoY reading largely due to increases in rent and housing costs.[1]
- Meanwhile, the Producer Price Index (PPI) declined in March to 2.7% YoY from February's 4.9% YoY figure. Core-PPI, which excludes food, energy, and trade services also declined in March to 3.6% YoY.[1]
- Retail sales came in lower than expected in March, falling -1.0% from February—however much of this decline was due to falling gasoline prices. Total retail sales in Q1-2023 were +5.4% higher than in Q1-2022.[1]
- Industrial production was stronger in March than expected, growing by 0.4% month-over-month, but all of the gain came from utilities—both mining and manufacturing activity declined by -0.5%. Capacity utilization moved up to 79.8% edging it just above its 50-year average of 79.7%.[1]
- Consumer sentiment inched up in April to 63.5 from 62.0 in March, but remains well below its long-run average of 85.8, while consumer expectations for inflation next year jumped from 3.6% last month to 4.6%.[1]

EXPECTATIONS

- As we headed into the Easter-weekend, markets had priced about a 50% chance that Fed would hike rates by another 25 basis points at its next meeting in early May. However, by end of the last week, markets had re-priced the probability of a May-rate hike at over 80%. The cause of this shift in expectations came from another high reading on core-inflation, another strong jobs report, and the Fed minutes from its last meeting which signaled that despite the turmoil in the banking sector last month the majority of Fed officials judged that additional hikes were needed to curb demand and lower inflation.[1]
- While consensus expectations have solidified around one more rate hike in May, markets are also anticipating at least one rate cut in the final quarter of 2023, which is currently at odds with the public comment of most Fed officials, thus far, which have poured cold water on the idea of cutting rates this year.[1]

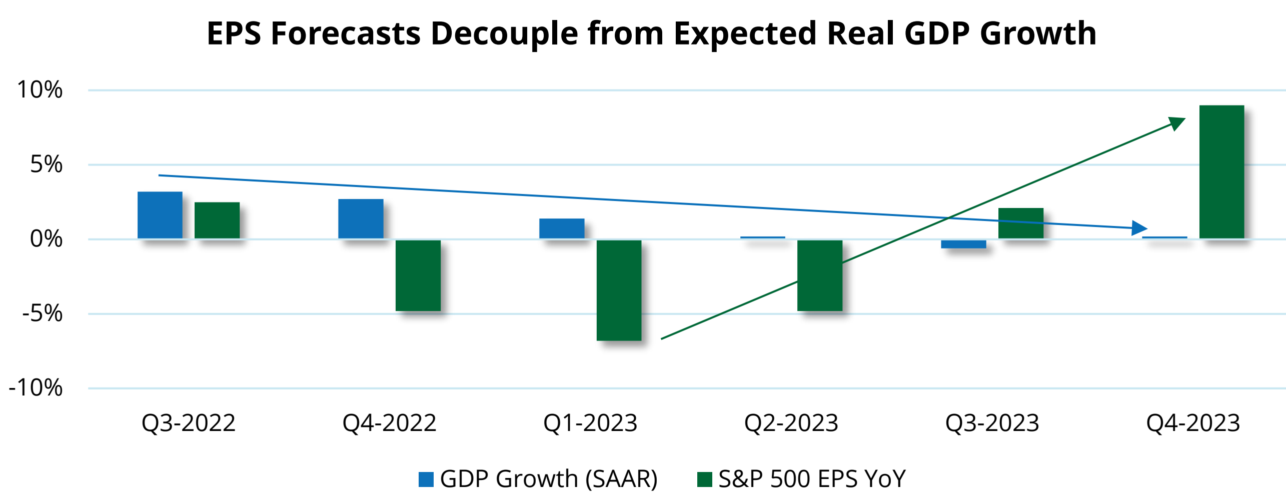
ONE MORE THOUGHT: *Q1-2023 Earnings Season Kicking Off*[3]

The Q1 earnings season kicked-off last Friday with strong earnings reports from several large banks. Bank profits soared in Q1 (as compared to a year ago) at JPMorgan (+52%), Wells Fargo (+32%), and Citi (+8%), and each of these banks noted that their net interest margin improved. Nonetheless, these banks also set aside additional funds to offset potential non-performing loans which they expect to increase as 2023 unfolds. Overall, both companies and analysts are becoming increasingly pessimistic about this earnings season. Already, nearly 78 companies had

[1] *Bloomberg LP, 4/15/2023*
[2] *https://www.construction.com/news/March2023DMI*
[3] *Bloomberg LP, Factset Earnings Insight*

already issued negative guidance, which is well above historic norms. In fact, Q1 has seen the highest number of S&P 500 companies issuing negative EPS guidance for a quarter since Q3-2019. Similarly, in terms of estimate revisions, industry analysts lowered their earnings estimates for Q1-2023 by a larger margin than historic averages—analysts typically revise down estimates as the quarter unfolds. On a per-share basis, estimated earnings for Q1 decreased by -6.2% from December 31 to March 31. This downward revision is greater than the 5-year average of -2.8% and the 10-year average of -3.3% and this is the largest downward quarterly revision since Q2-2020—when the US economy shutdown due to the Covid pandemic. At a broader level, analysts expect earnings growth to improve as the year unfolds; currently analysts forecast that the S&P 500 will experience EPS growth in Q4-2023 of +9.0% greater than Q4-2022. However, this relatively upbeat assessment of positive momentum in earnings growth in 2023 is directly at odds with the growing consensus that overall economic growth in the US will decelerate each quarter throughout the rest of the year. Equally, the analysts estimates for the rest of 2023 imply increasing profit margins for S&P 500 firms at a time when CEOs are increasingly citing margin pressure on earnings calls and a majority of US CEOs are pessimistic about business conditions in 2023, according to the latest survey of CEOs by the Conference Board. This creates an ideal backdrop for increased volatility in the months ahead and leaves the risk of downside surprises elevated.

CHART OF THE WEEK



Source: Bloomberg LP & Factset 4/15/2022, SAAR = Seasonally Adjusted Annualized Rate, Quarterly GDP Growth in 2023 based on Bloomberg consensus expectations.

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