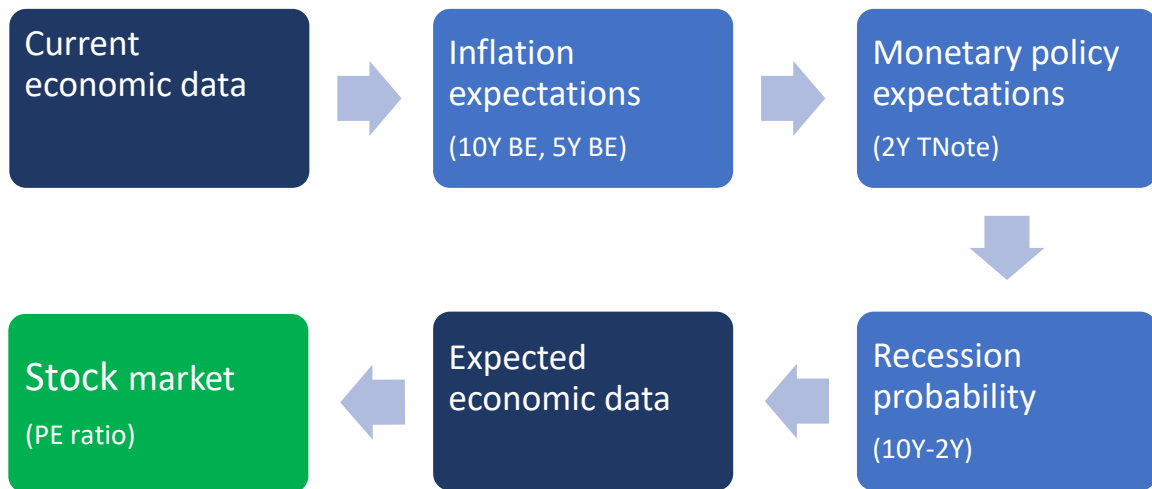


GAV Weekly S&P 500 Outlook



Executive Summary

Fundamentals: Labor market remains strong, which supports strong current growth and high inflation. Long-term inflation expectations increased, which supports even more aggressive monetary tightening. As a result, the recession probability is still very high. Currently, with the PE ratio at 25, S&P 500 is priced for a strong future earnings growth, while the recession probability is very high. Thus, S&P 500 is overvalued and the outlook is negative.

Technicals: S&P 500 is already in a downtrend – bear market. After the bear market rally, the next leg down has likely started last week with the market pricing the Fed’s announcement of the QT program (rising real rates), which is likely to continue into the Fed’s meeting in May. Current level: right above the key 200dma support. Expect 200dma breakdown.

Weekly Data Analysis

Current economic data

GDP:	6.9% Q4 2021 (increase from 2.3%) 5.5% Q4 2021 yoy (increase from 4.9%)
Unemployment rate	3.6% March 2022 (decrease from 3.8%) Weekly claims 166K (matching low point – strong labor market)
Inflation:	7.9% Feb 2022 CPI (increase from 7.5%) 6.4% Feb 2022 Core CPI (increase from 6%)

Weekly note: The labor market remains strong, which supports high growth and higher inflation.

Inflation expectations

	Nominal Yield (<i>last week</i>)	Real Rate	10Y BE Inflation Expectations
5Y	2.75%	-0.65%	3.40% (3.34%) – above 3%
10Y	2.70% (2.38%)	-0.19% (-0.44%)	2.89% (2.82%) – above 2.75%, 2.99% high
30Y	2.72%	0.19%	2.53% (2.56%)

Weekly note: A big increase in real rates as both 1) nominal increased and 2) inflation expectations increased. The Fed announced the beginning of **QT program** in May – QE ended in March. Long-term inflation expectations are de-anchoring, longer term **de-globalization** is the key driver.

Monetary policy expectations

Current	Jan 2023	Jan 2024	High	First cut	Jan 27 -terminal
0.34%	2.54 (2.48)	3.22	3.23 Aug 23 (3.21 Sep 23)	2.88 Dec 24 (2.75 Dec 24)	3.07 (2.95) <i>last week</i>

QE ended in March. QT starting in May – balance sheet reduction \$95 bill/month

Weekly note: Still more aggressive hikes in 2022 and quicker in 2023. First cut unchanged. Fed behind inflation curve -policy error.

Recession probability

10Y-2Y spread	0.19% (-0.08)	Inverted week of March 28 th , now positive (QT)
10Y-5Y spread	-0.05% (-0.18)	Still inverted – recession forthcoming
2Y-3mo spread	1.83 (1.95)	An imminent recession not expected

Weekly note: Recession probability over next 12-18 months still very high, but slightly lower last week due to the increase in 10Y yields (QT announcement widened the curve).

Expected data

Slower growth and an eventual recession High and persistent inflation (de-globalization)

Weekly note: Stagflation with an ultimate recession. Outlook unchanged.

Stock market outlook – SELL

PE = 25 (overvalued – predicting high growth while bond market predicts a recession). Stock market to reflect the expected data – recession, as more incoming data provides support. Balance sheet reduction to bust all speculative asset price bubbles, as real rates increase.

Weekly note: Fed-caused recession and the bear market. No change in outlook.

Other

Credit risk	BBB-10Y	1.77% (1.93%)	Still falling – high 2.38% March 10. No credit distress, but HYG falling.
	HYG	-7.55% YTD	
International	US10Y-Bund	2% (2.01%)	Germany more affected by Russia.
ECB	Rate to 0%	Sep 2022	Current -44%. ECB inflation mandate.

Weekly note: ECB announced a tool to control rising interest rates, but likely to control risk spreads Ger-periphery. Crisis expected? Effect on the Euro?

Expected economic data

Expected economic data is the function of:

- Whether the monetary policy is as expected, or more/less aggressive, which depends on the inflation-path (and economic data).
- The effects of the expected monetary policy, which is designed to affect the demand-side of inflation dynamics.
- Note: There were 13 Fed's interest rate hiking cycles since 1945, which caused a recession 10 times. Exceptions: 1994-95, 1983-84, 1965-66

Key inflation drivers

Demand shock:	Supply shock:
<ul style="list-style-type: none"> *Extraordinary pandemic-related monetary stimulus causing higher credit consumption. (Higher rates to lower credit consumption.) *Extraordinary pandemic-related fiscal stimulus - direct cash, benefits. (Fiscal benefits expiring - less consumption) *Investment gains and wealth effect: rising stock market, housing, cryptocurrencies caused higher consumption. (Rising real rates designed to deflate bubbles – QT) *Pandemic-related labor shortage causing rising wages 5.6%, which leads to more consumption. (Lower consumption to increase unemployment rate.) 	<ul style="list-style-type: none"> *Pandemic-related labor shortage - low participation rate 62.4%. (Needs to increase labor participation – end of pandemics, increase immigration or productivity.) *Pandemic-related supply chain bottlenecks - China 0-covid policy (End of pandemics and globalization to improve supply chains.) *Pandemic-related material shortages – such as semiconductors. (End of pandemics and globalization to improve shortages.) *Commodity shortages: Russia sanctions, geopolitics (long-term problem – economic war) *Longer term: de-globalization reduces supply (Russia/China block developing)
<p>Monetary policy works with a lag: labor market still strong, asset prices still inflated, consumption still strong, wages still rising.</p>	<p>End of pandemics could improve supply-chains and some shortages – but still lockdowns in China. De-globalization will keep supplies tight for longer-term – implying higher long-term inflation expectations.</p>

Weekly note: Demand is still strong and supply is still tight – implying aggressive monetary policy tightening, as expected. The risk is a more aggressive tightening.

Events expectations

- The Fed to start implementing monetary tightening – hike by 50bp in May
- The Fed to start implementing QT in May
- Corporate guidance in April to reflect higher inflation and the effect on margins, and reflect on recession probability – effect on sales and earnings (negative guidance and downgrades).
- Escalating Russia-Ukraine crisis and accelerated de-globalization

Weekly note: Russia initially failed at Kyiv, the conflict is now at pause and expected to escalate as Russia regroup.

Economic data expectations

Slower growth – eventually recession

Higher interest rates (Fed) – less credit consumption – lower sales (discretionary sector)
Higher mortgage rates (10y) – lower housing prices (wealth effect – housing sector)
Lower stock market and cryptocurrencies – wealth effect (less consumption)
Russia sanctions and higher oil – lower consumption (as long as sanctions last) (energy)
Longer-term: de-globalization leads to slower growth (less exports)

Uptick in Unemployment

Slower growth will lead to uptick in unemployment rate (lower demand)

High Inflation to persist

Higher oil (Russia) will keep inflation high (oil as well as other commodities)
Longer-term de-globalization is inflationary.
Pandemic related supply-chain bottlenecks still inflationary (China lockdowns).
Supply issues unresolved – demand still not affected by the Fed and Oil

Weekly note: No changes in the economic data expectations, which is still consistent with the yield curve prediction (aggressive monetary tightening, combined with de-globalization).

Stock market pricing analysis

S&P 500 Sector Performance: -5.83% YTD, -1.26% 5 days

Leaders YTD	Laggards YTD	Leaders 5 Days	Laggards 5 Days
Energy XLE 43.3%	Comm XLC -12.36%	Healthcare XLV 3.45%	Tech XLK -3.82%
Utilities XLU 7.52%	Tech XLK -12.34%	Energy XLE 3.21%	Con.Dis. XLY -3.10%
Staples XLP 2.09%	ConDis -12.21%	Staples XLP 2.70%	Indus. XLY -2.52%
Healthcare 1.38%	Indus. XLY -5.87%	Utilities WLU 1.93%	Comm XLC -1.75%

Finance, Real Estate, Materials also negative YTD.

Weekly note: Bear market unfolding. Consistent with expected recession and high inflation (Energy). Buy low beta (Utilities, Staples, Healthcare) – sell high beta (Tech, Discretionary) and cyclicals (Industrials). Last week performance consistent with the YTD trend – reaction to the QT announcement (rising real rates).

Factors/Global Performance

	YTD	Week		YTD	Week
Russell IWM	-11.05%	-4.67%	Stoxx50	-10.46%	-1.69%
EEM	-8.02%	-2.11%	StoxxBanks	-11.87%	-3.82%
EAFE	-7.36%	-1.88%	FTSE100	4.84%	1.69%

Weekly Note: Bear markets unfolding, consistent with the global recession expectations. FTSE heavily weighted on Energy – consistent with high inflation. Last week performance consistent with the YTD trend – reaction to the QT announcement (rising real rates).

FX/Commodity Performance

	YTD	1M		YTD	Week
Euro	-4.54%	-0.32%	Silver	6.17%	-7.07%
AUD	2.57%	2.49%	Platinum	0.93%	-15.27%
Br.Real	21.36%	8.58%	Oil	32.89%	-17.88%
Gold	6.12%	-4.94%	Copper	6.10%	0.32%

Weekly note: Strong USD consistent with weak global growth – deglobalization. Commodity currencies strong consistent with high inflation. Falling gold prices consistent with rising real rates. Oil – Russian sanctions vs SPR release.

S&P 500 Technical analysis



- **Bear market: short the rallies – buy the sell-offs**
- High point: Jan 4th, 2022.
- First leg down – reaction to higher interest rates (fundamental adjustment, broke all supports).
- Second leg down – reaction to Russian invasion of Ukraine and higher oil prices.
- Bear market rally:
 - Fed's first hike only 25bp, due to Ukraine uncertainty
 - Oil price correction – release from SPR
 - Expectations of cease-fire in Russia
- Current trend: **Next leg down?**
 - Primarily pricing implementation of **the Fed's QT**, which starts in May.
 - Reduction in liquidity to deflate all bubbles.
 - Right above 200dma (support) – expect breakdown
 - Right below 100dma (resistance)