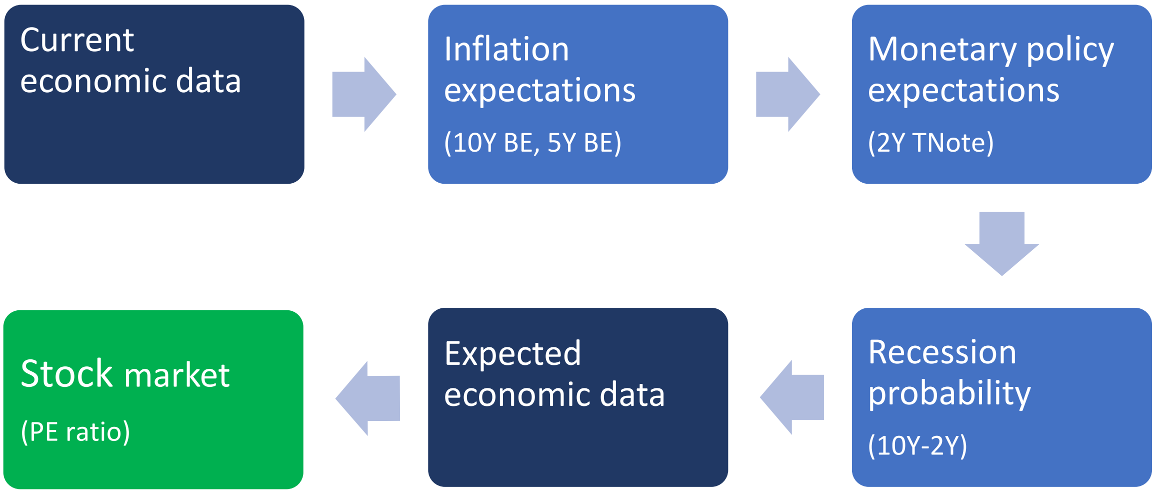
GAV Weekly S&P 500 Outlook



Executive Summary

Current data: Labor market remains strong, inflation still rising.

Inflation expectations: Still continue to rise. Real rates also continue to rise (QT).

Monetary policy expectations: Last week, market priced slightly less aggressive Fed - disconnect with rising inflation expectations. Resolution?

Recession probability: Yield curves inverted in March – thus high probability of a recession. Currently, yield curves positive – rising long term yields due to rising real rates – pricing QT.

Expected economic data: Higher inflation with slower growth and eventually a Fed-induced recession.

Stock market: Pricing rising real rates and QT – last week sell tech and high beta. Bear market unfolding – consistent with expected economic data. **Outlook: SHORT**

S&P 500 Technical: Last week 200dma breakdown – the downtrend continues. Peak inflation bounce failed. Supports the outlook: SHORT.

Other: Last week notables, increase in credit spreads and narrowing of 2Y-3mo spread.

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 **185K** (slight uptick from 166K - strong labor market)
Inflation:	**8.5%** March 2022 CPI (increase from 7.9%) **6.5%** March 2022 Core CPI (increase from 6.4%)

Weekly note: Inflation still rising. The labor market remains strong, supports higher wages.

Inflation expectations			
	Nominal Yield (*last week*)	Real Rate	BE Inflation Expectations
5Y	2.79% (2.75%)	-0.65% (-0.65%)	3.44% (3.40%) – above 3%
10Y	2.83% (2.70%)	**-0.09% (-0.19%)**	2.92% (2.89%) – above 2.75%, 2.99% high
30Y	2.91% (2.72%)	0.33% (0.19%)	2.58% (2.53%)

Weekly note: A big increase in longer term nominal yields, as long-term real rates increased, and **expected inflation continues to rise** as well. Market pricing Fed's QT program, which starts in May. 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
0.33% (0.34%)	2.47 (2.54)	3.05 (3.22)	3.18 **Jul 24** 3.23 Aug 23	2.76 Dec 24 (2.88 Dec 24)	2.95 (3.07) *last week*
QE ended in March. QT starting in May – balance sheet reduction $95 bill/month					

Weekly note: Fed less aggressive, but hikes for longer – high point delayed. First cut unchanged. *Disconnnect*: inflation exp rising, but Fed less aggressive? Fed behind inflation curve -policy error.

Recession probability		
10Y-2Y spread	0.38% (0.19%)	Inverted week of March 28th, now positive- rising (QT)
10Y-5Y spread	0.04% (-0.05%)	Inverted in March, now positive (QT)
2Y-3mo spread	1.70% (1.83%)	**Narrowing**, but an imminent recession not expected

Weekly note: Narrowing of the 2Y-3mo spread – expected monetary policy. Recession probability still very high, the yield curve already inverted. Expectations of QT is 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 = 22-25 (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 HYG	1.94% (1.77%) -7.78% (-7.55%) YTD	**Rising** – high 2.38% March 10. Slight decrease
International	US10Y-Bund	1.99 (2%)	Stable. Germany more affected by Russia.
ECB	Rate to 0%	Sep 2022	Current -44%. ECB inflation mandate.

Weekly note: Increase in credit risk.

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 the in-coming 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:
*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 consumptio**n** to increase unemployment rate.)	*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)
Monetary policy works with a lag: labor market still strong, asset prices still inflated, consumption still strong, wages still rising.	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.

Weekly note: Demand is still strong and supply is still tight – implying aggressive monetary policy tightening, as expected. Effect on economy: Recession. Peak-inflation point?

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: JPM increases loss reserves. Financials sold off after earnings.

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 an 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: -7.84% YTD, -2.39% 5 days			
Leaders YTD	Laggards YTD	Leaders 5 Days	Laggards 5 Days
Energy XLE 43.9% Utilities XLU 6.3% Staples XLP 2.2%	Tech XLK -15.5% Comm XLC -14.4% ConDis -12.7%	Energy XLE 3.7% Materials XLB 1.2% Staples XLP 0.5%	Tech XLK -5.13% Comm XLC -2.78% Healthcare XLV -2.3% Financials -1.6% Con.Dis. XLY -1.6%

Industrials, Healthcare, Finance, Real Estate, Materials also negative YTD.

Weekly note: Healthcare turned negative YTD. Bear market unfolding. Consistent with expected recession and high inflation (Energy). Buy low beta – sell high beta and cyclicals. Last week performance consistent with the YTD trend. Key driver - QT (**rising real rates**).

Global/Factor performance			
	YTD (last week)		YTD (last week)
Russell IWM	-10.56% (-11.05%)	Stoxx50	-10.34% (-10.46%)
EEM	-9.46% (-8.02%)	StoxxBanks	-11.35% (-11.87%)
EAFE	-8.75% (-7.36%)	FTSE100	4.21% (4.84%)

Weekly Note: Bear markets unfolding, consistent with the global recession expectations. FTSE heavily weighted on Energy – consistent with high inflation. Last week: less selling in global markets – **US tech bubble deflation due the QT announcement and rising real rates**.

FX/Commodity Performance			
	YTD (last week)		YTD (last week)
Euro	-5.03% (-4.54%)	Silver	9.92% (6.17%)
AUD	1.95% (2.57%)	Platinum	2.86% (0.93%)
Br.Real	21.76% (21.36%)	Oil	45% (32.89%)
Gold	7.72% (6.12%)	Copper	6.06% (6.10%)

Weekly note: Strong USD consistent with weak global growth – deglobalization. Commodity currencies strong consistent with high inflation. Gold rising despite 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 (real rates)**, which starts in May.
    - Reduction in liquidity to deflate all bubbles.
  - 200dma breakdown – (200dma new resistance)
  - Right below 50dma – next target 4300.
  - Peak-inflation bullish trade failed.

Risk factors (to the short S&P 500 outlook)

- Fed Dovish turn
  - Inflation peaks and inflation expectations significantly decrease
    - Global supply chains improve
      - The pandemic ends and the China lockdown ends – (de-globalization)
      - Russia sanctions are lifted (peace agreement with Ukraine) - **unlikely**
    - US labor participation increases (end of pandemics, immigration reform)
    - Longer-term: the return of globalization - **unlikely**
      - US-China trade dispute is resolved – tariffs lifted on China
    - The US stock market crashes in a liquidity/credit event – cover short
  - Fed tolerates high inflation and decides to protect the markets – the Fed put
- Fiscal stimulus (China, Japan, and US)