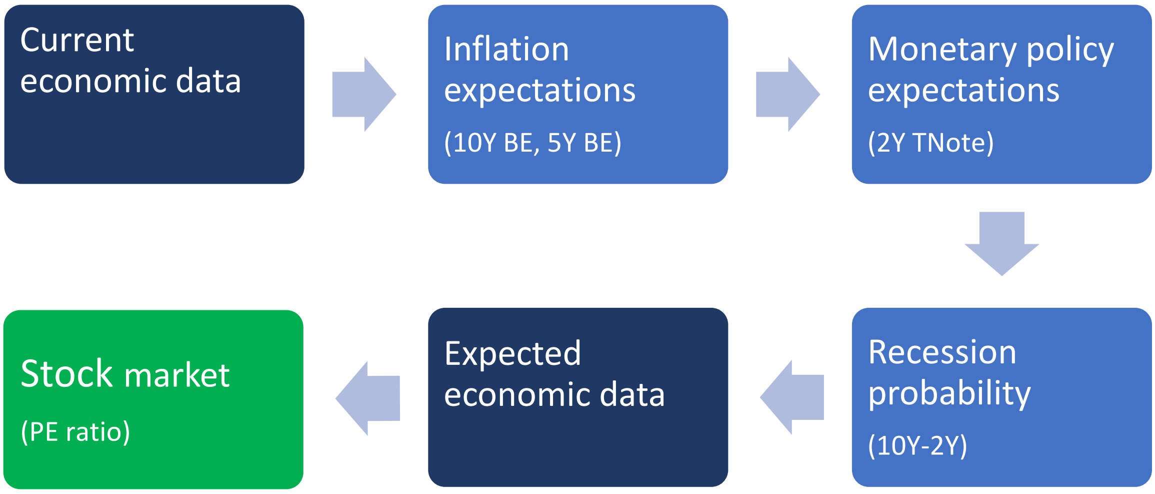
GAV Weekly S&P 500 Outlook



Executive Summary

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

Inflation expectations: Still continue to rise.

Monetary policy expectations: More aggressive Fed – Powell hawkish IMF speech.

Recession probability: Yield curves inverted in March, and 10y-5y reinverted last week: high probability of a recession, but not in imminent.

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

Stock market: Pricing more aggressive Fed – last week **sell everything** (recession). Bear market unfolding – consistent with expected economic data. **Outlook: SHORT**

S&P 500 Technical: Last week 200dma breakdown continues – **4300 target reached** – the downtrend continues. Supports the outlook: SHORT. Risk: counter rally post sell-all liquidity event.

Other: Last week notables, sell-off in commodities and cyclicals – sign of a recession.

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 **184K** (slight downtick from 185K - 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: The labor market remains strong, supports higher wages.

Inflation expectations			
	Nominal Yield (*last week*)	Real Rate	BE Inflation Expectations
5Y	2.93% (2.79%)	-0.44% (-0.65%)	3.37% (3.44%) – lower - above 3%
10Y	2.90% (2.83%)	**-0.09% (-0.09%)**	2.99% (2.92%) – above 2.75%, **2.99%** high
30Y	2.94% (2.91%)	0.31% (0.33%)	2.63% (2.58%) - higher

Weekly note: Increase in nominal yields as **expected inflation continues to rise**. 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%)	**2.83** (2.47)	3.32 (3.05)	3.43 Jul 24 (3.18 **Jul 24)**	3.01 Dec 24 (2.76 Dec 24)	3.20 (2.95) *last week*
QE ended in March. QT starting in May – balance sheet reduction $95 bill/month					

Weekly note: Fed **more aggressive** in 23, 0.25bp extra in other years, high still Jul 24, hike still Dec 24. *Powell IMF speech very hawkish.*

Recession probability		
10Y-2Y spread	0.23% (0.38%)	Inverted week of March 28th, narrowing
10Y-5Y spread	-0.03% (0.04%)	First inverted in March, inverted again
2Y-3mo spread	1.90% (1.70%)	Widening, an imminent recession not expected

Weekly note: Recession probability still very high, the yield curve already inverted, 10-5 inverted again, but no imminent recession yet.

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

Weekly note: Stagflation with an ultimate recession. Outlook unchanged. IMF growth downgrade.

Stock market outlook – **SELL**
PE = 25 (overvalued – predicting high growth while bond market predicts a recession). Aggressive monetary tightening – Fed induced recession. Stock market to reflect the expected data – recession. 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	1.93% (1.94%) -8.91% (-7.78%) YTD	No change – high 2.38% March 10. **Falling**
International	US10Y-Bund	1.93 (1.99%)	Narrowing. Germany inflation 7.3%
ECB	Rate to 0%	July 22 (Sep 22)	Current -44%. ECB inflation mandate.

Weekly note: HYG falls, more aggressive ECB

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 consumption 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: NFTX losing subscribers.

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: -10.37% YTD, -2.77% 5 days			
Leaders YTD	Laggards YTD	Leaders 5 Days	Laggards 5 Days
Energy XLE 37%	Comm XLC -21.6%		Materials XLB -3.74%
Utilities XLU 3.7%	Tech XLK -17.7%		Healthcare XLV -3.65%
Staples XLP 2.7%	ConDis -14%		Financials -2.98%
			Tech XLK -2.80%

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

Weekly note: Healthcare continues sell-off. Materials and finance down – cyclicals – recession? Bear market unfolding. Consistent with expected recession and high inflation (Energy). Buy low beta – sell high beta and cyclicals. Last week all sectors down. Key driver – **more aggressive Fed**. <u>QT last week</u>

Global/Factor performance			
	YTD (last week)		YTD (last week)
Russell IWM	-13.38 (-10.56%)	Stoxx50	**-10.53** (-10.34%)
EEM	-13.24 (-9.46%)	StoxxBanks	-**9.60** (-11.35%)
EAFE	-10.80 (-8.75%)	FTSE100	3.20 (4.21%)

Weekly Note: Bear markets unfolding, consistent with the global recession expectations. FTSE heavily weighted on Energy – consistent with high inflation. Last week: less selling Europe – **US bubble deflation due the more aggressive Fed** and QT with rising real rates. Higher rates good for EU banks.

FX/Commodity Performance			
	YTD (last week)		YTD (last week)
Euro	-5.43 (-5.03%)	Silver	3.76 (9.92%)
AUD	-0.53 (1.95%)	Platinum	-4.06 (2.86%)
Br.Real	18.52 (21.76%)	Oil	39.12 (45%)
Gold	5.5 (7.72%)	Copper	3.59 (6.06%)

Weekly note: Strong USD consistent with weak global growth – deglobalization. Commodity currencies strong consistent with high inflation (but and AUD sold-off – global recession). Oil – Russian sanctions vs SPR release vs demand (China covid). All commodities sold-off.

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 **more aggressive Fed** and **the Fed's QT (real rates)**, which starts in May.
    - Fed induced recession.
    - Reduction in liquidity to deflate all bubbles.
  - 200dma breakdown – 4300 reached.
  - Approaching previous low 4150
  - Peak-inflation bullish trade (rally) vs more aggressive Fed (sell-off).

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 (liquidly event last week – but not credit event – too early for Fed put)

    - Fed tolerates high inflation and decides to protect the markets – the Fed put
- Fiscal stimulus (China, Japan, and US)