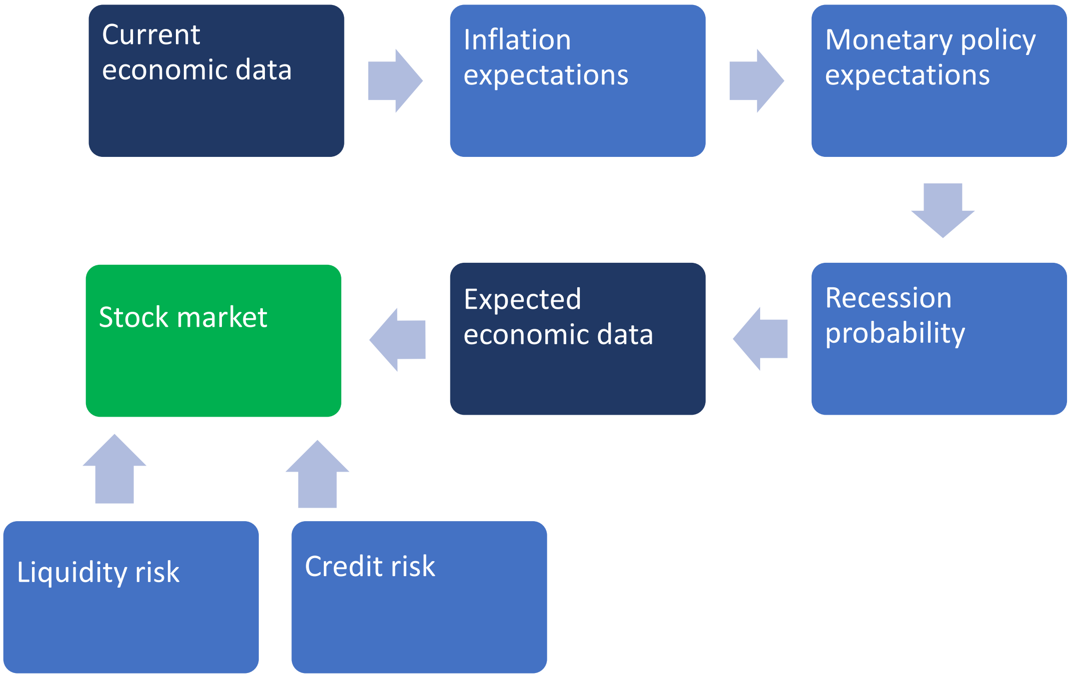
GAV Weekly S&P 500 Outlook



Executive Summary

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

Inflation expectations: Still falling – the peak inflation expectations hypothesis.

Monetary policy expectations: Slightly less hawkish for 2022 and 2023 – the peak Fed hawkishness hypothesis.

Recession probability: Yield curves widening – lower recession probability, but still high.

Expected economic data: Higher inflation with slower growth - ultimately a Fed-induced recession, possibly late 2024.

Liquidity risk: Very high due to the rise in nominal and real rates in expectations of the Fed's QT.

Credit risk: Slight increase to moderate level.

S&P 500 Outlook:

- Current 14% drawdown primarily due to the Fed's liquidity shock – the phase 1 selloff.
- Higher interest rates also causing the PE ratios contraction for growth stocks.
- Expect the bounce rally as the liquidity risk eases – the peak Fed's hawkishness.
- Longer-term: the Fed's induced **recessionary bear market** – the phase 2 selloff.
- Currently, we are approaching the period between the phase 1 and phase 2 selloffs, thus the extended counter rally very likely.
- Short-term outlook is **neutral** until more clarity emerges on duration of the liquidity shock.

Weekly Macro Analysis and S&P 500 Outlook

Current economic data :	
GDP:	**-1.4%** Q1 2022 (down from 6.9%) – *Consumption 2.7% (strong)* **3.4%** Q1 2022 yoy (down from 5.5%)
Unemployment rate	**3.6%** April 2022 (last 3.6%) Weekly claims **200K** (up from 181K – **still** strong labor market)
Inflation:	**8.5%** March 2022 CPI (up from 7.9%) - *PCE 6.6% (6.3%)* **6.5%** March 2022 Core CPI (up from 6.4%) - *Core PCE **5.2% (5.3%)***

Weekly note: The labor market remains strong, supports higher wages – and strong economy.

Inflation expectations			
	Nominal Yield (*last week*)	Real Rate	BE Inflation Expectations
5Y	3.08% (2.95%)	**-0.16%** (-0.40%)	3.24% (3.35%) – **still falling** - above 3%
10Y	3.13% (2.93%)	**0.26%** (-0.01%)	2.87% (2.94%) – **still falling** 2.99 high
30Y	3.23% (3.00%)	**0.65%** (0.40%)	2.58% (2.60%) – **still falling**

Weekly note: Inflation expectations are **falling**, for the second week – **peak inflation expectations**? Real yields are significantly rising – **pricing QT** – liquidity risk in Treasuries!

Monetary policy expectations					
Current	Jan 2023	Jan 2024	High	First cut	Jan 27 -terminal
0.768% (0.34%)	2.80 (2.83)	**3.19** (3.23)	**3.33 July 23** (3.33 Aug 23)	3.00 Dec 24 (2.93 Dec 24)	**3.24** (3.13) *last week*
QE ended in March. QT starting in June – June-Aug $47.5 bill/month, after $95bill/month					

Weekly note: Fed **slightly less aggressive** in 23 and 24, high earlier in July 23, first cut still Dec 24. Higher terminal rate. **Peak hawkishness**?

Recession probability – Phase 2 selloff - inactive		
10Y-2Y spread	**0.40%** (0.22%)	**Widening** (Inverted week of March 28th)
10Y-5Y spread	0.05% (-0.02%)	Positive (First inverted in March, reinverted)
2Y-3mo spread	1.92% (1.89%)	**Positive - an imminent recession not expected**

Weekly note: Recession probability decreasing - **Spreads widening**.

Expected data	
Fed-induced recession (late 2024?)	De-globalization related higher inflation

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

S&P 500 outlook

- PE = 21-22 – Falling but still moderately overvalued.
- Expectations: Ultimately, the Fed-induced recessionary bear market.
- Sell before the predicted recession – as 2Y-3mo inverts (current exp. Dec 24).
- The current 14% drawdown is a Phase 1 correction if the recession is in 2024 – and not an unfolding bear market.

Weekly note: The correction deepens.

Liquidity risk – High – Phase 1 selloff - active

Balance sheet reduction to bust all speculative bubbles, as real rates increase (QT).
Forced selling of all positions – margin calls

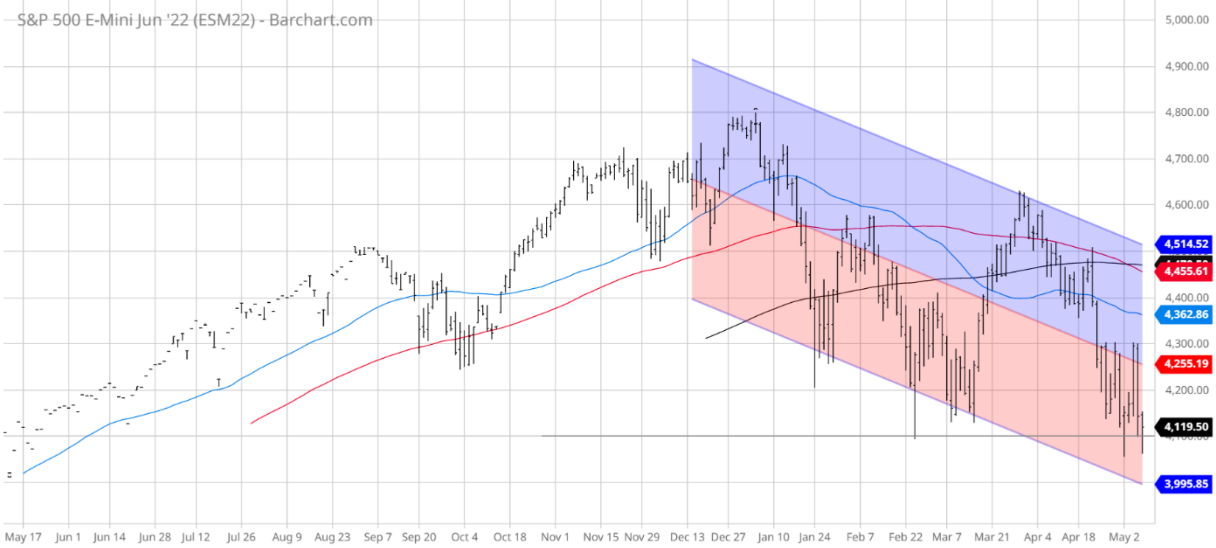
- 10Y Bond (Fed's bond bubble) – **nominal and real rates rising**
- Crypto – Bitcoin: -23% YTD QQQ: -23%% YTD

Weekly note: Large increase in real rates and nominal rates causing liquidity shock. At which point real rates adjust to QT?

Credit risk – Moderate – Phase 3 selloff – inactive			
Credit risk	BBB-10Y	**2.10%** (2.06%)	**Increase** to moderate. High 2.38% Mar 10.
	HYG	-10.83% (-9.75%) YTD	**Still falling**

Weekly note: Moderate level of credit risk.

S&P 500 Technical analysis



- **Correction 14%: Jan 4th – May 6**
- First leg down – reaction to long term higher interest rates – PE adjustment
- 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: **Third leg down – liquidity shock**
  - Drivers: **more aggressive Fed** and **the Fed's QT (rising real rates)**.
    - Reduction in liquidity to deflate all bubbles – **liquidity shock**
  - Currently: **at new low**.
  - Next week: **Holding the 4100 level** – needs to see stability in 10Y yields and evaluate the liquidity risk.

Short-term S&P 500 Tactical next-move outlook

Fundamental Thematic pricing — Tactical trade**: Neutral**

- Negative driver: Liquidity shock from the Treasury Bond sell-off in reaction to QT.
- Possible positive catalyst: Peak inflation expectations/Peak Fed hawkishness trade.
- Wait until the Bond prices stabilize and re-evaluate the positive catalyst pricing.

Technical — Technical trade: **Neutral**

- **Still** near bottom of the downtrend channel: **high bounce rally probability**
- Further sell-off possible if the liquidity shock persists
- Strategy 1: Sell 4000 breakdown (liquidity shock – sharp rise in interest rates)
- Strategy 2: Buy bottom of the range (now to 4000)
- Strategy 3: Buy the 4300 breakout (peak inflation/peak hawkishness)

Longer term: Sell as 2Y-3mo inverts as a sign of an imminent recession

- Fed induced recessionary bear market (possibly 2024)

Expected economic data assumptions

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.

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: Stagflation with an ultimate recession. No changes in the economic data expectations.