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Risk On!

I can't think of any two words that better describe equity markets in the U.S. so far this year.

After big losses in both stocks and bonds last year, optimists hoped we would soon see markets recover as both inflation and interest rate hikes were going to end. Pessimists expected continued tough market conditions driven by tightening monetary conditions, continued interest rate hikes, a softening economy, and the likelihood of a recession. So far, optimists are winning. Although weakening as February ended, gains were respectable for two months with the S&P 500 Index up 3.69%, although well-down from its 2023 high of 4195.01 on February 2. Growth-oriented indices rose further, with the Russell 1000® Growth Index up 7.05%. Value indices fared worse with the Russell 1000® Value Index up 1.47% and the venerable Dow Jones Industrial Index down 1.13%.

The changes in sector performance between last year and this year are especially notable.

Sector	2022 % Chg.	YTD 2/28/2023 % Chg.
Energy	59.0%	-5.1%
Utilities	-1.4%	-8.3%
Consumer Staples	-3.2%	-3.5%
Healthcare	-3.6%	-6.7%
Industrials	-7.1%	2.5%
Financials	-12.4%	4.1%
Materials	-14.1%	5.2%
Real Estate	-28.4%	3.2%
Technology	-28.9%	9.6%
Consumer Discr.	37.6%	12.4%
Comm. Services	-40.4%	8.9%
S&P 500	-19.4%	3.6%

Source: Telemet

"Last year's losing sectors have become this year's winners, so far at least."

Last year's losing sectors have become this year's winners, so far at least. This also applies to individual stocks as shown with some well-known large-cap stocks below:

Sector	2022 % Chg.	YTD 2/28/2023 % Chg.
Tesla	-65.0%	67.0%
Nvidia	-50.3%	58.9%
Meta Platforms	-64.2%	45.4%
Occidental Petroleum	117.3%	-7.0%
Chevron	53.0%	-10.4%
Exxon Mobil	80.3%	-0.35%

Source: Telemet

There are several things that make market action so far this year surprising.

Cash, for one, is no longer trash. A three-month U.S. Treasury bill will pay you 4.82% today, up from 4.42% at year end and up from 0.33% (over)

one year ago. A 10-year U.S. Treasury bond will pay 3.93% now, flat so far this year, but up from 1.73% one year ago. Although below the rate of inflation, the yields on both short and long term fixed income investments offer compelling returns with fairly low risk.

In addition, earnings growth in 2023 probably will not help markets much. As of February 28th, S&P Capital IQ's estimate of S&P 500 earnings for 2023 was $219.44. This is barely above the $218.00 estimate for 2022. At the month end closing price of 3907.1, the S&P 500 is selling for 18.1x estimated earnings. This is close to the five-year average of 18.5x forward earnings and above the 17.2x average for the past 10 years. And it is important to note that those historical p/e ratios were in a period of lower interest rates than what exist today. It is even more important to note that the pace of upward earnings revisions for S&P 500 companies is lower than what it has been in several years.

As many of you know, our investment process combines both technical and fundamental indicators. We often describe the technical indicators as traffic lights giving us an indication as to whether it's a good time to invest in a particular stock. If the indicators are strong, we have a "green" light; if weak, we have a "red" light. If so-so, we have a "caution" signal.

Markets today are flashing that "caution" signal: equity market valuations are high, interest rates are more likely than not to be hiked a few more times, inflation does not seem to be whipped now and there are a lot of geopolitical areas of concern. Although up year-to-date, markets seem to be weakening with every passing week. While it rarely pays to be totally out of stocks, it does pay from time to time to focus on asset allocation and see if one is comfortable with the mix of stocks, bonds, and cash. This is one of those times.

As always, we are here to help with whatever investment questions you might have.