Guide to the Gauges

Quarterly Economic and Capital Market Review

First Quarter 2023

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Guide to the Gauges

Our Latest Assessment of Key Economic Indicators

We believe that over the long term, stock prices are driven by two things: earnings, and what people are willing to pay for those earnings. These five gauges reflect our outlook for the factors that we believe drive stock prices.

Each gauge is comprised of a number of individual indicators, which the Investment Team evaluates on an ongoing basis to determine if the gauge is neutral, positive, or negative.

First Quarter Summary

After a choppy 2022, the first quarter of 2023 ended on a positive note for stocks. Importantly, it was the second quarter in a row where the S&P 500 was up. This is important as over the last 70 years, bear markets have all ended when there were two consecutive quarters of the S&P 500 being in positive territory. Most areas of fixed income ended the quarter up as well.

During the quarter, the headline event was the banking situation, which involved a run on a few regional banks and resulted in closures. While the situation may not be over, we do believe that the worst is behind us.

As inflation continues to trend downward, we believe that the Federal Reserve is at or near the end of the current rate hike cycle. Fed Fund Futures currently imply about a 50/50 chance of a 25 basis point rate hike in May and a few rate cuts later this year, although Federal Reserve officials have not messaged that.

P/E multiples have moved higher from the end of Q3 2022, and we now view stocks as “fairly valued” at the index level. Investor sentiment, which is a contrarion indicator, remains slightly negative, but has come down from peak levels in 2022. Typically, when investor sentiment reaches extreme levels of bullishness or bearishness, a change in direction for the market often follows.

No change in position

Economy

This quarter, we held the Economy gauge in a Neutral position to reflect our expectations that GDP growth will be at or near trend for Q1. During the quarter, we saw continued contraction in the manufacturing sector, although services continue to be in expansion. Given the likelihood of tighter lending standards from banks, the odds of a mild recession have increased. Given the strength of the jobs market, we believe a potential recession would be short and shallow.

Key Takeaways

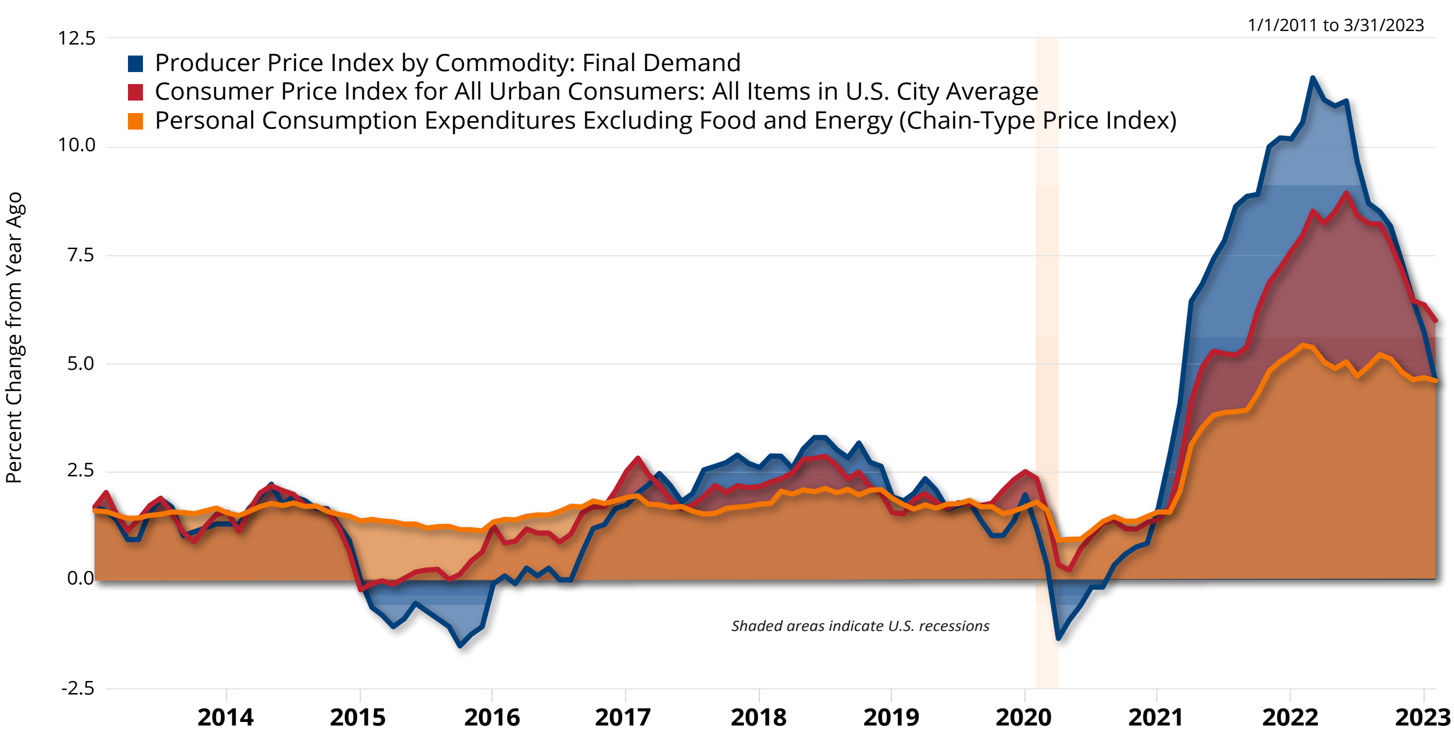
GDP
The Atlanta Fed's GDPNow is currently forecasting growth of 2.2% for Q1. However, we anticipate that GDP growth could slow in coming quarters, but should remain positive.

Labor Market
The unemployment rate of 3.6% is near its lowest level in decades and job openings are plentiful.

Inflation
Inflation likely peaked last year and has moderated further since then.

Producer Price Index vs Consumer Price Index vs Personal Consumption

The Producer Price Index (PPI) and Consumer Price Index (CPI) are well off their peaks of 2022. The Fed's preferred measure of inflation, Core PCE, is also off its peak, but remains above the FOMC's 2% target.



Source: fred.stlouis.org

For illustrative purposes only. Past performance is not indicative of future results.

Moved Forward One Notch

Monetary Policy

This quarter, we moved the Monetary Policy gauge forward one notch to Slow Reverse to reflect that the Federal Reserve has continued to "step down" the size of rate increases from 50 basis points in December to 25 basis points in February and March. While Fed policy is still a headwind for risk assets, we believe that the Federal Reserve is at or near the end of the current rate hike cycle.

Key Takeaways

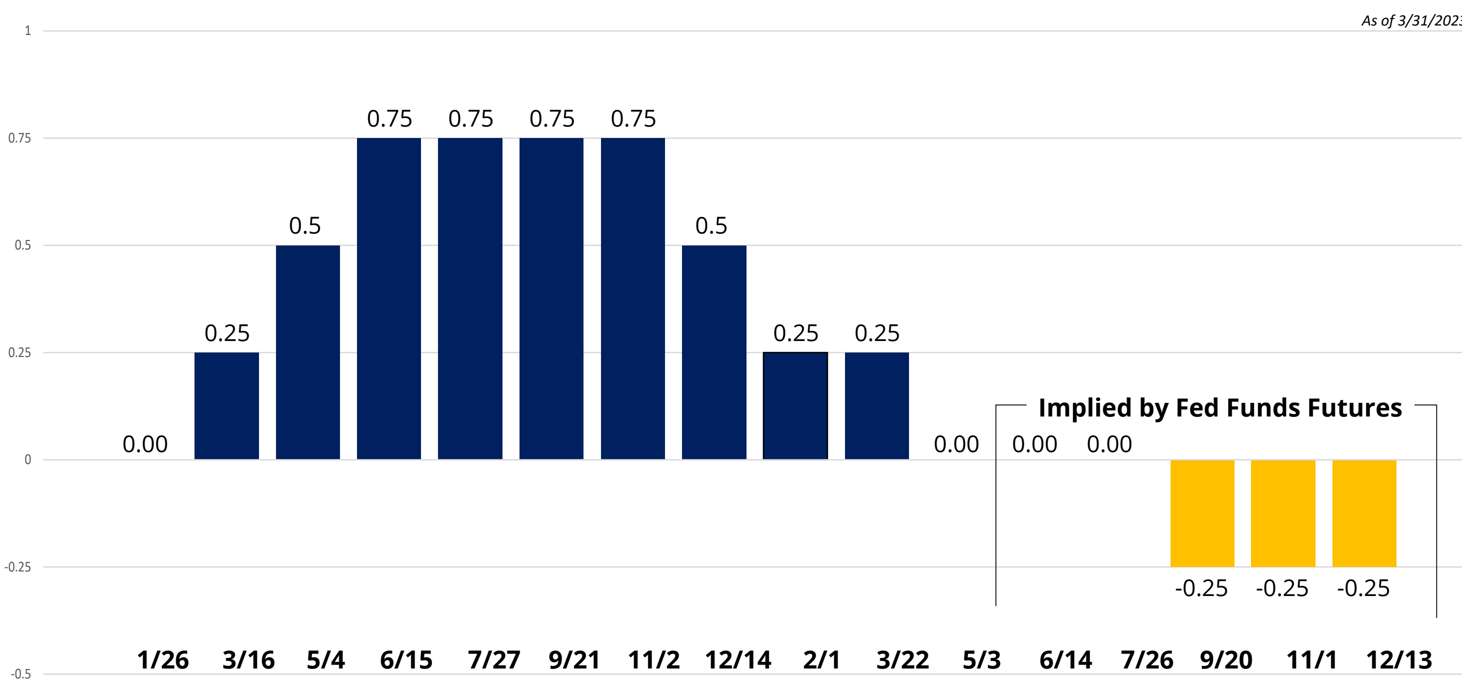
Rate Hikes
After four consecutive 75 basis point rate hikes, the Fed has "stepped down" the size of their rate increases to 50 basis points last December and to 25 basis points in February and March.

Fed Fund Futures
Fed Fund Futures currently imply about a 50/50 chance of a 25 basis point rate hike in May and a few rate cuts later this year.

Balance Sheet
After shrinking for several months, the Fed's balance sheet increased during the quarter as some banks have accessed the Fed's Discount Window and Bank Term Funding Program.

Fed Rate Hikes: Actual and Implied by Fed Funds Futures

Prior to the recent banking situation, the Fed appeared to be headed "even higher for even longer." Current market expectations are that the FOMC is either at or near the end of the rate hike cycle and may even cut interest rates later this year, although Federal Reserve officials have not messaged that.



Source: Clark Capital, fred.stlouisfed.org, CME FedWatch Tool For illustrative purposes only. Past performance is not indicative of future results. Neither past actual, projections, nor other forward looking statements regarding future financial performance of markets are only predictions and actual events or results

Valuations

This quarter, we held the Valuations gauge in Neutral to reflect that P/E multiples have moved higher from the end of Q3 2022. We now view stocks as "fairly valued" at the index level.

No change in position

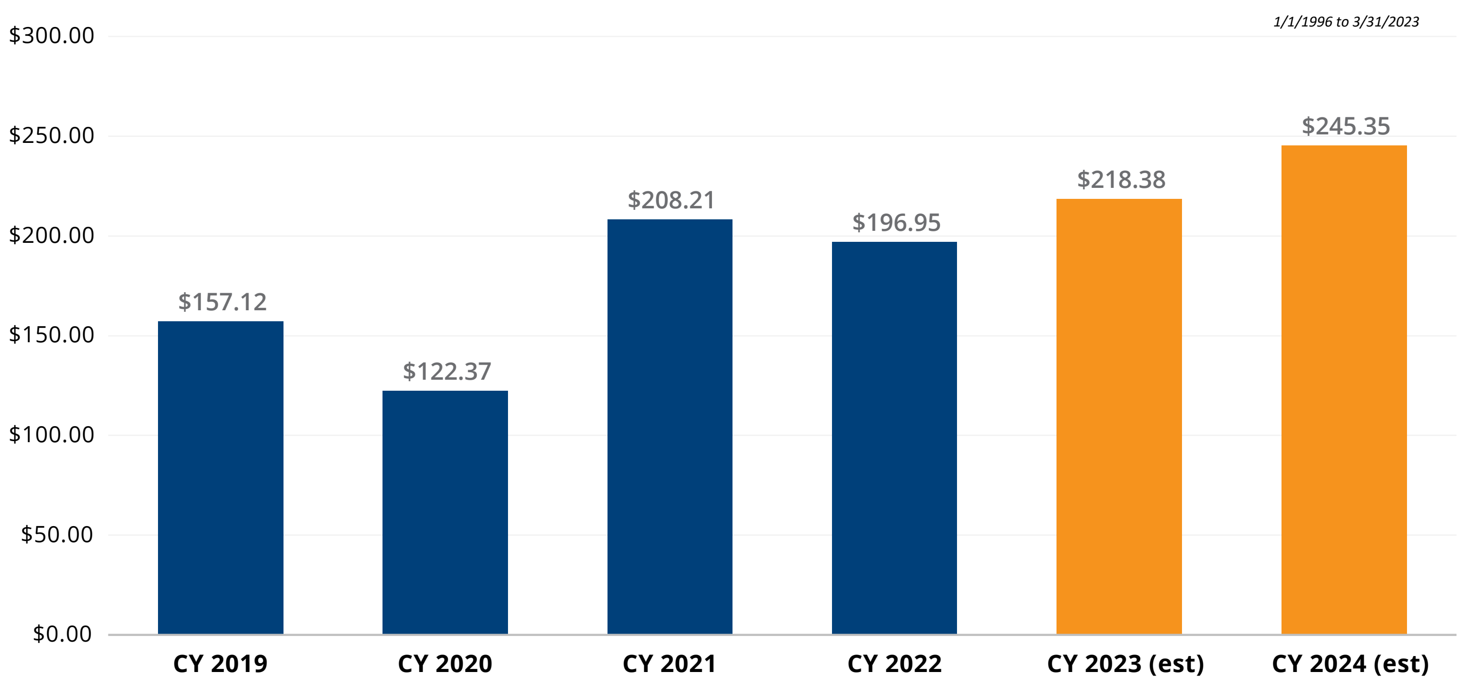
Key Takeaways

P/E Multiples
After reaching slightly undervalued levels at the end of Q3 2022, stocks have staged a rally and have returned closer to "fair value" range.

Earnings
After record operating EPS in 2021, earnings declined slightly in 2022. Wall Street analysts expect a rebound in 2023 and 2024.

S&P 500 Calendar Year Operating EPS Actuals & Estimates

In 2022 S&P 500 operating EPS declined by 5%, albeit from a record level in 2021. For 2023 and 2024, the consensus among Wall Street analysts is for earnings growth of 11%-12% each year, although we acknowledge the possibility of revisions to those estimates.



Source: S&P Global 1/1/1996 to 3/31/2023. For illustrative purposes only. Past performance is not indicative of future results. Neither past actual, projections, nor other forward looking statements regarding future financial performance of markets are only predictions and actual events or results may differ materially

No change in position

Investor Sentiment

This quarter, we held the Investor Sentiment gauge in Slow Forward to reflect that investor sentiment is still slightly negative, although down from peak levels of bearishness recorded in September of 2022. We also observed that stock volatility, as measured by the VIX Index, became more subdued as the quarter ended.

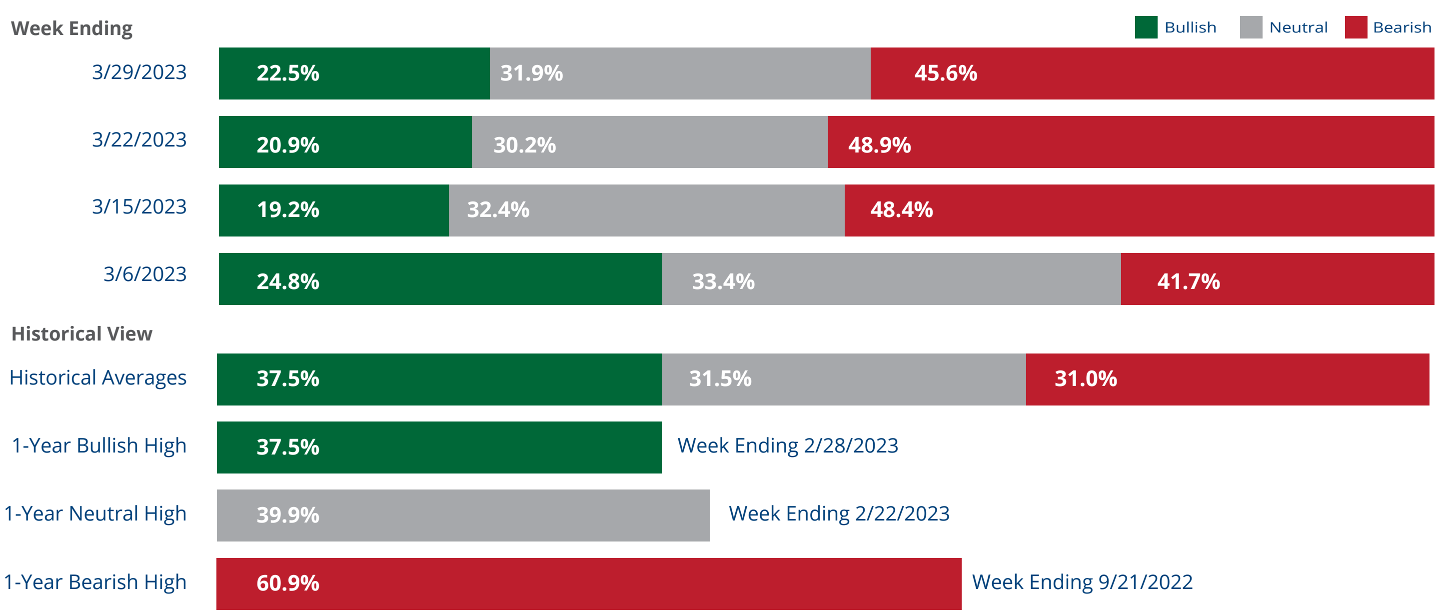
Key Takeaways

AAII Survey
The AAII Survey saw a decrease in bearish investors in January and February only to see an increase in March as concerns over some regional banks emerged.

VIX Index
After briefly reaching 30 in mid-March, the VIX Index retreated to below 20 by the end of the month.

Sentiment Votes

Since its inception in 1987, the AAII Survey has been a useful contrarian indicator. In the past, when the survey reaches extreme levels of bullishness or bearishness, a change in direction for the market often follows.



Source: American Association of Individual Investors

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No Change in Position

Interest Rates

This quarter, we held the Interest Rates gauge one notch in the Slow Reverse position to reflect that both the level of interest rates and shape of the yield curve remain a slight headwind for risk assets.

Key Takeaways

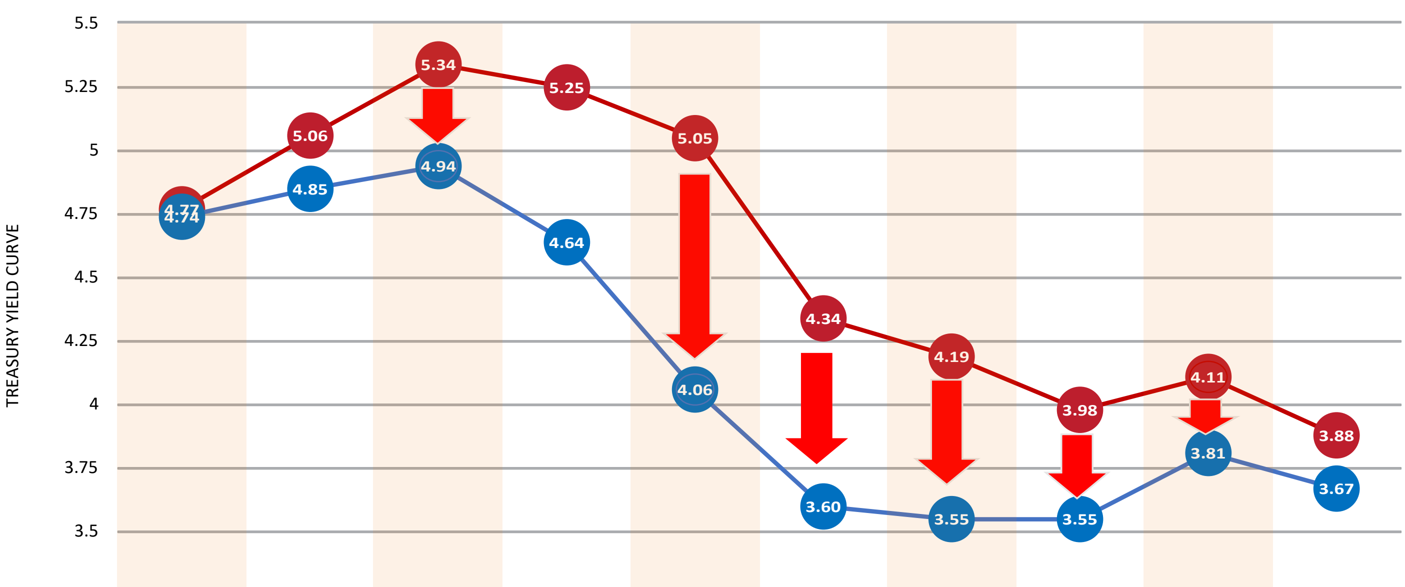
Change in Yields
After moving above 5% in early March, short-term interest rates moved dramatically lower as the market began to price in potential rate cuts in response to issues at some regional banks.

Yield Curve
The spread between 3-month and 10-year Treasuries remains inverted. While this signal has preceded prior recessions, it does not indicate the depth or duration of a potential recession.

Interest Rate Volatility
Interest rate volatility, as measured by the MOVE Index, reached levels not seen since October of 2008.

U.S. Treasuries Yield Curve

The yield curve moved lower across all maturities in the wake of recent issues with a handful of regional banks. Short-term interest rates appeared to have peaked on March 8th, when several parts of the yield curve were above 5%.



	1 Mo	3 Mo	6 Mo	1 Yr	2 Yr	5 Yr	7 Yr	10 Yr	20 Yr	30 Yr
3/8/2023	4.77	5.06	5.34	5.25	5.05	4.34	4.19	3.98	4.11	3.88
3/31/2023	4.74	4.85	4.94	4.64	4.06	3.60	3.55	3.55	3.81	3.67

Source: www.ustreasuryyieldcurve.com

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The core PCE price index measures the prices paid by consumers for goods and services without the volatility caused by movements in food and energy prices to reveal underlying inflation trends.

The Standard and Poor's 500, or simply the S&P 500, is a stock market index tracking the stock performance of 500 large companies listed on stock exchanges in the United States.

The price-to-earnings (P/E) ratio relates a company's share price to its earnings per share.

The GDPNow model forecasts GDP growth by aggregating 13 subcomponents that make up GDP with the chain-weighting methodology used by the U.S. Bureau of Economic Analysis.

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Indexes are available for the U.S. and various geographic areas.

The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output.

The MOVE Index measures U.S. interest rate volatility. The index tracks the movement in U.S. Treasury yield volatility implied by current prices of 1-month OTC options.The S&P U.S. Treasury Bond Current 10-Year Index is a one-security index comprising the most recently issued 10-year U.S. Treasury note or bond.

VIX is the ticker symbol and the popular name for the Chicago Board Options Exchange's CBOE Volatility Index, a popular measure of the stock market's expectation of volatility based on S&P 500 index options.

Gross domestic product (GDP) is a monetary measure of the market value of all the final goods and services produced and sold in a specific time period by countries.

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