January 30, 2023

Beacon Weekly Investment Insights

Last week was a strongly positive one for equity markets, with the S&P 500 ending the week up 2.40%, the Dow up 1.8%, and the Nasdaq gaining 4.3% for the week. Oil prices moved down about 2.2% for the week, with WTI Crude closing at $79.45/barrel. The 10-year yield moved up from 3.48% to 3.51% to close the week.

Economic data released last week included the Leading Economic Index (LEI), which is comprised of 10 indicators that are designed to forecast economic activity. The LEI continued its downward descent in December, and has fallen for 10 consecutive months. The LEI retreated by a larger than expected 1% for the month, and continues to foreshadow a recession. Likewise, the S&P U.S. Manufacturing and Services PMI data was released last Tuesday, and both continue to point to contraction with readings coming in at 46.8 and 46.6, respectively (any reading below 50 signals contraction in the economy). However, these reports were counterbalanced by a slightly better than expected Real GDP figure of 2.9% in the 4th quarter (expectations were for 2.8%). In addition, new home sales came in a bit better than expected at 616,000 for December, vs. expectations of 615,000 and up from the prior reading of 602,000. Lastly, the Core PCE (personal consumption expenditures) index, which is the Fed's preferred measure of inflation, came in as expected with an increase of 0.3% for December, and slowed to 4.4% year over year from 4.7% in the prior reading. Despite the downward trajectory, inflation still remains well above the Fed's 2% target. As a result, we expect the Fed to continue to strike a hawkish tone in the upcoming meeting this Wednesday, with a 0.25% interest rate hike being priced in as a virtual certainty. Markets expect another 0.25% hike to occur in the March meeting, with the Fed Funds rate leveling off in the 4.75%-5.00% range until the end of the year, at which point the market is looking towards a potential rate cut of 0.25%. Ultimately, rates are expected to remain higher for longer, and our base case continues to be that the U.S. economy will experience a mild recession this year.

Aside from the economic data, headlines about the debt ceiling have been front and center for markets. Every year or two, the U.S. bumps up against the debt-ceiling, which is essentially the amount of money that the federal government can borrow to pay its bills. The U.S. government is borrowing up to the current debt ceiling of $31.4 trillion, which will have to be raised or the government runs the risk of not having enough funds to pay its bills and of defaulting on its U.S. Treasury obligations. The consequences of a default would be dire, in that in addition to the U.S. government not having enough funds to pay its bills, trillions of dollars of U.S. treasuries that are currently considered high investment grade would subsequently be considered junk bonds. This would drastically raise the cost/interest expense that the U.S. government has to pay on debt issuances, and likely lead to an increase in taxes over the long-run. In addition, a default would meaningfully rattle financial markets, potentially leading to a significant downturn in financial assets. Given the severity of the implications if the debt ceiling is not raised, the headline risk of the typical back and forth that takes place in Congress up until the deadline to raise the debt ceiling, has the potential to drive volatility in the markets in the short-term. The U.S. Treasury has the ability to delay the need for action for several months, however Congress will ultimately need to agree on a deal to raise the debt ceiling.

Complicating matters is the fact that the majority of the House and Senate have to approve the expansion in the debt ceiling, and the current House speaker, Kevin McCarthy, was not able to get elected until 15 rounds of voting were conducted. Many members of Congress that opposed McCarthy's nomination have said that they want more meaningful fiscal austerity, and have said they will not vote to raise the debt ceiling without meaningful concessions. The good news is that Congress does not want to be responsible for a U.S. default and the lack of the government's ability to pay entitlement benefits such as Social Security and Medicaid. Our view is that as usual, we will experience a lot of political theatre taking the debt ceiling debate down to the wire, which could drive short-term volatility in

markets. However, we expect that Congress will, also as usual, eventually strike a deal to raise the debt ceiling and avoid default. We will continue to provide updates on this as the situation evolves.

Earnings season is in full swing, with just shy of 30% of stocks in the S&P 500 having reported results for Q4 2022 as of the end of last week. Thus far, 69% of companies in the S&P 500 have beaten earnings expectations and 60% have beaten revenue expectations, both below longer-term averages. Recent layoffs, notably from big banks such as Goldman Sachs and Morgan Stanley, as well as tech companies including Meta (formerly Facebook) Amazon, Microsoft and Alphabet (Google), continue to make headlines. Big Tech, for example, has laid off more than 60,000 employees so far this year, as a past hiring boom meets with expectations for slower growth. Heading into the Q4 earnings season, earnings were expected to contract by -3.2%. As of the end of last week, the blended earnings decline for S&P 500 companies that have reported has come in lower than expected, at -5.0%. Also of note, is the fact that Bed Bath and Beyond has defaulted on their credit line and is likely headed for bankruptcy. With the expectation for slowing growth in the broader economy/a potential recession, earnings declines, and higher rates/costs of capital for an extended period of time, companies on weak financial footing have an elevated risk of default. With that said, we continue to focus on investing in quality businesses with above average profitability profiles, strong free cash flow generation, and strong balance sheets, for the long term.

There is a significant amount of economic data on tap to be released this week. S&P Case-Shiller Home Price Index and Consumer Confidence data is due out on Tuesday. On Wednesday, all eyes will be on the Fed with the Fed Funds rate announcement and Chair Powell speaking at 2:30 p.m. Wednesday will also see the release of the ADP Employment report, JOLTS (job openings and labor turnover survey), and the ISM Manufacturing Index data. Factory Orders data will be released alongside the weekly unemployment claims data on Thursday, and nonfarm payrolls data and the ISM Services Index readout will be released on Friday.

Market Scorecard:	**1/27/2023**	**YTD Price Change**
Dow Jones Industrial Average	33,978.08	2.51%
S&P 500 Index	4,070.56	6.02%
NASDAQ Composite	11,621.71	11.04%
Russell 1000 Growth Index	2,336.90	8.28%
Russell 1000 Value Index	1,566.64	4.64%
Russell 2000 Small Cap Index	1,911.46	8.53%
MSCI EAFE Index	2,109.29	8.51%
US 10 Year Treasury Yield	3.51%	-37 basis points
WTI Crude Oil	$79.38	(1.10)%
Gold $/Oz.	$1,927.60	5.55%

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