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MACRO MUSINGS

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Q1 2023 Quarter in Review: Markets Rebound, But Recession Risks Remain

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SUMMARY

- **macro**cast™ indicates the risk of a recessionary bear market remains high. Our current **micro**cast™ signal is suggesting a neutral allocation. The lower **macro**cast™ score and neutral **micro**cast™ allocation suggest volatility has not yet subsided, and the environment for stocks remains challenging.
- The **macro**cast™ score has been negative since last Spring. Economic data continues to be weak, with several key metrics signaling recession risks remain high.
- Major asset classes enjoyed a strong start to the year, a reversal of the way 2022 began. Equities around the globe and across market caps saw mostly positive returns. Bonds also performed well, with the Bloomberg Aggregate Bond index posting its best return since Spring 2020.
- Historically, strong starts for the S&P 500 led to positive returns the rest of the year in almost all cases. However, the periods that saw negative returns were all crisis environments—a scenario that could play out later this year if the economy enters a recession or the debt ceiling is not resolved in a timely manner.

THE MESSAGE FROM **macro**cast™

As a reminder, **macro**cast™ is Corbett Road's proprietary investment model. **macro**cast™ measures the appeal of risk assets by looking at the **VITALS** of the market—**V**aluation, **I**nflation, **T**echnical Analysis, **A**ggregate Economy, **L**iquidity, and **S**entiment. By looking at multiple factors, we seek to better gauge market conditions and the probability of a major, sustained market decline.

macrocast™ has been consistently negative since last Spring, reflecting the elevated risk in the current market environment and suggesting caution towards risk assets.

Among the **VITALS**, the **Aggregate Economy** category is the largest negative contributor to the **macro**cast™ score, but it is not the only category with negative signals. Every category in the model has indicators flashing warning signs.

For example, in the aftermath of a market downturn, our **Valuation** indicators normally improve to a level where they become a positive contributor to the **macro**cast™ score.

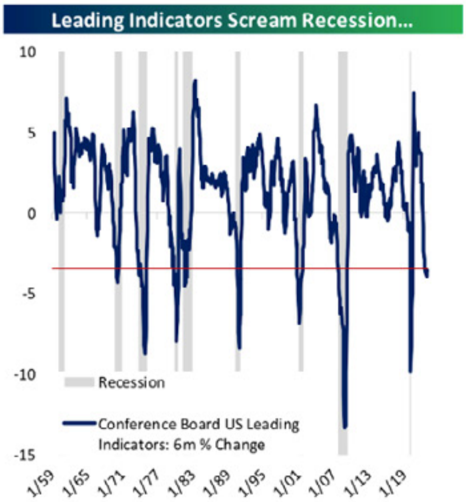
This is because valuations typically become more attractive as asset prices decline while the earnings outlook stabilizes or begins to improve, which often leads to better-than-average returns going forward. However, the current market resurgence has not been accompanied by a corresponding increase in earnings expectations. This has led to a rise in the price-to-earnings ratio (P/E), causing the S&P 500 to trade at historically elevated valuation levels.

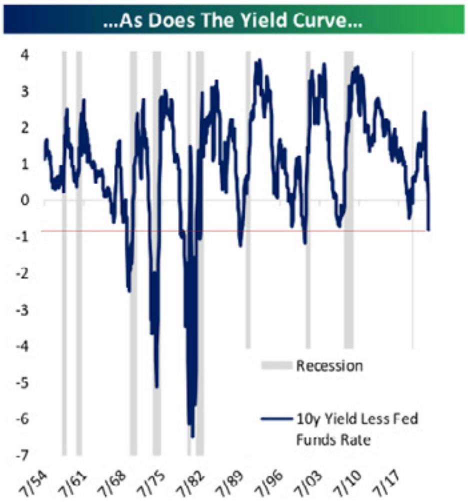
Additionally, while Inflation has clearly peaked, it is still much higher than the Fed's target. Previous bear market bottoms have occurred when inflationary pressures ease to a level where our inflation indicators flip from negative to positive contributors to **macro**cast™, which has yet to occur.

THREE KEY INDICATORS ARE **SENDING RECESSION WARNINGS**

The Conference Board Leading Economic Index® (LEI) is supporting the message from **macro**cast™ about a possible recession. The LEI is currently hovering at a level that has historically been linked with an economic downturn. Another signal with a strong track record of predicting recessions is the **Yield Curve**, which continues to be negatively inverted. Further, **Building Permits**, which have been a reliable indicator of future housing market activity, are declining.

The data is nicely summarized in the chart below (from Bespoke) that shows where each indicator currently stands and how it compares to levels that have historically been associated with past recessions.





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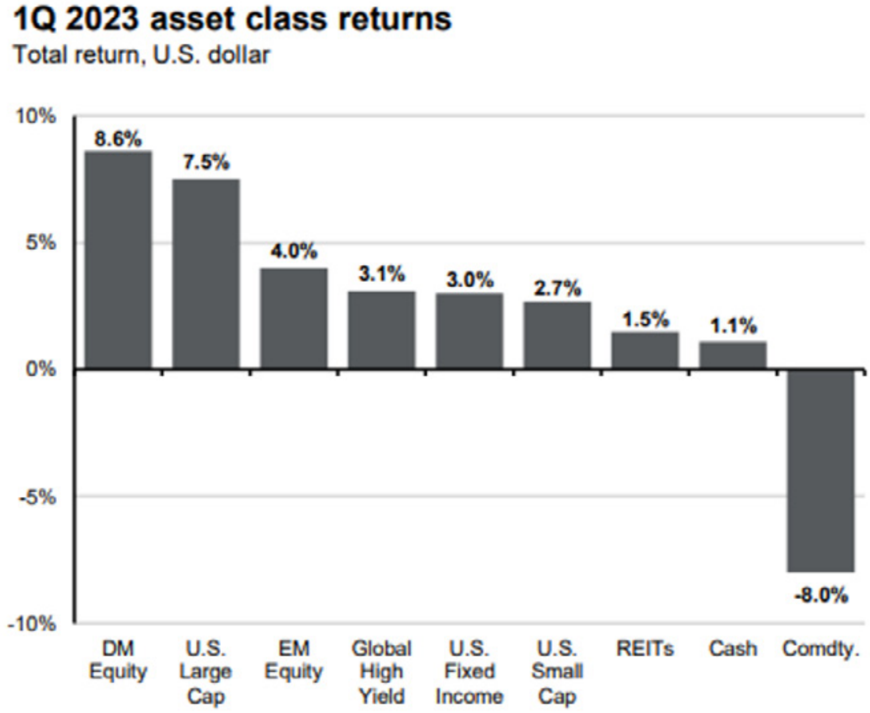
ASSET CLASS REVIEW: **A BROAD-BASED REBOUND**

The following chart highlights major asset class returns for the first quarter (from JP Morgan):



Some additional insights:

Stocks saw big gains in January before giving up some of their returns in February and March. The S&P 500 Index of large cap stocks ended the first quarter up +7.5%, outperforming the Russell 2000 Index's +2.7% return. Most of the S&P 500's relative outperformance occurred in March as investors de-risked their portfolios following the bank failures.

The S&P 500 was boosted by its Big Tech components. While the index returned a solid 7.5%, most of those gains were concentrated in well known "Big Tech" companies. Only 3 of the 11 sectors of the S&P 500 outperformed the index. In contrast, the Equal Weighted S&P 500 was up only around 2.9%. Both these factors illustrate how narrow market leadership is at the moment.

Growth outperformed Value, especially as the banking crisis unfolded. The Russell 1000 Growth Index gained +14.3%, outperforming the Russell 1000 Value's +0.9% return. Like the S&P 500, the Growth factor's relative outperformance occurred in March after the bank failures. Growth stocks tend to be higher quality businesses with stronger fundamentals, and recent bank failures may have motivated investors to rotate into higher quality companies. Regardless of the cause, Growth's outperformance is a significant change from 2022 when the Federal Reserve's interest rate increases weighed on expensive stock valuations.

International stocks saw continued strength from last year. The MSCI EAFE Index of developed market stocks gained +9.0%. Europe was the top performing international region and boosted developed markets' performance. The region managed to avoid a major energy crisis during the winter months thanks to unseasonably warm weather and

Please see important disclosures at the end of this article efforts to secure alternative natural gas sources after Russia cut off most of its supply. In Asia, all eyes remain on China as the country reopens after relaxing its zero-Covid restrictions. The reopening is expected to boost China's economy, and potentially the global economy, but it is unclear how strong or lasting the growth will be. As a result, the MSCI Emerging Market index (with 33% China exposure) finished positive but lagged the developed market. The MSCI Emerging Market Index returned 4.1% in Q1.

Bonds had their best quarter since the second quarter of 2020. As the Fed began its historic cycle of rate hikes last year, bonds have struggled mightily. With a Q1 return of +3%, the Bloomberg Aggregate Bond Index posted its best quarter since Spring 2020. Over the past two years, returns for the index were negative in 6 out of 8 quarters. A positive return from bonds in Q1 is a welcome change and a relief to investors in fixed income.

STOCKS ARE USUALLY STRONG AFTER A GOOD FIRST QUARTER, **UNLESS THERE IS A CRISIS LATER IN THE YEAR.**

As mentioned above, the S&P 500 was up over 7% in Q1. The following table highlights every historical instance when the market was up 5% or more to start the year (from Nautilus Research):

Event Dates	Return	3Mo	6Mo	Rest Of Year
03/30/1951	5.14%	-1.77%	8.33%	10.66%
03/31/1954	8.59%	8.43%	20.64%	33.56%
03/29/1956	6.60%	-2.78%	-5.94%	-3.73%
03/31/1958	5.28%	7.46%	18.46%	31.14%
03/30/1961	11.96%	-0.65%	2.57%	9.98%
03/29/1963	5.50%	4.21%	8.35%	12.69%
03/31/1964	5.28%	3.37%	6.71%	7.31%
03/31/1967	12.29%	0.72%	7.31%	6.95%
03/31/1971	8.86%	-0.61%	-2.40%	1.77%
03/30/1972	5.01%	-0.35%	2.94%	10.12%
03/31/1975	21.59%	13.74%	3.39%	8.19%
03/31/1976	13.95%	1.47%	2.53%	4.56%
03/30/1979	5.70%	1.30%	7.61%	6.25%
03/31/1983	8.76%	9.90%	9.33%	7.83%
03/29/1985	8.02%	6.19%	0.35%	16.95%
03/31/1986	13.07%	4.48%	-2.79%	1.37%
03/31/1987	20.45%	4.22%	10.28%	-15.30%
03/31/1989	6.18%	8.41%	18.22%	19.85%
03/28/1991	13.63%	-0.22%	3.00%	11.16%
03/31/1995	9.02%	8.80%	16.72%	23.01%
03/31/1998	13.53%	2.91%	-4.79%	11.57%
03/31/2011	5.42%	-0.39%	-12.48%	-5.15%
03/30/2012	12.00%	-3.29%	2.29%	1.26%
03/28/2013	10.03%	2.80%	8.25%	17.79%
03/31/2017	5.53%	2.57%	6.63%	13.16%
03/29/2019	13.07%	3.79%	4.49%	13.98%
03/31/2021	5.77%	8.17%	9.73%	19.97%
03/31/2023	7.03%			
Avg after Signals		3.44%	5.55%	10.26%
Average All Periods		2.13%	4.32%	6.61%
T-Statistic		1.58	0.83	1.80
# Events Up/Down		19 / 8	22 / 5	24 / 3
Significance		94%	79%	96%

NAUTILUS INVESTMENT RESEARCH

Data Source: FactSet 4/3/2023 6:34

Historically, stocks have done well after a strong Q1, rising in the final 9 months of the year in 24 out of 27 instances. However, notably, the years in which the market declined the rest of the year (1957, 1987, 2011) were all cases where either the Fed raised rates leading to recession (1956) or a major crisis occurred (Black Monday in 1987, Debt Ceiling Crisis/ Greek Debt Crisis in 2011).

The historical study suggests that absent a significant stressor later this year, momentum from Q1 could carry over into the rest of the year. However, **we believe that there are conditions in place for such a stressor**, in the form of either a recession or debt ceiling crisis.

To summarize, the negative **macro**cast™ score continues to reflect the elevated risk of a sustained, recessionary bear market with indicators in each of the VITALS categories flashing warnings signals. Among other possibilities, a rebound in leading economic indicators, cheaper valuations, and further declines in inflation data could all help to improve the **macro**cast™ score, but most of these indicators continue to be negative. However, despite recessionary concerns, the S&P 500 rose over 7% in the first quarter. While such an occurrence has historically led to positive outcomes for the remainder of the year, it's important to note the few exceptions that saw negative returns, all of which occurred during crisis scenarios.

Considering the negative **macro**cast™ score, key indicators signaling an upcoming recession, and potential debt ceiling challenges later in the year, we believe this remains a challenging environment for risk assets.

APRIL SHOWERS…

Don't waste those rainy days. Take the opportunity to review your financial budget. You may find a few easy items you could trim and save money or apply to an upcoming summer vacation!

Contact your Wealth Manager today to discuss budgeting and planning questions or thoughts you may have.

IMPORTANT DISCLOSURES

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Use of Indicators
Corbett Road's quantitative models utilize a variety of factors to analyze trends in economic conditions and the stock market to determine asset and sector allocations that help us gauge market movements in the short- and intermediate term. There is no guarantee that these models or any of the factors used by these models will result in favorable performance returns.

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