The Longo Group

Week Ahead

Please contact:

The Longo Group
Ted Longo, Steve Longo, Chris Collins - Advisors
985-445-1042 | Toll Free: 833-475-6646
info@longogroup.net
www.longogroup.net

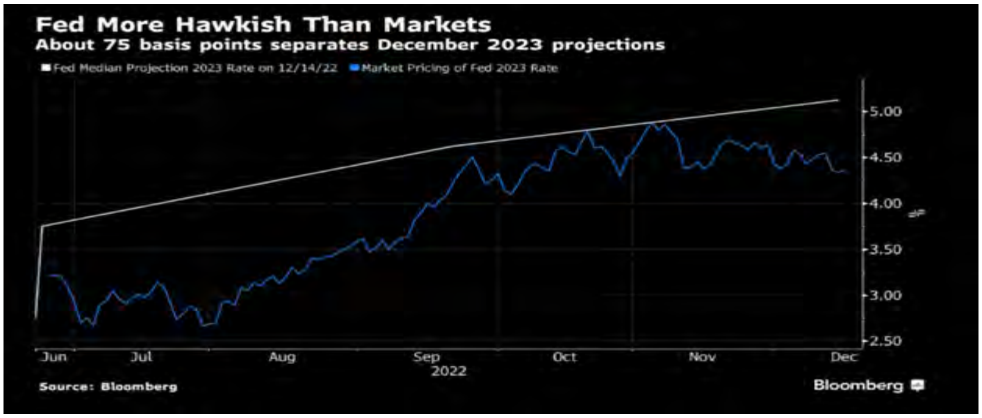
Source: Bloomberg 12/2022

Week of December 19, 2022

Fed Still Playing Scrooge

Last week, the CPI (Consumer Price Index) data came in softer, i.e., better, than expected and markets cheered by rallying. The next day, the Fed raised the Fed Fund interest rate 50 basis points – as expected – but Chair Jerome Powell's comments remained hawkish.

In his speech, he highlighted the Dot Plot several times to encourage the market to look at what the Fed Governors are forecasting for the terminal rate. So what is the Dot Plot? It's a chart that records anonymously each Fed official's projection for the central bank's key short-term interest rate. Currently, the Dot Plot shows the average Fed forecast for the terminal rate of 5.217%. But what does the market think the rate should be? The market is actually saying that the terminal rate will be below 5%. So there is a 75-basis points difference between the Fed forecast and the market forecast.
The message to take from this is that, as long as the Fed is raising interest rates, expect volatility in both the bond and stock markets.



Source: Bloomberg 12/2022

Remember: the Fed remains hawkish because Powell needs to anchor inflation expectations. He can't afford to risk pausing or cutting rates too soon... only to then reaccelerate with new rate hikes – the lesson learned from past regimes' mistakes. This is why the Fed won't take its foot off the brake as it tries to slow the economy.

Summary Table of the Dot Plot Fed Forecasts

Pace of Policy Firming	2022	2023	2024	2025	Longer Run
Median	4.375%	5.125%	4.125%	3.125%	2.500%
Prior median expectation	4.375%	4.625%	3.875%	2.875%	2.500%
Average	4.375%	5.217%	4.296%	3.322%	2.507%
High	4.375%	5.625%	5.625%	5.625%	3.250%
Low	4.375%	4.875%	3.125%	2.375%	2.250%
Mode (most frequent)	4.375%	5.125%	4.125%	3.125%	2.500%
Range (basis points)	0	75	250	325	100

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Stocks at Risk of Testing October Lows

Despite the strong seasonal bias for equities to rally into year-end, we think they stay volatile and are at risk of testing the October low, near 3500. In our "Year Ahead Outlook 2023," we said the Bull is already running and it is. But the Bull is not showing up in the market averages like the S&P 500 and Nasdaq because Growth stocks are in a Bear market, particularly technology names and the FAANG gang. There is a heavy market capitalization burden weighing on the indexes.

We see the Bull in Energy, Industrials, Materials and Healthcare. There are several stocks in these sectors at or near record all-time highs. We think there will a be a tug of war between the Bull and the Bear for several more months. We can have market averages going down and still have the Bull running. Once the correction is completed in Growth stocks, though, we believe the market should be able to bottom, go through a healing process and begin the new Bull market in the averages as well.

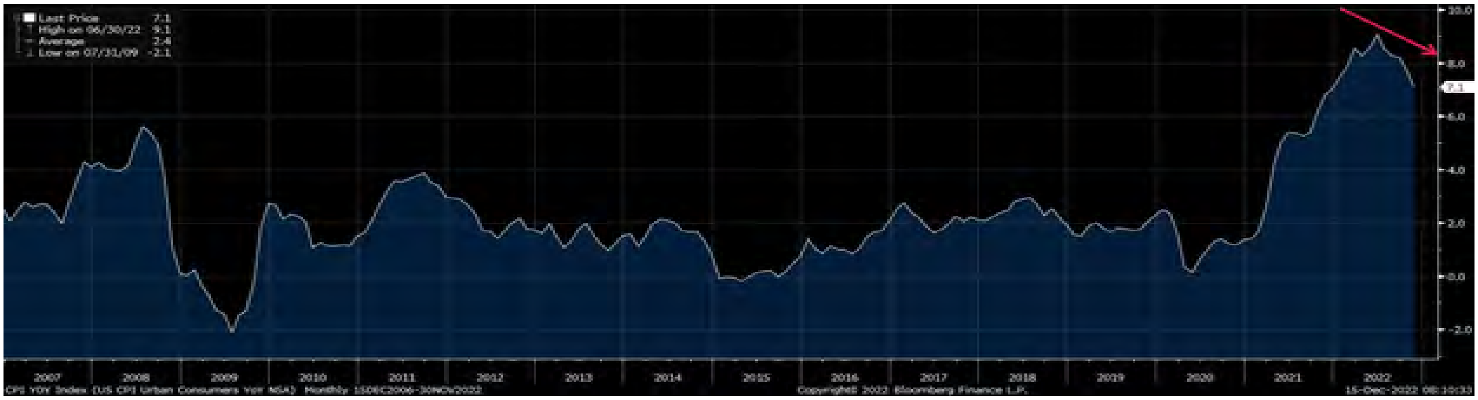
At a recent client event, I was asked if it was safe to buy stocks that have hit all-time highs. At this point, we believe that answer is yes as long as they are part of the Bull. These equities are early in their move and there are those that will continue to repeatedly hit all-time highs as the Bull fords ahead.

Has Inflation Peaked?

Last week we got another CPI data point with inflation falling to 7.1% year-on-year and, ex Food and Energy, it has fallen to 6.0%. This weakening in the CPI numbers, while other areas of the market – such as Housing and Manufacturing – has allowed the bond market to become more dovish than the Fed. Last Friday, November retail sales were released, and they were much worse than expected – down 0.6% versus an expected negative of only 0.2%.

More and more data is showing that parts of the economy are clearly slowing down. In the months ahead ,we would continue to expect inflation data to come down. In our "Year Ahead Outlook 2023," we compare today's inflation to the 1950s – an era when inflation spiked to 10% before falling sharply. Back then, 10-Year Treasury yields hovered around 2.5%. Today we believe that rates will again reach this level in 2023 with 10-Year Treasuries falling to 2.5%.

CPI Year-on-Year



Source: Bloomberg 12/15/2022

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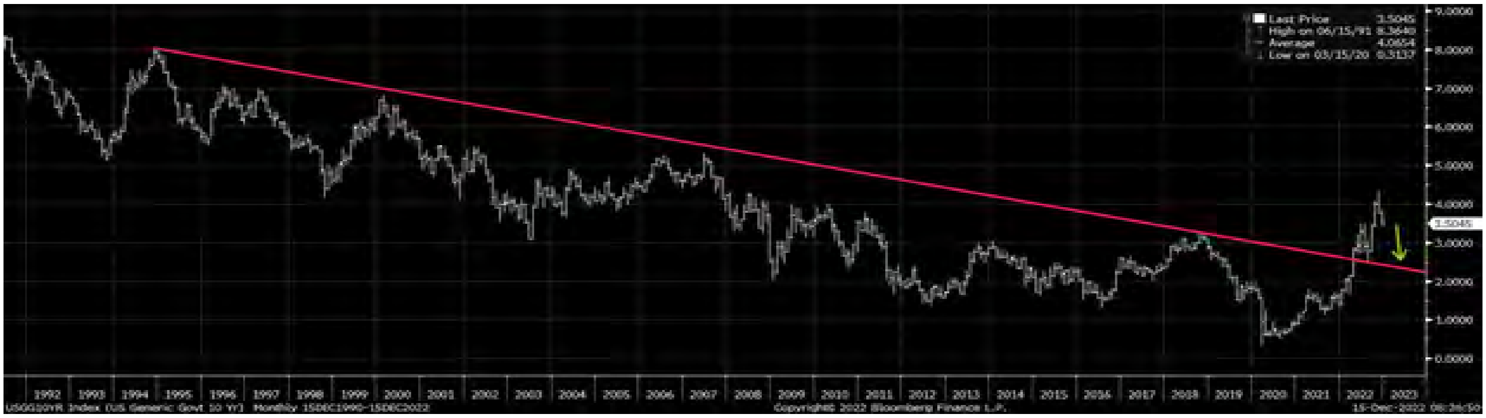
Mr. Bond. You're Alive!

The call for the death of bonds came as the Fed moved to a zero-bound monetary policy and the demise of the 60/40 asset allocation model was tolled. TINA (There Is No Alternative) became the strategy de rigueur and owning equities, only equities, became the norm. There was no way the Fed could get out of their zero-bound policy without pain to the bond market. And pain we have had (!), with bonds moving into a Bear market in 2022. We originally thought 10-year Treasury yields could reach 5% as the Fed moved to raise rates to fight inflation. But – with inflation peaking… with weakness in both Housing and Manufacturing… with the PMI index falling below 50 to 49 (a recession signal!) – it appears that both short and long rates are peaking. And that's despite the Fed clearly indicating it will "keep it at" and continue to tighten by raising rates.

10-Year Treasury Yield



Source: Bloomberg 12/15/2022

More Data, No Problem

This week we'll see several key economic reports, including the PCE (Personal Consumption Expenditures) Price Index, housing starts and home sales, consumer spending and consumer confidence, and jobless claims. All important reports – but none that will move the needle on our above discussion points about what lies ahead.

Calendar

Mon.

10:00 a.m. NAHB home builders' index Federal Budget
Earnings: Heico, Steelcase

Tue.

8:30 a.m. Housing permits & starts
Earnings: Nike, BlackBerry, Calavo Growers, FactSet, FuelCell Energy, General Mills, Neogen, Worthington Industries

Wed.

10:00 a.m. Consumer confidence index, Existing home sales
Earnings: Micron Technology, Cintas, MillerKnoll, Rite Aid, Toro

Thu.

8:30 a.m. Initial & Continuing jobless claims, Real GDP revisions
Earnings: Carmax, Agopee Enterprises, Paychex

Fri.

8:30 a.m. PCE, Real consumer & disposable spending, Durable goods orders
10:00 a.m. New home sales

Source: MarketWatch/Kiplinger's