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

Source: Bloomberg 12/2022

Week of **January 3, 2023**

Welcome 2023!

Last year is now in the history books and will be remembered (not fondly) for its Bear market in both stocks and bonds and the Fed's warpath approach to fighting inflation by taking the Fed Funds rate from the zero-bound to 4.50%. Markets responded – as they should – by going down, down, down.

This year, we'll see more interest rate hikes with the market expecting two hikes of 25 basis points to get the terminal rate to 5.00%. (We'll see the first hike in February.) Our view remains unchanged: as long as the Fed is raising rates, markets will remain unpredictable, marked by episodic volatility at times.

The good news? We're now getting closer to the end of the rate hikes – as long as the data is supportive of inflation ebbing.

Economy and Employment Still Strong Like Bull

The Atlanta Fed has a model called GDPNow, which is estimating that 4Q22 GDP is running at 3.70% (based on data available from 12/23/22). This is a very strong number that is certainly not signaling a recession.

Meanwhile, Mastercard's SpendingPulse, which tracks sales across all payment types, reports that holiday retail sales increased 7.6% from November 1st to Christmas Eve. Shoppers were spending more in many categories: compared to last year, restaurant spending was up 15.1%, clothing sales up 4.4%, in-store shopping up 6.8%, and online sales up 10.6%. Who didn't enjoy a bump? Department stores saw only a modest increase of 1% over 2021, and not outperforming last year's sales were electronics, down 5.3%, and jewelry, down 5.4%.

As for employment, the unemployment rate sits at 3.70% and we believe the Fed is likely targeting a move toward 5%. The leading indicator we're watching is the weekly initial jobless claims; the data is rising but needs to go higher in order to placate the Fed – who wants demand for services to slow (which should help inflation). Demand for goods has already slowed significantly.

Hike, Hold, Cut – The Right Process to Keep Bonds Alive

Once the Fed reaches its target rate at 5.00%, the market is expecting that rate to hold into the spring. Rate cuts are not expected to come until later in the year. The one mistake the Fed does not want to make is cutting the rate too soon, only to see inflation coming roaring back. But both the bond and stock markets will anticipate Fed movements, and each will move before we have solid evidence of what the Fed path will be. In fact, we believe the bond market is already signaling that the Fed is closer to peak rates than what the market is expecting.

We anticipate rates to peak in the first to second quarters of 2023. This will bring the opportunity to buy bonds and move out on the duration curve. Because CPI appears to have peaked, and if the Fed succeeds in bringing inflation down, the 10-year Treasury yield could fall to 2.5% -- which would make bonds maybe one of the best investments for 2023.

October Low for Stocks to be Tested

As the economy and employment slow and rates continue to rise, the stock market will remain volatile. We believe the market is now in the process of testing the October lows near 3500 for the S&P 500. When we take the average earning forecast for the S&P 500 of $213 and give it at an historically based price-earnings multiple of 16.5x, we get 3515. But if the market trades down to a very reasonable price-earnings multiple of only 15x, then the risk would be near 3200. So, as you can see, stocks will remain volatile until they have a strong sense of earnings and the nearing of rate peaks.

Week Ahead

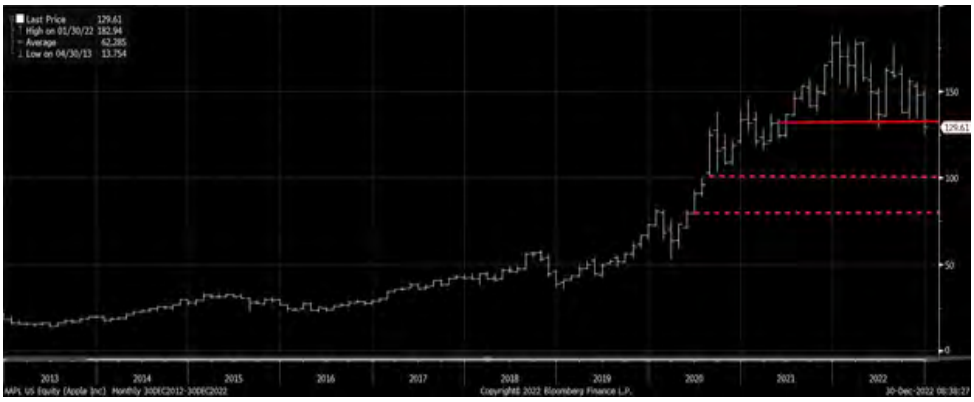
Please contact:

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

Week of **January 3, 2023**

The biggest risk in 2023 will be Growth stocks, particularly in Technology and the FAANG names. Of that group, the one stock that has held up the best in 2022 and is the true bellwether name in this market is Apple (AAPL). Apple's stock has had a significant technical breakdown, pointing to a potential fall to $100 or possibly $80. Apple is 6.00% in the S&P 500 SPDR ETF and 11.70% in the Invesco QQQ ETF. As it is the largest stock in the market, a significant drop in its price will put pressure on many market averages.

When a bellwether stock begins to lose, it's a signal that we're at the end of the Bear. The bellwether is the last to fall.



Source: Bloomberg 12/30/2022

The Bull is Running – Where to Find It

I learned from my Aunt Bernadette, who went to Wall Street in 1956, that the Bull starts running near the end of the Bear market. There is always a leadership shift going from the Bear market to the new Bull market. The same stocks don't lead in the next cycle. So, the 2023 Bear will tear down Growth and FAANG, and we'll see the Bull lift up Value. To be specific: the Value that is showing the best strength is Energy, Industrials, Materials, and Healthcare.

Positioning

As long as the Fed is raising interest rates, stay with Quality. In equities, we would reduce exposure to Growth and shift to areas in Value. We expect Dividends to remain in demand as Baby Boomers move toward and into retirement. This would include holding cash as short-term US Treasuries are yielding as high as 4.70%. Utilities remain attractive for yield as the demand for electricity is projected to rise well into 2030-2050. We would look to continue to diversify into bonds and our duration recommendation is in the 3–5-year range, but as the Fed gets closer to its peak terminal rate of 5%, we would consider moving to longer duration assets.

This Week

This is the week we pay attention to employment data.

Important data for manufacturing and employment will be released this week. But we already know that manufacturing is in a recession. This week's key numbers will tell the employment story – with the monthly unemployment rate out on Friday. That's what everyone, especially the Fed, will be paying attention to.

So, it's the first week of the new year. What should you do? Remain patient! It will be a little rocky for a few quarters, but if you get your positioning right, you'll have a good, rewarding 2023. There will be rain this year, even storms, but afterwards: rainbows. And at the end of the rainbow? Well, we believe there will be a pot of gold.

As always, I look forward to talking with you and your clients about the possibilities that lie ahead.

Calendar

Mon.

New Year Holiday

Tue.

9:45 a.m. S&P US Manufacturing P<I
Earnings: SMART Global

Wed.

10:00 a.m. ISM manufacturing, Job openings, Quits
2:00 p.m. FOMC minutes
Earnings: UniFirst, Resources Connection, Simulations Plus

Thu.

8:15 a.m. ADP employment
8:30 a.m. Initial & Continuing jobless claims, Trade deficit
Earnings: AngioDynamics, Bed Bath & Beyond, Conagra, Constellation Brands, Helen of Troy, Lindsay, Neogen, Schnitzer Steel, Walgreens Boots Alliance

Fri.

8:30 a.m. Nonfarm payrolls, Unemployment
10:00 a.m. Greenbrier

Source: MarketWatch/Kiplinger's