Monthly Newsletter February 2023

ARCH GLOBAL ADVISORS

Monthly Market Recap

Equity markets rebounded strongly to start 2023, with all major indexes gaining during January on the back of continued falling CPI and PCE, declining recession expectations (perhaps a coin flip now), economic resilience and a hopeful end to the interest rate hike cycle, likely in March.

The NASDAQ was the best performing index during the month, posting a gain of 10.7%. Also, the S&P 500 and Dow Jones saw positive performance in January, up 6.2% and 2.8% respectively. Since 1971, the NASDAQ has only had 33 months of 10% gains or more, with January representing the highest monthly gain since July 2022. Small caps, which have generally outperformed post-recession (average return of 39.2% 12 months out), were also up 9.7% for the month. We believe the reason for market enthusiasm/optimism can be attributed to investors already looking beyond softening earnings in Q1 and Q2, as well as a more dovish Fed on the horizon (Powell at times has sent the markets in a tailspin with his unwavering hawkishness).

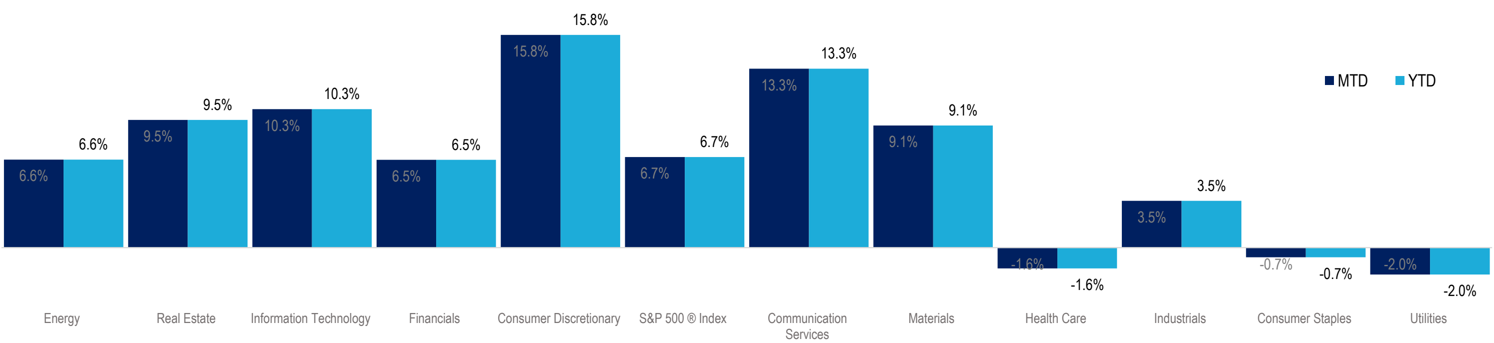
There is historical precedence for what occurred in January, with the markets routinely acting as a forward discounting mechanism, often foretelling what will occur 6-7 months out. While forecasting is not an investing strategy, we seek to get in front of trends that we believe have the highest probability of occurring. History doesn't repeat itself, but it often rhymes (another Mark Twain quote!) For example, stocks continued to rally in the mid 70's and early 80's recessions after inflation peaked, even though the economy and earnings continued to weaken. While on the surface this might seem confounding, since 1927 the S&P posts an average annualized gain of 12.7% when earnings are between -20% and 5%. When earnings are above 20%, annualized returns are only 1.9%. Corporate earnings, by their very nature, are backward looking. As of Friday, 29% of S&P companies have reported earnings for the quarter, with 69% beating expectations. Current estimates for 2023 EPS growth are at 5.05%, which may get cut further.

We continue to be impressed (surprised?) with the soundness of the labor market, as the demand for workers continues to remain robust, despite a slew of announced layoffs recently. There are structural explanations for what we are seeing that account for historically low unemployment. As such, job openings increased recently to 11.01 million, according to the Bureau of Labor Statistics. January Nonfarm Payrolls will be announced on Friday, with an expectation of 190,000 jobs added for the month. It's worth pointing out that none of the indicators that the National Bureau of Economic Research (NBER) normally looks at for declaring a recession, including employment, suggest we are in a recession at the moment, increasing the likelihood that a soft landing will ultimately occur (this remains our base case assuming no black swan event or uptick in inflation happens).

Headline CPI clocked in at 6.5% YoY and -0.1% MoM in January, and core CPI was at 5.7%, YoY and 0.3% MoM. Goods inflation continues to fall rapidly, with stickier services inflation still at levels considerably above target. Also, wage inflation continues to fall. China reopening will continue to help with supply chain bottlenecks, but pent-up demand may affect commodity prices. On the whole, the China story will be one worth keeping an eye on, as stimulus in support of their real estate crises may have unintended inflation consequences down the line.

The FOMC met yesterday and raised interest rates another 25bps (0.25%), as was widely expected (markets rallied on this announcement). Since June, the Fed has reduced its balance sheet by $445 billion, which is equivalent to another 200bps in hikes according to the San Francisco Fed. A Fed pause is good for equity and credit markets. Historically, the S&P 500 is up 15% in the following 12 months once the Fed pauses.

While 2022 was a tough year for both stocks and bonds, we remain cautiously optimistic. We continue to be Fed watchers, as central bank policy will either propel the recent rally higher or derail it. The Fed meets again March 21-22, until then we think it is prudent to maintain a balanced stance in the market.



	Index Return %	
Equities	**MTD**	**YTD**
S&P 500	6.3%	6.3%
Russell 3000	6.9%	6.9%
Nasdaq	10.7%	10.7%
Dow Jones	2.9%	2.9%
Fixed Income		
US Aggregate	3.1%	3.1%
US Corporate High Yield	3.8%	3.8%

	Rate %
Economic Metrics	**Dec-22**
US Unemployment Rate	3.50%
US Inflation Rate	6.45%

	Levels	
Commodities	**Dec-22**	**Jan-23**
Oil (WTI)	80.16	77.97
Gold	1,813.80	1,923.10
DowJ. Commodity Index	1,048.69	1,050.12

	Rate %	
Interest Rates	**Dec-22**	**Jan-23**
10 Year Treasury Rate	3.88%	3.52%
30 Year Treasury Rate	3.97%	3.65%
30 Year Mortgage Rate	6.42%	6.13%
US Corp. AAA Effective Yield	4.67%	4.31%

All numbers reported are as of January 31, 2023

Major Economic Events	Date
Employment Situation	3-Feb
Inflation Rate	14-Feb
FOMC Meeting	22-Mar

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Sources

S&P 500 Performance	https://ycharts.com/indices/%5ESPXTR/level
Russell 3000 Performance	https://ycharts.com/indices/%5ERUATR/level
Nasdaq Performance	https://ycharts.com/indices/%5ENA100TR/level
Dow Jones Performance	https://ycharts.com/indices/%5EDJITR
US Aggregate Performance	https://ycharts.com/indices/%5EBBUSATR
US Corporate High Yield Performance	https://ycharts.com/indices/%5EBBUSCOHYTR
US Unemployment Rate	https://ycharts.com/indicators/us_unemployment_rate
US Inflation Rate	https://ycharts.com/indicators/us_inflation_rate
10 Year Treasury Rate	https://ycharts.com/indicators/10_year_treasury_rate
30 Year Treasury Rate	https://ycharts.com/indicators/30_year_treasury_rate
30 Year Mortgage Rate	https://ycharts.com/indicators/30_year_mortgage_rate
US Corp. AAA Effective Yield	https://ycharts.com/indicators/us_coporate_aaa_effective_yield
European Markets Performance	https://russellinvestments.com/middle-east/global-market-outlook#ColorBoxesRoot_5c2d1932-eb2f-4ad5-a377-5c496b847736
Sectors & Industries Performance	https://ycharts.com
Dow Jones Commodity Index	https://ycharts.com/indices/%5EDJC
Gold Price	https://ycharts.com/indicators/gold_price_in_us_dollar
Crude Oil Price	https://ycharts.com/indicators/wti_crude_oil_spot_price