BESPOKE Investment Group

The Bespoke Report

February 10, 2023

Flesh Wound

For all the fanfare and billions of dollars that have been plowed into AI and Chat GPT tools, what good is it if they can't even tell us if this week's pullback was a sign that the rally is over? Clearly not ready for primetime.

P Is the stock market rally over?

It's not possible to determine if a stock market rally is over until it actually ends. The stock market can experience short-term fluctuations and changes in trend, but it's difficult to predict its future performance with certainty. Factors such as economic conditions, company performance, and global events can all influence the stock market, and these can change quickly and unexpectedly. It's important to consider your personal financial situation and risk tolerance before making any investment decisions, and to consult with a financial advisor.

While the market is still right in the thick of earnings season, it was a quiet week in terms of news and macro data. After the deluge of both earnings reports and economic data to kick off February, and ahead of next week's busy slate, investors could use a break. With the vacuum of info, though, investors chose to focus on the looming inflation report next week and expectations for a big jump relative to December's deflationary reading. Based on the surge in rates, especially at the short-end of the curve, investors are bracing for a hot number.

Given the strong rally to start the year, bulls were due for a disappointment. As we'll discuss in this week's reports, rallies in some mega-cap stocks were unsustainable and they couldn't just keep going up like that all year. The market was also at overbought levels. The key will be how investors react and if they continue to buy the dip. At this point, the pullback hasn't done anywhere nearly enough damage to hurt the technical backdrop. The S&P 500 and the majority of sectors remain above their 50 and 200-day moving averages, and we've started to see shorter term moving averages cross above longer-term ones which is typically a positive technical trend.

This week's decline also coincided with a big improvement in investor sentiment, so it's only fitting that the market gives these new bulls a reality check. Make no mistake, though, the improvement in bullish sentiment was on a relative basis. The weekly investor sentiment poll from the *American Association of Individual Investors (AAII),* for example, is still below its historical average.

Heading into the new year, investors were just as, if not, more concerned about earnings season than they currently are about next week's CPI report. Yet now that we're past the peak of the reporting cycle, the results haven't been that bad. While we haven't seen the high percentage of EPS and sales beats that were typical of recent earnings seasons, they have still been much better than most investors would have expected. We've actually been surprised by how many calls we've heard where management had an upbeat outlook for the second half of the year. That's not exactly what Fed officials want to hear, but if inflation can continue to drift back towards its historical range, they may just be able to put up with an economy that doesn't crash and burn.

To the right, we have updated our ETF Asset Class Performance Matrix showing returns of key ETFs across various asset classes.

YTD, most of ETFs across both he equity and fixed income universe are still positive. The only sectors down on the year are defensives like Consumer Staples, Health Care, and Utilities. The only international ETF down on the year is India, but commodity ETFs have underperformed, especially natural gas which is down over 35% YTD!

This month, performance has been much more of a mixed bag. While the Nasdaq 100 has led the gains at the index level, the Dow is down fractionally. There's quite a degree of dispersion among sectors with Materials and Utilities both down over 2% while Technology is up over 3%.

After outperforming to kick off the year, international ETFs have had a rough February so far with most individual country ETFs down over 1%.

It's a similar story in the fixed income universe as Treasury ETFs across the curve are down MTD but still positive on the year.

Asset Class Performance MTD, YTD, and 1-Year - Total Return (%)

US Related

ETF	Description	MTD	YTD	1-Year
SPY	S&P 500	0.38	6.70	-7.71
DIA	Dow 30	-0.62	2.32	-2.02
QQQ	Nasdaq 100	1.72	12.55	-15.77
IJH	S&P Midcap 400	-0.44	8.78	0.06
IJR	S&P Smallcap 600	-0.01	9.50	-1.50
IWB	Russell 1000	0.33	6.99	-8.41
IWM	Russell 2000	-0.61	9.15	-5.09
IWV	Russell 3000	0.25	7.06	-8.27
IVW	S&P 500 Growth	1.00	6.67	-17.10
IJK	Midcap 400 Growth	0.10	7.26	-5.12
IJT	Smallcap 600 Growth	0.17	7.52	-6.30
IVE	S&P 500 Value	-0.22	6.73	1.98
IJJ	Midcap 400 Value	-0.98	10.27	5.15
IJS	Smallcap 600 Value	-0.29	11.62	3.05
DVY	DJ Dividend	-0.80	3.36	3.28
RSP	S&P 500 Equalweight	-0.51	6.87	-2.34
FXB	British Pound	-2.09	0.05	-10.63
FXE	Euro	-1.75	-0.20	-7.12
FXY	Yen	-1.06	-0.28	-12.23
GBTC	Bitcoin Trust	-12.18	28.71	-65.58
ETHE	Ethereum Trust	-8.02	42.23	-73.72
XLY	Cons Disc	-0.37	14.70	-19.58
XLP	Cons Stap	-1.04	-2.12	-0.89
XLE	Energy	0.31	3.13	37.34
XLF	Financials	-0.19	6.70	-8.44
XLV	Health Care	-0.65	-2.47	1.86
XLI	Industrials	0.28	4.00	2.98
XLB	Materials	-3.10	5.60	-1.66
XLK	Technology	3.25	12.81	-11.28
XLC	Comm Services	-0.22	14.52	-21.67
XLU	Utilities	-2.00	-3.96	4.08

Global

ETF	Description	MTD	YTD	1-Year
EWA	Australia	-2.78	8.73	6.34
EWZ	Brazil	-7.38	0.46	-2.30
EWC	Canada	-0.95	8.43	-6.79
ASHR	China	-3.40	7.60	-17.00
EWQ	France	-1.49	9.93	-2.36
EWG	Germany	-0.96	12.29	-11.20
EWH	Hong Kong	-2.54	2.28	-9.68
PIN	India	-0.66	-0.70	-7.79
EWI	Italy	0.03	12.40	-3.80
EWJ	Japan	-0.94	6.76	-8.78
EWW	Mexico	-2.32	13.87	17.30
EWP	Spain	-0.33	10.92	1.27
EIS	Israel	-2.49	1.70	-22.44
EWU	UK	-0.61	5.58	-3.36
EFA	EAFE	-1.23	7.66	-5.58
EEM	Emerging Mkts	-2.83	6.04	-16.81
IOO	Global 100	0.35	6.48	-9.10
BKF	BRIC	-4.09	3.80	-19.98
CWI	All World ex US	-1.57	6.90	-8.69
DBC	Commodities	-2.17	-1.30	7.40
DBA	Agric. Commod.	-0.25	0.15	-3.57
USO	Oil	0.79	-0.34	9.24
UNG	Nat. Gas	-5.69	-37.66	-36.72
GLD	Gold	-3.37	2.19	1.64
SLV	Silver	-7.28	-8.08	-5.51
SHY	1-3 Yr Treasuries	-0.50	0.27	-2.10
IEF	7-10 Yr Treasuries	-2.06	1.45	-10.10
TLT	20+ Yr Treasuries	-3.28	4.11	-22.24
AGG	Aggregate Bond	-1.56	1.72	-7.86
BND	Total Bond Market	-1.59	1.67	-7.95
TIP	T.I.P.S.	-0.89	1.16	-7.03

Past performance is no guarantee of future results.

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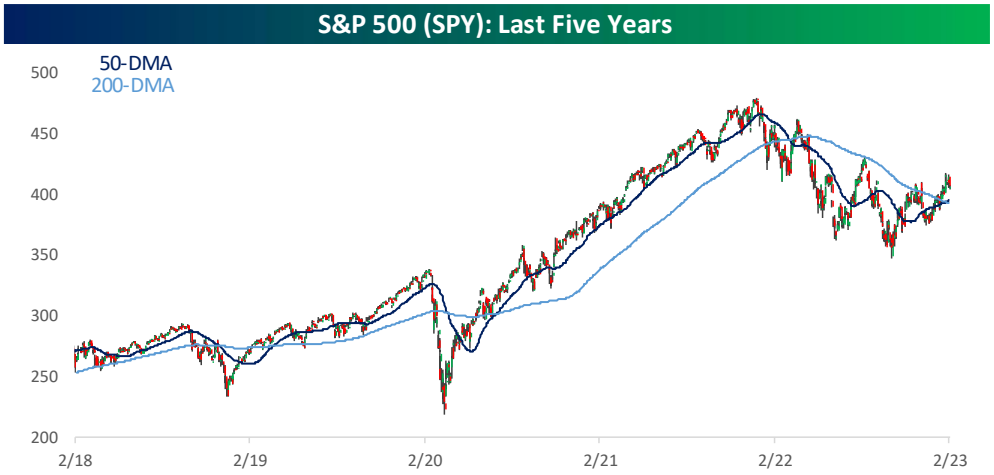
February 10, 2023

This week was one of the quietest non-holiday weeks we can remember when it comes to data outside of earnings. To fill the void, we thought it would be a good time to look at how the charts of the market and individual sectors look following the massive volatility last year and the sharp rallies to kick off 2023.

On the pages that follow, we provide five-year and one-year charts of the Russell 2000 ETF (IWM), the 20+ Year Treasury ETF (TLT), and each of the eleven sector ETFs.

Starting with the S&P 500 (SPY), while last year experienced a nasty decline of 19.5%, over the last five years it is still up 55% (thru 2/9/23). At the lows in December, the S&P 500 bottomed just above its pre-COVID peak and essentially erased its post-COVID gains. Looking just at a one-year chart, the pattern has been looking increasingly positive. After making a higher low in December, SPY broke its downtrend and traded above its 200-DMA in January and made a higher high this month.



The Russell 2000 (IWM) was the first major index to peak in late 2021 after trading sideways for most of that year. After many unsuccessful attempts to break its downtrend in 2022, IWM finally broke above that and its 200-DMA in early 2023. While the S&P 500 remains well below its August 2022 high, IWM is already testing that level. The initial attempt has been unsuccessful, and how this test plays out will provide an early signal of what to expect for the S&P 500. It's also notable that IWM's 50-DMA crossed above its 200-DMA.

2022 was one of the worst years in history for long-term Treasuries, and the iShares 20+ Year US Treasury ETF (TLT) was down over 32%. This year has seen a rebound of 4%, but even as it has broken its downtrend, this year's rally stalled out just below the 200-DMA. This was the first time the 200-DMA even came into play for the ETF in over a year, so this remains a level investors should watch for an upside break before becoming overly positive on long-duration treasuries.

Russell 2000 (IWM): Last Five Years

20+ Year US Treasury (TLT): Last Five Years

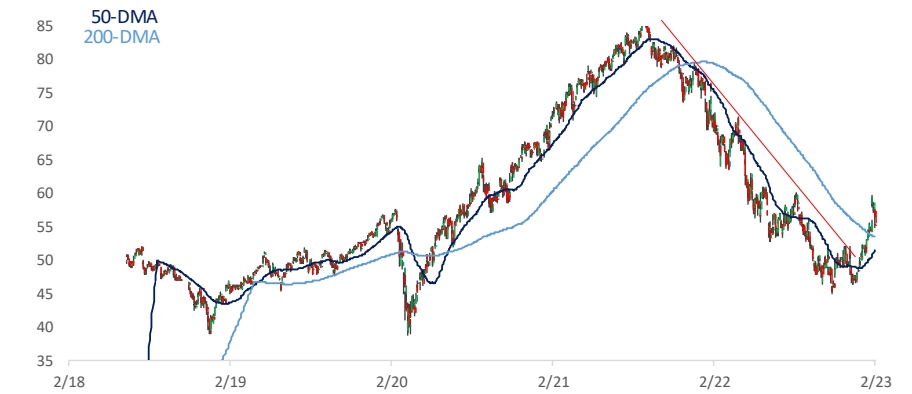
Russell 2000 (IWM): Last Year

20+ Year US Treasury (TLT): Last Year

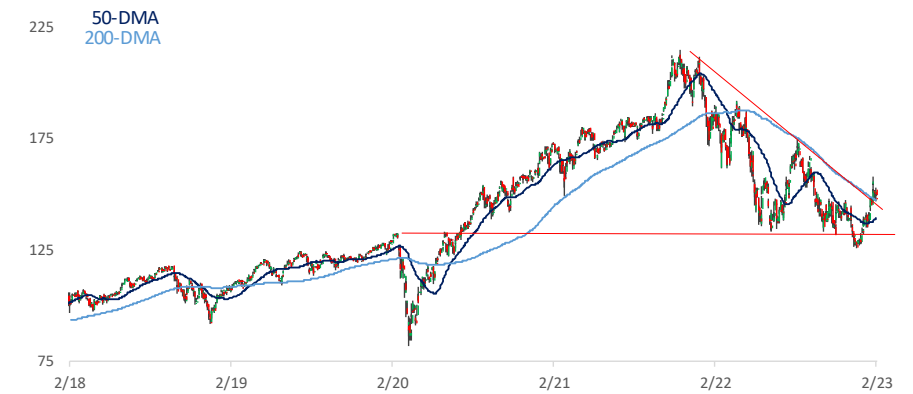
The Communication Services sector (XLC) was the hardest hit of 2022, falling over 38%, but this year so far it has been one of the biggest winners, surging 15%. In addition to breaking its downtrend, the surge pushed the sector back above its 200-DMA. This week's pullback has been relatively minor so far, but the first test for the sector will be if it can hold above its 200-DMA just as the 50-DMA makes an upside cross of that level.

Right behind XLC, the Consumer Discretionary sector (XLY) fell over 36% in 2022, but its performance in 2023 so far has been just as strong as XLC. While the S&P 500 held support at the pre-COVID highs, XLY briefly broke below that level to close out 2022, and despite its big rally so far in 2023, it has only traded marginally above its 200-DMA and hasn't been able to stay above the downtrend it briefly broke above last week.

Communication Services (XLC): Last Five Years



Consumer Discretionary (XLY): Last Five Years

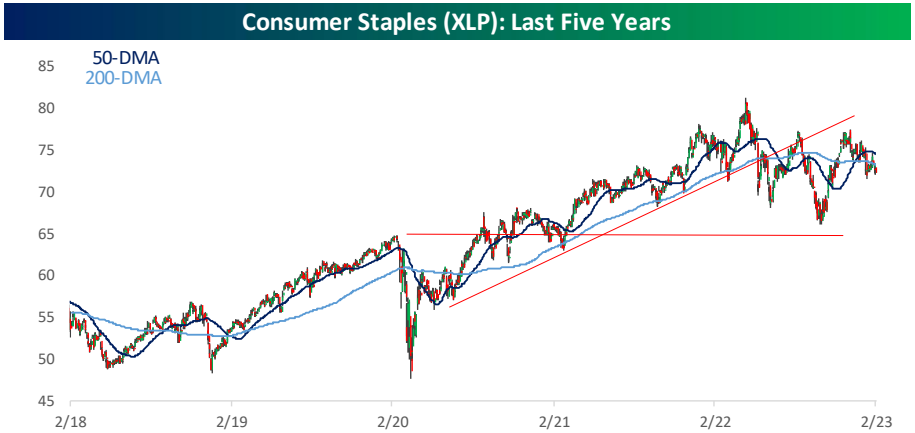


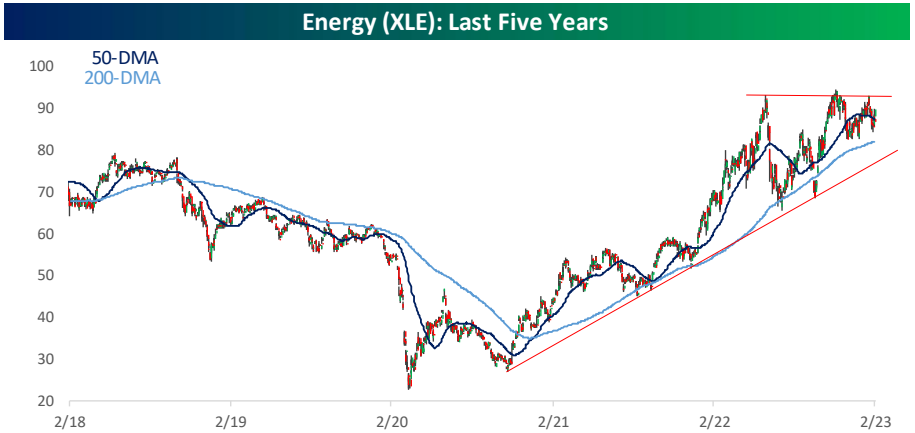
Communication Services (XLC): Last Year

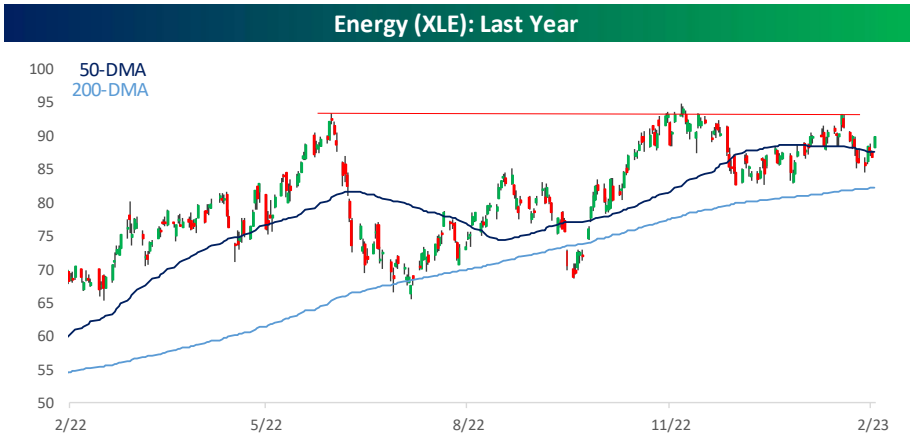
Consumer Discretionary (XLY): Last Year

With a decline of only 3% in 2022, the Consumer Staples (XLP) sector was practically up, but as stocks have recovered, the picture for XLP has weakened. In August, the sector made a lower high and then a lower low in October. The ensuing rally stalled out just shy of the August highs, and ever since then it's been a slow bleed lower for the sector even as the S&P 500 has rallied. In terms of relative strength, the picture for XLP has been even weaker.

One could look at the recent performance of the Energy (XLE) sector in one of two ways. For starters, the sector looks to have made a triple top with multiple pullbacks right around $95. While the inability to break out is concerning, when you consider the fact that oil and natural gas prices have crashed from their 2022 highs, it's impressive that the sector remains right near 52-week highs.

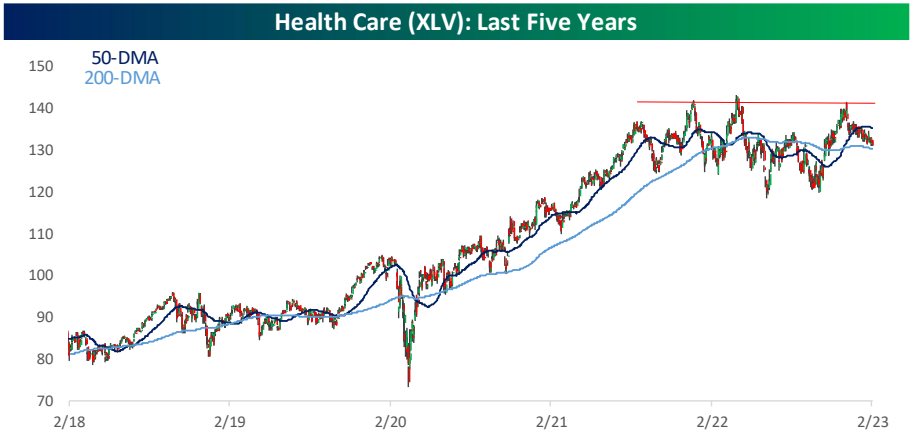


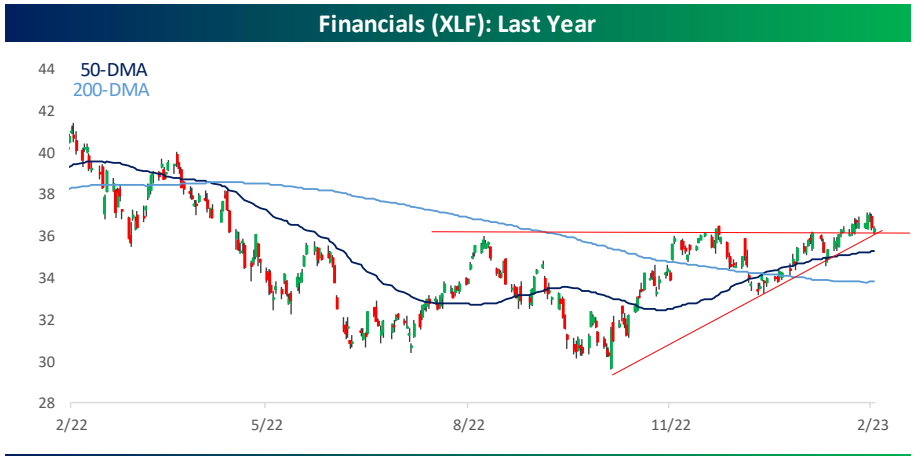


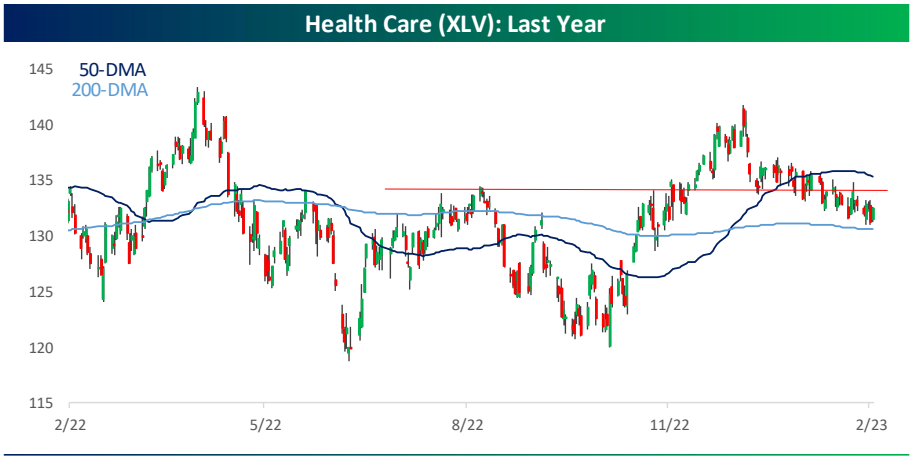


Financials is another sector that tested and briefly broke below the pre-Covid highs in 2022, and it tested that level twice. We've seen a solid rebound since then, though, as the sector has formed a short-term uptrend with a higher low and two higher highs (although you have to squint to see them). Even if they've only been modest higher highs, though, this isn't the type of pattern you'd expect to see if a recession was imminent.

Like Consumer Staples, Health Care was a port in the 2022 storm, falling only 3% for the year. Like the Energy sector, it made multiple attempts throughout the year to break out only to face restraint each time. Now that the market has started to turn, though, investors have been rotating out of this safety trade, and it's been a slow and steady bleed lower for the sector for nearly two months now.

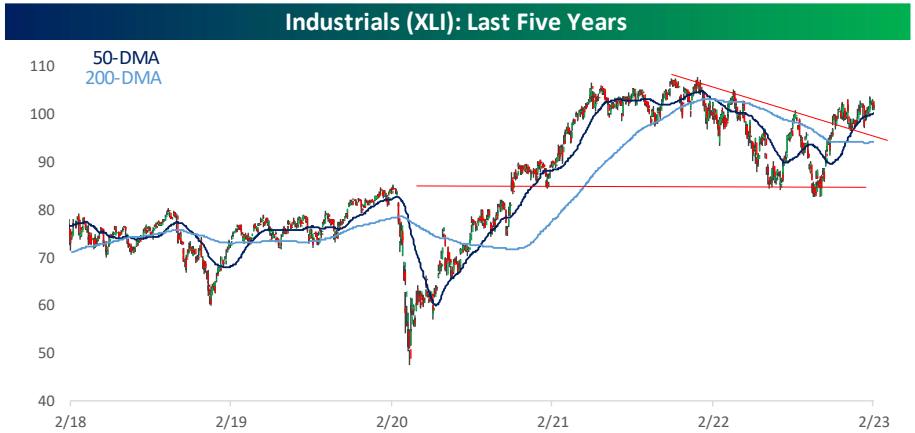


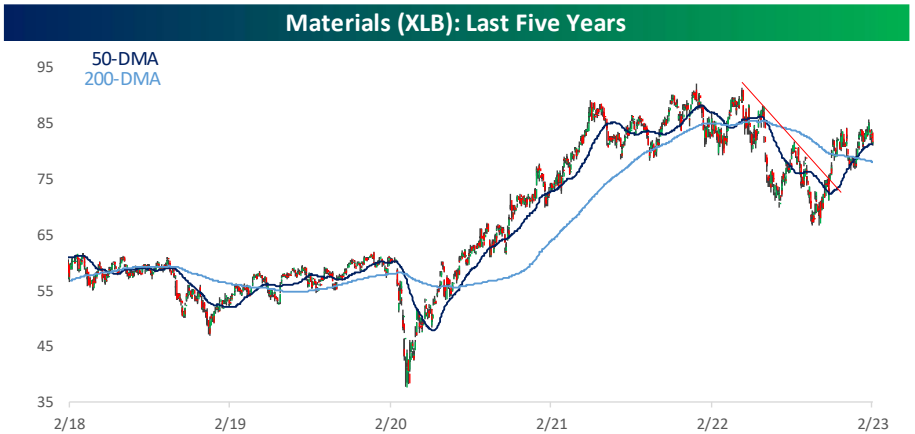


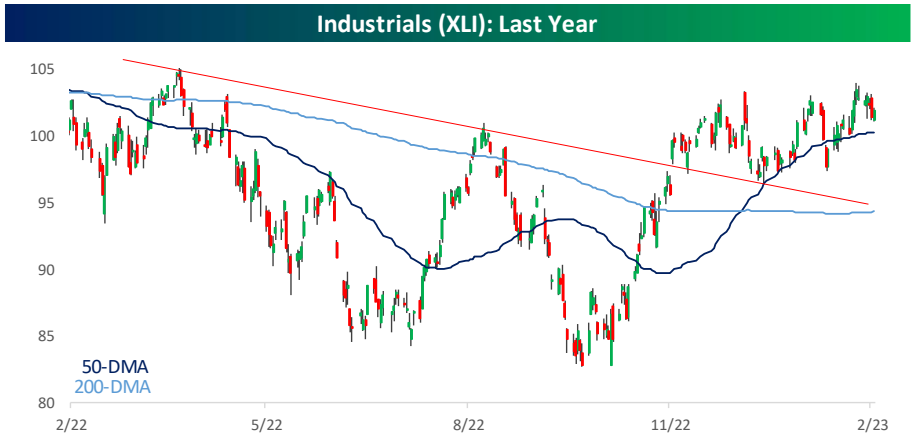


The Industrials sector has lagged the broader market this year, rallying just over 3%, but that comes after outperforming the S&P 500 by 12 percentage points in 2022. While the gains off the October lows haven't been dramatic, the downtrend line from the 2021 highs has clearly been broken to the upside, and the sector isn't far from 52-week highs. The next level of resistance to watch is the 52-week high from Spring 2022. Industrials are another sector that doesn't currently look recessionary.

The pattern for the Materials sector looks very much like the Industrials sector as it too has broken its downtrend from the 2021 highs. The key difference between the two has been that rally off the October lows has been more muted. While the sector has pulled back over the last week, it's uptrend off the lows remains intact…for now.

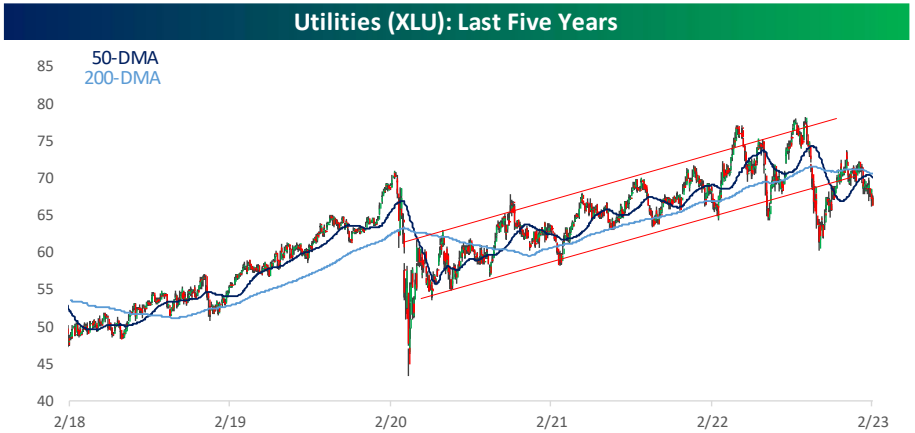


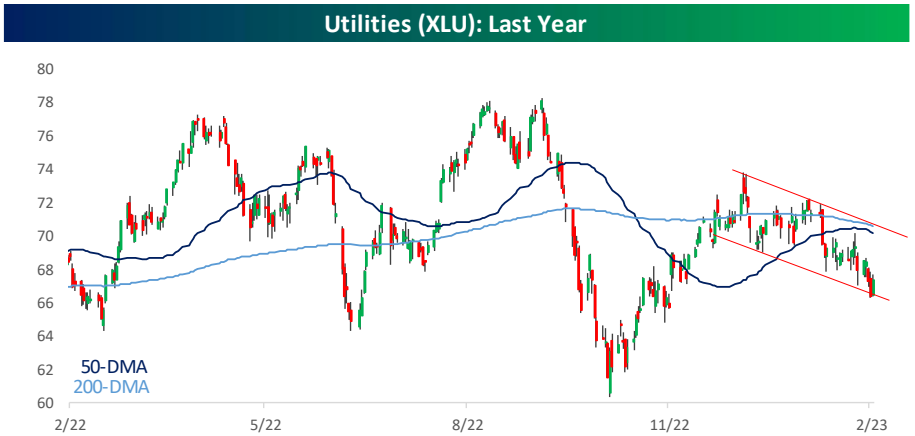




Higher interest rates have been painful for the Real Estate sector, and it was one of the worst performers of 2022, falling 28.7%. The sector has seen a nice bounce back off the October lows, forming a steady uptrend in the process, but it also has yet to convincingly break its downtrend from the 2021 highs which coincidentally matches up to the pre-Covid highs as well.

Utilities was another sector that held up great in 2022 (even with higher interest rates) but has come under pressure in 2023. It's down more YTD now (-4.5%) than it was in all of 2022 (-1.5%). After breaking down in the fall, the sector attempted to rebound late in the year and into early 2023 but quickly rolled over as its 50 and 200-DMA start to follow suit. Its break below its uptrend channel in the first chart below looks daunting.

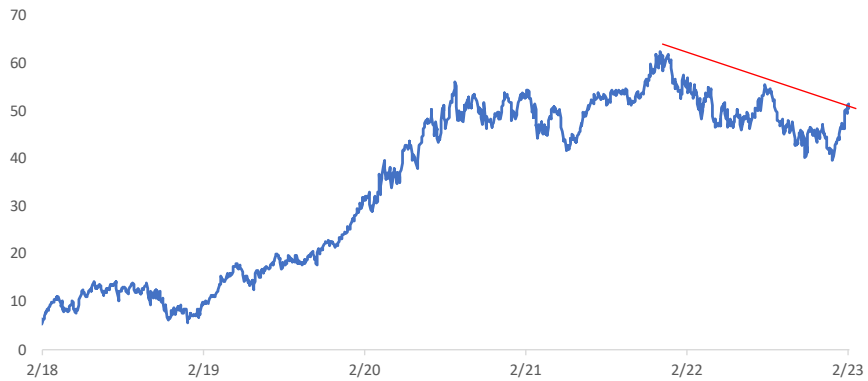




We went a little out of alphabetical order but wanted to give the Technology sector its own page since it's easily the largest sector in the S&P 500. After the 28% decline in 2022, Tech is one of the leaders to the upside this year, rallying over 12%. The sector's pattern in late 2021/early 2022 was a clear head and shoulders, but the pattern towards year end and into this year was the reverse with an inverse head and shoulders.

As it starts carving out an uptrend of higher highs and higher lows, the sector has broken its downtrend and traded above its 200-DMA in the process. Even on a relative strength basis (chart below), the tech sector has shown signs of breaking its downtrend from the 2021. The rally got a little ahead of itself in recent days, so it's not a surprise to see some short-term give back.

Technology (XLK) vs S&P 500 (SPY): Last Five Years

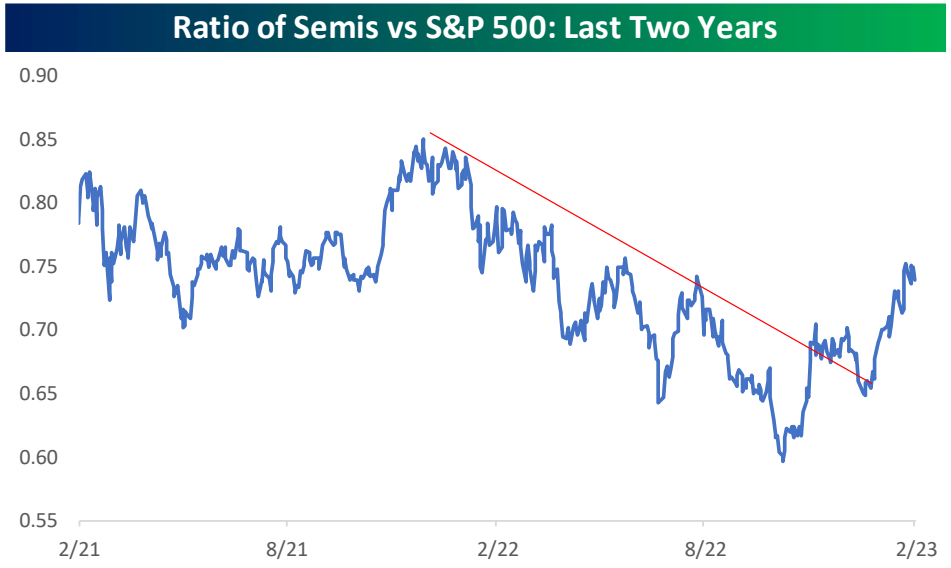


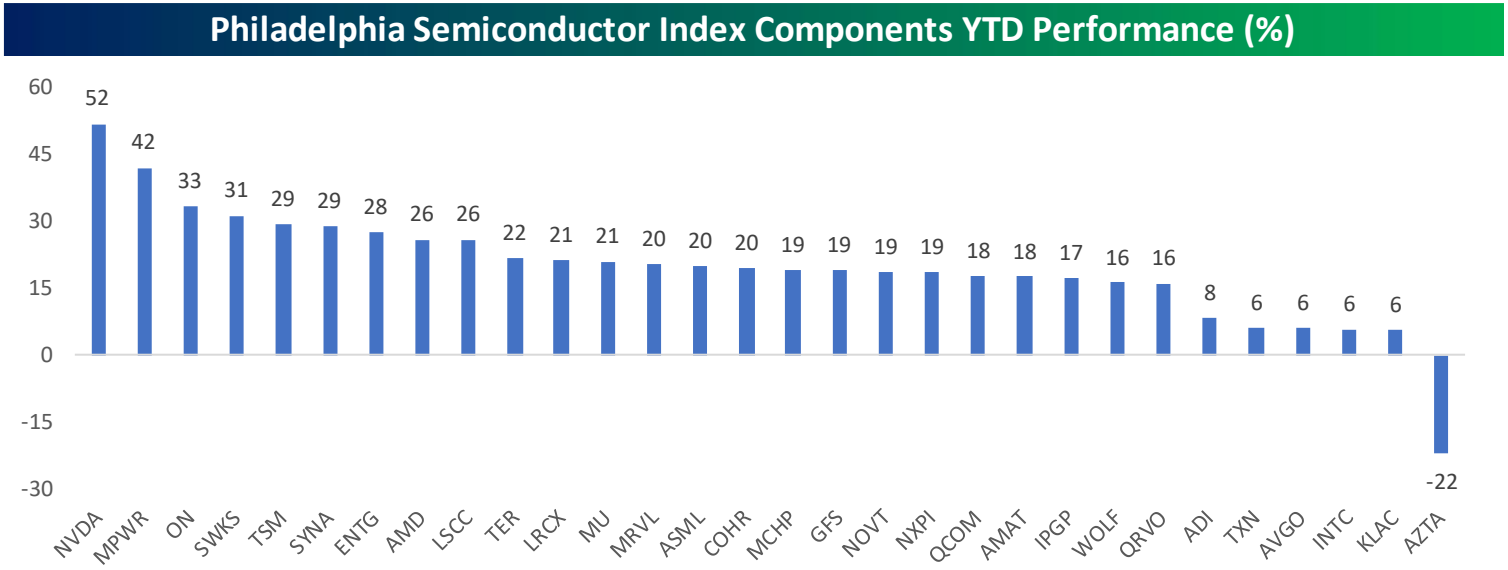
Technology (XLK): Last Five Years

Technology (XLK): Last Year

While not a sector, semiconductors are one of the most important groups in the market, and after a rough 2022, this year has been much improved. Year to date, just one of the 30 components of the Philadelphia Semiconductor Index is down, and that one stock, Azenta (AZTA), is no longer really a semiconductor stock following last year's spin-off of Brooks Automation and name change. Overall, though, the average YTD performance of the 30 stocks in the index is a gain of 20%. It has been an impressive run, but the pace of this rally is simply unsustainable. Nvidia (NVDA) is already up 52% YTD. Companies with $500 billion market caps don't normally rally 50% in the span of six weeks.

Bigger picture, though, even if the rally in semis is due for a breather, the relative strength of the SOX versus the S&P 500 has been a great leading indicator for the broader market, and since its October low, it has broken its downtrend from the 2021 peak and steadily trended higher.





NVDA isn't the only stock in the S&P 500 that has surged so far this year. Within the index, 48 stocks are up over 20%, and 19 (listed to the right) have rallied more than 30% on the year. Along with NVDA, four stocks are up more than 50% this year after less than thirty days of trading. Leading the way higher, Tesla (TSLA), with its market cap of $655 billion, has rallied close to 63% on the year. Overall, the 19 names listed have an average market cap of $103 billion, which is skewed by TSLA, NVDA, and META. The median market cap is less than a fifth of that, but at $19 billion, these are still large cap stocks we're talking about.

Again, rallies of this magnitude are unsustainable, so investors should at least expect a pause in these rallies and not be surprised to see short-term losses. What is notable about this list is that although the gains so far this year have been astronomical, the median decline of these stocks in 2022 was over 50%, so they're still down sharply from prior highs. Unless the economy is headed for a deep recession, a lot of bad news has been priced in.

S&P 500 Top Performing Stocks Year to Date (Through 2/10)

Ticker	Name	Sector	Market Cap ($, bln)	Price	Performance (%) 2023 YTD	2022
TSLA	Tesla	Con Discret	655.98	194.88	62.92	-65.03
CTLT	Catalent	Health Care	12.97	70.57	59.99	-64.84
NVDA	NVIDIA	Technology	549.49	210.05	52.85	-50.31
ALGN	Align	Health Care	25.10	312.76	52.37	-67.91
WBD	Warner/Discovery	Comm Svcs	34.90	14.22	50.79	-62.82
META	Meta Platforms	Comm Svcs	461.28	175.43	48.37	-64.22
RCL	Royal Caribbean Cruises	Con Discret	18.77	72.16	46.59	-35.72
CCL	Carnival	Con Discret	14.37	11.23	43.05	-59.94
MPWR	Monolithic Power Systems	Technology	24.04	493.06	40.97	-28.32
SIVB	SVB Financial	Financials	18.69	311.53	37.04	-66.07
NCLH	Norwegian Cruise Line	Con Discret	7.13	16.39	34.48	-40.98
ON	ON Semiconductor	Technology	36.61	83.20	34.42	-8.17
EXPE	Expedia	Con Discret	18.37	108.35	34.37	-51.53
WDC	Western Digital	Technology	13.41	42.87	33.09	-51.62
STX	Seagate Technology	Technology	14.41	70.90	32.67	-53.43
WYNN	Wynn Resorts	Con Discret	12.30	109.06	32.19	-3.02
MGM	MGM Resorts	Con Discret	16.72	43.90	32.12	-25.29
SWKS	Skyworks Solutions	Technology	19.22	117.95	31.22	-41.26
AAL	American Airlines	Industrials	10.83	16.27	30.97	-29.18
				Average	**41.60**	**-45.77**
				Median	**37.04**	**-51.53**

As discussed in the charts on the prior pages, both the S&P 500 and Russell 2000 have seen their 50-day moving averages (DMA) cross up above their 200-DMAs. While these types of patterns are often referred to as golden crosses, we only consider it a golden cross if *both* moving averages are sloping upwards at the time of the crossover. That wasn't the case with either the S&P 500 or the Russell 2000 this time around.

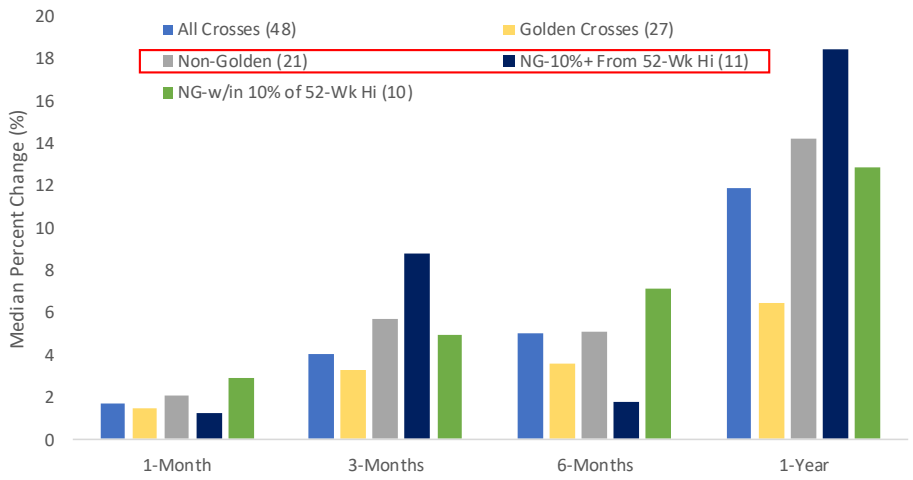
Whatever you want to call it, these types of crosses between the 50 and 200-DMAs are generally considered a bullish pattern, but to give you a better idea of how bullish they may be, the charts to the right quantify the returns of both indices following prior upward crosses of the 50 and 200-DMA. For each index, we looked at all upward crosses (light blue bars), golden crosses (gold bars), non-golden crosses (gray bars), and then non-golden upward crosses based on how far each index was trading below its 52-week high the day before the crossover occurred.

At the time of each index's cross, they were both more than 10% below their respective 52-week highs, so the bars that are most applicable are the gray and dark blue ones.

Regarding the S&P 500, the two best scenarios over the three and twelve-month time frames are non-golden crosses as well as crosses that occur when the S&P 500 was at least 10% below a 52-week high which was the case with the most recent cross.

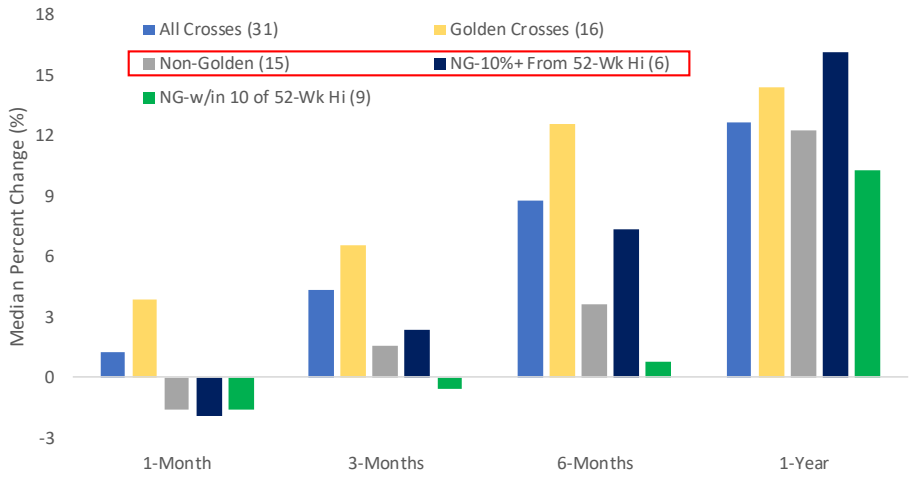
For the Russell 2000, the results for the current scenarios aren't as positive. Over each timeframe, median performance following non-golden crosses (gray bars) has been weaker than performance following golden crosses (gold bars). That said, median forward returns have tended to be better following crosses when the Russell 2000 was more than 10% below a 52-week high than within 10% of a 52-week high.

S&P 500 Performance Following 50 vs 200-DMA Upward Crosses*



**Post WWII*

Russell 2000 Performance Following 50 vs 200-DMA Upward Crosses*



**Since 1978*

You don't typically think of elevated volatility during periods when the market is rallying, but that's what we've seen this year. For example, since the five-trading day week in its present form started on the NYSE in late 1952, the week ending 2/3 was only the 23rd time that every trading day of a full trading week (five days) involved a gain or loss of 1%+. A quick look at a very long-term chart of the S&P 500 shows that these weeks of 1% moves have almost always occurred during or very late in a market downturn.

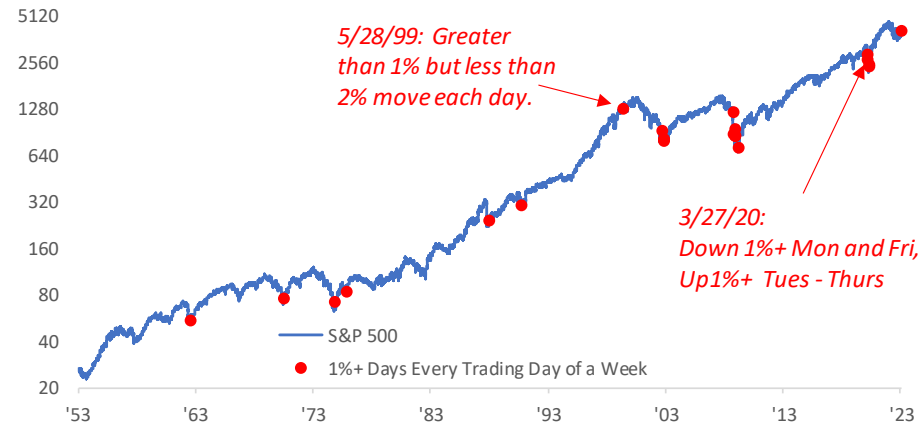
Taking a more detailed look at performance, the table to the right lists each full trading week since late 1952 when every trading day had a gain or loss of at least 1% (with no prior occurrences in the last three months).

Looking at forward returns, there has been a clear divergence between performance over the following month versus the following three, six, and twelve months.

On a median basis, the S&P 500 was down 4.18% over the next month with positive returns just three out of ten times, and that's well below the historical average for all one-month periods since 1953.

Once the market got past the rockiness of the first month, returns shifted overwhelmingly positive with performance well in excess of historical averages. One year later, for example, the S&P 500 was higher nine out of ten times for a median gain of just over 22%!

S&P 500 Log Scale: 1953 - 2023



1% Daily Moves All Five Trading Days of a Week*

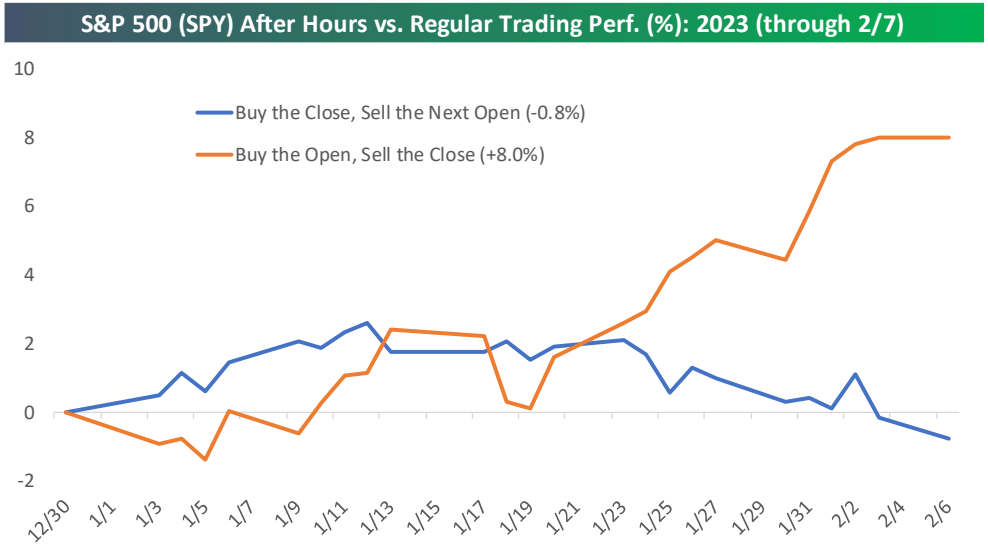
	S&P 500 Performance (%)			
Date	**One Month**	**Three Months**	**Six Months**	**One Year**
6/15/62	3.47	5.37	11.95	25.69
5/29/70	-4.78	6.94	12.25	30.15
10/18/74	-4.16	-1.83	19.40	22.94
10/3/75	2.49	5.76	18.96	21.20
11/13/87	-4.20	4.88	4.54	9.07
9/28/90	-0.44	7.41	22.60	26.09
5/28/99	2.27	3.57	8.82	5.85
8/23/02	-11.39	-1.10	-9.85	5.55
9/19/08	-25.06	-29.26	-37.53	-14.88
3/6/20	-10.39	7.45	15.29	29.26
2/3/23	-1.30			
Median	**-4.18**	**5.12**	**12.10**	**22.07**
% Positive	**30**	**70**	**80**	**90**
Avg since 1953				
All Periods	**0.68**	**2.02**	**4.26**	**8.76**
% Positive	**61**	**66**	**69**	**73**

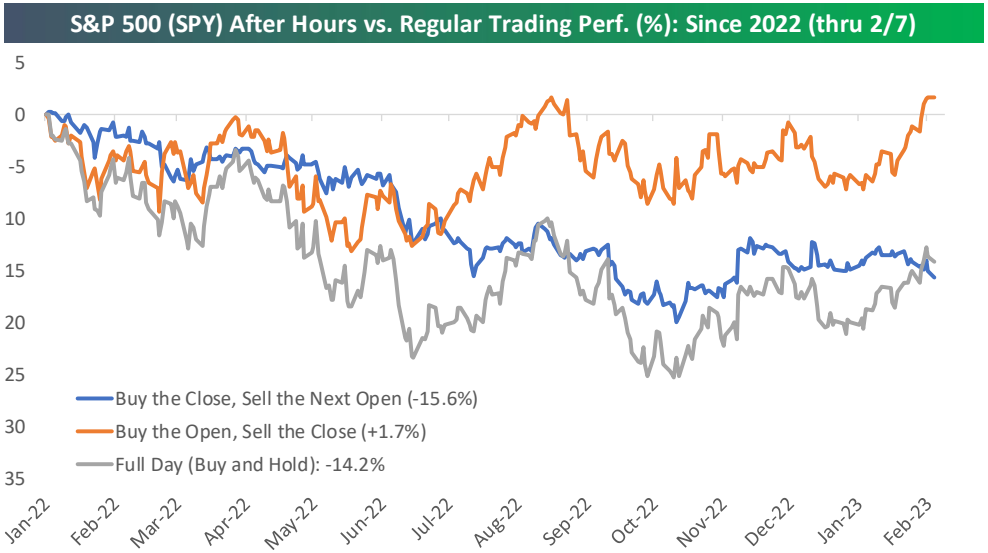
**No occurrences within three months of prior instance.*

Another interesting aspect of this year concerns where the gains have come. As we highlighted in Tuesday's Chart of the Day, all of this year's gains have come during regular trading hours as opposed to 'after hours.'

Had you hypothetically bought SPY at the open every trading day at 9:30 AM ET and sold it at the 4 PM close, you'd currently be up 8% year-to-date. Had you done the opposite and bought SPY at the close every trading day and sold it at the next morning's open, you'd be down -0.8%.

The relative strength of the market during regular trading hours hasn't just been a characteristic of this year either. Going back to the start of 2022, a period in which SPY is down 14.2%, had you simply bought SPY at the open and sold at the close every trading day, you'd be up 1.7%. Had you done the opposite and bought SPY at the close every trading day and sold at the next open, you'd be down 15.6% (lower chart). The entire bear market's decline has come from moves in after hours trading while the intraday action has actually been positive.

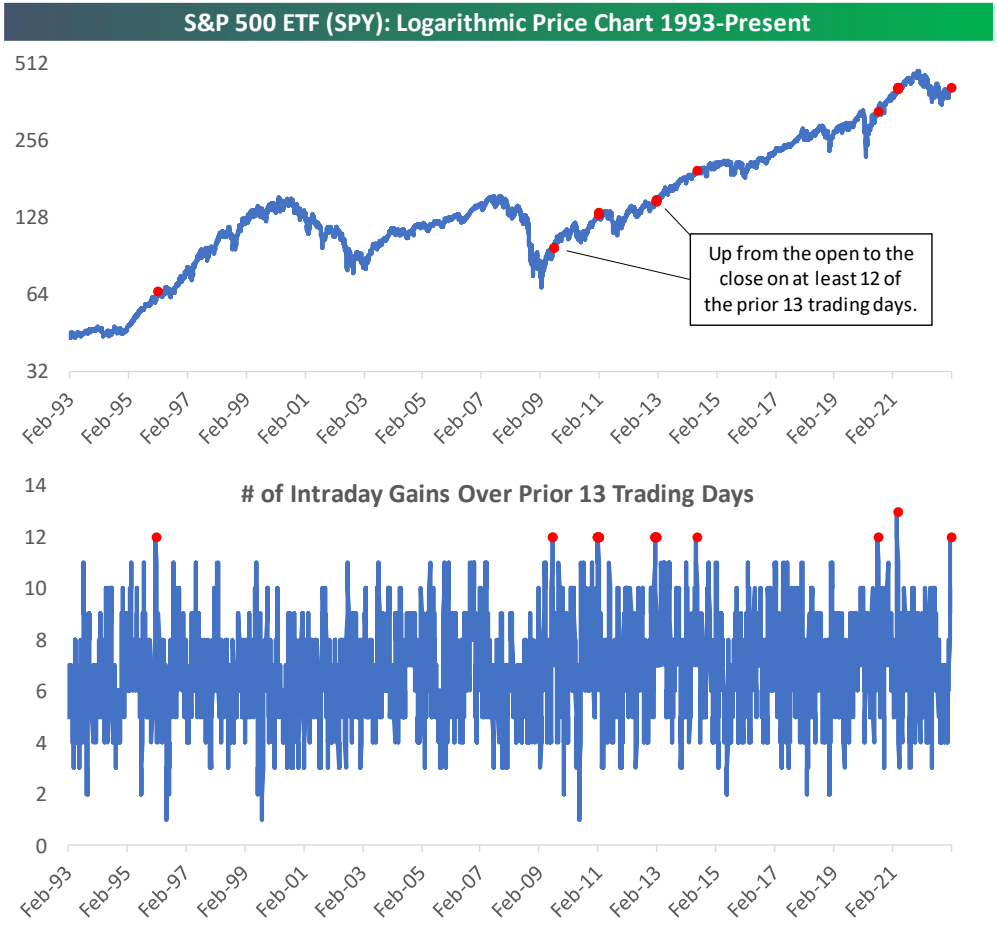




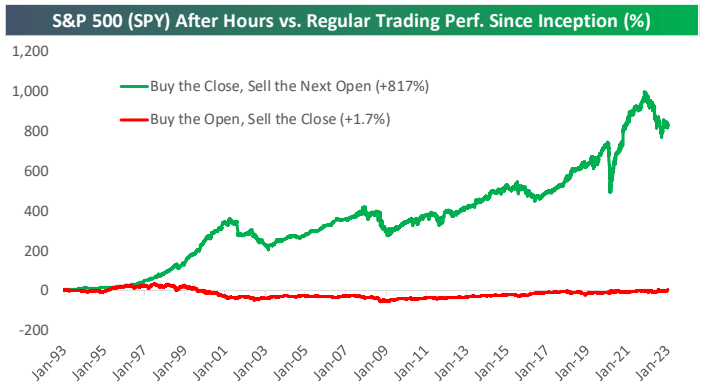
As long-time clients are aware, this recent trend of intraday strength and after-hours weakness is not the historical norm. Since 1993 when SPY began trading, had you hypothetically bought at the open and sold at the close every day, you'd only be up 1.7% over this entire period. Had you done the opposite and bought SPY at the close every trading day and sold it at the next open, you'd be up 817%. This 817% gain doesn't include dividends either, which would only be captured with the "after hours" strategy.

The fact that the after-hours strategy really started to perform poorly in the middle of last year just as ETFs were launched to try and capitalize on the strategy shows just how the market is always on its toes and looking to inflict pain on anyone who thinks they have it figured out!

Getting back to the recent intraday strength we've seen, through Tuesday, SPY had gained from the open to the close on 12 of 13 trading days. To the right is a logarithmic chart of SPY since its inception showing prior times when it has gained on an intraday basis on at least 12 of the prior 13 trading days. As you can see, none of the prior occurrences came during any of the three bear markets over the last few decades, and they usually occur in the early to middle stages of long-term rallies.

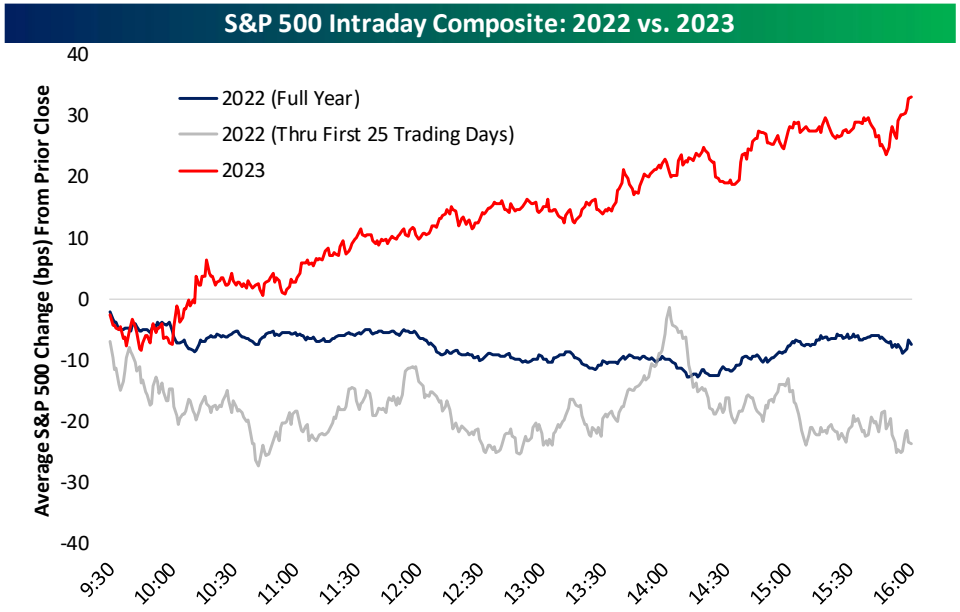


Past performance is no guarantee of future results.



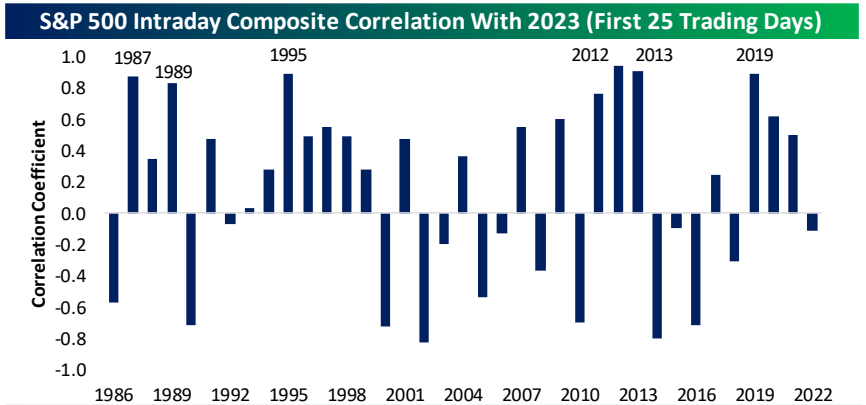
Earlier, we highlighted how all of the S&P 500's gains so far in 2023 have been a result of performance during regular trading hours (intraday), making this year a complete reversal of what we saw last year.

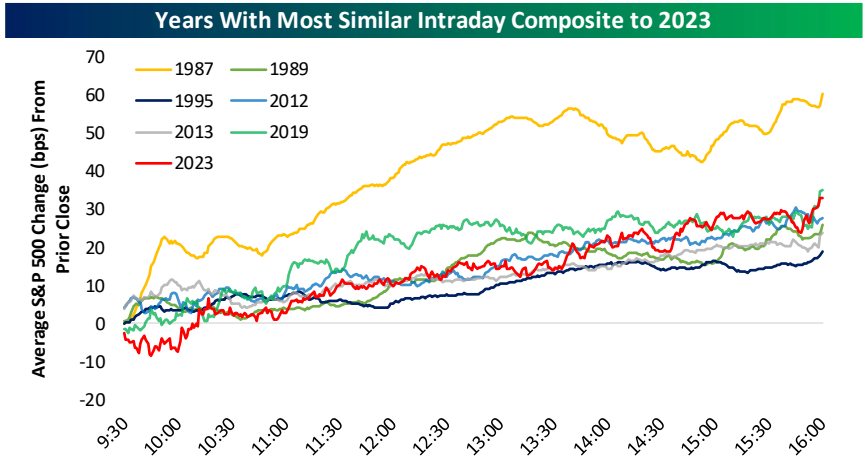
In the chart below, we show the average intraday change (versus the prior day's close) in basis points (bps) for the S&P 500 so far in 2023 and then for all of 2022 as well as 2022's first 25 trading days. This year has been similar to last year in terms of the market opening down and trading lower in the first half hour of trading. That's where the similarities end. From 10 AM ET on, the trends of 2022 and 2023 are radically different. Whereas last year the S&P would tend to trade lower throughout the trading day (on average both during the full year and on a more like-for-like basis through only the first 25 trading days), this year, the trend has been an advance throughout the day with a close near the highs of the day.



Going back to 1986 (first full year when the NYSE opened at 9:30 AM ET), there have been six years in which the intraday patterns through the first 25 trading days have resembled 2023 relatively closely (correlation coefficient greater than +0.80).

In the second chart, we show intraday composites of the S&P through the first 25 trading days of each of those years. In most of these years, the market tended to close right near the highs of the day. In other words, the "smart money" was buying.





** Through the first 25 trading days of the year.*

Given that there is plenty of year left in the tank, below we show the path of the S&P 500 over the full course of each of the six prior years highlighted in the chart on the prior page. In five of the six years, the S&P 500 continued higher from the 25th trading day's close through year-end, and the median rest-of-year change for all six years was a gain of 18.8%. The only exception was 1987 when the S&P 500 fell 12% from the close on the 25th trading day (2/5/1987) through year-end, but that was only after it had rallied an additional 19.8% through the closing high on 8/25/1987. Not only that, but on the 25th trading day of 1987, the S&P 500 was already up over 16% YTD. This year, it's up just half that through 25 trading days, and in the five other years, the YTD gain after 25 trading days was just under 9% (2019). In other words, 1987 was in a league of its own.

S&P 500 During Years Where Intraday Composite of First 25 Trading Days Was Most Correlated to 2023

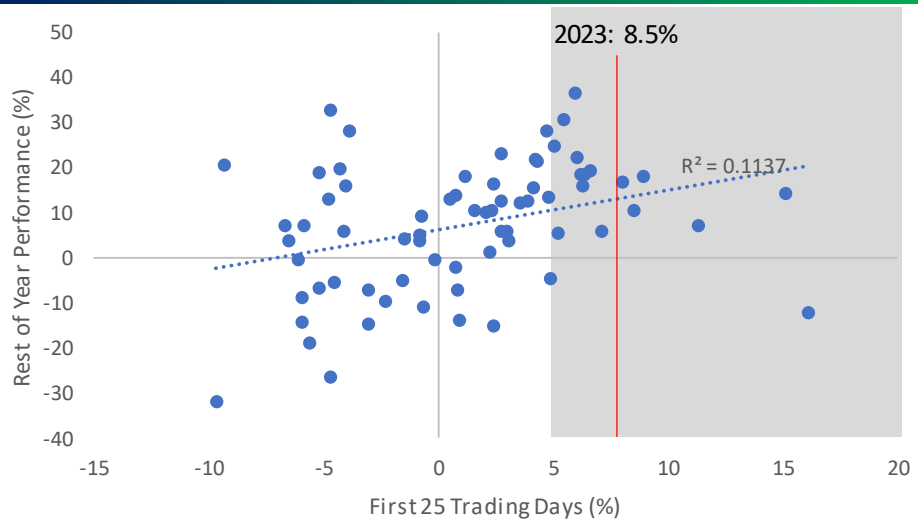
Instead of just looking at correlation, the first 25 trading days of 2023 have been among the strongest on record. Since 1953 when the five-trading day week in its current form started, this year ranks as the sixth best start for the S&P 500 and the 17th year that it rallied more than 5% to start the year.

The charts below compare performance in the first 25 trading days of each year to the rest of the year. In the 17 years that the S&P 500 rallied 5% in the first 25 trading days, the median rest of year performance was a gain of 17.6% with positive returns all but once (1987). For all other years, the median gain was just 6.0% with positive returns 65% of the time.

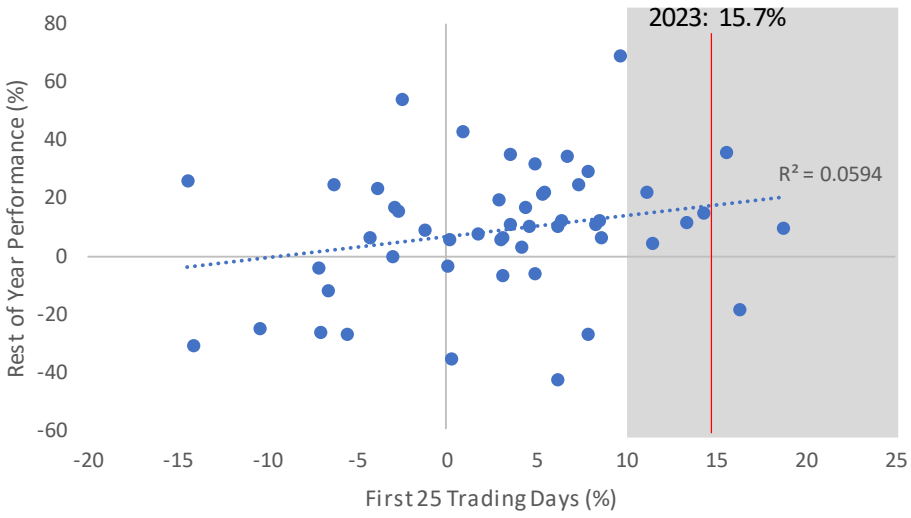
This year's start for the Nasdaq has been even stronger than the S&P 500. Since 1972 (the first full year of price history for the index), this year ranks as the third best start to a year trailing only 1975 and 1987.

In the seven prior years that the Nasdaq rallied more than 10% to kick off a year, the median rest of year return was a gain of 11.2%. While the median return is less than a percentage point than the median rest of year performance for all other years (+10.3%), the consistency of positive returns was greater. Whereas the Nasdaq continued higher for the remainder of the year six out of the seven times when it kicked off a year with a gain of at least 10%, in the 44 remaining years, it only continued higher 70% of the time.

S&P 500: First 25 Trading Days vs Rest of Year



Nasdaq: First 25 Trading Days vs Rest of Year

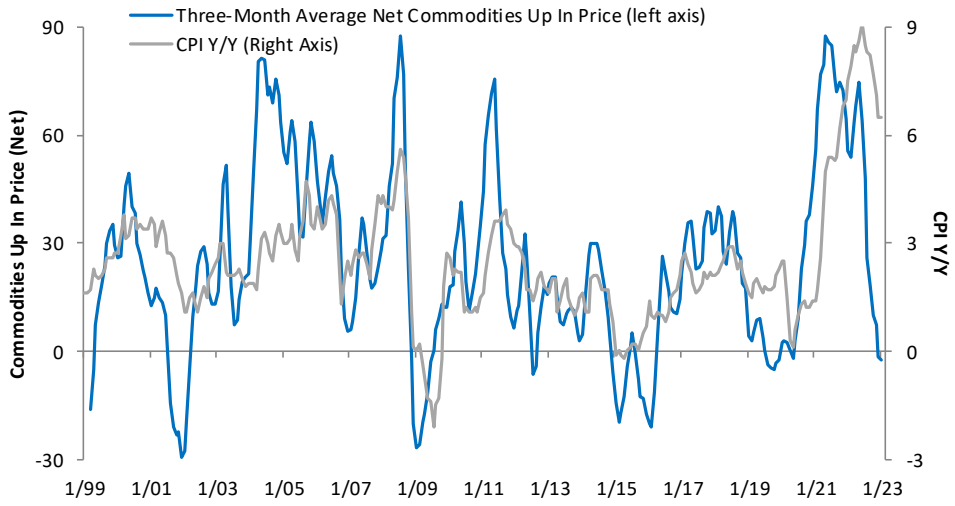


It was a slow week for economic data, but next week will be a busy one, and the most notable report will likely be January CPI on Tuesday. While there are some upside risks to the report (discussed on the following page), we still expect the general trend in inflation to be lower.

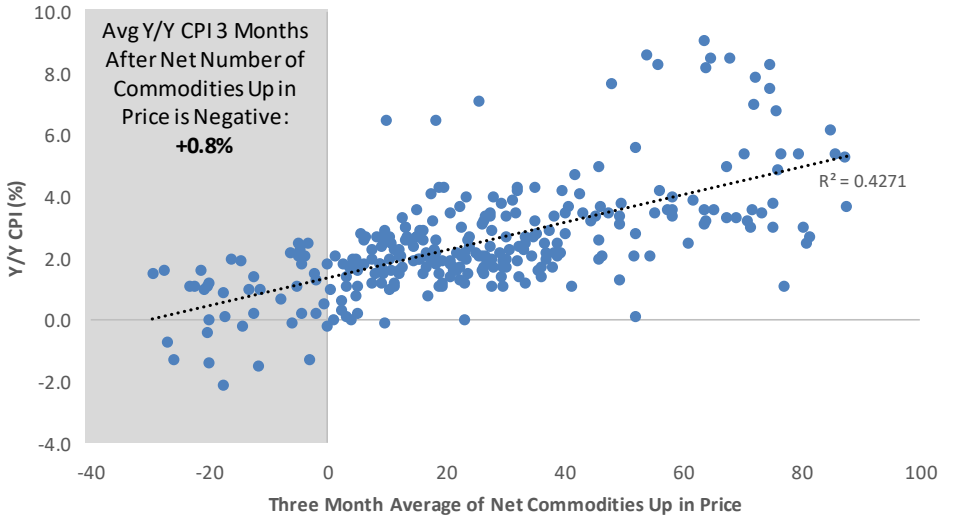
Updating our charts summarizing the number of commodities cited as rising and falling in price in each month's ISM reports, the three month moving average moved slightly lower this month. In the month of January, respondents in the manufacturing and services noted price increases in a total of 25 different commodities and decreases in 28 for a net of -3. That brought the three-month moving average to -2.3 which is the lowest since December 2019. As we have highlighted countless times in the past, trends in the number of commodities rising and falling in price tend to track or even lead shifts in CPI. As shown in the top right chart, while the net number of commodities rising in price has been plunging in recent months, y/y CPI is only just starting to roll over.

The second chart compares the three-month average net number of commodities rising in price to the y/y change in CPI three months in the future. The two series are clearly positively correlated with an r-squared of 0.42. In the past, when the three-month average has been negative, average CPI on a y/y basis three months ahead was just 0.8% and the highest it ever was dating back to 1999 was 2.5%. There's a long way between 6.5% (current y/y CPI) and 2.5%!

Services & Manufacturing Sectors Net Commodities Up in Price: 1999 - 2022



ISM Commodity Survey vs Y/Y CPI: 2000 - 2022



One concern heading into Tuesday's CPI report is the fact that gasoline prices have risen so much this year. In the month of January, the AAA national average price of a gallon of gas rose 9.1% for the largest January increase since 2009 (15.5%) and the second largest gain to start a year since 2005. As shown in the first chart at right, while it's common for gas prices to increase in the first half of the year, they typically don't really start to get going until February.

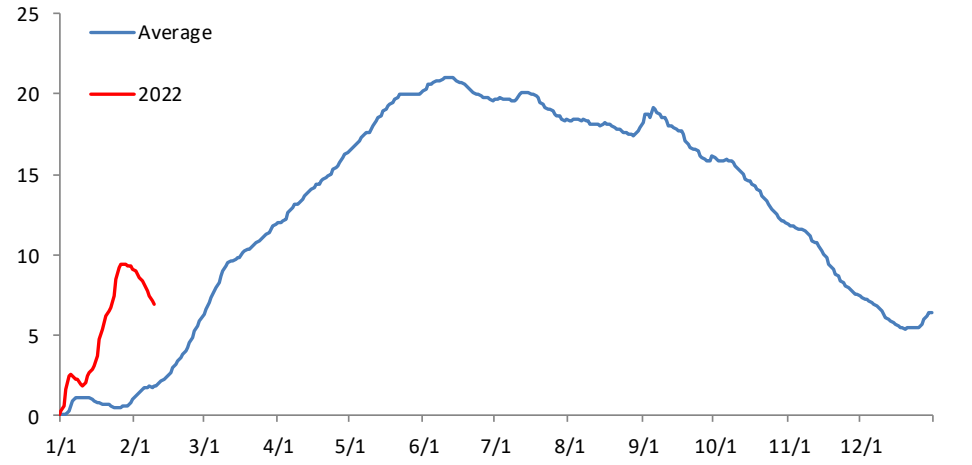
The good news here is that so far in February, we have seen prices pull back 2%. In large part, the January surge in prices was caused by some refineries that were taken offline due to extreme winter weather. Now that those pressures have started to ease, and the refineries are coming back online, there has been some relief at the pump as well.

Even though it may not be a persistent trend going forward, the spike higher in gas prices will impact January's CPI report. The second chart at right compares monthly changes in gas prices to monthly changes in CPI. Historically, the r-squared between the two has been 0.3784 which implies that gas prices do in fact impact CPI.

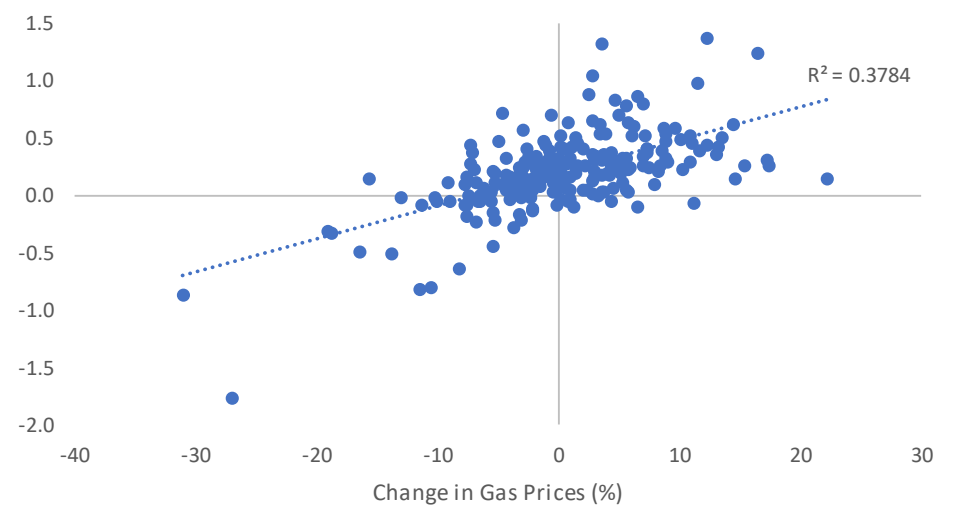
Since 2004, there have been 21 prior months where the AAA national average gas price increased 9% or more, and in those months, CPI increased by an average of 0.5% (median: 0.4%). That's a pretty big increase, especially after December's 0.1% decline, but it's also exactly what the consensus forecast for Tuesday's CPI report is, so the increase should be priced in by the market.

While gas prices at the pump rose significantly in January, natural gas prices plummeted by 30% for the second month in a row. Consecutive declines of that magnitude are unprecedented, but from an inflation perspective, there has been little correlation between monthly changes in natural gas prices and CPI.

Average YTD Change in AAA Average Gas Price Since 2005 (%)



Monthly Change in Gas Prices vs CPI: 2004 - 2022



Next week's most important economic indicator for the market will likely be Tuesday's CPI report for the month of January. After CPI declined 0.1% m/m in December, consensus forecasts for January's report are for a big jump of 0.5%. Barring any revisions, that would keep the y/y reading at 6% or above, while anything less would result in the first 5-handle for CPI on a y/y basis since September 2021.

Regarding the relationship between y/y CPI and the Fed Funds rate, even if CPI comes in at 0.5% for the first three months of the year, CPI will be the same or lower than the Fed Funds rate by the second quarter, and any downside surprises would put inflation well below the Fed Funds rate.

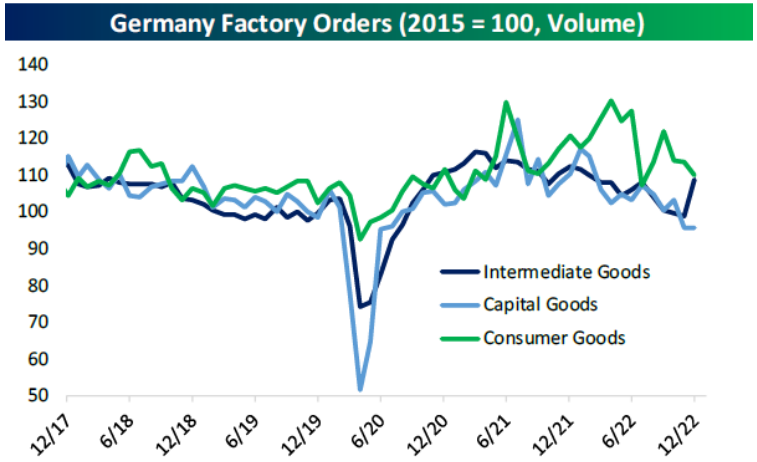
In the first half of 2022, m/m CPI was 0.6% or above five out of six times. As those readings sunset and we add new readings this year, anything but extreme upward surprises will result in downward pressure on CPI.

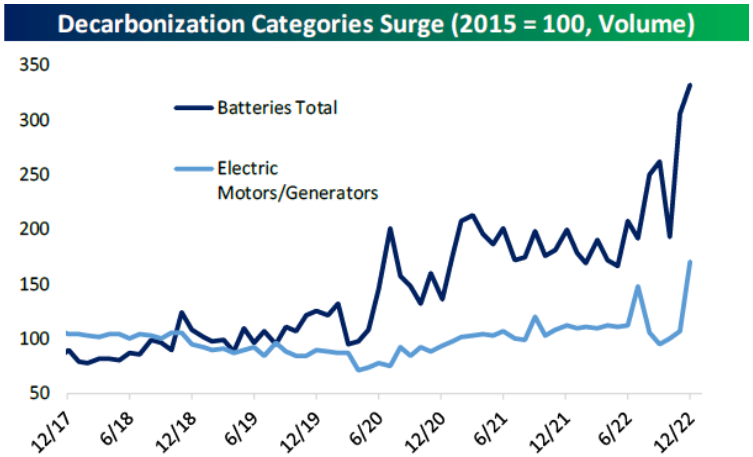
Potential Paths for YoY CPI Based on Constant MoM Changes (Non-Seasonally Adjusted)

Month		Actual CPI YoY %	Fed Funds Rate (%)
Jun-21		*5.39*	*0.08*
Jul-21		*5.37*	*0.07*
Aug-21		*5.25*	*0.06*
Sep-21		*5.39*	*0.06*
Oct-21		*6.22*	*0.07*
Nov-21		*6.81*	*0.07*
Dec-21		*7.04*	*0.07*
Jan-22		*7.48*	*0.08*
Feb-22		*7.87*	*0.08*
Mar-22		*8.54*	*0.33*
Apr-22		*8.26*	*0.33*
May-22		*8.58*	*0.83*
Jun-22	*Peak CPI (so far):*	*9.06*	*1.58*
Jul-22		*8.52*	*2.32*
Aug-22		*8.26*	*2.32*
Sep-22		*8.20*	*3.08*
Oct-22		*7.75*	*3.83*
Nov-22		*7.11*	*3.83*
Dec-22		*6.45*	*4.33*

Future YoY CPI w/:	-0.2% MoM	-0.1% MoM	0.0% MoM	0.1% MoM	0.2% MoM	0.3% MoM	0.4% MoM	0.5% MoM	0.6% MoM	Fed Fund Futures:
Jan-23	5.35	5.46	5.57	5.67	5.78	5.88	5.99	6.09	6.20	4.33
Feb-23	4.19	4.40	4.61	4.82	5.03	5.24	5.45	5.66	5.87	4.59
Mar-23	2.61	2.92	3.23	3.54	3.85	4.16	4.48	4.79	5.10	4.79
Apr-23	1.84	2.25	2.66	3.07	3.48	3.90	4.31	4.73	5.15	4.79
May-23	0.53	1.03	1.54	2.05	2.56	3.07	3.59	4.10	4.62	4.90
Jun-23	-1.03	-0.44	0.16	0.77	1.37	1.98	2.59	3.21	3.82	4.91
Jul-23	-1.22	-0.52	0.18	0.88	1.59	2.30	3.01	3.74	4.46	4.85
Aug-23	-1.38	-0.59	0.21	1.02	1.83	2.64	3.46	4.29	5.12	4.85
Sep-23	-1.79	-0.90	0.00	0.90	1.81	2.73	3.65	4.59	5.53	4.76
Oct-23	-2.38	-1.40	-0.41	0.59	1.60	2.62	3.65	4.69	5.73	4.76
Nov-23	-2.48	-1.40	-0.31	0.80	1.91	3.03	4.17	5.32	6.47	4.64
Dec-23	-2.37	-1.19	0.00	1.21	2.43	3.66	4.91	6.17	7.44	4.47
Jan-24	-2.37	-1.19	0.00	1.21	2.43	3.66	4.91	6.17	7.44	4.27

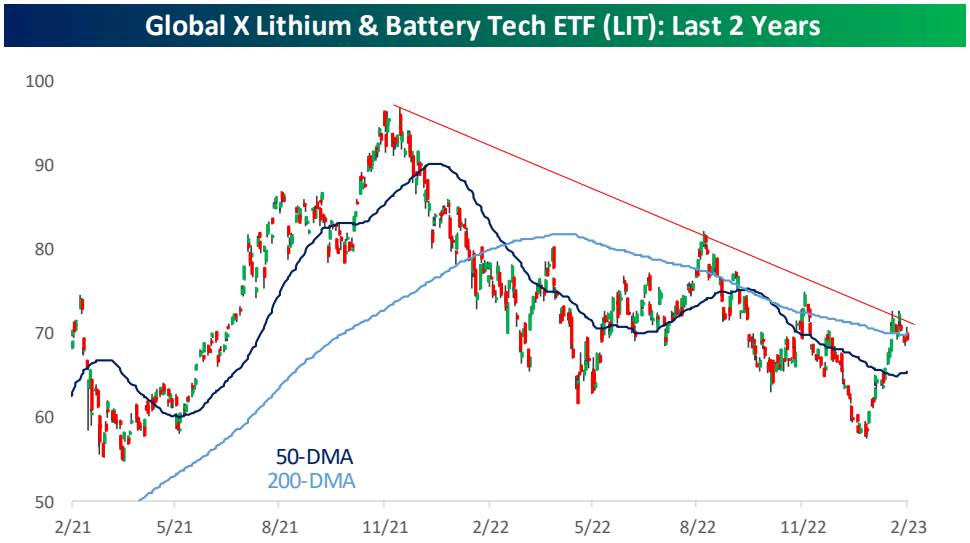
One economic report we thought was worth highlighting on this quiet week was German Factory Orders for December. The headline reading topped forecasts driven by a 15% surge in intermediate goods (top chart). That gain was driven in part by a surge in order volumes for electrical equipment and batteries (bottom chart), which are two key categories to watch in order to track trends in the secular trend of decarbonization.





Given the surges in battery production, lithium is an important sector to watch, but the stocks most exposed to the lithium prices have been going in the opposite direction as battery production.

The Global X Lithium & Battery Tech ETF (LIT) is down nearly 30% from its late 2021 high at the height of the speculative period for equities and right before the Fed shifted policy. After trading to a 52-week low and making a lower low to close out 2022, LIT has surged along with all the other beaten down stocks to kick off 2023. While the rally has been impressive, it stalled out this week just as it started to tests its downtrend. Until the ETF can break this downtrend and make a higher high in the process, it doesn't matter how strong battery orders are.

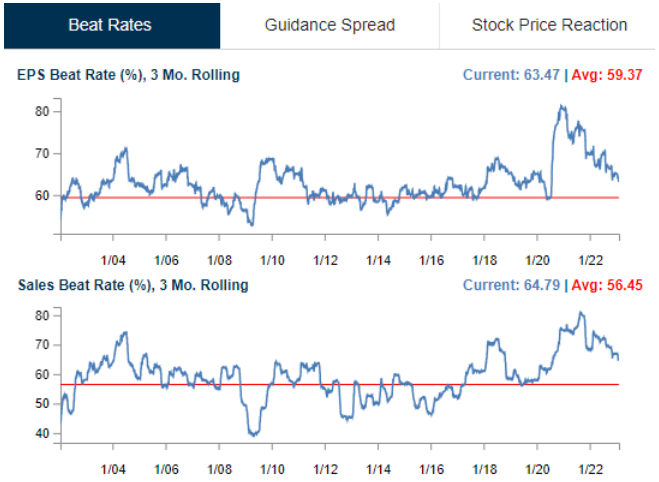


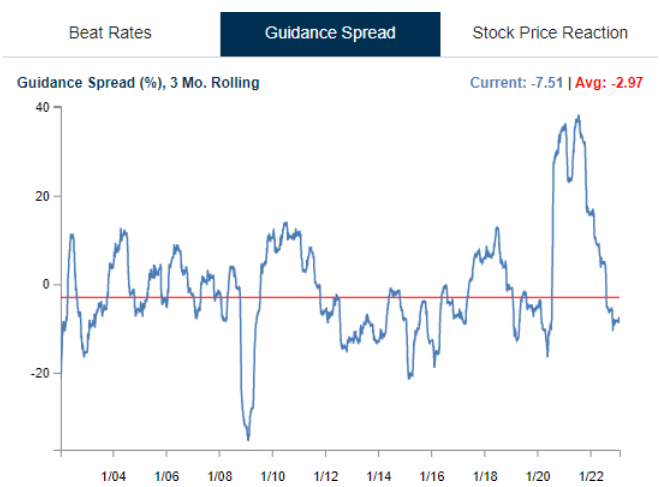
We're now well past the peak of earnings season in terms of both the number and market cap of companies reporting. Through Thursday morning, a total of 848 companies had reported, and most would agree that it could have been worse. Two-thirds of companies managed to beat on the bottom line while 63% exceeded top-line results, and both of these readings are above the historical average. In terms of guidance, 8% of companies reporting have managed to raise forecasts while 10% have lowered guidance. Again, given the economic weakness in Q4, we would have expected more companies to lower guidance, and as we'll highlight on the following pages, managements were generally positive about the second half of the year.

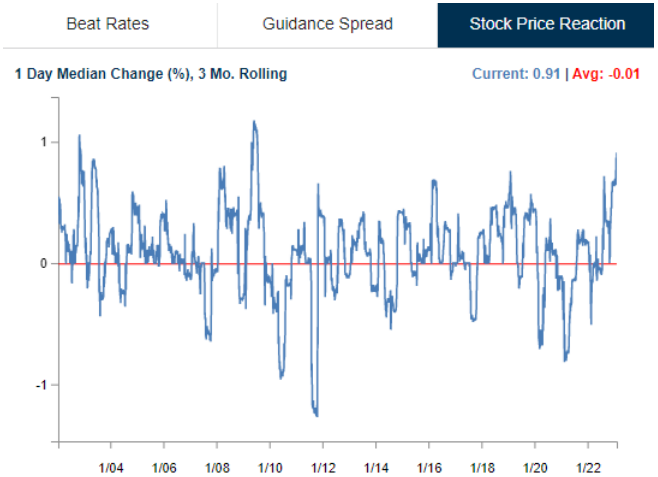
In terms of stock price reactions, stocks reporting earnings have gapped up an average of 0.26% on their earnings reaction days and then rallied an additional 0.33% from the open to close for a full day gain of 0.60%. That may not sound like much, but as shown in the bottom right chart, the recent strength of stocks in reaction to earnings is one of the strongest on record, trailing only the periods coming out of the Financial crisis and the lows of the dot-com bust.

Aggregate Stats - Since 1/1/23

	Beat Rate		Guidance		Average Stock Price % Chg			
Count	EPS	Sales	Raised	Lowered	Opening Gap	Open to Close	Full 1 Day	Volatility
848	66%	63%	8%	10%	0.26	0.33	0.60	5.51







Now that we're more than halfway through the earnings season, we've gotten a pretty good read on how companies have fared relative to expectations, as well as how managements feel about the economy going forward. While economic concerns remain elevated as most economists think a recession is likely, listening to some of the major earnings conference calls, while many companies experienced weakness in the quarter, there were numerous instances of management sounding optimistic about the second half.

Throughout earnings season we listen to major earnings conference calls in order to get a read, not only how the individual companies are making out, but also the broader economy in general. For a synopsis of what we've heard so far this quarter, below and on the following pages we have provided one or two sentence summaries on key calls. For more detailed summaries, check out our *Earnings Conference Call Recaps*.

Communication Services

Alphabet (GOOGL): There wasn't much positive to say about the current backdrop from Alphabet management. While investors debate the prospects of a soft-landing, online advertising spending has slowed considerably. To counter that weaker backdrop, GOOGL management, like a lot of other tech companies this quarter appears to have found religion when it comes to watching expenses.

Meta Platforms (META): The online ad market is still facing a "challenging macro environment," but with expectations low, META beat on the top and bottom line. The company appears to be re-focused on driving growth in its core brand and cutting expenses in non-performing areas of the business.

Netflix (NFLX): Management said on the call that they're thus far not seeing many customers downgrade from higher-priced plans.

Consumer Discretionary

Amazon.com (AMZN): Amazon's engine of growth over the last several years has been AWS, so that was obviously a focal point of the call, and management noted that customers are looking to reduce spending on those services where possible, which led to the record low mid-teens growth rate.

Tesla (TSLA): Musk sounded confident and upbeat on the call as usual, although he voiced concerns that a severe recession is in the cards and that the Fed is risking serious damage to the stock market and the economy by continuing to raise rates in what he sees as an already deflationary environment.

Brunswick (BC): Company noted slower levels of dealer inventory restocking but has yet to see signs of material wholesale cancellations. Higher interest rates have mainly only been an issue for value purchasers.

MarineMax (HZO): Increased economic challenges have started to impact buyers, especially at the lower end. Says buying trends have returned to a more seasonal basis.

Polaris (PII): While recreation sales have softened, commercial and utility customers have remained positive. Premium and higher end business lines remain strong.

MGM Resorts (MGM): If you were looking for signs of an economic slowdown in MGM's conference call, you didn't find it. Management noted record attendance at conferences and maximum hotel occupancy not just at MGM owned properties but for the entire strip.

Consumer Discretionary (cont.)

PulteGroup (PHM): Management was upbeat on the call and acted surprisingly optimistic about Q1 trends given an increase in activity as Q4 progressed and into the start of the new year. The overall lack of supply in the housing market remains a broad macro trend that homebuilders universally cite as a reason to be bullish on the sector long-term.

Lennar (LEN): Higher interest rates have caused prices to come down rapidly in many parts of the country, and Lennar is pricing homes to sell and clear inventory, which reduced margins. Lennar expects the downturn to be "fairly short duration" because of the chronic housing production shortfall over the past decade.

Whirlpool (WHR): The current operating environment for WHR has been a tough one, and management expects to see continued headwinds to start 2023, but throughout the call, they took numerous opportunities to project improved trends in the second half.

Consumer Staples

Costco (COST): While they haven't been immune to the headwinds facing every other retailer, they have been able to handle them thus far. Supply chain issues have completely eased and now the concern is too much rather than too little inventory.

Hershey (HSY): The main reference to the macro backdrop was that "consumer demand has continued to pace ahead of our expectations." Regarding inflationary trends, the company expects pressures to remain but sees the pace of increases slowing.

Consumer Staples (cont.)

Constellation Brands (STZ): Management noted that it hasn't seen any evidence of consumers trading down from high end brands. Inflation remains a key concern for the company as the term was mentioned fourteen different times on the call.

Tyson (TSN): Q1 was a tough one for TSN as the company misread the demand dynamic in a big way. Faced with larger than expected supplies of meat protein on the market and a weak demand picture, average selling prices declined. Looking ahead, TSN does see better things in the second half of the year.

Financials

Bank of America (BAC): Throughout the earnings call, management noted that its base case for the US economy is for a 'mild recession' with the unemployment rate peaking at 5.5% early this year. The bank noted that while consumer balances remain well above pre-pandemic levels, delinquencies remain low.

Health Care

Johnson & Johnson (JNJ): In terms of the cadence of results in 2023, management noted that they expect the second half to be better than the first and the second quarter to be better than the first.

Industrials

Cintas (CTAS): From a macro-economic perspective, CTAS should see emerging economic trends earlier in the cycle than others. While broader economic concerns have been on the rise, CTAS doesn't appear to be noticing much in the way of weakness among its customers.

FedEx (FDX): The company didn't provide much in the way of color on the macro backdrop looking forward but noted that demand trends remain weak as the pandemic surge in e-commerce sales reverts back towards pre-pandemic levels.

Old Dominion (ODFL): It was no surprise to anyone that the environment for shipping companies was weak in 2022. Looking ahead, management at ODFL sounds confident, based on its conversations with customers, that the environment will be improving as the year progresses.

Technology

Apple (AAPL): The company failed to deliver a beat this quarter due to notable weakness across its Products (hardware). iPhone sales were weak due to production shortages for the Pro models, but Tim Cook noted that those supply chain issues have now cleared.

Adobe (ADBE): There was very little mention of macro headwinds, inflationary pressures, labor market stress, or anything negative on Adobe's Q4 conference call, as it appeared executives almost had a directive to remain as upbeat as possible throughout the entirety of the call.

Technology (cont.)

Mastercard (MA): One of the more positive trends throughout MA's call was that management continues to see a healthy consumer and a steady but plateauing economy. At a point where a recession seems to be a foregone conclusion, the term 'recession' wasn't even used a single time on MA's call.

Microsoft (MSFT): The company is very optimistic about future prospects, but it noted the weaker macro backdrop and noted that customers were 'optimizing' resources - code for slowing purchases - 16 different times through the call.

Oracle (ORCL): Management remained upbeat about the environment going forward and made little mention of difficult macro conditions.

Taiwan Semiconductor (TSM): Like the consensus towards the overall economy, TSM anticipates a weak first half but a rebound in the second half of 2023.

The Bespoke Report

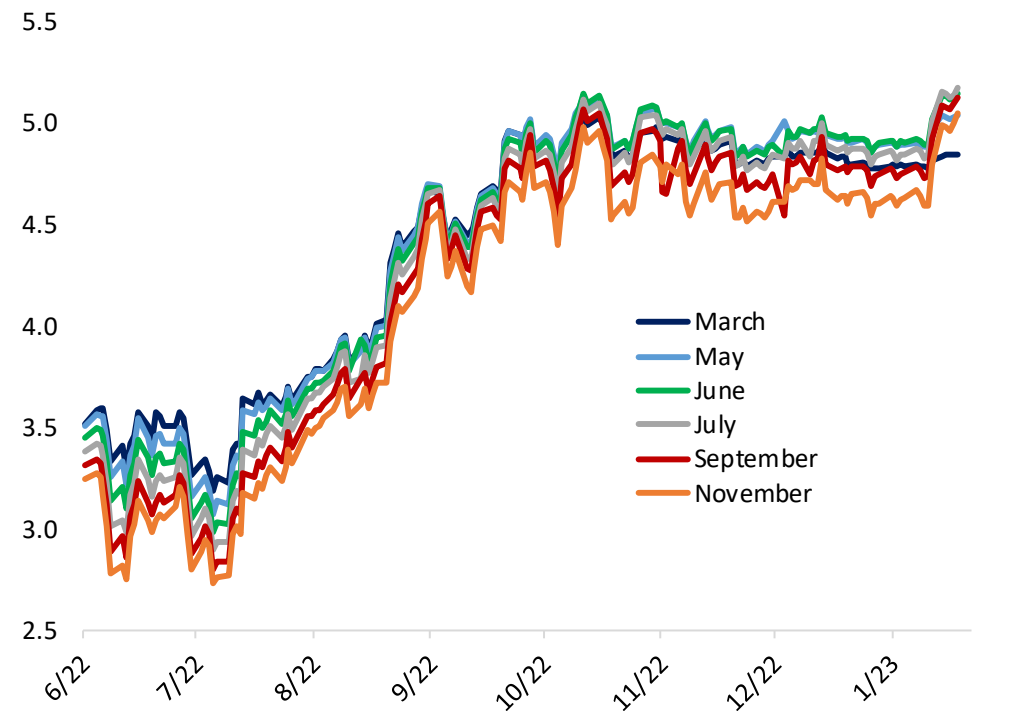
February 10, 2023

After a much stronger-than-expected jobs report last week, markets rapidly repriced the peak Fed Funds rate for the cycle. Immediate reaction from Atlanta Fed President Bostic on Monday suggested that the jobs data "raises the possibility of a higher peak rate." The next day, Chair Powell said that "if strong labor data persists, the peak rate may be higher" at an interview on stage at the Economic Club of New York.

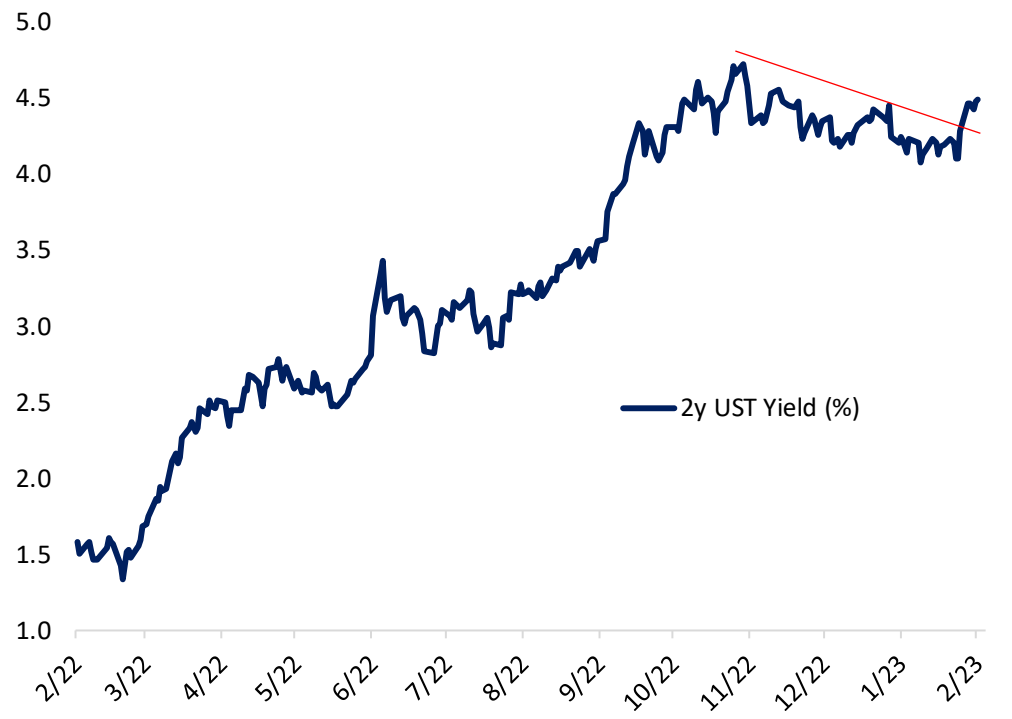
Markets confirmed the initial reaction to the move higher in pricing for the terminal (highest) rate of the cycle. As-of Friday morning, the Fed Funds rate is priced above 5% for the five-meeting span from May to November. That's basically consistent with the Fed's forecast for Fed Funds this year, which in the most recent Summary of Economic Projections (SEP) from December showed the median forecast for Fed Funds at year end in the 5.00% to 5.25% range.

What isn't consistent with the SEP is market pricing of rapid cuts as rates peak. Powell says the Fed "must keep rates at a restrictive level for a period of time" while later in the week Governor Waller said the FOMC "may need rates higher for longer than some expect." Two-year yields reflect the uptick in terminal rate pricing but are still off their highest levels of the cycle because the market, contrary to Fed guidance, now prices aggressive cuts.

Fed Funds Futures Price >5% Fed Funds From May - November



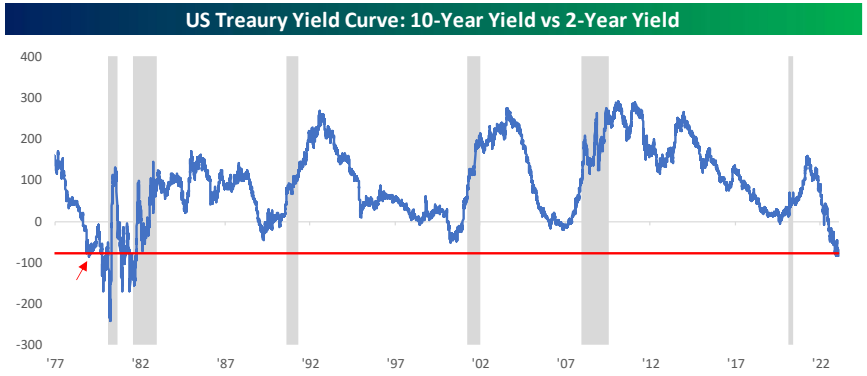
2y Yields Are Not Yet At New Highs



Although the yield on the two-year Treasury broke its downtrend from the peak in yields last fall, the downtrend in the 10-year yield hasn't quite broken yet, although it bumped right up against that level to close out this week. Heading into next week, this will be the key chart investors will be watching, and any signs of yields getting back up to their prior highs will be a serious headwind for the market.

The fact that the 2-year yield has been rising faster than the 10-year yield has only moved the yield curve to more inverted levels. On Thursday (2/9), the 10y/2y curve inverted by as much as 82 basis points which is the most inverted it has been since the early 1980s. As shown in the lower chart, every time the yield curve has inverted by anywhere near as much as it is now, a recession followed. It wasn't always immediate, though. Back in November 1978, the curve inverted by a similar amount as it is now, and it took more than a full year before the recession arrived.

Concerns over inflation have filled the news vacuum this week, and the market looks like it's positioning itself for a hot reading which has caused higher yields and a higher terminal Fed Funds rate. The silver lining is that if the number does come in higher than expected, it won't be as much of a shock as it would have been a week ago.



The pace of data was so quiet this week that Thursday's report on sentiment from the *American Association of Individual Investors (AAII)* was cited by many reputable news organizations as one of the reasons behind the market weakness. Sentiment surveys are an important part of the investment process, but it's extremely rare for one of these weekly surveys to move markets. In the media, every market move has to have a 'reason' behind it, so in a week with little concrete catalysts, the headline writers really had to dig down to find a *reason*.

It's not as of this week's AAII survey was extreme either. Bullish sentiment increased to 37.5% which was the highest level in more than a year, but it was still below the historical average! What was notable about this week's report was that for the first week in 44, bullish sentiment exceeded bearish sentiment, ending what was the longest streak of negative readings in the history of the survey.

There are not many examples of bearish sentiment remaining this pessimistic for so long but looking to the end of past streaks of negative bull-bear spreads lasting at least 10 weeks, forward performance has generally been positive once they end. As shown in the table below, the next week has seen mixed performance, but returns further out have generally improved. In the two prior streaks that lasted longer than twenty weeks, performance over the next week was negative both times, but one year later, the S&P 500 was up 30% both times. While investor sentiment is typically considered a contrarian indicator, signals have been less contrarian in periods when sentiment swings back to optimism after extended periods of pessimism.

S&P 500 After 10+ Weeks of Negative Bull-Bear Spreads

	AAII Sentiment (%)			Consecutive Weeks	S&P 500 Performance (%)				
Date	Bull	Neutral	Bear	of Bears > Bulls	Week	Month	3 Month	6 Month	Year
1/4/1991	31.0	39.0	30.0	22	-1.80	6.87	18.22	16.30	30.64
10/30/1992	35.0	35.0	30.0	13	-0.26	3.03	4.64	5.14	11.74
9/3/1993	38.0	33.0	29.0	12	0.16	0.00	0.10	0.36	2.09
8/24/2006	39.4	23.2	37.4	14	0.60	1.44	8.11	11.83	13.17
3/27/2008	41.6	24.8	33.6	14	3.28	4.76	-0.59	-10.37	-37.18
8/9/2012	36.5	36.2	27.4	13	0.91	2.50	1.82	8.14	20.77
10/22/2020	35.8	31.2	33.0	34	-4.15	3.72	11.53	21.04	31.60
3/31/2022	31.9	40.6	27.5	12	-0.67	-8.80	-15.65	-19.64	?
2/9/2023	37.5	37.5	25.0	44	?	?	?	?	?
Average	36.3	33.4	30.3		-0.24	1.69	3.52	4.10	10.40
Median	36.5	35.0	30.0		-0.05	2.76	3.23	6.64	13.17
% Positive					50.0	75.0	75.0	75.0	85.7
All Periods Since 1987									
Average	37.6	31.4	31.0		0.17	0.66	1.99	4.40	9.42
Median	37.0	31.2	29.9		0.32	1.09	2.84	5.17	10.91

The Bespoke Report

February 10, 2023

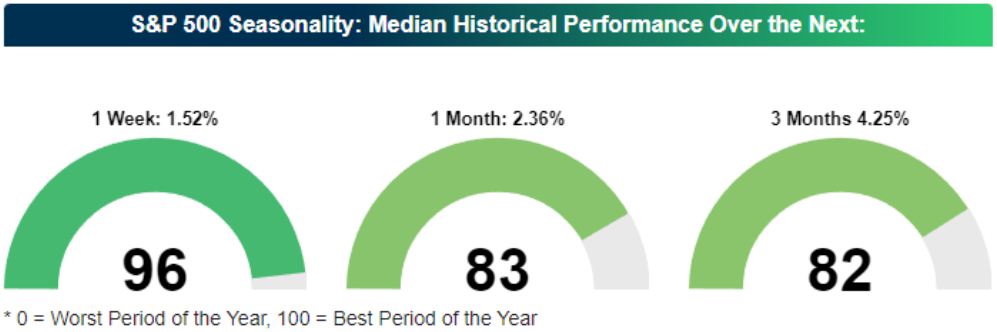
We'll leave off this week with a brief look at seasonality. The snapshot at right comes from the *Seasonality Tool* on our website, and it shows the S&P 500's median historical performance for the next week, month, and three months based on the last ten years.

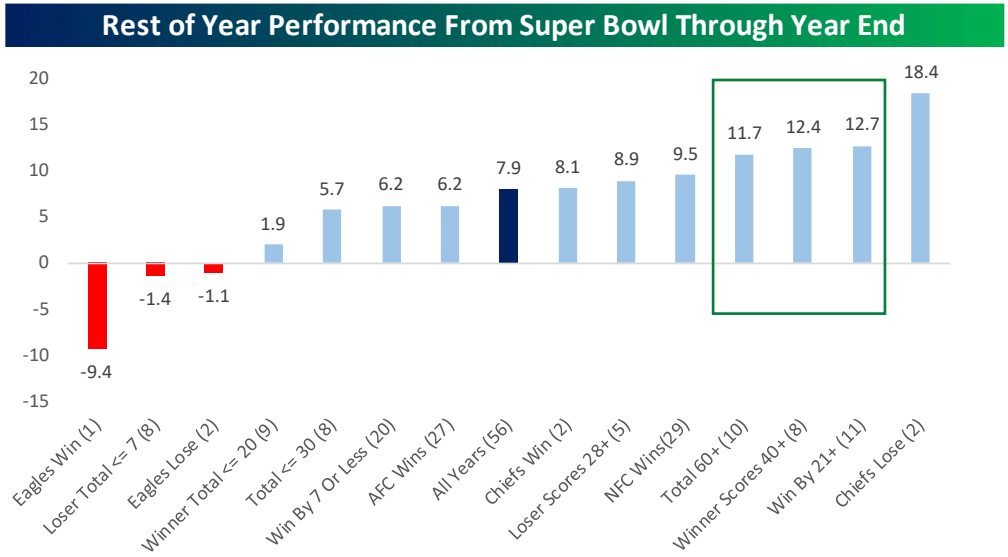
Looking ahead to the next week, the S&P 500's median performance from the close on 2/10 has been a gain of 1.52% which ranks in the 96th percentile of all rolling one-week periods in the year. Looking further out over the next one and three months, performance has also been on the strong side with median gains of 2.36% and 4.25%, respectively, and both ranking in the 82nd percentile or better.

Finally, as we all get ready for the big game this weekend, we've taken a slightly different take on the Super Bowl Indicator. Rather than just looking at performance following AFC and NFC wins, we also included games won or lost by the Chiefs and Eagles as well as performance based on how many points the winner and loser scored as well as the total. Obviously, this is all nonsensical, but at least it's a ridiculous stat you can use at the party this Sunday.

While it's a small sample size, the fact that the Eagles are even in the Super Bowl is bad enough for New Yorkers. The stock market hasn't performed particularly well after Eagles Super Bowls either! The one year they won, the S&P 500 was down 9.4% for the remainder of the year, and the average return after the two they lost was a decline of 1.1%. However, the Chiefs have made the Super Bowl four times, winning twice and losing twice. When they lost, the S&P 500 rallied an average of 8.1% and when they won, the average rest of year gain was 18.4%. Something will have to give this year, but let's just hope for a high scoring blowout.

Have a great weekend!





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