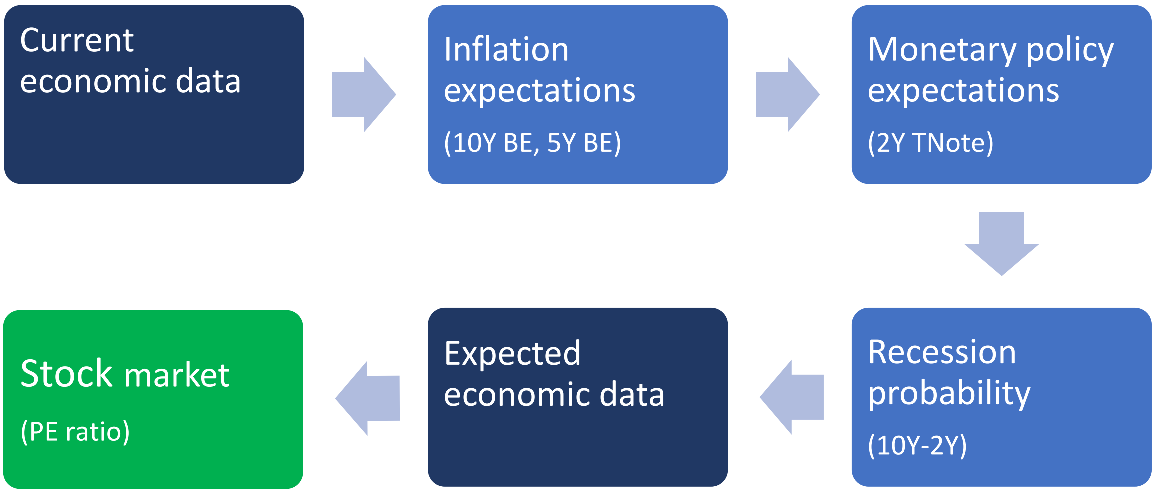
GAV Weekly S&P 500 Outlook



Executive Summary

Current data**:** Growth weakening while inflation still rising – starting to reflect the expected data. Labor market still remains strong, supports rising inflation.

Inflation expectations: Falling – the peak inflation expectations hypothesis.

Monetary policy expectations: Fed policy priced in for 2022, less aggressive for 2023 – the peak Fed hawkishness hypothesis.

Recession probability**:** Yield curves inverted in March, 10y-5y reinverted and still inverted: high probability of a recession, but no imminent recession.

Expected economic data: Higher inflation with slower growth and eventually a Fed-induced recession. First indications of stagflation in recent data.

S&P 500 Strategic Outlook: **The Fed-induced recessionary bear market** is unfolding – consistent with the expected economic data.

Tactical opportunity: High probability of the **bear market rally** due to the peak inflation expectations/monetary policy hypothesis and the technical support level.

Weekly Macro Analysis and S&P 500 Outlook

Current economic data	
GDP:	**-1.4%** Q1 2022 (down from 6.9%) – *Consumption 2.7% (strong)* **3.4%** Q1 2022 yoy (down from 5.5%)
Unemployment rate	**3.6%** March 2022 (down from 3.8%) Weekly claims **180K** (down from 184K - strong labor market)
Inflation:	**8.5%** March 2022 CPI (up from 7.9%) - *PCE 6.6% (6.3%)* **6.5%** March 2022 Core CPI (up from 6.4%) - *Core PCE* ***5.2% (5.3%)***

Weekly note: Growth slowing (peak growth Q4 21) – inflation rising (but core PCE lower). The labor market remains strong, supports higher wages – and strong economy.

Inflation expectations			
	Nominal Yield (*last week*)	Real Rate	BE Inflation Expectations
5Y	2.95% (2.93%)	-0.40% (-0.44%)	3.35% (3.37%) – **still falling** - above 3%
10Y	2.93% (2.90%)	**-0.01% (-0.09%)**	2.94% (2.99%) – **falling** 2.99 high 2.75 key
30Y	3.00% (2.94%)	0.40% (0.31%)	2.60% (2.63%) - **falling**

Weekly note: Inflation expectations are **falling**, for the first week – **peak inflation expectations**? Real yields are rising (10Y at 0%) – pricing QT.

Monetary policy expectations					
Current	Jan 2023	Jan 2024	High	First cut	Jan 27 -terminal
0.33% (0.34%)	2.83 (2.83)	**3.23** (3.32)	**3.33 Aug 23** (3.43 Jul 24)	**2.93** Dec 24 (3.01 Dec 24)	**3.13** (3.20) *last week*
QE ended in March. QT starting in May – balance sheet reduction $95 bill/month					

Weekly note: Fed **priced in** for 22, **less aggressive** in 23 and after until terminal, high point much earlier in Aug 23, first cut still Dec 24. **Peak hawkishness**?

Recession probability		
10Y-2Y spread	0.22% (0.23%)	Inverted week of March 28th, slight narrowing
10Y-5Y spread	-0.02% (-0.03%)	First inverted in March, reinverted – still inverted
2Y-3mo spread	1.89% (1.90%)	Positive - an imminent recession not expected

Weekly note: Recession probability still very high - but no an imminent recession yet. **Spreads stable**.

Credit and international			
Credit risk	BBB-10Y HYG	**2.06%** (1.93%) -9.75% (-8.91%) YTD	**Increase** to moderate. High 2.38% Mar 10. **Falling**
US vs Ger	US10Y-Bund	1.99% (1.93%)	Stable at this level. Germany inf. 7.3%
ECB	Rate to 0%	July 22 (July 22)	No change.

Weekly note: Modest **increase in credit risk**. No international market shocks.

Expected data	
Slower growth and an eventual recession (Fed)	High and persistent inflation (de-globalization)

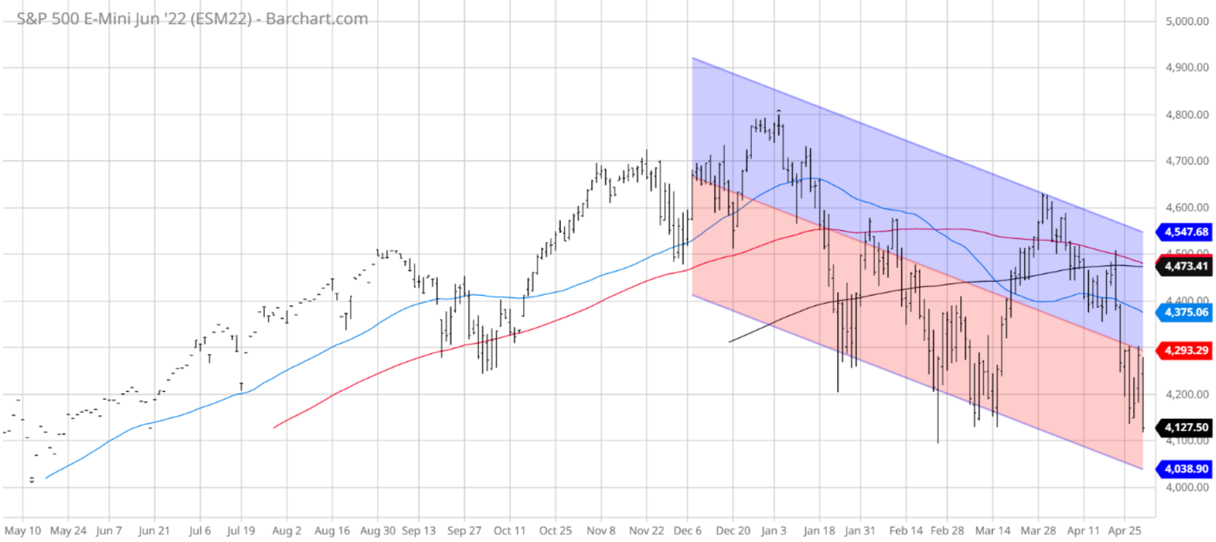
Weekly note: Stagflation with an ultimate recession. Outlook unchanged. IMF growth downgrade.

S&P 500 outlook – SELL

- PE = 24 - Overvalued (predicting high growth while bond market predicts stagflation).
- Aggressive monetary tightening will cause the recession.
- Stock market to reflect the expected data – recession. Current data already stagflationary.
- Balance sheet reduction to bust all speculative bubbles, as real rates increase (QT).

Weekly note: No change in outlook.

S&P 500 Technical analysis



- **Correction 14%** (consistent with the outlook).
- High point: Jan 4th, 2022
- Low Point: April 29th, 2022
- First leg down – reaction to higher interest rates.
- Second leg down – reaction to Russian invasion of Ukraine and higher oil prices.
- Bear market rally:
  - Fed's first hike only 25bp, due to Ukraine uncertainty
  - Oil price correction – release from SPR
  - Expectations of cease-fire in Russia
- Current trend: **Third leg down**
  - Drivers: **more aggressive Fed** and **the Fed's QT (real rates)**, which starts in May.
    - Fed induced recession.
    - Reduction in liquidity to deflate all bubbles.
  - Currently: at new low.
  - Next week: down to 4000 resistance or rally back to 50dma.

S&P 500 Tactical next-move outlook

Fundamental pricing trigger duration — Tactical trade**: Buy**

- Peak inflation expectations/Peak Fed hawkishness trade – the trigger priced-in?
  10Y BE inflation stays below 3%
  Fed hikes by 50bp in May
  10 real interest rate at 0%

Technical — Technical trade: **Buy**

- Near bottom of the downtrend channel: high bounce probability
  Possible short-term bottom at 4000 – low entry point
  First target: 4300
  Second targe 50dma
  Stop loss: Sub 4000 (current 4130)

Longer term:

- Fed induced recessionary bear market (must be confirmed with economic data)

Market pricing analysis

S&P 500 Sector Performance: -13.31% YTD, -3.27% 5 days			
Leaders YTD	Laggards YTD	Leaders 5 Days	Laggards 5 Days
Energy XLE 35.4% Staples XLP 0.69%	Comm XLC -24% ConDis -20% Tech XLK -18.7%		ConDis -7% RealEstate -5.6% Uliltities -4%

Weekly note: Sell-all liquidity event – pricing QT and aggressive policy tightening. Next week Fed! <u>Consistent with the S&P 500 outlook – unfolding bear market.</u>

Global/Factor Performance			
	YTD (last week)		YTD (last week)
Russell IWM	-16.86 (-13.38%)	Stoxx50	**-11.31** (-10.53%)
EEM	-**13.24** (-13.24%)	StoxxBanks	-13.42 (-9.60%)
EAFE	-13.19 (-10.80%)	FTSE100	**3.36** (3.20%)

Weekly Note: Bear markets unfolding, consistent with the global recession expectations. FTSE heavily weighted on Energy - inflation. Last week **again** less selling Europe, also EEM – **US bubble deflation due the more aggressive Fed** and QT with rising real rates. <u>Consistent with the S&P 500 outlook.</u>

FX/Commodity Performance			
	YTD (last week)		YTD (last week)
Euro	-7.40 (-5.43%)	Silver	-1.41% (3.76%)
AUD	-2.66% (-0.53%)	Platinum	2.79% (-4.06%)
Br.Real	16.3% (18.5%)	Oil	42.49% (39.12%)
Gold	4.27% (5.5%)	Copper	**-0.77%** (3.59%)

Weekly note: Strong USD consistent with weak global growth – Fed + deglobalization. AUD sell-off continues – global recession?. Copper turned negative YTD – global recession? <u>Consistent with the S&P 500 outlook.</u>

Risk factors (to the short S&P 500 outlook)

- Fed Dovish turn
  - Inflation peaks and inflation expectations <u>significantly decrease</u>
    - Global supply chains improve
      - The pandemic ends and the China lockdown ends – (de-globalization)
      - Russia sanctions are lifted (peace agreement with Ukraine) - **unlikely**
    - US labor participation increases (end of pandemics, immigration reform)
    - Longer-term: the return of globalization - **unlikely**
      - US-China trade dispute is resolved – tariffs lifted on China
    - The US stock market crashes in a liquidity/credit event – cover short (liquidly event last week – but not credit event – too early for Fed put)
  - Fed tolerates high inflation and decides to protect the markets – the Fed put

- Fiscal stimulus (China, Japan, and US)

Expected economic data analysis

Expected economic data is the function of:

- Whether the monetary policy is as expected, or more/less aggressive, which depends on the inflation-path (and the in-coming economic data).
- The effects of the expected monetary policy, which is designed to affect the demand-side of inflation dynamics.
- Note: There were 13 Fed's interest rate hiking cycles since 1945, which caused a recession 10 times. Exceptions: 1994-95, 1983-84, 1965-66

Key inflation drivers	
Demand shock:	Supply shock:
*Extraordinary pandemic-related monetary stimulus causing higher credit consumption. (Higher rates to lower credit consumption.) *Extraordinary pandemic-related fiscal stimulus - direct cash, benefits. (Fiscal benefits expiring - less consumption) *Investment gains and wealth effect: rising stock market, housing, cryptocurrencies caused higher consumption. (Rising real rates designed to deflate bubbles – QT) *Pandemic-related labor shortage causing rising wages 5.6%, which leads to more consumption. (Lower consumptio**n** to increase unemployment rate.)	*Pandemic-related labor shortage - low participation rate 62.4%. (Needs to increase labor participation – **end of pandemics**, increase immigration or productivity.) *Pandemic-related supply chain bottlenecks - China 0-covid policy (End of pandemics and globalization to improve supply chains.) *Pandemic-related material shortages – such as semiconductors. (End of pandemics and globalization to improve shortages.) *Commodity shortages: **Russia sanctions**, geopolitics (long-term problem – economic war) *Longer term: **de-globalization** reduces supply (Russia/China block developing)
Monetary policy works with a lag: labor market still strong, asset prices still inflated, consumption still strong, wages still rising.	End of pandemics could improve supply-chains and some shortages – but still lockdowns in China. De-globalization will keep supplies tight for longer-term – implying higher long-term inflation expectations.

Weekly note: Demand is still strong and supply is still tight – implying aggressive monetary policy tightening, as expected. Effect on economy: Recession. Peak-inflation point?

Events expectations

- The Fed to start implementing monetary tightening – hike by 50bp in May
- The Fed to start implementing QT in May
- Corporate guidance in April to reflect higher inflation and the effect on margins, and reflect on recession probability – effect on sales and earnings (negative guidance and downgrades).
- Escalating Russia-Ukraine crisis and accelerated de-globalization

Weekly note: NFTX losing subscribers, negative guidance from AMZN

Economic data expectations
Slower growth – eventually recession
Higher interest rates (Fed) – less credit consumption – lower sales (discretionary sector) Higher mortgage rates (10y) – lower housing prices (wealth effect – housing sector) Lower stock market and cryptocurrencies – wealth effect (less consumption) Russia sanctions and higher oil – lower consumption (as long as sanctions last) (energy) Longer-term: de-globalization leads to slower growth (less exports)
Uptick in Unemployment
Slower growth will lead to uptick in an unemployment rate (lower demand)
High Inflation to persist
Higher oil (Russia) will keep inflation high (oil as well as other commodities) Longer-term de-globalization is inflationary. Pandemic related supply-chain bottlenecks still inflationary (China lockdowns). Supply issues unresolved – demand still not affected by the Fed and Oil

Weekly note: No changes in the economic data expectations. Last week slower growth with higher inflation – first confirmation of stagflationary environment.