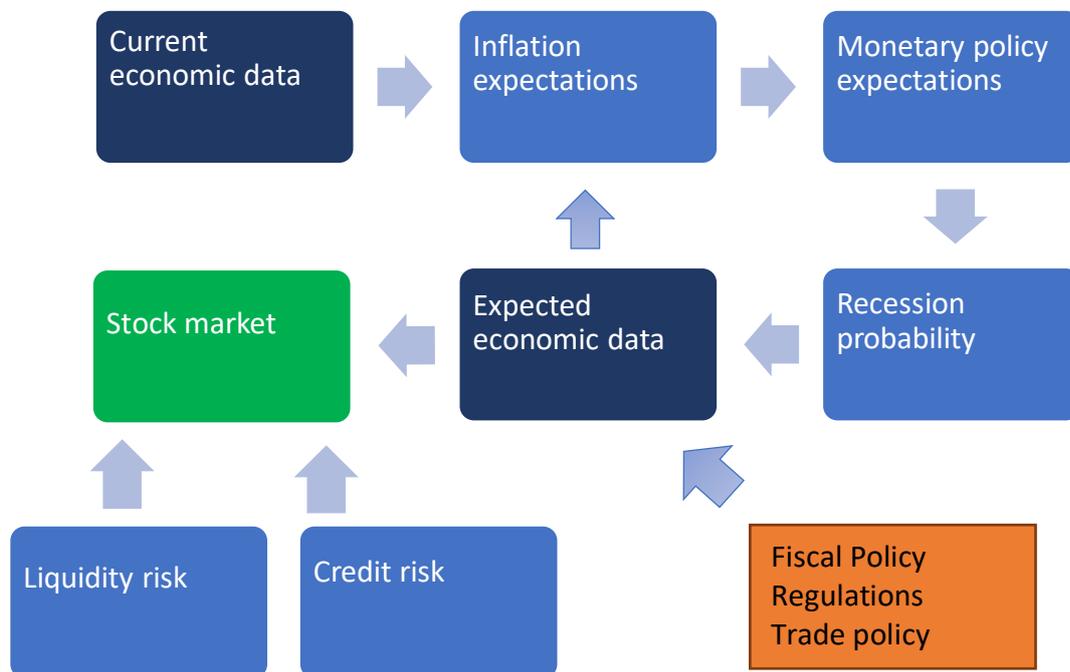


## Weekly S&P 500 Outlook



### Executive Summary

**Key drivers last week:** S&P500 went up by 4.42% for the total drawdown of -18.37% YTD. Falling real rates and expectations of less aggressive Fed eased the liquidity risk. Selloff in commodities and lower PMI numbers support the growth slowdown, thus, lower inflation and less aggressive Fed, which lowers the recession probability.

**Tactical SP500 outlook: Bullish.** Falling commodity prices support lower headline CPI, and thus, less aggressive Fed and lower recession probability. Liquidity risk is low above the 3840 level. Bullish on S&P500 above the 3840 level.

**Strategic SP500 outlook: Neutral.** Bear market is a buying opportunity for long term investors. However, no clarity yet on how deep the bear market will be. The liquidity risk can lead to a much deeper selloff – and it's still uncertain whether 1) the Fed will induce a recession (late 2023?), and 2) whether the recession will lead to a credit crunch (housing market bubble).

## Weekly Macro Analysis and S&P 500 Outlook

### Current economic data

GDP: **-1.5%** Q1 2022 (down from 6.9%) **manufacturing PMI 52 (down from 56)**  
**3.5%** Q1 2022 yoy (down from 5.5%)

Unemployment rate **3.6%** May 2022 (last 3.6%)  
 Weekly claims **229K** (down from 231K) 166K low Mar 20<sup>th</sup>

Inflation: **8.6%** May 2022 CPI (up from 8.3% - **new high**)  
**6%** May 2022 Core CPI (down from 6.2% high **6.5% March**)

**Note:** Labor market still strong but claims stay high. ISM numbers show the beginning of slowdown?

### BE Inflation expectations

	Nominal Yield ( <i>last week</i> )	Real Rate	BE Inflation Expectations
5Y	3.19% (3.34%)	<b>0.35%</b> (0.51%)	<b>2.84%</b> (2.83%) – <b>3.59% peak Mar 25<sup>th</sup></b>
10Y	3.13% (3.23%)	<b>0.56%</b> (0.63%)	<b>2.57%</b> (2.60%) – <b>3.02% peak Apr 21<sup>st</sup></b>
30Y	3.26% (3.28%)	<b>0.82%</b> (0.84%)	<b>2.44%</b> (2.44%) – <b>2.63% peak Apr 21<sup>st</sup></b>

**Note:** Inflation expectations **stable** and real rates **fell** – **QT priced-in?** Peak inflation 10Y BE expectations Apr 21 at 3.02%.

### Monetary policy expectations

Front	Jan 2023	Jan 2024	High	First cut	Low	Jan 27 -long term
1.21%	<b>3.41</b>	<b>3.16</b>	<b>3.52 Apr 23</b>	<b>3.22 Nov 23</b>	<b>2.57 Jul 24</b>	<b>3.11</b>
(1.21)	(3.67)	(3.45)	(3.77 Jul 23)	(3.51 Mar 24)		(3.51) <i>last week</i>

QE ended in March. QT starting in June – June-Aug \$47.5 bill/month, after \$95bill/month

**Note:** Fed significantly **less aggressive** – **Recession late 23 (1% cut)?** Peak hawkishness Jun 17<sup>th</sup> (3.67 for 2022).

### 12-Month Recession probability: low

10Y-2Y spread	0.07% (0.05%)	<b>Flat-stable</b> (Inverted week of March 28 <sup>th</sup> )
10Y-5Y spread	-0.06% (-0.11%)	<b>Inverted</b> (First inverted in March, reinverted)
2Y-3mo spread	<b>1.43%</b> (1.62%)	<b>Narrowing*</b> – an imminent recession not expected

**Note:** Still low chance of an imminent recession (2Y-3mo) – but the spread narrowing fast\*, expected to invert by the end of year. Recession late 2023? (commodities selling off)

### Fiscal Policy, Trade, Regulations

Biden considering dropping China tariffs – should lower inflation expectations (re-globalization)

**Note:** “The agency is collecting comments from industry participants in two batches, ending July 5 and Aug. 22.”

### Expected data

Level 1: Fed-induced slower growth and still persistently elevated inflation (de-globalization)

Level 2: Fed-induced **Recession (late 2023) or Soft landing?**

**Note:** Claims stay high – beginning of slowdown in labor market? ISM at 52.

### S&P 500 pricing: Past performance: 5 Days: 4.42% YTD: -18.37% (-23.41%)

- PE = **19** – Fell from 36 on Jan 4<sup>th</sup>, 2022 – **still modestly expensive**.
- The Fed-induced liquidity shock selloff eased: **New Bounce** – out of Bear market territory
- **The Latest:** Pricing-in **less aggressive Fed** as slowdown is expected, but not a recession
- Reacting **positively** to the possibility of dropping the China tariffs (lower inflation)
- Reacts **positively** to less aggressive Fed (lower recession probability)
- Reacts **negatively** to more aggressive Fed (higher recession probability)

**Note:** Beginning of the new bounce. How far?

**Liquidity risk – High – Phase 1 selloff – ACTIVE but eased**

*Expectations of an aggressive monetary policy tightening in the presence of a bubble causes the liquidity shock and bubble burst.*

The ultra-hawkish Powell IMF speech on 4/21 reduced the market depth in short term bonds, which caused the liquidity shock in S&P 500 futures and burst in speculative bubbles 1) tech stocks, 2) meme stocks, 3) cryptocurrencies. **The peak Fed hawkishness Jun 17<sup>th</sup> – the liquidity shock eased.**

- Crypto – Bitcoin: **-55%** (-59%) YTD      QQQ: **-27%** (-32%) YTD
- VIX = **27(35)** peak vol. May 2 at 36

**Note:** The bounce in BTC and QQQ, volatility well below the peak – **liquidity shock eased**

**An Imminent Recession risk – Low – Phase 2 selloff – not yet expected**

*In recessions: 1) corporate earnings decrease – further contraction of PE ratios 2) unemployment increases – lowers consumer spending.*

Key indicator **2Y-3mo spread** still indicates the low probability of an imminent recession. But the Fed is behind the curve and the spread is expected to significantly narrow by the end of 2022.

**Note:** Recession expected in late 2023.

**Credit risk – Moderate/Low – Phase 3 selloff – not yet expected**

*As recession hits and unemployment increases, corporate and individual bankruptcies increase – especially in the presence of a housing bubble, or other collateral value bubble. Systematic bankruptcies increase the credit risk to a high level, which causes forced selling – and the most severe phase of the bear market.*

Credit risk	BBB-10Y	<b>2.20%</b> (2.13%)	<b>Increase – but still low (2.38% high )</b>
	HYG	<b>-13.72%</b> (-14.8%) YTD	Higher with bonds
Housing	Case-Schiller	<b>21.2%</b> (20.1)% yoy	Highest increase ever – bubble?

**Note:** Moderate/Low level of credit risk – slight increase.

**Cross-asset analysis – signals**

	Pattern	Note
<b>Bonds</b>		<b>Ger bunds drops more* EU recession?</b>
Bund	Down <b>1.43%</b> (1.66%)	TY-Bu= <b>1.70%</b> (1.57%) – widening*
ECB 0%	July 2022	<b>Less aggressive tightening expected</b>
	Dec 22 <b>1.21</b> (1.50) Dec 23 <b>2.01</b> (2.45)	
<b>Stocks</b>	Bounce – liquidity shock eased (Fed)	
FTSE100	Downtrend – <b>bounce</b> – heavily commodity/energy weighted	Weaker commodity prices? – global recession?
STOXX50	Downtrend – <b>double bottom 3400</b>	Less aggressive ECB – recession?
EEM	Downtrend – <b>double bottom 39</b>	Resembles EUR chart – strong dollar
<b>Currencies</b>	Strong USD	
EUR	Downtrend – <b>double bottom 1.04</b>	Fed, war in Ukraine; ECB tightening
AUD	Downtrend – <b>double bottom 0.69</b>	Liquidity shock eased
<b>Commodity</b>		
Gold	<b>Still Holding</b> the 200dma - flat	Strong USD, rising real rates negative
Copper	Sharp selloff sub 4	<b>Global slowdown</b>
Oil	Selloff to 50dma - holding	Supply – sanction on Russia vs recession

**Note:** 1) lower interest rates, 2) USD flat (**liquidity shock continues**), 3) **weaker** copper and dip in oil (**global slowdown**), 4) stock markets bounce. **Short commodities trade?**

**S&P 500 Technical analysis**



- **Bear market 24%:** Jan 4<sup>th</sup> – May 17<sup>th</sup> (current -18%)
- **The new bounce** – out of bear market
- **Support:** Low point at 3650
- **Resistance:** 1) previous low 3840-3900 (at resistance), 2) 50dma 4066
- **Opinion:** Bullish above the 3840 level or the 20% drawdown threshold.

**S&P 500 Tactical outlook**

Tactical - Fundamental Thematic

**Bullish**

- The **Phase 1** liquidity shock eased (positive): lower real rates and less aggressive Fed.
- Weakening growth data will support less aggressive Fed - lower recession probability.
- Higher inflation data will require more aggressive Fed – higher chance of recession.
- Given that commodities are selling off, headline CPI is likely to fall – supports less aggressive Fed – and thus, lower recession probability – **bullish scenario** (end of Phase 1).
- Possible revision in corporate earnings to reflect slowdown, while PE ratio is still high at 19 (negative) – the valuation bubble continues to burst.

Technical

**Bullish**

- Bullish above the 3840 level – stop loss below the 3840 level.

Longer term

**Neutral**

- Bear market is a buying opportunity for long term investors.
- However, no clarity yet on how deep the bear market will be – the Phase 1 selloff eased but it’s still active.
- It’s not clear yet whether the recession will follow - the Phase 2 selloff.
- It’s not clear yet whether the credit crunch will follow as the housing market corrects - the Phase 3 selloff.

**Tactical Trades:**

- **Bullish:** Above the 3840 level, supported with the less aggressive Fed.
- **Bearish:** The bet on further downside is the bet on the deep recession and the rising credit risk, or the renewed liquidity risk (sub 3840).

### Expected economic data and inflation variables

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 incoming 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:
<p>*Extraordinary pandemic-related monetary stimulus causing higher credit consumption. (Higher rates to lower credit consumption.)</p> <p>*Extraordinary pandemic-related fiscal stimulus - direct cash, benefits. (Fiscal benefits expiring - less consumption)</p> <p>*Investment gains and wealth effect: rising stock market, housing, cryptocurrencies caused higher consumption. (Rising real rates designed to deflate bubbles – QT)</p> <p>*Pandemic-related labor shortage causing rising wages 5.6%, which leads to more consumption. (Lower consumption to increase unemployment rate.)</p>	<p>*Pandemic-related labor shortage - low participation rate 62.4%. (Needs to increase labor participation – <b>end of pandemics</b>, increase immigration or productivity.)</p> <p>*Pandemic-related supply chain bottlenecks - China 0-covid policy (End of pandemics and globalization to improve supply chains.)</p> <p>*Pandemic-related material shortages – such as semiconductors. (End of pandemics and globalization to improve shortages.)</p> <p>*Commodity shortages: <b>Russia sanctions</b>, geopolitics (long-term problem – economic war)</p> <p>*Longer term: <b>de-globalization</b> reduces supply (Russia/China block developing)</p>
<p>Monetary policy works with a lag: labor market still strong, asset prices still inflated (deeper correction needed), consumption still strong, wages still rising.</p>	<p>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.</p>

#### Weekly note: