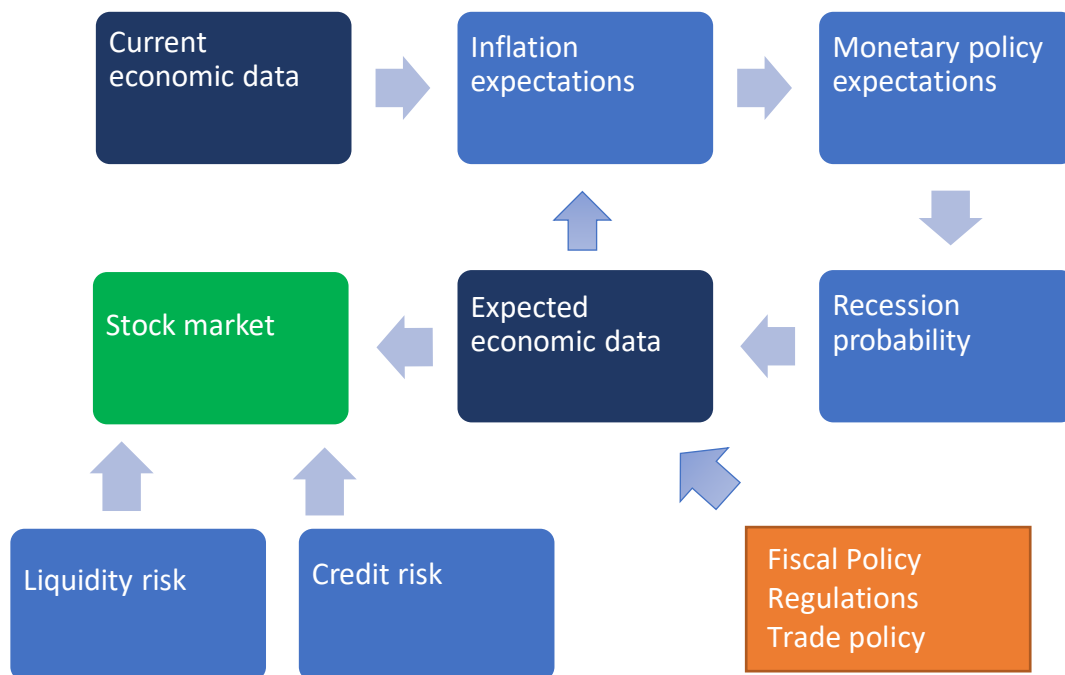


Weekly S&P 500 Outlook



Executive Summary

Current data: Employment still strong, initial claims decreased, supports strong economy.

Inflation expectations: Rising for 2nd week – at the upper bound the normal range (rising oil).

Monetary policy expectations: Significantly more aggressive (inflation expectations rising)

Recession probability: Still falling as long-term nominal rates rose.

Expected data: Near-term modest stagflation: dovish turn = higher inflation, modest growth. Longer-term: the Fed-induced recession vs. soft landing? Lower terminal rate supports soft landing.

Trade policy: Biden considering dropping China tariffs – re-globalization. Positive for inflation and growth.

Liquidity risk: Receding.

Credit risk: Falling.

S&P 500: The bounce after the 20% correction. - lower liquidity risk, lower credit risk – but higher inflation expectations.

Short-term outlook: Bullish. The bounce to continue to the 50-100-200dma levels. Watch for the rising inflation expectations as the signal to sell.

Longer-term outlook: Neutral. A deep and prolonged Fed-induced recessionary bear market is likely – especially if there is a credit crunch (housing bubble crash). However, lower expected Federal Funds terminal rate supports soft landing. Uncertainty means volatility, thus, neutral rating.

Weekly Macro Analysis and S&P 500 Outlook

Current economic data

GDP:	-1.5% Q1 2022 (down from 6.9%) consumer spending 3.1% - strong 3.5% Q1 2022 yoy (down from 5.5%)
Unemployment rate	3.6% May 2022 (last 3.6%) Weekly claims 200K (down from 211K) 166K low Mar 20 th
Inflation:	8.3% April 2022 CPI (down from 8.5%) Hourly earnings: 0.03% ex 0.04% 6.2% April 2022 Core CPI (down from 6.5%)

Note: Labor market still strong and supporting strong economy. Inflation elevated - peaked in March.

Inflation expectations

	Nominal Yield (<i>last week</i>)	Real Rate	BE Inflation Expectations
5Y	2.93% (2.72%)	-0.13% (-0.27%)	3.06% (2.99%) – over 3%
10Y	2.93% (3.74%)	0.17% (0.08%)	2.76% (2.66%) – over 2.75%
30Y	3.09% (2.96%)	0.53% (0.60%)	2.56% (2.39%) –

Note: Inflation expectations are **rising** for second week (higher oil prices)– Real rates and nominal also rising. Peak inflation expectations Apr 21 3.02%

Monetary policy expectations

Current	Jan 2023	Jan 2024	High	First cut	Jan 27 -terminal
0.76%	2.81	3.05	3.22 Jul 23	2.96 Dec 24	3.22
(0.76%)	(2.64)	(2.78)	(2.95 Jul 23)	(2.70 Dec 24)	(2.95) <i>last week</i>

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

Note: Fed significantly **more aggressive** (rising oil) - Peak hawkishness May 4th (3% 2022)

12-Month Recession probability: moderate

10Y-2Y spread	0.28% (0.26%)	Widening (Inverted week of March 28 th)
10Y-5Y spread	0.00% (0.02%)	Narrowed flat (First inverted in March, reinverted)
2Y-3mo spread	1.52% (1.45%)	Widening – an imminent recession not expected

Note: Recession probability **decreased**, low chance of an imminent recession (2Y-3mo)

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: Recession vs soft landing – soft landing favorite as terminal rate at around 3% is still low.

Note: No slowdown in labor market yet.

S&P 500 pricing: Past performance: 5 Days: -0.11% YTD: -14%

- PE = **21** – Fell from 36 on Jan 4th, 2022 – **still overvalued**.
- The Fed-induced liquidity shock correction (19% total): **Phase 1 selloff** (easing)
- **The Latest:** The bounce follow up week - muted (more aggressive Fed exp)
- 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 – higher oil)
- **Next:** Pricing of Level 1 expected data: stagflation (slower growth = less aggressive Fed if inflation peaked, but new peak in inflation will lead to a more aggressive Fed)

Note: The 6% bounce after 9 weeks down - follow up week muted.

Liquidity risk – High – Phase 1 selloff – ACTIVE – easing

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. **Mild dovish turn – lower liquidity risk.**

- Crypto – Bitcoin: **-37%** (-39%) YTD QQQ: **-23%** (-23%) YTD
- VIX = **24(25)** peak vol. May 2 at 36

Note: QQQ flat, volatility flat, bitcoin up – **liquidity risk receding** for second week.

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.

Labor market still strong. Initial claims down. The 2y-3mo widening/10y-5y flat.

Note: Recession prob decreased for the second week. Labor data still strong.

Credit risk – Moderate – 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 deepens the recession (Phase 2) and causes the liquidity shock (Phase 1).

Credit risk	BBB-10Y	2.10% (2.25%)	Decrease for 2 nd week (2.38% Mar 10). Lower with bonds
	HYG	-9.58% (-7.80%) YTD	
Housing	Case-Schiller	21.2% (20.1%) yoy	Highest increase ever – bubble?

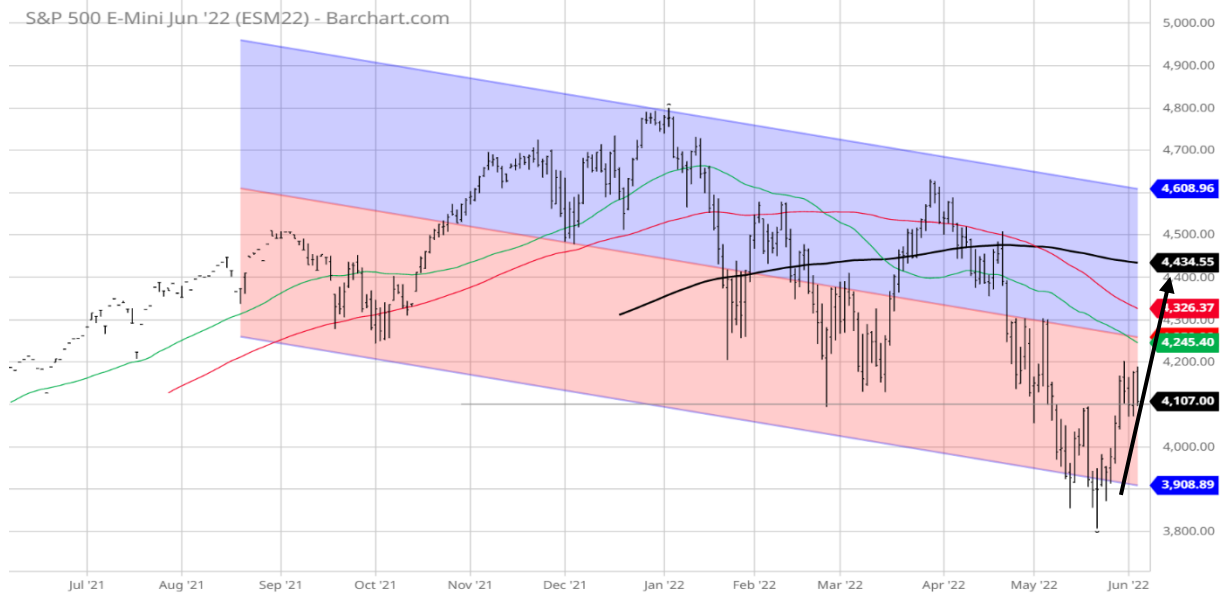
Note: Moderate level of credit risk, but Decreased for 2nd week.

Cross-asset analysis - signals

	Pattern	Note
Bonds		
Bund	Up-new high 1.27%	TY-Bu=1.66% - narrowing
ECB 0%	July 2022 Dec 22 1% Dec 23 2%	Aggressive tightening expected
Stocks		
Correction – liquidity shock (Fed)		
FTSE100	Just off ATH – heavily commodity/energy weighted	Strong commodity prices – no global recession
STOXX50	Downtrend – bounce to 100dma	Not as affected by US liquidity shock
EEM	Downtrend – bounce to 50dma	
Currencies		
Strong USD		
EUR	Downtrend – bounce to 50dma	Fed, war in Ukraine; ECB tightening
AUD	Downtrend – bounce to 200dma	Hit by the liquidity shock - bounced
Commodity		
Gold	Holding the 200dma - flat	Strong USD, rising real rates negative
Copper	Correction – bounce above 200dma	Hit by liquidity shock
Oil	Uptrend – near highs above March 7 th invasion	Supply issue – sanction on Russia

Note: weaker USD, stronger commodities, bounce to resistance in stock markets.

S&P 500 Technical analysis



- **Correction 19%:** Jan 4th – May 20th – held the 20% level – 3840.
- **Double bottom - the Bounce:** support 3840 – resistance 4100
- **Breakout above 4100: the Bounce-** target 50dma – 4245 (2nd target 100dma, 3rd target 200dma)
- **Support:** the 4100 level – at support now.
- **Opinion:** Bullish – the bounce continues.

S&P 500 Tactical outlook

Tactical - Fundamental Thematic

Bullish

- The liquidity shock easing (positive): Phase 1.
- An imminent recession risk still low (positive): Phase 2
- The credit risk easing (positive): Phase 3.
- The peaks in inflation/inflation expectations/Fed hawkishness (positive)
- The pending decision to drop China tariffs – positive catalyst
- Fed's mild dovish turn – but rising inflation expectations for second week (negative).
- Selling in reaction to the stagflation effect on corporate earnings (negative) – peaked?
- Expected weakening economic data (negative) but will support the Fed pause in Sep

Technical

Bullish

- The Bounce - the 4100 level support holding

Longer term

Neutral

- The Fed-induced recessionary bear market (recession possibly 2024).
- However, lower terminal rate favors soft landing.
- 2Y-3mo inversion to signal a possible Phase 2 selloff – an immediate recession (inactive).
- Spike in credit spreads above 3% to signal a possible Phase 3 selloff (inactive)

Tactical Trades:

- **Bullish:** Long the breakout above 4100 – the bounce still has legs.
- **Alt:** Bearish: Sell the breakdown below 4100 with rising inflation exp. – also stop loss.

Long term S&P 500 strategy

- Not recommended to allocate new money.
- Will likely have an opportunity to exit existing positions at higher price.

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 – end of pandemics, 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: Russia sanctions, geopolitics (long-term problem – economic war)</p> <p>*Longer term: de-globalization 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: Demand is still strong and supply is still tight.