Truist Advisory Services, Inc.

Market resiliency less than meets the eye as macro risks grow

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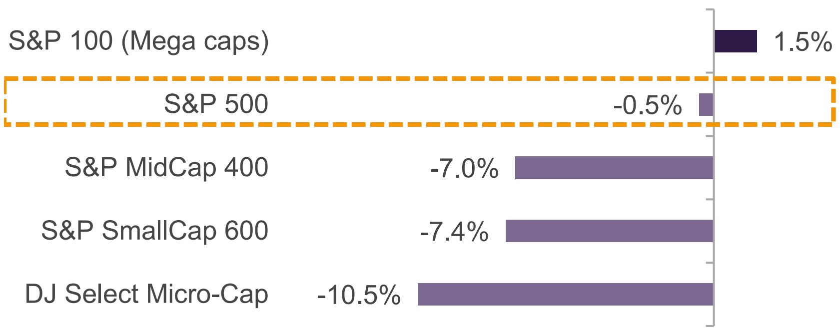
At face value, the market has been resilient with the S&P 500 down less than 1% since banking concerns escalated in early March. However, this masks weakness below the market's surface.

Indeed, over this time period, mid-size and smaller companies are down 7% or more, and traditional, economically-sensitive sectors, such as financials, energy, materials, and real estate are all down by more than 5%.

These declines have been more than offset by growth sectors, such as technology, which have a much larger weighting in the S&P 500 alongside defensive sectors, like staples.

Performance by market capitalization since March 8, 2023



Data source: Truist IAG, FactSet. Past performance does not guarantee future results.

There's a growing disconnect between consensus earnings projections, which see S&P 500 profits rebounding to a record in the second half, and a consensus looking for a material economic slowdown later in the year.

Notably, the 2-year U.S. Treasury yield recently fell below the Federal funds rate by more than 100 basis points for the sixth time since 1989.

- In all prior cases, the Fed cut rates during that month or the next.
- Often this signal was a harbinger of recession.

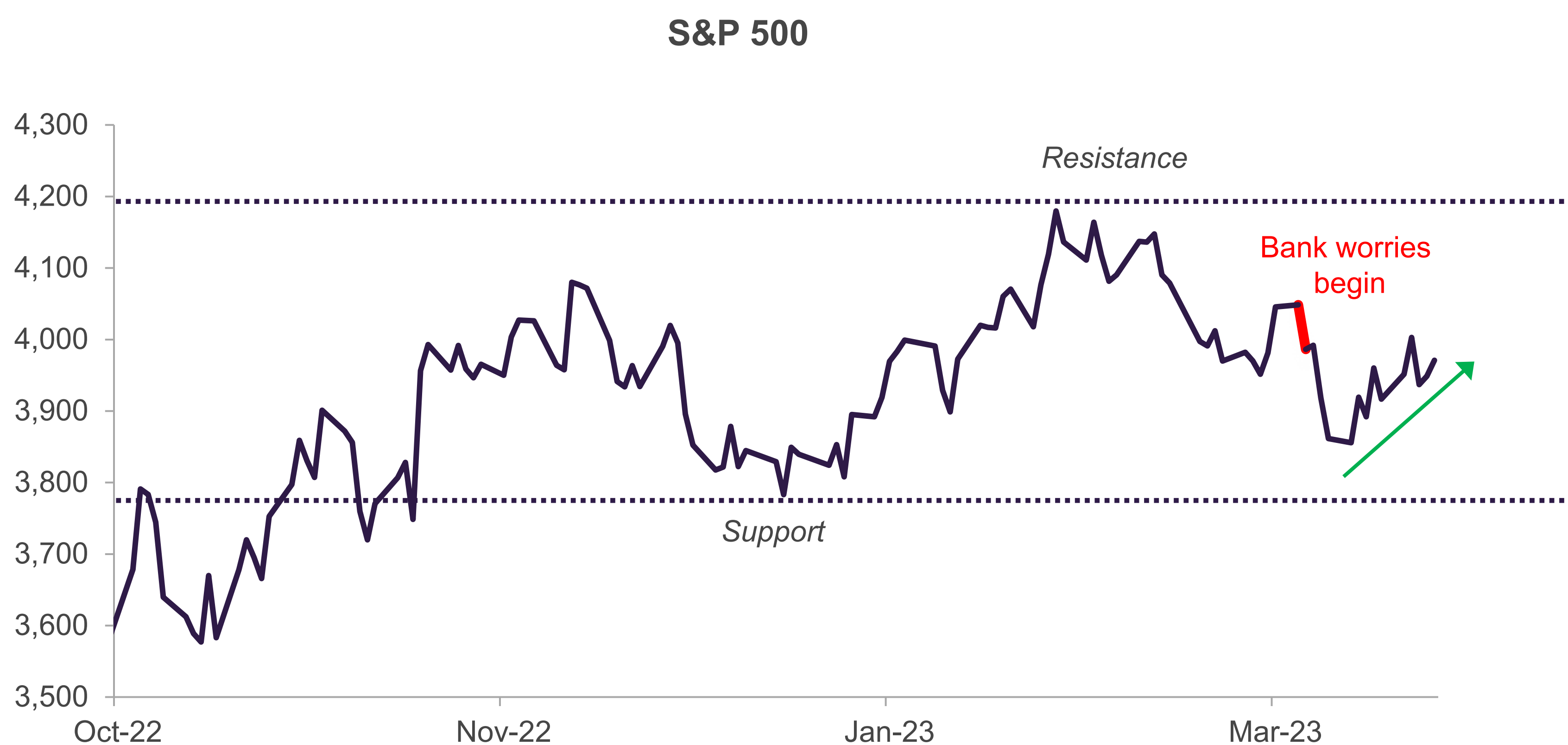
That said, the Fed faces a conundrum this time as core inflation is running above 5% versus an average of 2.8% during the five prior periods—this may hold it back from being as aggressive relative to past periods.

- Even if the Fed begins to cut rates later this year, as markets have started to price in, one only needs to look to 2001 or 2008 to see that this isn't necessarily a panacea for equity markets or the economy.
- Our *House View* is that recession risks remain elevated in 2023, and we see stiff resistance around the 4100-4200 level for the S&P 500, which closed Friday at a level of 3970.

Bottom line

Although some investors may look at the strength seen in some of the popular market indices as a positive sign, weakness is evident below the surface, and macro risks are growing. In our view, investors are not being adequately compensated for above-average macro risks, as both stocks and high yield corporate bonds trade near average valuations. This serves to reinforce our current defensive posture.

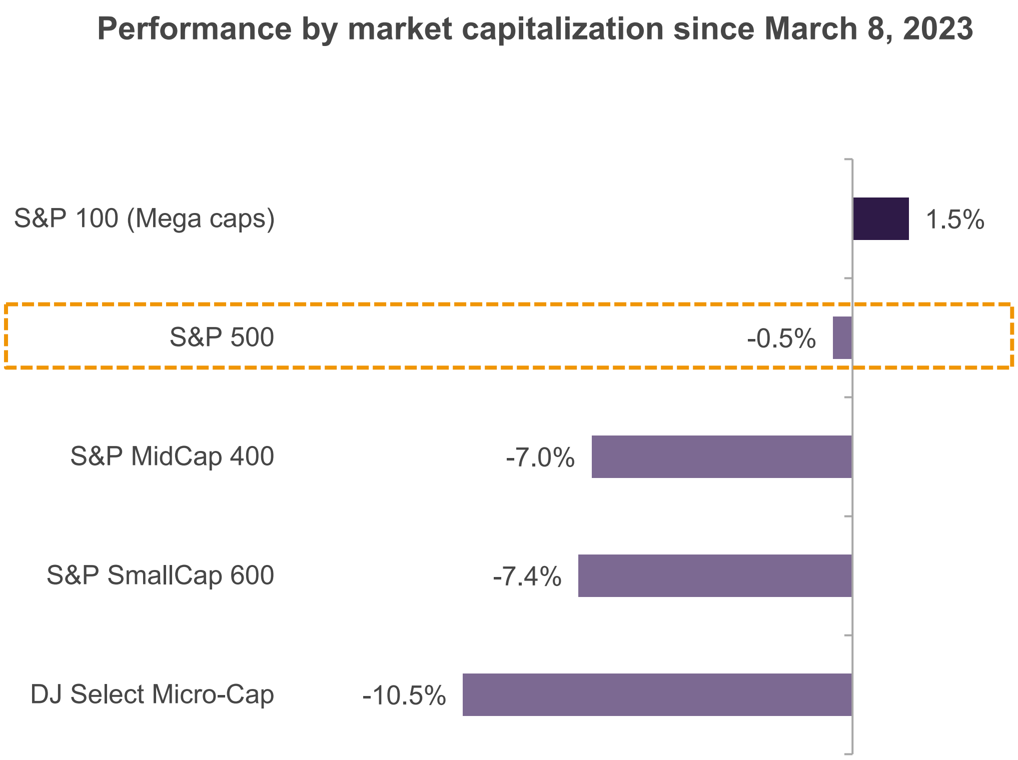
Market has bounced back after selling off in early March



Data source: Truist IAG, FactSet. Past performance does not guarantee future results.

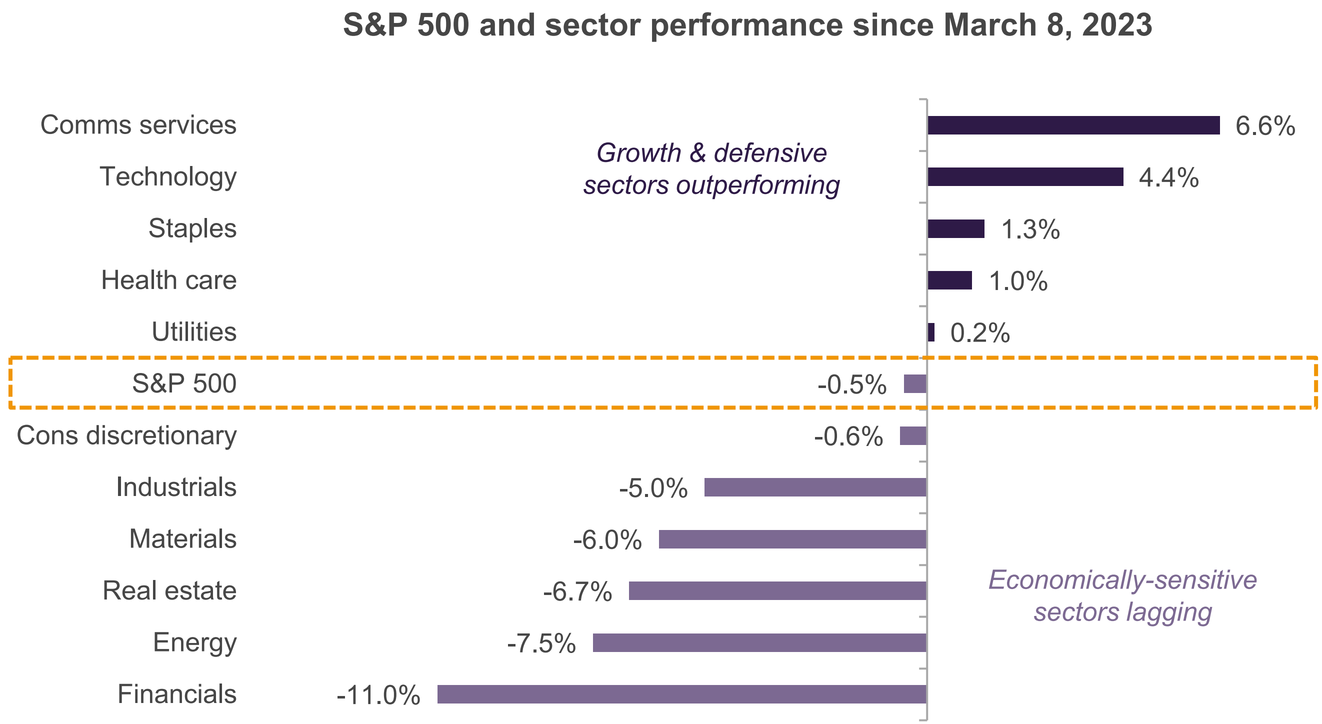
Market less resilient moving from mega to micro caps

- Investors have gravitated toward the largest stocks in the market, which are perceived to have stronger balance sheets and diversified businesses.
- These companies are more likely to withstand an economic slowdown. The larger cap indices also generally have a greater proportion of growth sectors, such as technology, and have less concerns around financing.
- We continue to favor U.S. large cap stocks from an asset allocation perspective.



Data source: Truist IAG, FactSet. Past performance does not guarantee future results.

Market less resilient as shown at the sector level where economically-sensitive sectors have been hit and growth and defense areas have led



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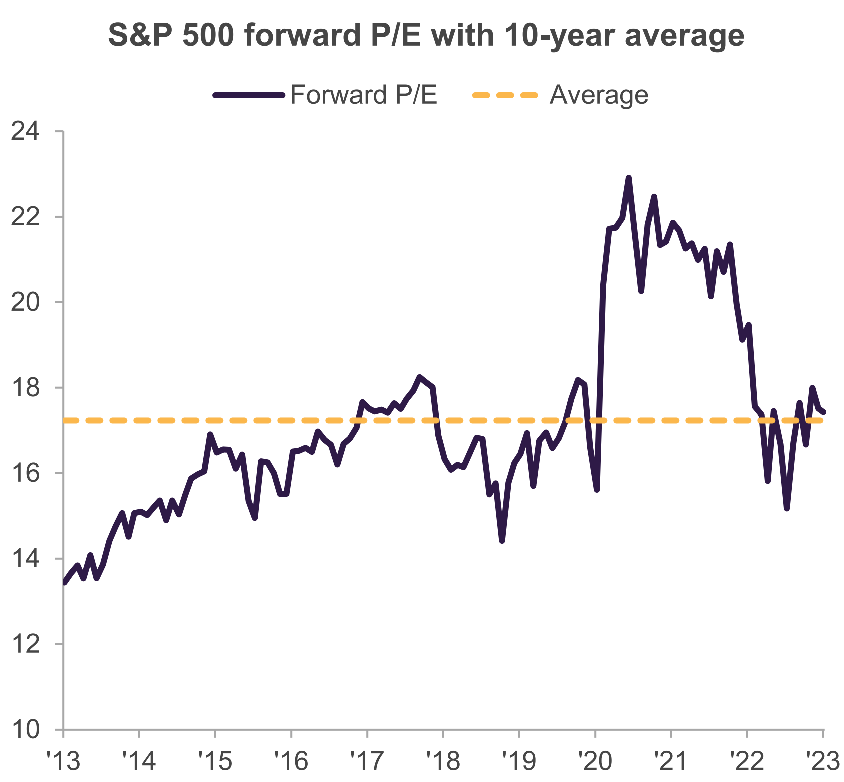
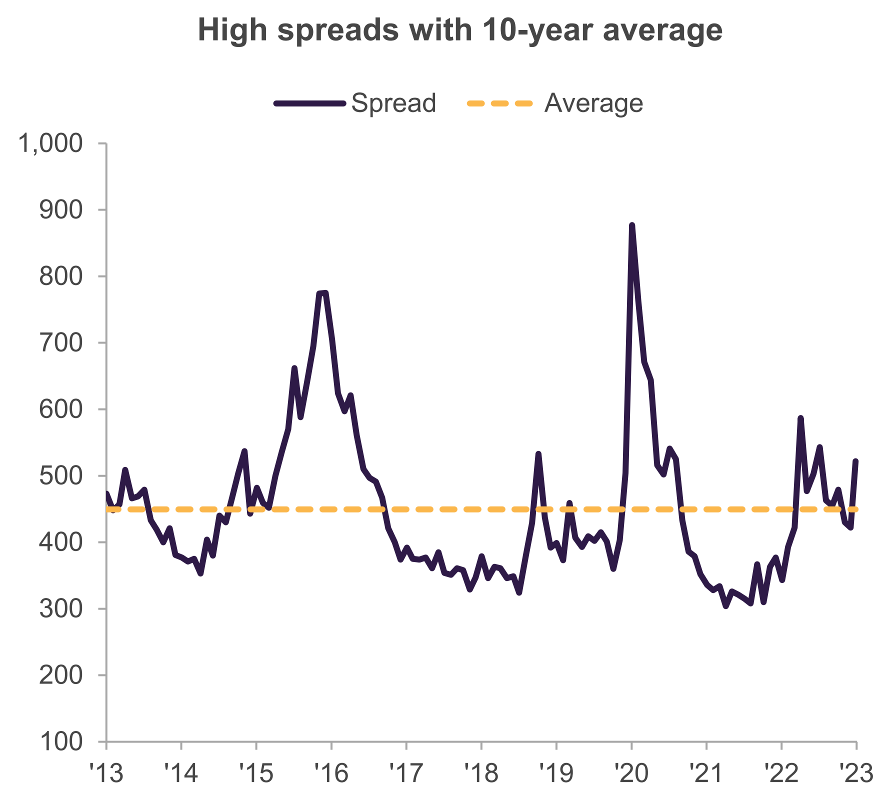
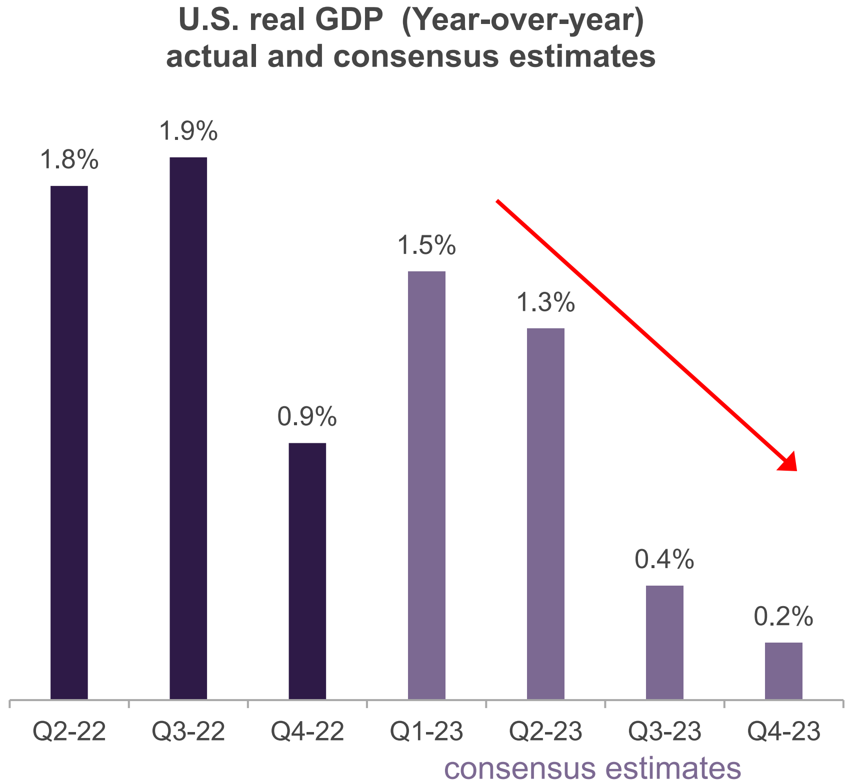
Investors not being compensated for above-average macro risks, as both stocks and high yield corporate bonds trade near average valuations





Data source: Truist IAG, FactSet. Past performance does not guarantee future results.

Disconnect between consensus earnings estimates that are expected to reach a record in the 2nd half vs. a material projected economic slowdown



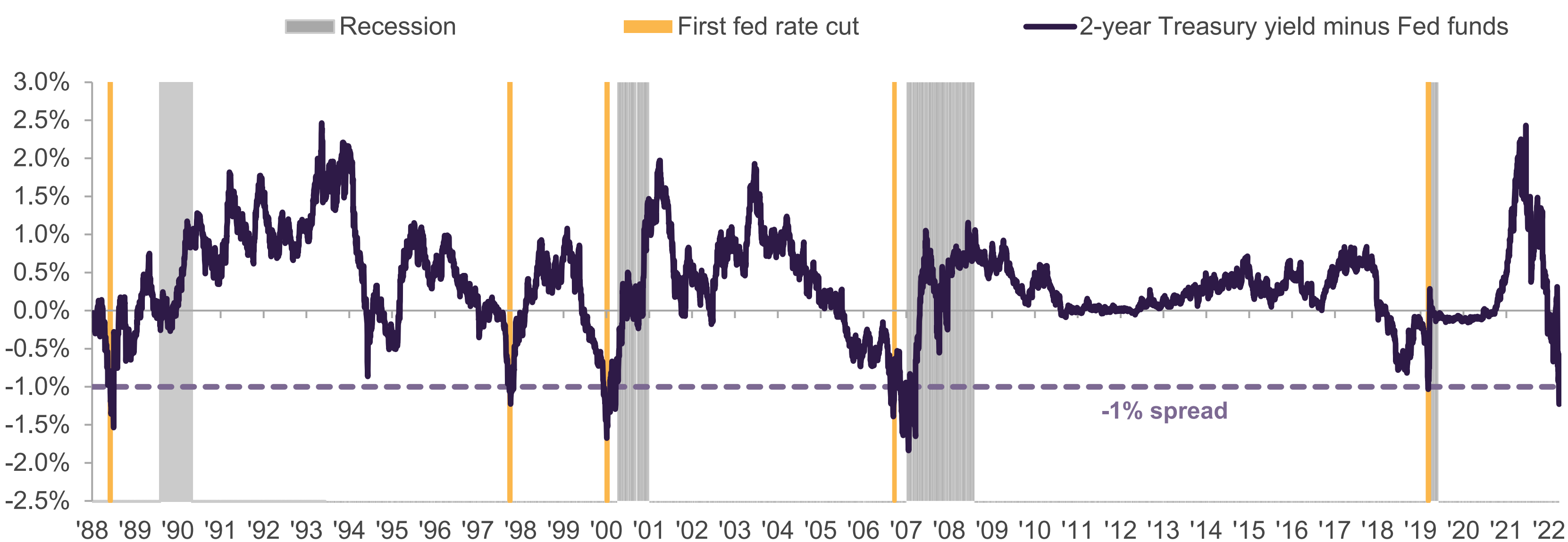
Data source: Truist IAG, FactSet. Bloomberg consensus GDP estimates

Past performance does not guarantee future results.

Recent action in Treasury market consistent with nearby Fed rate cuts and often a looming recession, but higher inflation is a dilemma

The 2-year U.S. Treasury yield recently fell below the Federal funds rate by more than one percentage point for the sixth time since 1989. In all prior cases, the Fed cut rates during that month or the next. That said, the Fed faces a conundrum this time as core inflation is running above 5% versus an average of 2.8% during the five prior periods—this may hold it back from being as aggressive relative to past periods. Notably, recessions also occurred sometime over the next year following all signals except 1998. This is consistent with our view of elevated recession risks this year.

2-year U.S. Treasury rate goes 1 percentage point below Fed funds



Data source: Truist IAG, FactSet, Haver. First rate cut after 2-year U.S. Treasury yield falls below Fed funds rate by more than 100 basis points.

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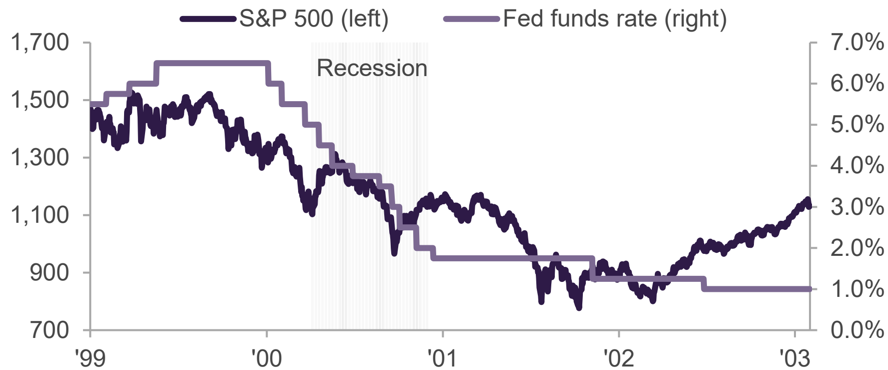
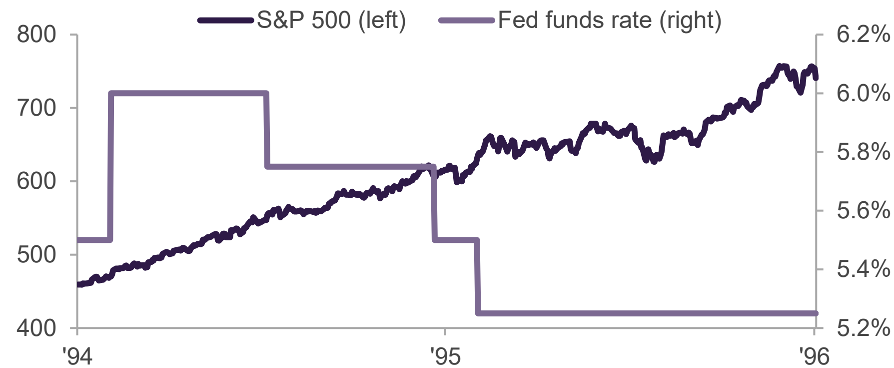
A Fed pivot less helpful for the market if economy is headed into a recession

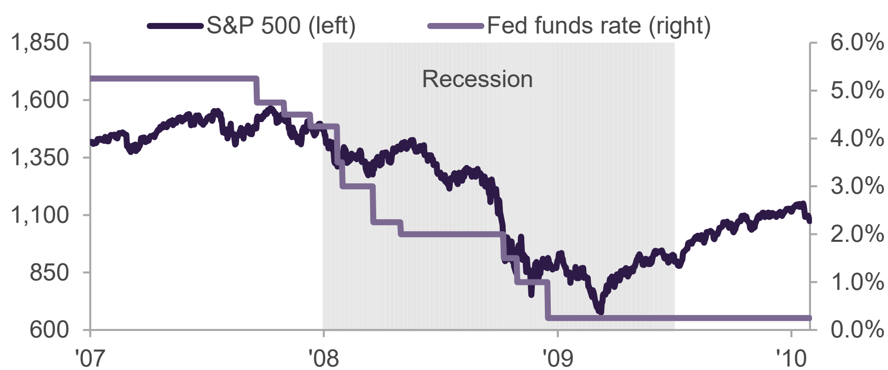
2001 – Recession, stocks continued to fall



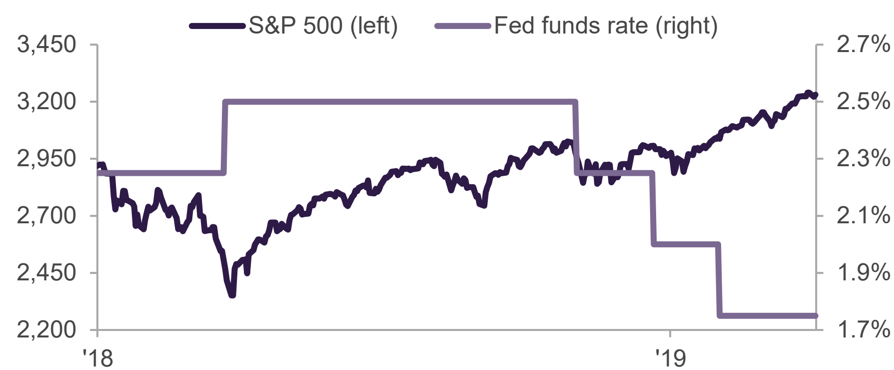
1995 – No recession, stocks climbed



2008 – Recession, stocks continued to fall



2018 – No recession, stocks climbed



Data source: Truist IAG, FactSet, Haver. Past performance does not guarantee future results.

Disclosures

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