Truist Advisory Services, Inc.

Market Perspective from the Investment Advisory Group

Where we stand following the recent selloff

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Highlights

- Selling pressure intensified late last week as central bankers continued to discuss the need to tighten monetary policy in an aggressive fashion in order to tame inflation and has continued into the new week given worsening China COVID trends.
- Concerns around a more aggressive Federal Reserve (Fed) as well as China lockdowns were among the reasons that factored into our decision to downgrade equities to neutral a few weeks ago, to increase fixed income, and to reduce exposure to more economically-sensitive areas of the market, such as small caps, and maintain a more defensive sector posture.
- Although there are many concerns and reasons that led us to advise taking on less portfolio risk, there are also some positive offsets. Perhaps the biggest asset for the market from a contrarian standpoint is the current depressed sentiment.
- Last Friday, we saw the greatest demand for downside market protection in the options market since the depths of the pandemic, as well as the greatest weekly equity fund outflows in a year. Retail sentiment surveys remain near a record low; at the same time market valuations have reset, while earnings have remained resilient. This should help cushion the downside.
- For the market, however, to gain much traction to the upside on a sustained basis, investors will likely need to see the relentless repricing of short-term interest rates abate and have greater confidence that the Fed's actions will be able to tame inflation without unduly hurting the economy.
- Given the crosscurrents discussed and wide range of potential outcomes, we recommend investors maintain a more neutral risk posture relative to the past two years when the risk/reward was more heavily skewed to the positive side.

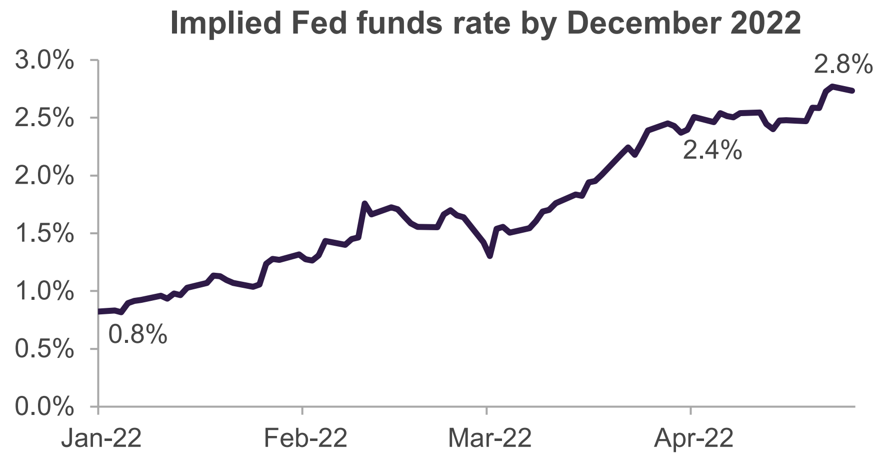
What happened

Following a sharp rally into the end of last month, global markets have been under pressure for most of April. Global stocks are now off about 8% from their late March high.

Selling pressure intensified late last week as central bankers continued to discuss the need to tighten monetary policy in an aggressive fashion in order to tame inflation**. At the start of the**

year, the market was anticipating the Federal Funds rate to be 0.8% by year end. That moved up to 2.8% last week, which is up from 2.4% at the end of March alone.

The extreme repricing of Fed rate hikes has weighted on markets



Data Source: Truist IAG, FactSet, Haver

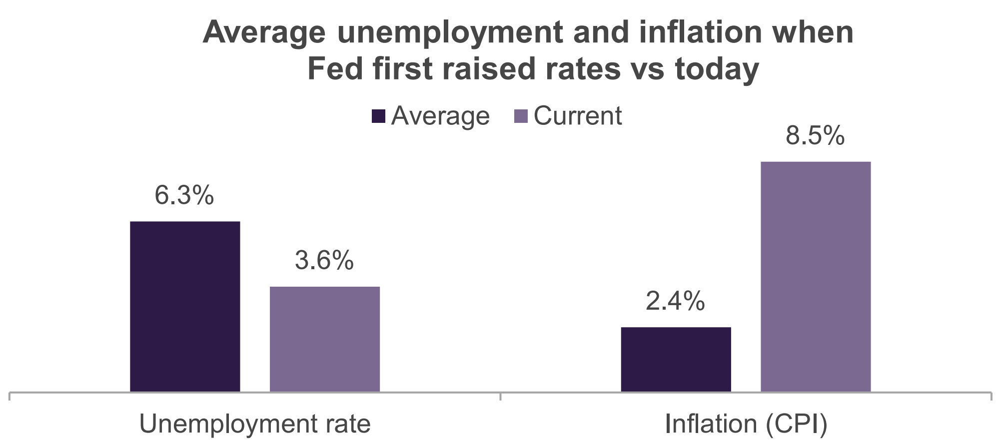
Adding to the market pressure is the ongoing COVID-19 wave in China, the world's second largest economy, and what this means for global growth and supply chains. Much of Shanghai remains locked down, and there are fresh concerns about new cases in Beijing from this weekend.

Our take

Concerns around a more aggressive Fed as well as China lockdowns were among the reasons that factored into our decision to downgrade equities to neutral a few weeks ago, to increase fixed income, and to reduce exposure to more economically-sensitive areas of the market.

Indeed, the Fed appears behind the curve in adjusting policy and is trying to play catch up (chart below). They face a challenging balancing act of trying to tame inflation without unduly hurting the economy. This uncertainty is pressuring stocks and leading to a more defensive tone.

The Fed appears behind the curve in adjusting policy and is trying to play catch up



Data Source: Truist IAG, Haver

Economically-sensitive areas—such as stocks in the transportation, financials, homebuilders, and semiconductor sectors—have been deteriorating. Conversely, more defensive sectors, such as staples, utilities, REITs, and health care continue to lead.

And while the recent market selloff has been relatively sharp, it is not yet in a deep oversold condition. As an example, the number of stocks in an uptrend, as defined by the percentage of S&P 500 stocks trading above their 50-day moving average, closed Friday at 43%. Below 25% is more consistent with a market bottom.

Some silver linings

Although there are many concerns and reasons to take on less portfolio risk, as we have advised earlier this month, there are also some positive offsets.

Base case still not recession: While we expect economic growth to slow down, we don't expect a recession in the near term. Stocks have risen about 85% of the time on a 1-year basis during expansions. The service side of the economy is booming as travel and leisure is on the upswing following the pandemic. The labor market remains very strong, as witnessed by jobless claims at the lowest level since 1969. The Leading Economic Index, which is a composite of indicators, is still rising and just below an all-time high.

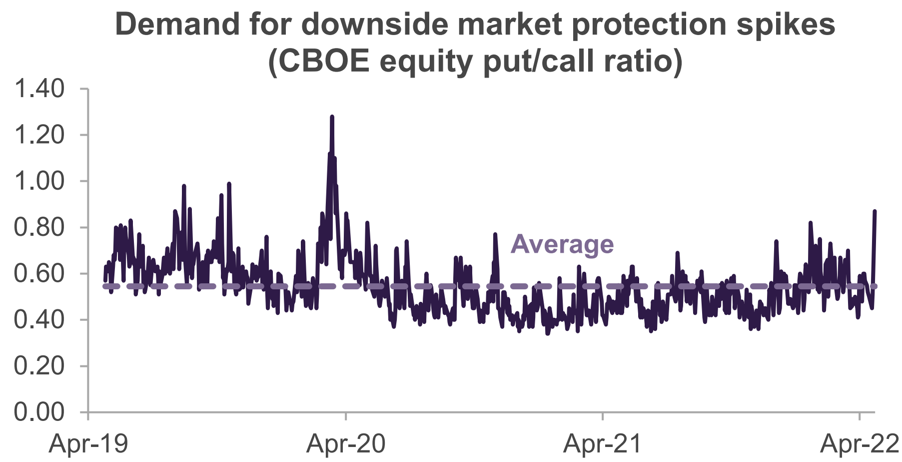
Sentiment is perhaps the biggest asset for the market as the hurdle rate for positives is low

Sentiment depressed: Perhaps the biggest asset for the market from a contrarian standpoint is current depressed sentiment. Indeed, the hurdle rate for positive surprises is low.

Earlier this month, a survey from the American Association of Individual Investors showed the percentage of bullish investors reached the lowest level since 1992 and is currently at just 18.9%. Historically, when the percentage of bulls has been less than 20%, the S&P 500 has **been up one year later 30 out of 31 times**. The one loss was the signal from January 2008, which occurred when the economy was already in a recession—thus, the importance of the recession point of view.

Also, what is somewhat encouraging, given markets tend to bottom on fear, is that we have moved from investors saying they are bearish to acting on that. **The equity put/call ratio, a gauge that reflects the demand by investors to help protect themselves from market downside, spiked on Friday to the highest level since March 2020** (during the depths of the pandemic). Also, **investors sold more than $20 billion in equity** mutual funds and exchange-traded funds last week, the greatest outflow in about a year.

Demand for downside protection spike to the highest level since the depth of the pandemic, a positive from a contrarian standpoint



Data Source: Truist IAG, FactSet

Fundamentals: Valuations have corrected, and earnings remain resilient. Although valuations are not cheap, they have compressed sharply this year as stocks have pulled back, and forward earnings estimates have moved to a record high. The current forward price-to-earnings ratio for the S&P 500 is once again down to 18x versus 21.5x late last year.

The 18x P/E level has been an area where we have seen buyers step into this market several times. If this level fails to hold, there is additional fundamental support around a 17x P/E multiple, or near the 4000-price level for the S&P 500 (versus 4225 currently).

We don't see much sustained downside beyond that unless a recession becomes more likely. Importantly, around recessions, stocks have fallen a median of 24% (average 29%) since 1948. **With stocks down 12%, the market is already pricing in between a 40%-50% chance of recession; at a S&P level of 4000, the market would be pricing in roughly a 60%-70% probability. This suggests a degree of bad news is already discounted into stocks.**

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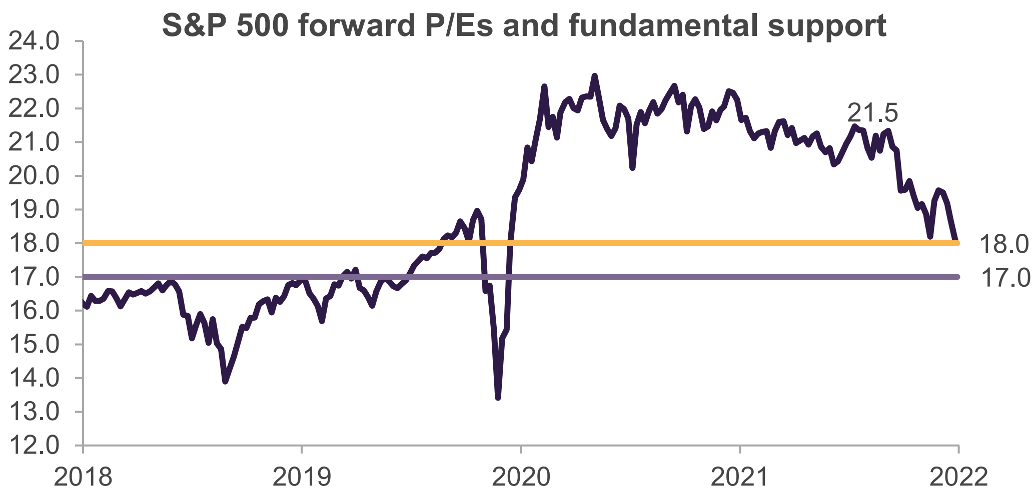

Data Source: Truist IAG, FactSet

Positioning

Given the unusually wide range of potential outcomes, we continue to advise that investors have less risk in portfolios relative to the past two years when the risk/reward was heavily skewed to the positive side.

This includes upping the quality of portfolios, holding a little more fixed income as ballast, slightly lower equity allocations and some defensive positioning. Within equities, we continue to favor the U.S. which we view as the big blue-chip country, with an emphasis on large caps. Given ongoing COVID, regulatory, global growth and earnings concerns, we continue to hold a negative view of emerging markets and also maintain an underweight to international developed markets.

We recently downgraded small caps, and from a sector perspective, we continue to favor defensive areas of the market, such as consumer staples, REITs, and healthcare alongside materials and energy. We stay underweight the more cyclical areas of the markets, including financials, as well as technology and communications, where relative price trends remain weak.

Bottom line

There are many crosscurrents which makes for a challenging market environment. Fed uncertainty as well as global growth concerns and the jump in rates led to our move to a more neutral risk posture earlier this month. That said, there are some offsets such as the sharp reset in sentiment and valuations along with earnings which remain resilient. This should help cushion the downside.

For the market, however, to gain much traction to the upside on a sustained basis, investors will likely need to see the relentless repricing of short-term interest rates abate and have greater confidence that the Fed's actions will be able to tame inflation without unduly hurting the economy.

Given the crosscurrents discussed and the wide range of potential outcomes, we recommend investors maintain a more neutral risk posture relative to the past two years when the risk/reward was more heavily skewed to the positive side.

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