Market Perspective from the Investment Advisory Group

Reiterate less favorable equity risk/reward outlook

August 9, 2022

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What happened

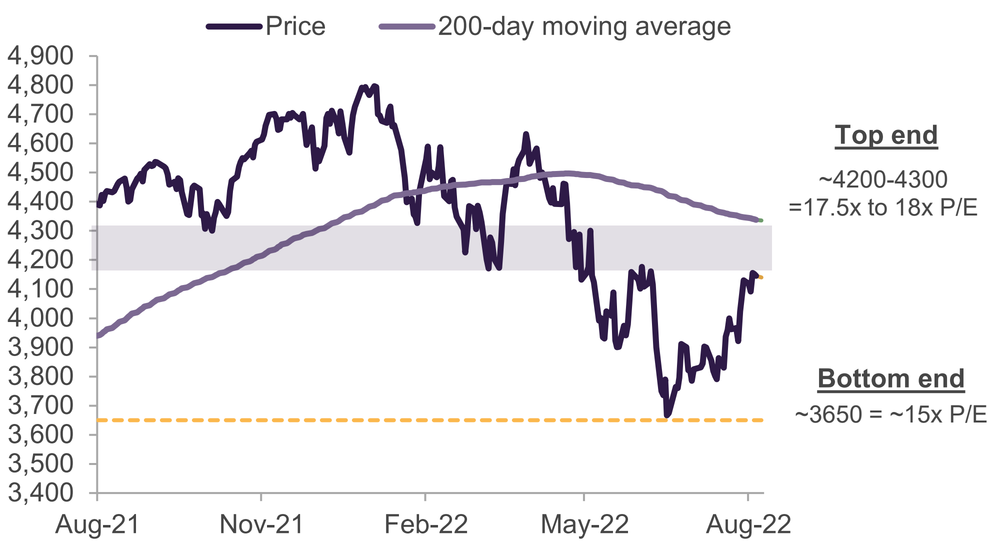
Since the mid-June lows, the technology-heavy NASDAQ Composite has climbed more than 20%, and the S&P 500 is up about 15%. So, the question becomes, now what?

Our take

After the sharp rebound and as the S&P 500 climbs closer to the upper end of our estimated range, the market's risk/reward appears less favorable. Given an ongoing slowdown in the economy and earnings risk, our view remains that the S&P 500's near-term upside potential is **likely capped in roughly the 4200-4300 range**, or 2% to 4% upside from current levels (note – the S&P 500 traded to 4186 on Monday). We believe the near-term downside potential exceeds this upside potential.

The top side of our estimated range coincides with a confluence of technical price and valuation levels. The S&P 500's price high in May was around the 4300 level, and the downward sloping 200-day moving average is currently nearby at 4333. Likewise, we see fundamental resistance for the S&P 500 around a 17.5x to 18.0x forward P/E, which roughly coincides with the aforementioned price range.

S&P 500 - Approaching upper-end of expected range



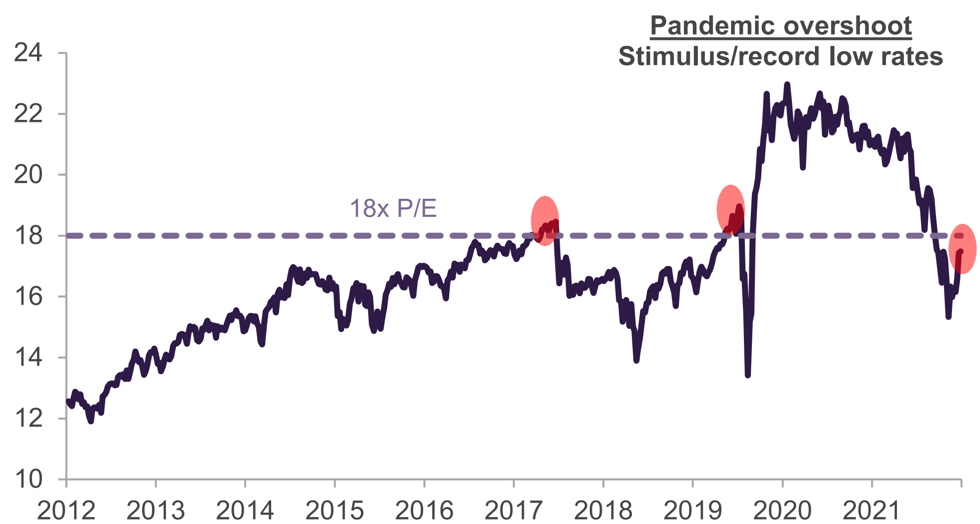
Data source: Truist IAG, FactSet. Past performance does not guarantee future results

Indeed, the S&P 500's forward P/E has already expanded from a low of 15.3x at the June low to 17.5x. The entire rally witnessed since mid-June has been driven by valuation expansion. This increase was partly based on hope of a Federal Reserve (Fed) pivot to a less aggressive policy stance and a sharp pullback in the 10-year U.S. Treasury yield. Such a pivot seems less likely near term given the very strong employment report from last week.

Notably, outside of the pandemic, which saw an overshoot of valuations given massive stimulus and very low interest rates, the S&P 500 has been unable to sustain a P/E above 18x for a prolonged period.

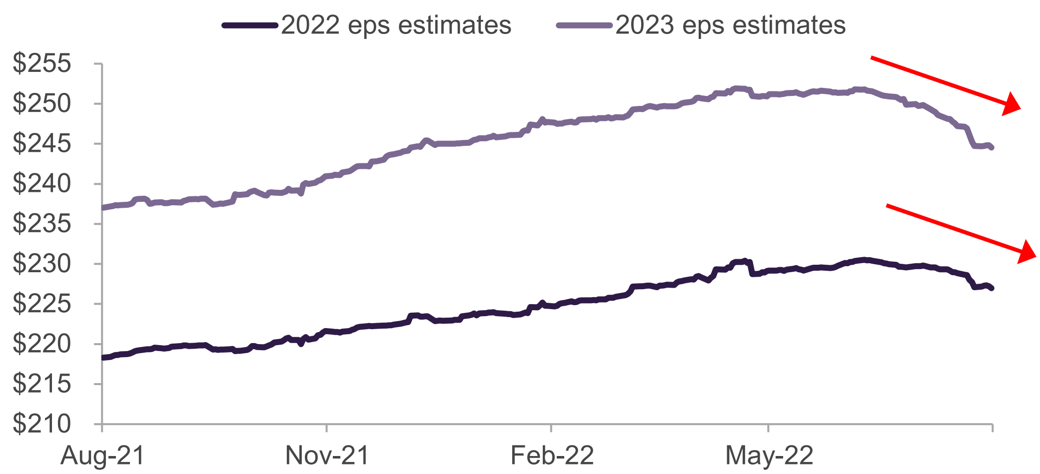
Outside of the pandemic overshoot, the S&P 500's P/E has been capped at around 18x over the past 20 years

S&P 500 forward P/E



Moreover, earnings trends are weakening. Even if earnings trends stay stable, which is unlikely given the massive monetary tightening underway and slowing economy we anticipate, markets are still not cheap from a historical perspective. It's also hard to suggest valuations should trade at a premium against this uncertain backdrop.

S&P 500 earnings estimates falling



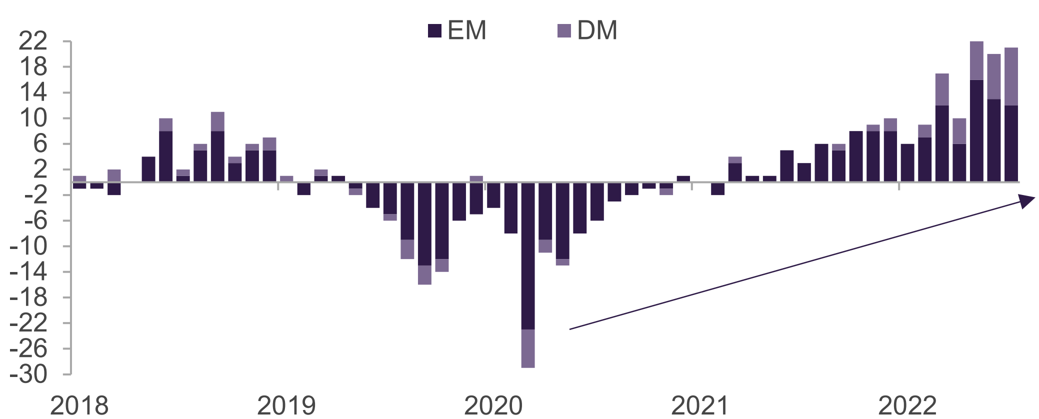
Data source: Truist IAG, FactSet. Past performance does not guarantee future results.

And, while the payrolls report strongly suggests the U.S. economy has not been in a recession, the sharpest global monetary tightening in several decades is set to weigh on global growth over the next six to 12 months.

Recall, the Fed *only* started raising rates in March, and the aggressive action since then, including moves by other central banks, works with a lag. Regardless, the strong employment report, including robust wage growth, suggests the Fed is not done and will remain focused on enemy #1 – inflation.

Sharpest global monetary tightening in decades to weigh on future economic growth

Number of central banks hiking minus easing

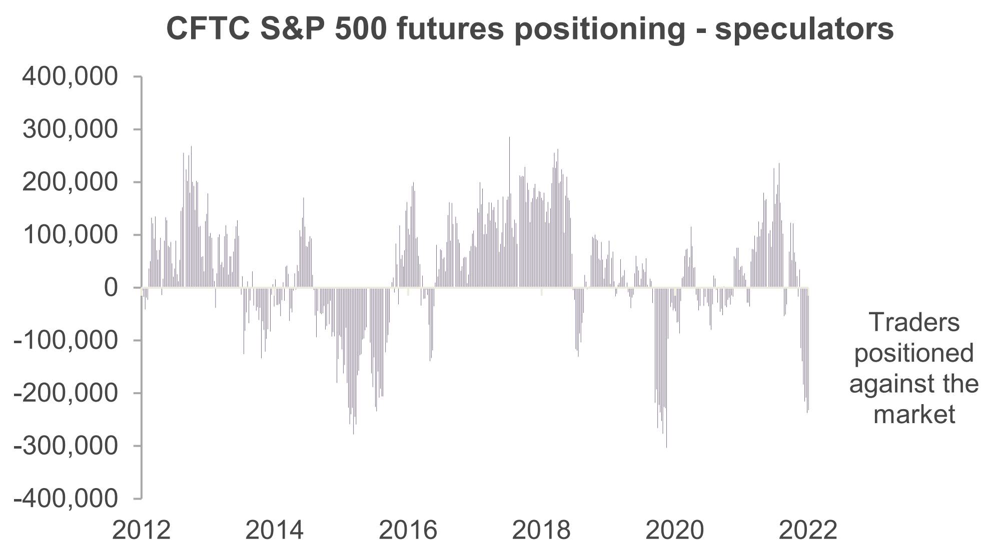


Data source: Truist IAG, Haver. Series constructed using predominantly countries in the MSCI All Country World Index EM = Emerging markets; DM = Developed markets Past performance does not guarantee future results.

Risks to our view

Among the biggest risks to our more cautious near-term view is that sentiment remains somewhat depressed. Many investors were caught offsides by the rally, and positioning remains relatively low. Indeed, speculators in the futures markets are still firmly betting against the market. If they and other traders are forced to cover their positions, this could create additional buying power and could contribute to a market overshoot to the upside.

Investors are still positioned against the market



Data source: Truist IAG, FactSet, Commodity Futures Trading Commission.
Past performance does not guarantee future results.

Bottom line

Following the strong market rebound and as stocks move closer towards the upper end of our estimated range, we reiterate our view that this is a more reasonable place for investors who are overallocated to equities to trim exposure.

Disclosures

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CN2022-4895276.1 EXP 08-2023