MORNING BRIEFING
November 13, 2023

Stock Investors Back In The Saddle Again

Check out the accompanying chart collection.

Executive Summary: The stock market has a good track record as a business-cycle indicator, even though last year's bear market was a false alarm, as investors expected a recession that never came. Since that bear market ended, in October 2022, the stock market has been in a bull market, with its August-through-October weakness simply a correction. Now the Bond Vigilantes and their concerns have retreated, clearing the way for the S&P 500 to rise to our targets of 4600 by year-end 2023 and 5400 by year-end 2024. … Such expected stock market strength jibes with our economic outlook, which presumes that a recession isn't likely before the end of 2024. ... And: Dr. Ed reviews "NYAD" (+).

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Strategy I: False Alarm. The S&P 500 bottomed last year on October 12 at 3577.03 (*Fig. 1*). At that point, it was down 25.4% from the January 3, 2022 record high of 4796.56. Those endpoints marked a relatively classic, but short, bear market—short because it was attributable to the most widely anticipated recession that didn't happen since the end of WWII (when a depression was widely expected but didn't happen). Excessive bearishness along with mounting evidence showing that a recession might not be coming after all helped lift the index off its bottom.

The S&P 500 does correlate with the business cycle; that's why it's one of the 10 components of the Index of Leading Economic Indicators (LEI) (*Fig. 2*). The S&P 500 peaked either just prior to or contemporaneously with the previous eight peaks in the business cycle. It bottomed just before seven of the troughs during the past eight business cycles. This time, the latest bear market in the S&P 500 has sounded a false alarm, so far.

Of course, the S&P 500 will still be viewed as a remarkably prescient leading indicator of the business cycle if a recession happens in 2024, as some pessimistic prognosticators never stopped expecting. They'll say that the S&P 500 was a bit early but right after all (as they were).

However, since bottoming last year on October 12, the S&P 500 rose 28.3% through July 31 of this year. That's a classic bull market. It also (like the bear market before it) would be relatively short—if it were over. We think it's not: Indeed, we are still expecting the S&P 500 to rise just above its July 31 peak to 4600 by year-end and proceed to 5400 by the end of 2024. The index's 10.3% drop to 4117.37 from July 31 through October 27 was a classic correction within a bull market, we believe. Since October 27, the S&P 500 is up 7.2% through Friday's close of 4415.24.

So the bull market since October 12, 2022 is still going on, in our view, with the S&P 500 up 23.4% since then through Friday's close.

Last year's bear market was attributable to widespread fears that soaring inflation would force the Fed to raise interest rates to levels that would cause a credit crunch and a recession. Sure enough, the Fed raised the federal funds rate by 300bps from March through October of last year, and by another 225bps through July of this year (*Fig. 3*). Yet the S&P 500 bottomed on October 12 because the widely anticipated recession was a no-show. The stock market rally since then suggests that the S&P 500 is back on track as a leading indicator if indeed there's no recession through 2024, which happens to be our outlook.

The strength of the economy, in the face of the dramatic increase in the federal funds and other interest rates since early last year, has surprised even optimistic prognosticators, including Debbie and me. The past 10 recessions were all preceded by significant increases in the federal funds rate (*Fig. 4*). Last week, in Wednesday's *Morning Briefing*, we reviewed our five explanations for the resilience of the economy.

Strategy II: Santa Rally Started Before Halloween. The stock market seems to be following the classic pattern of a bullish year that started with a very positive January Barometer. The S&P 500 was up 6.2% this year during that month. It is also the third year of the presidential cycle, which tends to be the best of the four years of a presidential term. Even the seasonal script is back in play after the last two weeks' epic rally. September and October tend to be tough months for the stock market, setting the stage for Santa Claus rallies during the final two months of the year.

This year, the Santa Claus rally might have started just before Halloween. Fears that the bond yield might continue to surge above 5.00% evaporated during the first week of this month in response to weaker-than-expected employment indicators and a broadening consensus that the Fed is done raising the federal funds rate. The 10-year US Treasury bond yield plunged 41bps from last month's peak of 4.98% on October 19 to 4.57% on Friday, November 3 (*Fig. 5*).

The stock market rose sharply on Friday, November 10 even though the 10-year Treasury bond yield ticked back up to 4.61%. Stock investors have learned that the economy can live with a 4.50%-5.00% long-term bond yield. If the yield stabilizes in this range, as we expect, then stock prices can move to new record highs through next year, if there's no recession. Stable bond yields would help to stabilize valuation multiples. The forward P/E of the S&P 500 was 18.2 on Friday (*Fig. 6*).

The yield-curve spread, which is also a component of the LEI, is now -43bps (*Fig. 7*). That's indicative of recession territory, but less so than on June 30, when the spread was -106bps. The yield-curve spread has a good record of calling recessions when it turns negative. This time has been different so far, so stock investors seem to be less concerned about that than they were during H2-2022.

By the way, also helping to boost stock prices on Friday was the uptick in the price of a barrel of Brent crude oil (*Fig. 8*). Investors have become increasingly concerned that the $15.12 drop since September 27 might reflect a rapidly weakening global economy.

We are expecting that both the bond yield and the oil price will stabilize around current levels. If so, then the Santa Claus rally may proceed through year-end as we project. During the latest stock market correction, the Bond Vigilantes saddled up and were riding high. Now stock investors may be back in the saddle again.

Strategy III: Recession Scare Ahead? So what could possibly go wrong? If Santa is early this year, might Halloween be late? Investors could still get spooked by weaker-than-expected economic indicators and higher-than-expected inflation. Of course, the geopolitical situation remains perilous. Domestic political partisanship remains unsettling. Mounting government debt could push bond yields higher to equilibrate supply with demand. The odds of a recession before the end of next year aren't insignificant, at 35%, in our opinion.

For now, let's focus on October's business and inflation indicators that are coming out this week:

(1) *Federal budget* (Monday). Every month, the Bond Vigilantes will be incited to riot again by the *Monthly Treasury Statement* (MTS), showing US government receipts and outlays. In addition to the widening gap between receipts and outlays, they'll be focusing on the fastest

growing outlays category, namely net interest paid by the federal government. Over the past 12 months, it totaled a record $659.2 billion (*Fig. 9*). It has doubled since May 2021.

Marketable Treasury securities held by the public totaled $26 trillion during October (*Fig. 10*). So the Treasury paid an average interest rate of 2.50%, according to the latest data. The current 2-year Treasury yield is close to 5.00%.

(2) *CPI* (Tuesday). October's headline CPI is expected to be around zero or even slightly negative on a m/m basis because of the drop in gasoline prices during the month (*Fig. 11*). The Cleveland Fed's *Inflation Nowcasting* shows that the CPI headline and core inflation rates rose 0.07% and 0.34% m/m, respectively, during October. That puts the two up 3.3% and 4.2% on a y/y basis.

(3) *Retail sales* (Wednesday). October's retail sales excluding gasoline might have been on the weak side. That's because our Earned Income Proxy for private-sector wages and salaries in personal income was flat during the month (*Fig. 12*). Retail sales were strong in September, rising 0.7% m/m even though consumer revolving credit rose just $3.1 billion during the month (*Fig. 13*).

(4) *Industrial production* (Thursday). October's employment report showed that aggregate weekly hours in manufacturing fell 0.3% m/m. That decline undoubtedly reflected the United Auto Workers strike (*Fig. 14*).

Movie. "NYAD" (+) (*link*) is a Netflix biopic about 64-year-old marathon swimmer Diana Nyad, who became the first person ever to swim from Cuba to Florida without the aid of a shark cage. After several tries during her career, she finally succeeds in 2013, completing the 110-mile swim in 53 hours. The only problem is that her feat wasn't independently verified. So her controversial achievement was not ratified by the World Open Water Swimming Association or the Guinness World Book of Records. The movie stars Annette Bening as the eponymous American swimmer, while Jodie Foster plays her coach.

Calendars

US: **Mon:** Consumer Inflation Expectations; Federal Budget Balance -$58.5b; OPEC Monthly Report; Crude Oil Inventories & Gasoline Production; Cook. **Tues:** Headline & Core CPI 0.1%/0.3%; NFIB Small Optimism Index; Real Earnings; IEA Monthly Report; Williams; Goolsbee; Jefferson. (FXStreet estimates)

Global: Mon: Japan Machine Tool Orders; Australia NAB Business Confidence; China M2 10.3%y/y; China New Loans & Total Social Financing 665.0b/1,900b; European Union Economic Forecasts; De Guindos; Breeden; Balz; Mann. **Tues:** Eurozone GDP -0.1%q/q/0.1%y/y; Eurozone ZEW Economic Sentiment; Eurozone Unemployment Rate; UK Average Earning Including & Excluding Bonus 8.3%/7.8%; UK Unemployment Rate; Elderson; Japan GDP -0.1%q/q/-0.6%y/y; Japan Industrial Production 0.2%; China Retail Sales 7.0%y/y; China Industrial 4.3%y/y; NBS Press Conference; Mauderer; Lane; Enria; Gravelle. (FXStreet estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index rose 1.3% last week and exited correction territory to finish at 9.1% below its record high on December 27, 2021. The US MSCI ranked eighth of the 48 global stock markets that we follow in a week when 15 of the 48 countries rose in US dollar terms. The AC World ex-US index underperformed the US MSCI as it fell 0.7% and moved back into bear market territory to end at 20.2% below its June 15, 2021 record high. EM Asia was the best performer with a gain of 0.2%, ahead of EMEA (0.1%), EM Latin America (-0.1), BIC (-0.2), and EMU (-0.4). EM Eastern Europe was the worst performing region last week, with a decline of 1.3%, followed by EAFE (-0.9). Egypt was the best-performing country last week, with a gain of 15.3%, followed by the Philippines (3.7), Pakistan (3.2), Israel (2.4), and Korea (2.0). Among the 22 countries that underperformed the AC World ex-US MSCI last week, Ireland's 6.9% decline was the worst, followed Chile (-5.8), South Africa (-4.8), Argentina (-3.8), and Hong Kong (-3.3). Looking at 2023's performance so far, the US MSCI is up 15.3%, as its ytd ranking remained rose four places to 10/48. The AC World ex-US's ytd gain of 2.0% is trailing the US's, with 26/48 countries in positive territory. EM Eastern Europe is the best regional performer ytd with a gain of 24.9%, followed by EM Latin America (10.5), EMU (7.5), and EAFE (3.5). The regional laggards so far in 2023: BIC (-4.7), EM Asia (-1.6), and EMEA (-0.7). This year's best ytd country performers: Egypt (38.0), Hungary (33.2), Sri Lanka (31.6), Greece (30.3), and Poland (24.0). Here are the worst-performing countries of the year so far: Hong Kong (-21.4), Pakistan (-18.5), Thailand (-18.2), Finland (-15.4), and Chile (-14.4).

S&P 500/400/600 Performance (*link*): Just one of these three indexes rose last week. LargeCap's 1.3% gain beat the 1.6% and 3.0% declines for MidCap and SmallCap. At Friday's close, LargeCap improved to 7.9% from its record high on January 3, 2022, MidCap remained in a correction at 16.2% from its record high on November 16, 2021, and

SmallCap remained in bear market territory at 24.0% from its November 8, 2021 record high. Just eight of the 33 LargeCap and SMidCap sectors moved higher for the week, down from all 33 sectors rising a week earlier. LargeCap Tech was the best performer with a gain of 4.8%, followed by LargeCap Communication Services (2.2), MidCap Tech (1.4), LargeCap Consumer Discretionary (0.9), and LargeCap Industrials (0.8). The biggest underperformers for the week were MidCap Energy (-8.1), SmallCap Energy (-6.6), SmallCap Utilities (-6.0), SmallCap Real Estate (-4.6), SmallCap Financials (-4.6), and MidCap Utilities (-4.6). Looking at performances so far in 2023, LargeCap, with a gain of 15.0%, remains well ahead of MidCap (0.4) and SmallCap (-3.7); 13 of the 33 sectors are higher ytd compared to 18 a week earlier. The top sector performers in 2023: LargeCap Tech (47.0), LargeCap Communication Services (45.5), LargeCap Consumer Discretionary (27.4), MidCap Industrials (13.6), and MidCap Tech (12.4). Here are 2023's biggest laggards: MidCap Utilities (-23.2), SmallCap Health Care (-20.2), MidCap Communication Services (-20.1), SmallCap Utilities (-17.1), and SmallCap Financials (-16.3).

S&P 500 Sectors and Industries Performance (*link*): Six of the 11 S&P 500 sectors rose last week, but only two outperformed the composite index's 1.3% gain. That compares to a 5.9% gain for the S&P 500 a week earlier, when all 11 sectors rose and five outperformed the index. Information Technology was the best performer with a gain of 4.8%, followed by Communication Services (2.2%). Energy was the worst performer with a decline of 3.8%, followed by Utilities (-2.6), Real Estate (-2.1), Materials (-1.8), Health Care (-1.0), Consumer Staples (0.2), Financials (0.3), Industrials (0.8), and Consumer Discretionary (0.9). Looking at 2023's performance so far, the S&P 500 is up 15.0% ytd, with just three sectors still outperforming the index and four higher for the year. The best ytd performers: Tech (47.0), Communication Services (45.5), and Consumer Discretionary (27.4). These are 2023's worst performers: Utilities (-14.7), Real Estate (-7.3), Health Care (-7.3), Consumer Staples (-6.5), Energy (-5.1), Financials (-1.2), Materials (-0.6), and Industrials (4.2).

S&P 500 Technical Indicators (*link*): The S&P 500 rose 1.3% last week and improved relative to its 50-day moving average (50-dma) and its 200-day moving average (200-dma). The index was above its 50-dma for a second after eight weeks below, and was also above its 200-dma for a second week after dropping below for the first time in 30 weeks. As for what the dmas themselves have been doing, the 50-dma moved lower for an eighth week, but the 200-dma rose for a 24th week in its longest positive streak since its 70-week streak ended in March 2022. The S&P 500 improved to 1.8% above its falling 50-dma from 0.2% above a week earlier and a 53-week low of 5.5% below the week before that. For perspective, the latest reading is down from a 20-week high of 5.4% above its (rising) 50-dma in mid-June. Other comparison points include: a four-month low of 10.6% below its (falling) 50-dma at the end of September 2022, a 23-month high of 8.7% above its (rising) 50-dma in August 2022, and a 27-month low of 11.1% below its (falling) 50-dma in June 2022. The index had been trading above its 50-dma from most of late April 2020 to early April 2022; in June 2020, it was 11.7% above, which was the highest since its record high of 14.0% in May 2009. That compares to 27.7% below on March 23, 2020—its lowest reading since it was 29.7% below on Black Monday, October 19, 1987. Turning to the 200-dma, the price index improved to 3.6% above its rising 200-dma versus 2.4% above a week earlier and a 42-week low of 3.1% below its rising 200-dma the week before that. That compares to a 24-month high of 12.4% above its (rising) 200-dma in mid-July. The S&P 500 is well above its 26-month low of 17.1% below its (falling) 200-dma in June 2022 and compares to 17.0% above in December 2020, which was the highest since November 2009 and up from the 26.6% below registered during the Great Virus Crisis on March 23, 2020—the lowest reading since March 2009. At its worst level of the Great Financial Crisis following the failure of Lehman Brothers, the S&P 500 index was 39.6% below its 200-dma on November 11, 2008.

S&P 500 Sectors Technical Indicators (*link*): Five of the 11 S&P 500 sectors trade above their 50-dmas, unchanged from a week earlier as two sectors switched places. Still, that's a big turnaround from late October when all 11 sectors were trading below that measure. The Consumer Discretionary and Industrials sectors moved above their 50-dma this week, joining Communication Services, Financials, and Tech in that club. Real Estate and Utilities moved below their 50-dmas. Communication Services and Information Technology are still the only two sectors with a rising 50-dma, but that's up from all 11 sectors having a falling 50-dma in late October. Looking at the more stable longer-term 200-dmas, Energy fell below in the latest week. That leaves these four sectors as the only members of the positive 200-dma club: Communication Services, Consumer Discretionary, Financials, and Information Technology. The rising 200-dma club dropped the Industrials sector this week, leaving Communication Services, Consumer Discretionary, and Information Technology as the only members.

US Economic Indicators

Consumer Sentiment Index (*link*): *Sentiment* dropped in mid-November for the fourth month, according to preliminary estimates, from a 21-month high of 71.5 in July to a six-month low of 60.4. The *present situation* component also sank for the fourth month, to 65.7 in October, after climbing five of the prior seven months by 16.9 points to 76.5 in July—which was the highest level since October 2021. The *expectations* component in mid-

November dropped to a six-month low of 56.9 from July's 19-month high of 68.3. According to the survey, while current and expected personal finances both improved modestly this month, the long-run economic outlook dropped 12%, in part due to growing concerns about the negative effect of high interest rates. Also weighing on consumer sentiment were the ongoing wars in Gaza and Ukraine. Turning to inflation, the *one-year expected inflation rate* shot up from 3.2% in September to 4.2% in October and 4.4% in mid-November—the highest since April's 4.7%. It remains well above the 2.3%-3.0% range in the two years prior to the pandemic. The *five-year expected inflation rate* moved up for the second month, from 2.8% in September to 3.2% in mid-November—the highest percentage since March 2011. Both short- and long-run gas price expectations rose to their highest readings this year.

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102