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Highland Associates

Multi-Asset Solutions
Weekly Commentary
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Stocks: Muddling Through Month-To-Date As Mixed Messages Abound; Earnings Season Ramping Up With Over 40% Of The S&P 500 Reporting This Week.

The S&P 500 traded in a narrow range between 4,115 and 4,170 over the balance of last week, ultimately falling 0.1% as investors weighed and measured mixed signals being sent from lukewarm economic data and better than feared earnings results up to this point. After consistently lagging the S&P 500 over the past month, the small-cap Russell 2000 index fared a bit better than the S&P 500 as it gained almost 0.6% on the week. While April has historically been a strong month for equities, with just one week to go a seasonal lift has so far been elusive and daily price action and lackluster trading volume has exhibited signs of this being a tired market, for lack of a better descriptor, displaying little desire to move much in either direction. "Sell in May and go away," an adage oft cited by market participants around this time of year, may have been pulled forward a bit judging by the rudderless nature of the market month-to-date, but forthcoming earnings results and inflation data could yet jolt the market from its April slumber. With the CBOE Volatility Index, or VIX, back to levels last seen in November of 2021, investors should prepare for the recent relative calm to give way to a period of elevated volatility sooner rather than later.

- Developed markets abroad have continued to perform well on an absolute and relative basis in April, with the MSCI EAFE higher by just shy of 3% month-to-date after ending last week higher by 0.5%. The April Purchasing Managers Index (PMI) Composite reading out of the Eurozone was released Friday and is the latest in a series of economic data releases to surprise to the upside at 54.4 versus the consensus estimate of 53.8 and the March reading of 53.7 as strength in services offset manufacturing weakness. Eurozone inflation remains elevated, likely requiring additional rate hikes out of the European Central Bank (ECB) over coming months, but with Eurozone economic data trending in a more constructive direction despite tighter monetary policy, a bearish position on Eurozone equities is increasingly difficult to justify.

- With just shy of 20% of the S&P 500 having posted quarterly results, early returns have been better than expected, or perhaps more accurately, feared. 76% of companies that have reported bested the consensus revenue estimate, but reported earnings growth has been a paltry 0.4% year over year. Prior to the start of quarterly earnings season, the consensus estimate called for S&P 500 EPS to fall 5.8% year over year in the first quarter of 2023, and after a solid start that figure has improved modestly to -5.6%. However, given that the financial services sector is the only S&P 500 sector with more than 25% of constituents having reported, and with banking stress materializing near quarter-end, we hesitate to infer much from releases up to this point and believe it prudent to wait before passing judgement as over 40% of the S&P 500 is slated to report this week with Amazon,

Alphabet, and Microsoft, among others, worth watching.

- The S&P 500 took another run at its year-to-date high of 4,180 early last week. That level provided a formidable ceiling of resistance and capped gains for the index back in February and a failure to break/close above 4,180 two months ago ultimately ushered in a nasty selloff that took the S&P 500 down to the 3,850 level in just two weeks' time. Both bulls and bears are likely keying off price action at/around the 4,180 level, and the longer the index spends below it, the greater the likelihood that we give back some of the S&P 500's sizable year-to-date gains over the near- term. The S&P 500's 50-day moving average at 4,034 and the 100-day moving average at 3,999, are potential levels of support should earnings deteriorate and provide market bears with a downside catalyst and reason to press short positions over the near-term.
- West Texas Intermediate (WTI) crude oil ended last week at $77.95 per barrel, a 5.7% weekly decline amid weaker U.S. economic data releases (Philly Fed, Leading Economic Indicators) that called into question the outlook for near-term demand. The S&P 500 energy sector tracked the underlying commodity lower but fared a bit better, falling 2.5% on the week. The move lower in crude prices is notable given we're on the cusp of what has historically been a strong seasonal period for demand as the summer driving/travel season ramps up.

Bonds: A Stalemate In The Rates Market As Investors Grapple With Mixed U.S. Economic Data, Debt Ceiling Concerns, And Elevated U.K. Inflation.

Sovereign bond yields across the globe remained volatile over the balance of last week. U.K. inflation data and concerns surrounding Congress' ability to raise the debt ceiling forced yields higher into mid-week but the release of the Philadelphia Fed Index for April and Leading Economic Indicators for March, which both came in weaker than expected, pulled yields lower. While equities have remained remarkably calm month-to-date, corporate credit is likely a better potential canary in the coal mine as stocks tend to either look through or miss early signs of economic deterioration. Last week, the Bloomberg Corporate and U.S. High Yield indices fell 0.2% and 0.3%, respectively, but remain higher by 3% and 3.5% year-to-date, hardly indicative of financing stress ramping up. That said, with U.S. economic data sending mixed messages, tighter monetary policy on the horizon, and with high yield issuers facing a maturity wall beginning in '24, the coming quarters could present investors with an opportune time to improve the credit quality of their fixed income portfolios.

- The Philadelphia Fed Index released last Thursday was noteworthy as this gauge of regional manufacturing activity declined to -31.3 from -23.2 in March, much weaker than the consensus estimate of a -20.0 reading. The Philly Fed Index has been in negative territory for 8 consecutive months now, but the April reading was the lowest level since May of 2020 when the U.S. was in the early innings of dealing with the COVID-19 pandemic. Most notably, more

than 32% of firms responding to the survey expected decreases in future manufacturing activity, up from 29% in March. Interestingly, the Philly Fed Index is almost a 180-degree turn from the Empire State Manufacturing Survey released early last week that showed a marked improvement month over month with a 10.8 reading versus the -18.0 consensus estimate and -24.6 reading from March. These two manufacturing data releases last week highlight how confounding recent economic data releases have proven to be and given this backdrop it comes as little surprise that interest rate volatility has remained a hallmark of the current market backdrop.

- U.K. Consumer Price Index (CPI) for March was released Wednesday with a headline reading of 0.8% month over month at 10.1% year over year, driven primarily by rising food prices. Core CPI, which excludes food and energy, rose 6.2% in March, in-line with the February reading, evidence that even outside of food prices, inflationary pressures remain sticky. All told, inflation in the U.K. remains far too high and will likely force the Bank of England (BoE) to hike key policy rates to even loftier levels over coming months. The yield on 10-year U.K. gilts rose 11 basis points Wednesday to 3.86%, 3 basis points shy of a year-to-date high, but that upward lift proved short lived, and the 10-year gilt caught a bid into the weekend and closed at 3.75%. With inflation running north of 10% year over year and with the central bank's key policy rate well below that at 4.25%, it's reasonable to expect the BoE will be in policy tightening mode for months to come, likely contributing to upward pressure on long-term U.S. Treasury yields in the process.

What We're Watching:

• The Conference Board's Consumer Confidence survey for April is slated for release Tuesday and is expected to decline modestly to 104.1 after 104.2 reading in March.

• Durable Goods Orders for March are released Wednesday and are expected to rebound 0.7% month over month after failing 1.0% in February relative in January.

• Thursday brings with it the release of April confidence indicators out of the Eurozone, with consumer confidence and economic confidence the most notable data points worth monitoring.

• Personal Consumption Expenditure (PCE) Deflator, the FOMC's preferred inflation gauge, is released Friday. The March headline reading is expected to show 0.1% rise month over month after a 0.26% increase in February versus January. Year over year headline PCE is expected to rise 4.1% in March, down sharply from 5.0% in February. The Core PCE Deflator will likely garner much of the FOMC's attention, and month over month CORE PCE is expected to rise 0.3, in-line with the February reading which would be 'sticker' relative to the headline. Year over year, core PCE is expected to have risen 4.5%, down only modestly from 4.6% in February.

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