A Note From Your Advisors

BAIRD

THE MAIN, GOWIN, FISCHER, RICE GROUP

August 1, 2023

Last week we wrote about the (in)accuracy of stock market and economic forecasts. As markets continue to move higher, the two big questions facing markets in the middle of 2023 are: **(1)** how much more will the Federal Reserve raise interest rates? and **(2)** Are we heading into a recession?

We did our best to answer the first question in our July 11th post: Goldilocks or Hard Landing? Although recent data on inflation and the economy have been very encouraging, the Fed did raise its benchmark Fed Funds Rate by another 0.25% last week. And there's nothing about comments made following that decision nor in public speeches since that leads us to change our mind that a bit of caution is still warranted on this subject.

How about question two – recession risk? Again, we appear to be getting encouraging news by the day in the form of quarterly earnings from large companies. About half of the big companies in the S&P 500 have now reported their earnings for 2023's 2nd Quarter (ending June 30). According to our friends at Strategas 80% of firms have seen a positive upside surprise in earnings per share – this means that 8 in 10 companies across different industry sectors have outperformed what Wall Street analysts expected of them (vs the 10 year average of 73%).

Is that outperformance because the companies are doing remarkably well, or simply because Wall Street has already reduced expectations so far that actual numbers aren't as bad as feared? A little of both… Although companies are reporting earnings that are about 5.9% better than expected, those blended/combined earnings are still 7.3% below where they were a year ago. That is the biggest decline since 2020's 2nd Quarter (which was obviously impacted by Covid shutting the world down: -31.6%). To look one level deeper, six of the eleven S&P sectors are reporting earnings growth vs 2022 (led by consumer discretionary and communication services) while five of the sectors are down (led by energy, materials and healthcare).

Bottom line: there is some sign of deterioration in company earnings, but it's isolated and hard to spot a pattern. Meanwhile the stock market has just finished a very strong month of July as investors' optimism grows. We are more comfortable seeking opportunity in portfolios right now than we were six or twelve months ago. But we continue to feel it's critical to overweight and underweight certain parts of the market if possible.

Most importantly, we suggest all investors have an individual plan for how your portfolio can deal with a variety of risks: volatility, inflation risk, sequence of return risk, etc. If you haven't reviewed your plan with your advisor recently (or don't have a plan), now is a good time to have that conversation!

- The Main, Gowin, Fischer, Rice Group