1919 INVESTMENT COUNSEL
Complexity to Clarity

Weekly Market Insights

May 8, 2023

A Confused Market!

Financial Markets

Equity markets were buffeted this past week, as investors had conflicting reactions to major news events. The Dow fell 1.24%, the S&P 500 fell 0.80%, and the NASDAQ gained 0.10%. While the weekly returns look somewhat immaterial, they don't adequately capture the day-to-day volatility that occurred. Investors spent the first part of the week on a bearish tear, only to reverse much of the losses on Friday. The most anticipated, and to many the most important, news was the Federal Reserve's announcement of another 25 basis point rate hike with the potential for a pause at the next meeting. This news gave many investors increased confidence that a future recession was not imminent. Of course, a "pause" does not mean that further hikes are out of the question or that rate cuts are coming soon.

The Fed announcement was one of two primary investor concerns last week. The other, and perhaps more frightening, concern stemmed from continued issues in the banking sector. The fear of recession and bank failures are both directly related to the Federal Reserve's rapid tightening campaign over the past 14 months.

Finally, as has been common for the past decade, there are political risks with potentially significant market implications. At the moment, these risks relate to the ability of the House and the President to reach an agreement on raising the debt ceiling.

An important point to remember while trying to analyze market index behavior is the changing structure indices themselves. More and more, both the Dow and the S&P 500 are being dominated by just a few high market cap companies. So, index movement may be somewhat distorted and markets may not signal the same economic or business cycle information as they have in the past.

Economics

We ended the prior section with the intriguing thought that, because of index structure changes, perhaps markets are not sounding the same signals they have in the past. We believe this has something to do with the unique end to the last cycle, which came as a result of the pandemic. Normally, cycles end due to economic imbalances and sequential downturns and begin once the recovery ensues. Just because the current market signals are different does not make them irrelevant. They still provide signals for the health of the country's economy and its citizens, but the market signals may not indicate precise progress or regress of the economic cycle. Even if our thoughts about current market signaling are correct, it does not mean a reversion to past cycle behavior is out of the question. Instead, we believe a reversion is likely.

We haven't addressed changes occurring in the global economy involving issues like globalization and economic decoupling, along with their economic and political motivations. These are still vital questions, but we thought the issues concerning changes in domestic financial market structure to be the more immediate questions to address.

Conclusion

None of the above changes the importance of research. It just makes the need for an open mind that much more important. While a light recession in the United States remains a real possibility, it does not appear as an imminent threat. In the past, we have avoided delving too deep into issues inspired by the war in Ukraine, and we will continue to take that stance. Of course, when it comes to Ukraine, the most important question is how and when it will end. The answer to that is quite uncertain and is definitely out of our realm.

Michael Olin Clark
Senior Advisor
moclark@1919ic.com

Ryan Schutte, CFA, CFP®
Senior Investment Associate
rschutte@1919ic.com

Abigail McKenna
Portfolio Administrator
amckenna@1919ic.com

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