

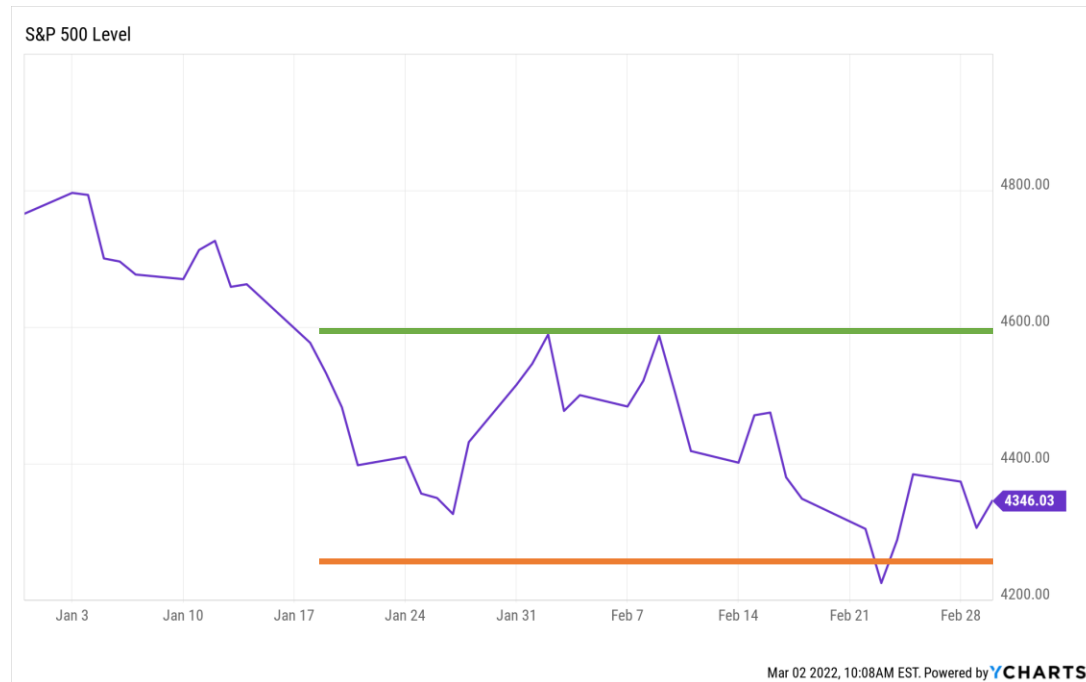
## Can the Market Climb a Wall of Worry?

March 3<sup>rd</sup>, 2022

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## Our View of the S&P 500: Still Rangebound Between 4300ish and 4600

- To break out of this trading range to the upside, we think the market must climb a relatively large “Wall of Worry.”

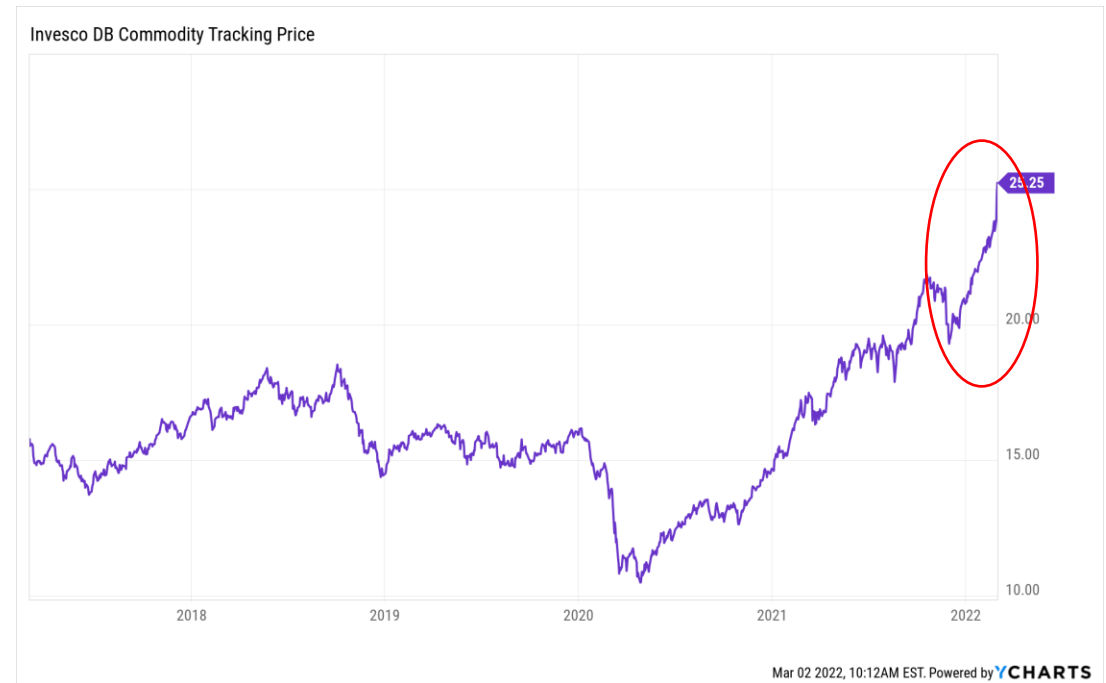


## What's On the Wall of Worry?

- Worry 1: Russia/Ukraine causes a sustainable surge in commodity prices.
- Worry 2: The Fed removes accommodation too aggressively and kills the economic recovery.
- Worry 3: Inflation does not peak and makes the Fed get more hawkish later in 2022.
- Worry 4: 2023 earnings growth stalls.

## Worry One: A Russia/Ukraine Commodity Spike

- Reason to Worry:
- A sustained conflict would put material upward pressure on commodity prices.
- That would make high inflation last longer.
- Higher inflation would increase the chances the Fed more aggressively removes accommodation, increasing the chances of a policy mistake.
- Concerns growing it's already too late to reverse this.



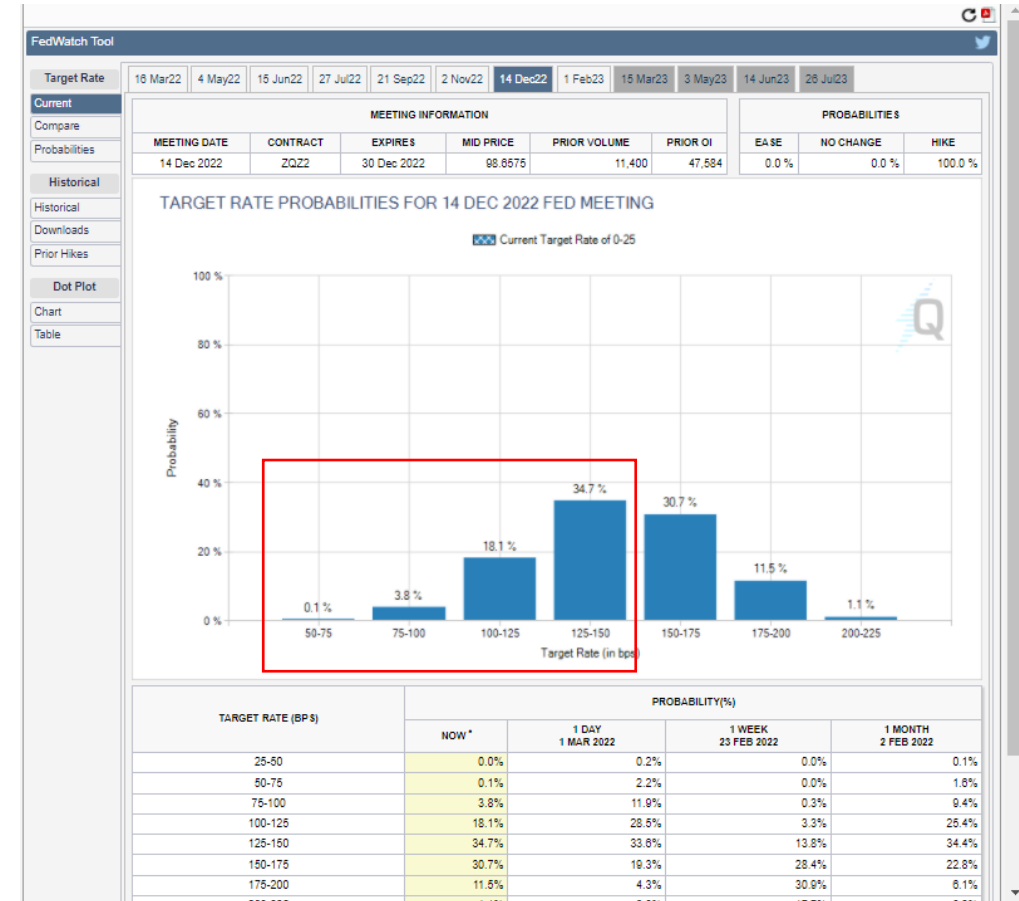
## How This Worry Is Resolved

- The Russia/Ukraine conflict is resolved in the coming days, which includes a halt to hostilities, no more sanctions on Russia and the removal of some sanctions in the next two-three weeks.
- That, in turn, reduces the geopolitical risk premium in oil and commodities more broadly, and the surge in oil above \$100/bbl is not sustainable.
- Key Dates: March 20th
- Key metrics to watch: Oil prices (need to get back below \$100/bbl).



## Worry Two: The Fed Removes Accommodation Too Quickly

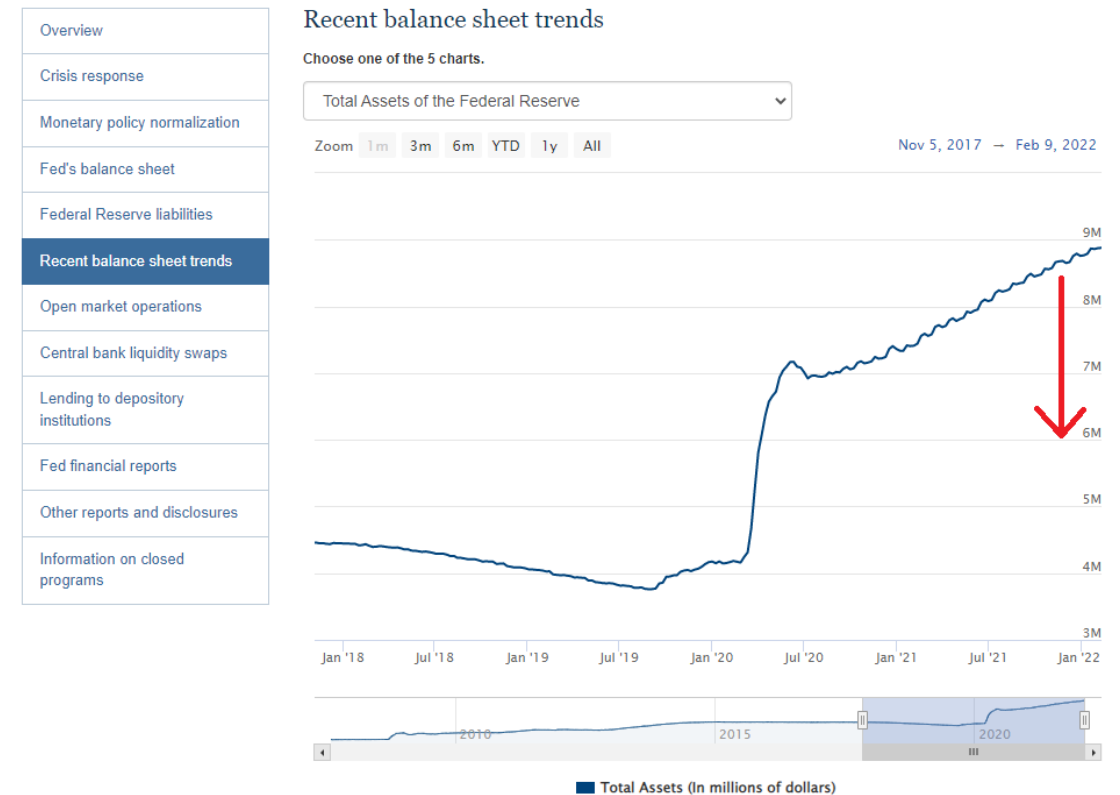
- Reason To Worry:
- If the Fed removes accommodation too quickly, that will kill the economic recovery and send stocks sharply lower.
- Nearly a 60% chance we have five rate hikes in 2022.



## How This Worry Is Resolved

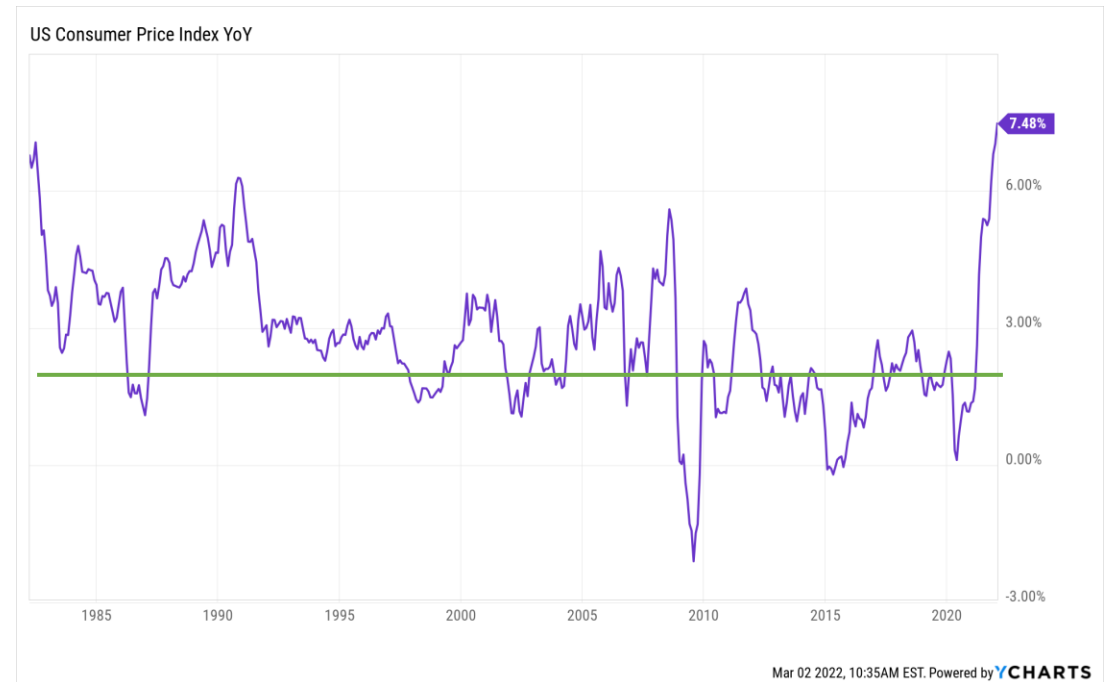
- Fed hikes 25 bps in March
- Fed hikes total of 75 bps through June.
- Fed does not reduce the balance sheet by more than \$100/bln per month (during the last bout of QT, the Fed reduced the balance sheet by \$50 bln/month).
- Key Date: March 16<sup>th</sup> (FOMC meeting).

### Credit and Liquidity Programs and the Balance Sheet



## Worry Three: Inflation Does Not Recede

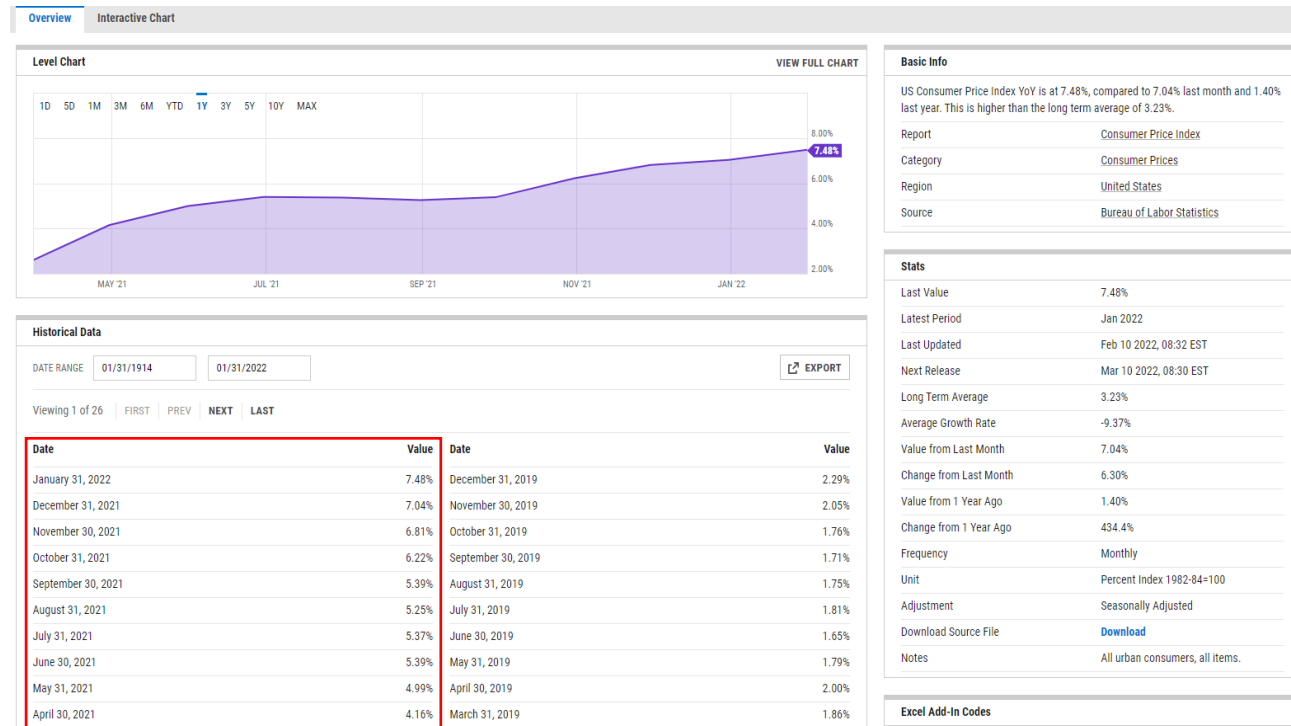
- Reason to Worry:
- Inflation is the single biggest influence on the Fed right now, and still high inflation increases the chances the Fed makes a policy mistake.
- Sustained inflation compresses corporate margins, reducing profits and earnings.
- Sustained inflation eats away at disposable income, reducing consumer spending and increasing stagflation risks.





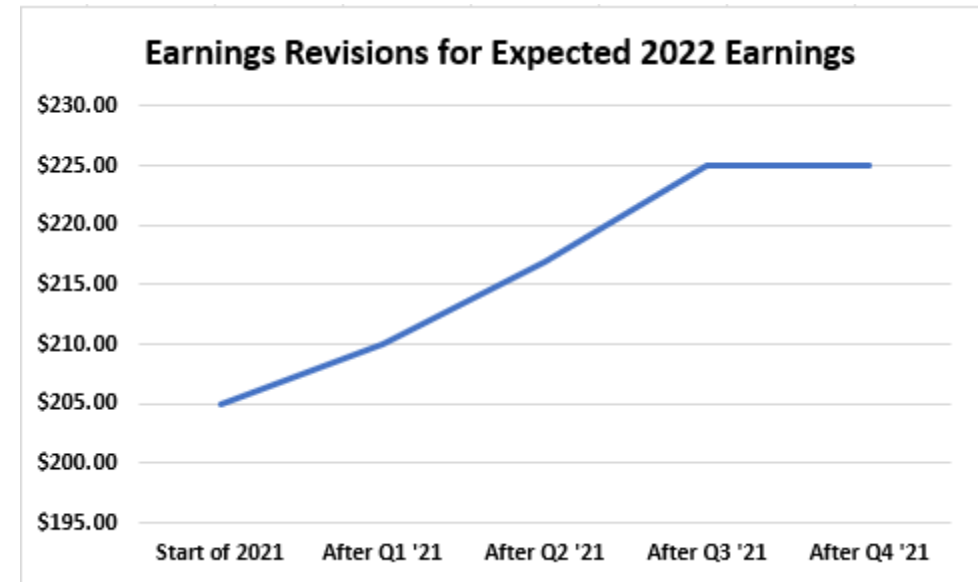
## How This Worry is Resolved

- CPI peaks and begins to recede, starting with the February CPI report (out this month).
- Inflation will remain solidly above the Fed's 2% target for quarters if not years. But, if the increase in inflation begins to slow, that will help investors get less worried the Fed will get too aggressive.
- Key Date: March 10<sup>th</sup> (February CPI).



## Worry Four: Earnings Growth Stalls

- Aggressive bulls are starting to try to value the market by 2023 S&P 500 earnings.
- Currently, expected 2023 S&P 500 EPS are \$243/share. That's 8% earnings growth over the 2022 expected S&P 500 EPS of \$225/share.
- On 2022 EPS, the S&P 500 is fully valued at these levels. But, on 2023 EPS, it's borderline cheap.
- If earnings growth stalls, that removes any compelling valuation arguments for owning stocks at these levels.



## How This Worry is Resolved

- Earnings growth for 2023 S&P 500 earnings stays solidly positive.
- Key Dates: April 11 – April 30 (Q1 earnings season).
- July 2022 (When investors will begin to use 2023 estimates).

<u>Year</u>	<u>Expected S&amp;P 500 EPS</u>	<u>Current S&amp;P 500 Level</u>	<u>Valuation</u>
2022	\$225	4343	19.3X
2023	\$243	4343	17.9X

## If Wall of Worry Is Scaled – How High Can Stocks Go?

If the Wall of Worry is scaled, expect a 10% ish rally.



<u>Year</u>	<u>Expected S&amp;P 500 EPS</u>	<u>Valuation</u>	<u>Level</u>
2023	\$243	19.5X	4739

## Alpha Strategies for a Scaled Wall of Worry

- “Quality” ETFs. 1/25/22. FXO/QVAL/SYLD/RPV.
- REITS. 11/30/21. VNQ/SRVR/INDS/REZ.
- Small Caps. 4/20/21. PSCD/FXG/RWJ/ISCV.
- “Old” Economy. 1/26/21. DJD/FDL.
- Value. 11/3/20. RSP/VTV.
- High Quality Tech: 3/23/21. RYT/SMH/TDIV.