First Trust
Monday Morning OUTLOOK

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Still Bearish

If you were bullish for 2023…congratulations! The S&P 500 rose 7.0% in the first quarter and, although we still have more data to analyze before we finalize our prediction, it looks like real GDP grew at about a 2.0% annual rate in Q1. No drop in stocks, no recession. At least not yet.

While we wish we hadn't been bearish when this year began, our forecast for a drop in stocks and a recession hasn't changed. Using corporate profits for the fourth quarter and the current 3.5% yield on the 10-year Treasury Note, our Capitalized Profits Model suggests a fair value for the S&P 500 of 3,891, which is lower than where stocks are today.

The economy is still absorbing and responding to the 40% surge in the M2 measure of the money supply during COVID. Think of that enormous surge in the money supply as installing a furnace built for a 10,000 square foot mansion into a home that's only 2,000 square feet, and then running it full blast.

Even when you have finally turned the furnace off – like the Federal Reserve did with the money supply in the past year, with the largest drop since the Great Depression – that 2,000 square foot home doesn't immediately get cold. It takes time for the home to gradually cool off and eventually get cold. Given the drop in the money supply, we are headed for a much colder economy; we're just not there yet.

And when the US economy cools off, we expect profits, which were artificially boosted by easy money and government handouts, to fall. This means our model will eventually move stocks' fair value lower, too. The only thing that could change that forecast is if interest rates fall at the same time profits do.

At present, the stock market seems priced for both multiple expansion (the price-to-earnings ratio moving up) as well as higher profits. This is unlikely. The Fed and federal banking regulators have ring-fenced the banking system to prevent losses for depositors. In turn, because the Fed feels like rate hikes won't break things, future rate hikes will likely exceed current expectations and long-term interest rates will move higher, too.

No one knows for sure. COVID policies were unprecedented. Of prime importance to us is the historical increase in the money supply, which is the best explanation for 40-year highs in inflation. Equally important is the sudden decline in the M2 measure of money. If we are correct, this will hit the economy soon…and just like so many times in history, the drop in activity will take many businesses and investors by surprise. That means more layoffs, lower profits, and lower stock prices.

COVID-related shutdowns were a catastrophe for the US economy, more man-made than anything else. The policy measures taken to ease the pain of the shutdowns were unprecedented, too. Now those policies are wearing off and we expect a period of economic and financial pain. Given the unprecedented nature of the problems, it's the timing of the pain that's tough to forecast, not predicting that the pain will eventually come. Clearly the market is having a hard time digesting or believing that in 2023.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-3 / 9:00 am	ISM Index – Mar	47.5	**47.7**	46.3	47.7
9:00 am	Construction Spending – Feb	0.0%	**+0.2%**	-0.1%	-0.1%
afternoon	Total Car/Truck Sales – Mar	14.5 Mil	**14.2 Mil**		14.9 Mil
afternoon	Domestic Car/Truck Sales – Mar	11.7 Mil	**11.2 Mil**		11.2 Mil
4-4 / 9:00 am	Factory Orders – Feb	-0.5%	**-0.3%**		-1.9%
4-5 / 7:30 am	Int'l Trade Balance – Feb	-$68.8 Bil	**-$68.4 Bil**		-$68.3 Bil
9:00 am	ISM Non Mfg Index – Mar	54.4	**54.7**		55.1
4-6 / 7:30 am	Initial Claims – Apr 1	200K	**199K**		198K
4-7 / 7:30 am	Non-Farm Payrolls – Mar	240K	**230K**		311K
7:30 am	Private Payrolls – Mar	220K	**220K**		265K
7:30 am	Manufacturing Payrolls – Mar	0K	**10K**		-4K
7:30 am	Unemployment Rate – Mar	3.6%	**3.6%**		3.6%
7:30 am	Average Hourly Earnings – Mar	+0.3%	**+0.3%**		+0.2%
7:30 am	Average Weekly Hours – Mar	34.5	**34.5**		34.5