MARKET MINUTE
WITH McGAREL

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In Samuel Becketts' play *Waiting for Godot*, the two main characters sit around all day talking and anticipating when Godot will finally appear. He never arrives. Today, practically everyone is anticipating a recession and positioning for one. Is it possible, that, like Godot, it never shows up? Sure, anything is possible. But let's think about the consequences of that for a moment.

If we avoid a recession, will the Federal Reserve (Fed) cut rates significantly and quickly? Probably not. Will inflation get to the Fed's 2% goal without a recession and higher unemployment? Unlikely. So, in our view, a soft landing would mean a tougher inflation fight and higher rates for longer even if the Fed pauses for a while. Not great news for stocks nor a recipe for high earnings growth.

Meanwhile, we believe a recession would probably trigger the Fed to move faster to cut rates. However, we'd expect that the economic impact of recession would certainly affect earnings more negatively than a soft landing. Unemployment would likely increase. Not exactly good for stocks either.

So why is the S&P 500 Index up over 17% in the last seven months ending April 30th despite neither of the two scenarios above representing a terribly attractive environment for equities? Hope. Speculation. Naivete. Who knows? More importantly why bother trying to answer this question.

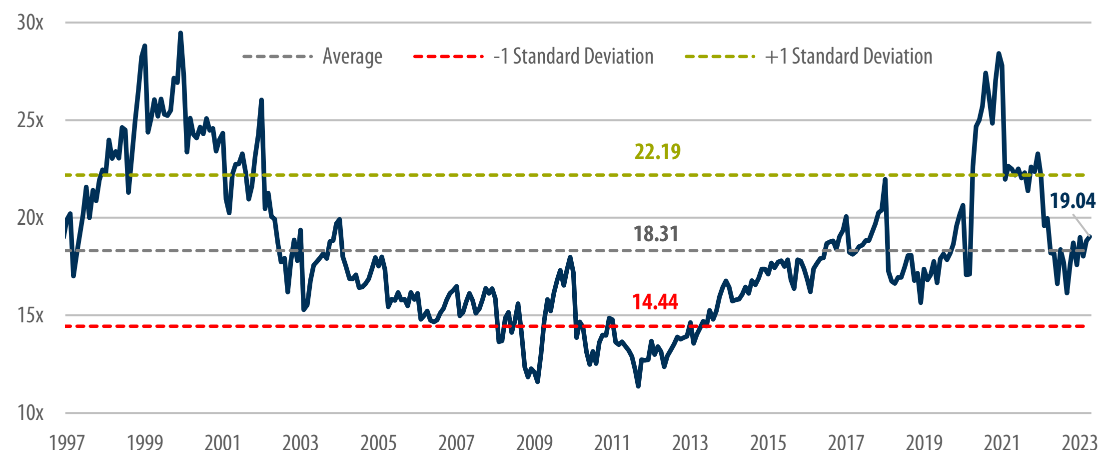
In our view, it's a fool's game to try to time the market. Inflation stays sticky, the Fed keeps raising rates, big banks fail, and the market goes higher! Instead of making predictions, simply acknowledging the landscape for stocks will be different than the recent past guides our positioning.

We continue to believe that earnings growth will be slower with rates higher and price-to-earnings multiples unlikely to expand in this environment. The S&P 500 Index trades at about 19x estimated 2023 earnings. This is up from 18x at the beginning of the year. Multiples have increased on a combination of falling earnings expectations and rising equity prices. In our view, that is not likely to continue.

A lot of this higher valuation is concentrated in the high growth, tech oriented areas of the market. Tremendous businesses but the future seems fairly priced in at this point, in our view. This does not mean there are no opportunities in the market however. We believe slow growth environments require a focus on quality (think high profitability) and valuation. You don't want to overpay for assets in a slower growth environment. Focus on those areas of the market that offer quality and value. We believe health care, industrials (especially infrastructure, reshoring, and defense companies) and energy are good places to focus your shopping list. Even the defensive areas like utilities and consumer staples, after underperforming year to date, are starting to offer some value along with their quality exposure.

Instead of waiting for a recession to show up, we believe in focusing on portfolio allocation in what is likely to be a slower growth environment.

S&P 500 Index Forward Price-to-Earnings



Source: Bloomberg. Data from 12/31/96 – 4/28/23.

Past performance is no guarantee of future results.

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The **S&P 500 Index** is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. **Forward Price-to-Earnings (P/E)** is the price of a stock divided by estimated forward earnings. **Forward Earnings** of S&P 500 Index is the next-twelve months consensus estimate.