MOE'S MARKET WRAP MINUTE

WEEK OF FEBRUARY 2, 2023

MOE'S MARKET MENTIONS

- It has been a busy week for earnings announcements and the results have been interesting. Companies have been reporting Q4 earnings generally in line with expectations, but guidance has been weak. With this seemingly poor news, stocks have rallied higher. This implies that, in the short run, the market expectations for an earnings recession were possibly overdone but doesn't mean we are out of the woods yet. The tightening of financial conditions by the US Federal Reserve is still working its way through the system and a potential earnings decline might just be delayed to later in 2023 or 2024. While we are seeing a market rally now, there most likely will be continued volatility going forward and limited upside on the S&P500 to potentially 4300.

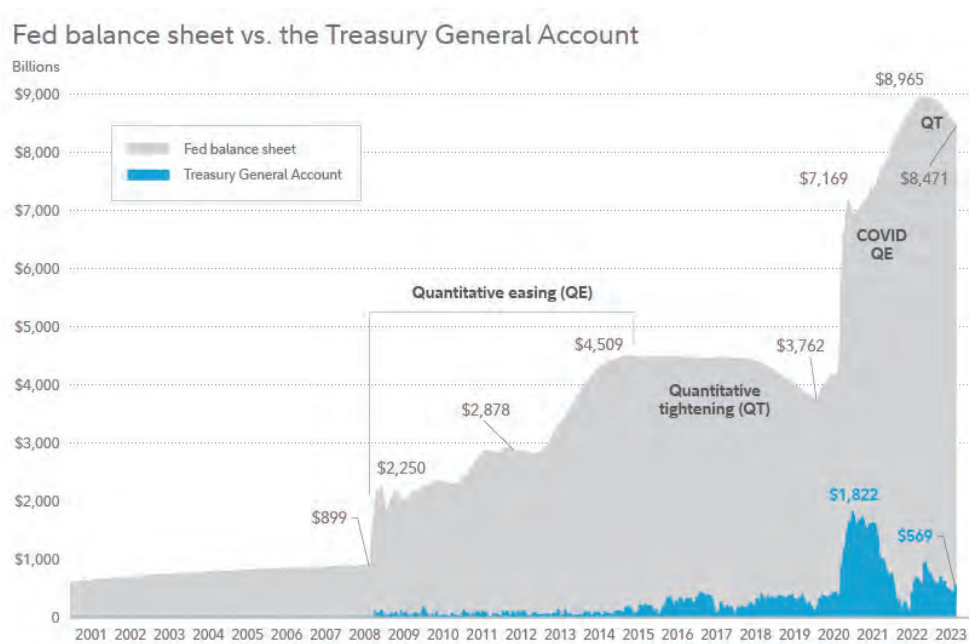
- The US Federal Reserve announced this week an increase on the Fed Fund rate of 0.25% and indicated that inflation is starting to come down. They maintained their stance that there will be more rate hikes to come to ensure the fight against inflation is completed, yet the market believes they are one rate hike away from completing their tightening cycle. Interestingly the market believes the Fed could possibly start cutting rates later in 2023 to possibly combat an economic recession. The US Treasury yield curve is deeply inverted so something will have to give in the next 12 to 24 months. Either the Fed will cut the Fed funds rate due to a slowing economy or the longer-term rates will rise due to a broadly improving economic outlook. Recession is clearly bad for risky assets and would mean more downside volatility. Rising interest rates isn't as bad as a recession, but it would limit the upside appreciation potential of assets due to valuations headwinds. Given this assessment focusing investments on dividends and interest payment might be a prudent strategy to whether the continued expected volatility.

CHART OF THE WEEK

For this week's chart we focus on the debt ceiling debate and the potential consequences for the market. Note how the TGA (US Treasury's checking account) spiked in 2020—as the Treasury increased borrowing in anticipation of paying for pandemic relief—at the same time as the Fed grew its balance sheet from $3.76 trillion to more than $7 trillion. Then, the Treasury drew down its TGA balance to pay for COVID stimulus packages.

With this setting there is potentially an ironic twist regarding the debt ceiling situation. A political showdown on the debt ceiling would force the Treasury to draw down its $569 billion TGA balance to avoid a technical default on the nation's debt. But drawing down that balance would be stimulative and would at least partly offset the Fed's overall efforts to restrict liquidity.

For comparison's sake, the Fed is currently engaging in quantitative tightening (the process of shrinking its balance sheet), by about $95 billion a month, meaning that drawing down the TGA balance could essentially offset 6 months' worth of quantitative tightening.



Source: FMRCo., Bloomberg as of 02.02.23

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Moeez Ansari is the President, Chief Investment Officer, and founder of Compak Asset Management. With over 35 years of investment experience, Moeez evaluates the markets using industry-leading technical and fundamental analysis.

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