SANCTUARY


Week of **October 31, 2022**

## Decoupling of Tech – FANG De-Fanged

**Last week we entered a busy earnings week with big cap tech, namely FANG+ stocks reporting, and it was a disaster for most of them. Amazon took it on the chin, while Apple held up better – but we are still concerned this is an at-risk stock. The FANG+ area of tech is basically broken at this point and there are indicators for further weakness. As previously noted, Snap's earnings report was a good leading indicator of advertising spend – which has been falling sharply and is impacting earnings among other factors.**

We continue to believe that large cap, high P/E technology and growth names will remain under pressure as long as the Fed is raising interest rates. Despite tech falling, other pockets of the market have been able to rally and lead to a positive swing. Last Thursday we had the DJIA close to the plus side, the S&P 500 was down less than 1% and the tech-heavy Nasdaq was down 1.6%.

### New Leadership Shift – Ghosts of Markets Past?

As Technology is under pressure with some stocks falling sharply after earnings, Energy names are hitting 52-week new highs (see ExxonMobil, ConocoPhillips and Hess Corp). This reminds us of the year 2000 timeframe, when Technology was giving up market leadership and Energy and Commodities emerged as the new leaders (note the valuations from 2000 to today are drastically different from 200x price-earning multiples compared to 20's today). The Energy sector is again showing a broad-based move, indicating the behavior of a leadership sector, but it accounts for only 5% of the S&P 500 and is currently frowned upon under gaze of ESG metrics. As long as the energy complex has firm pricing, the sector will perform well, and energy stocks will continue to rise. We are expecting Energy to be a strong sector over the next year. Likewise, the Industrial sector, especially companies leveraged to energy, and small and mid-caps, are also showing strong relative strength with attractive valuations.

### Across the Pond: Tightening and Frightening

Following the ouster of Liz Truss, the announcement of Rishi Sunak as the new UK Prime Minister seems to have calmed some fears, but Britain, its people and the markets await the new admin's new budget, which should arrive by mid-November. Meanwhile, the ECB raised its deposit facility rate (their version of our Fed Funds rate) up 75bps, the third consecutive increase this year. At the same time, it announced that the third program of its TLTROs (targeted longer-term refinancing operations – their version of quantitative tightening) will now peg its rates to the much higher deposit facility rate. This will greatly incentivize European banks to pay back their loans under a voluntary early repayment date – one of the ECB's objectives. With higher rates and quantitative tightening we can anticipate episodic volatility will continue in the European equity and debt markets. Europe is following the U.S. in hiking rates, but they're relatively early in their journey. It's worth noting that these tightening actions – in front of a recession – are highly unusually but underscores the global war on inflation.

### Data & Inflation: Fire & Brimstone

Pending home sales fell 10% in September, which was much worse than expected. The S&P Global Flash U.S. for both manufacturing and services dipped below the 50 level – traditionally a sign of a pending recession. The But the all-important Personal Consumption Expenditures (PCE) data remained elevated and consumer spending remains strong. This leaves us with full expectations that the Fed will raise rates again for the fourth time by 75bps, and the market is already pricing in another 50bps in December. With both those hikes priced in, stocks can continue to rally. There is strong resistance on the S&P 500 near 4120-4150 so we are only viewing this as a rally.

### Gory Gridlock: Good for Markets

With the mid-term elections just a week away, we thought it worth noting that, should the House and Senate both shift to the Republicans, the equity markets would view this shift of power as a positive. Why? A Democrat President and a Republican Congress would create gridlock in Washington and "nothing will get done" – perversely that's something markets like. Current polls suggest the House will likely shift to the Republicans, but the Senate races are too close to call. So, with mid-term elections historically preceding a rally and November and December seasonally positive, the markets can continue to rally – even if the Tech sector remains under pressure.

### Earnings: Doom and Gloom?

Last week had major earnings headlines and the stand-out was Mega Cap Tech stocks falling sharply. But taking a look at Mega Caps overall, we see that they remain expensive, trading at multiples of 50% above the equal-weighted S&P 500. Using 2023 earnings, they're now trading at P/E ratios below 15x for the first time since the pandemic correction. Market leaders are at the most risk of falling farther still.

On the flipside, SMIDs are showing good valuation along with the equal-weighted S&P 500. New leaders ready to spread their wings? Likely, because every bear market brings a change in leadership. We expect SMIDs, along with Energy and Industrials, to potentially take the lead in 2023-2024, as Tech might need that time for healing. So Value stays leadership over Growth.

According to FactSet: "The blended (year-over-year) earnings growth rate for Q3 2022 is 2.2%, which is below the 5-year average earnings growth rate of 14.6% and below the 10-year average earnings growth rate of 8.8%. If 2.2% is the actual growth rate for the quarter, it will mark the lowest (year-over-year) earnings growth rate reported by the index since Q3 2020 (-5.7%). Four of the eleven sectors are reporting year-over-year earnings growth, led by the Energy, Real Estate, and Industrials sectors. On the other hand, seven sectors are reporting a year-over-year decline in earnings, led by the Communication Services, Financials, and Materials sectors."

### Week Ahead

All eyes on Wednesday's Fed meeting where the foregone conclusion is another 75-basis point hike on interest rates. But we'll also be looking for the actual ISM Manufacturing data on Tuesday, to see if it confirms last week's S&P Global Flash U.S., and provide yet one more data point about a looming recession. There might be much to be frightened about, but fear stems from not knowing. Stay informed, keep your clients informed, and we'll keep you in the know.

**Mary Ann Bartels, Chief Investment Strategist**

# Calendar

**Mon.**

**9:45 a.m.** Chicago PMI
**Earnings:** American Water Works, Avis Budget, Cincinnati Financial, Fabrinet, Global Payments, Goodyear Tire, Herbalife Nutrition, Leggett & Platt, Marriott Vacations, NXP Semiconductors, ON Semiconductor, PG&E, Saia, SBA Communications, Varonis Systems, XPO Logistics, Williams Companies

**Tue.**

**9:45 a.m.** S&P U.S. manufacturing PMI (final)
**10:00 a.m.** ISM manufacturing index. Jobs openings. Quits, Construction Spending
**Earnings:** Aflac, Franklin Resources, Advanced Micro Devices, Airbnb, American International Group, Arconic, Caesars Entertainment, Camping World, Cheesecake Factory, Chesapeake Energy, Cirrus Logic, Clorox, CoreCivic, Denny's, Devon Energy, Eaton, Electronic Arts, Eli Lilly, Extra Space Storage, Fox, Henry Schein, Marathon Petroleum, Match Group, McKesson, MicroStrategy, Molson Coors Brewing, Mondelez International, Pfizer, Phillips 66, Public Storage, Sealed Air, Simon Properties, Sirius XM, SoFi Technologies, Super Micro Computer, Sysco, Uber Technologies

**Wed.**

**8:15 a.m.** ADP employment report (level change)
**10:00 a.m.** Rental vacancy rate
**2:00 p.m.** FOMC announcement
**2:30 p.m.** Fed Chair Jerome Powell press conference
**Earnings:** ACI Worldwide, Albemarle, Allegiant Travel, Apollo Global Management, Booking Holdings, Brinker, C.H. Robinson Worldwide, Canada Goose, CVS Health, Dine Brands, eBay, Entergy, Estee Lauder, Etsy, Fastly, Ferrari, Fisker, Fortinet, Generac, Hostess Brands, Humana, iRobot, LL Flooring Holdings, Marathon Oil, Martin Marietta Material, Matterport, MetLife, MGM Resorts, Norwegian Cruise Line, Nutrien, Qualcomm, Realty Income, Robinhood Markets, Roku, Sturm Ruger, Transocean, Under Armour, Zillow

**Thu.**

**8:30 a.m.** Initial jobless claims; Continuing jobless claims, Foreign trade deficit, Productivity (SAAR), Unit labor costs (SAAR)
**Earnings:** ADT, AmerisourceBergen, Amgen, Atlas Air Worldwide, Barrick, Bausch Health, Block, Carvana, Cheniere Energy, Cigna, Coinbase Global, ConocoPhillips, Crocs, Cummins, DoorDash, Dropbox, DXC Technology, El Pollo Loco, EOG Resources, Expedia Group, GoPro, Hanesbrands, Kellogg, KLratos Defense and Security, Marriott, MercadoLibre, Moderna, NRG Energy, Papa John's, PayPal, Peloton, PENN Entertainment, Planet Fitness, Skyworks, Starbucks, Twilio, Wayfair, World Wrestling, Yelp

**Fri.**

**8:30 a.m.** Nonfarm payrolls (level change), Unemployment rate, Average hourly earnings, Labor-force participation rate, ages 25-54
**Earnings:** DraftKings, AMC Networks, Cardinal Health, Cboe Global Markets, Dominion Energy, Duke Energy, Fluor, Groupon, Hershey Foods, Huntsman, W.P. Carey

Source: MarketWatch/Kiplinger's



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