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March Market Insights

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OUTLOOK - *Forgiveness is not without limits*

Inflation data that was released in February surprised firmly to the upside. That, along with a hard-to-believe job creation print of 500k+ for the month of January, rekindled fears that the Fed would need to take interest rates to an increasingly restrictive level. Indeed, the entire yield curve shifted upward last month as the "higher for longer" narrative for interest rates took hold.

In the coming months, we expect both inflation to cool and economic growth to slow as the impact of higher interest rates ripples through the economy. We also expect the coming February jobs report to offer some respite from January's eye-popping numbers, but it's unclear whether inflation data will resume its downward trajectory so quickly. If not, the limits of the market's forgiveness would likely be tested until more comforting inflation data re-emerges.

Looking past the stock market's short-term gyrations, however, the unprecedented strength of the labor market should allow for stable consumer spending even amid a slowing economy. It's the stability of consumer spending that we believe will gradually shift the mindset of corporations away from cost-cutting and toward preparing for growth – which means investing and capital expenditures. Back in 2000 and 2007, rising interest rates and a slowing economy resulted in deep spirals downward the following years. Today's economic imbalances appear far less extreme than were present in those periods, and this underlying economic stability also supports our belief in a soft landing.

POSITIONING

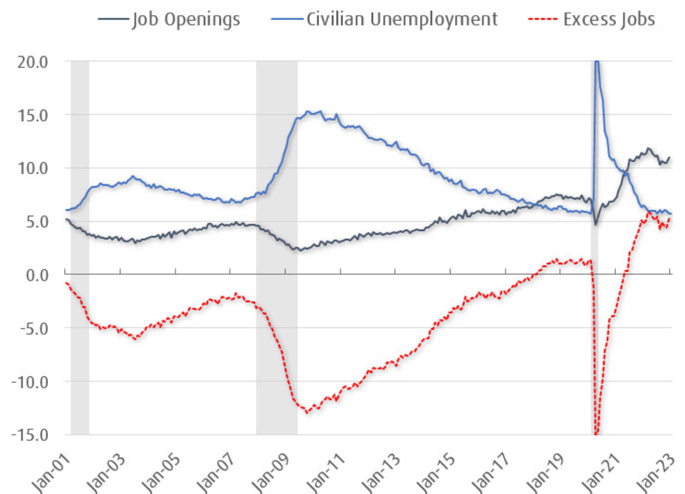
We recommend a balanced approach to risk-taking and believe that 2023 will produce returns more in line with historical averages for both stocks and bonds. We recently recommended an equity position that is focused on U.S. infrastructure. The supportive trends and spending focused on U.S. infrastructure should have a multi-year runway from three recent fiscal packages along with lasting interest in onshoring, supply chain resiliency, and international companies seeking energy security. Several paths are merging together, and the companies focused on U.S. infrastructure should benefit for years.

ON THE HORIZON

We believe the elements for a soft-landing remain in place, but that the near-term path for markets could be bumpy, particularly if inflation data takes longer to resume its downtrend. Other risks, such as a renewed energy shock, remain and there's a limit to how much our slightly bruised economy can absorb should something unexpected emerge.

It's also worth noting that future earnings expectations have come down at the same time the stock market has had strong start to the year. These developments, combined with rising interest rates, have pushed our quantitative Equity Valuation Metric into overvalued territory. That alone is not cause for alarm, but it does imply that another leg up in the equity markets likely requires fading headwinds.

JOLTS Job Openings vs People Seeking Employment (seasonally adjusted, in Millions)



Source: U.S. Bureau of Labor Statistics (2023), BMO Wealth Management (2023)

Please see disclosure on last page

Disclosure

The S&P 500® Index measures the performance of the large-cap segment of the market. Considered to be a proxy of the U.S. equity market, the index is composed of 500 constituent companies.

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