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February Market Insights

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OUTLOOK

The ingredients for an economic soft landing continue to take shape – falling inflation, a resilient labor market, moderating wage growth, and interest rates approaching peak levels. Near-term corporate earnings paint a bumpier path with growth expected to be negative in each of the next two quarters. The stock market, however, has shown an impressive amount of forgiveness to begin 2023 as it attempts to look past current difficulties and ahead to a healthier growth environment later in the year.

Fed policy remains at center stage, and Chairman Powell's February 1st announcement to raise interest rates by 0.25% percent was met with a barrage of reporter skepticism during the press conference. Chairman Powell was eventually jostled into a more dovish narrative and stated that the economy is in the early phases of disinflation and that it's possible for inflation to come down without the economy experiencing much damage.

Another salient feature of the current outlook is China's reopening after three years of lockdowns. China's government has an overwhelming incentive to continue to stimulate growth through fiscal and monetary policy and pent-up demand is likely to be considerable.

POSITIONING

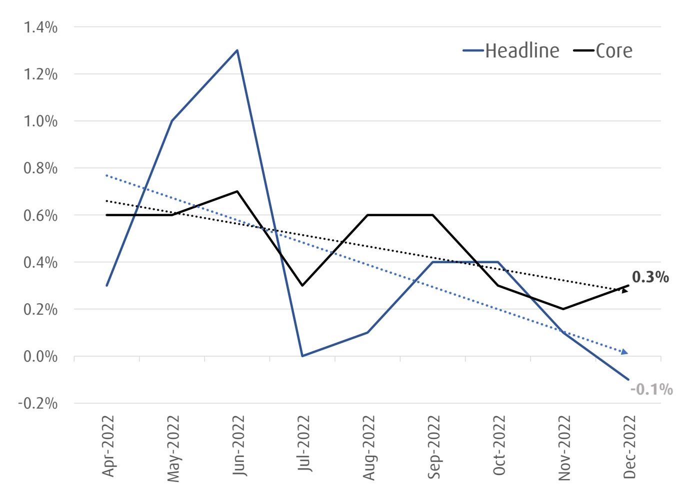
We recommend a balanced approach to risk-taking and believe that 2023 will produce returns more in line with historical averages for both stocks and bonds – that is low double-digit returns for equities and mid-single-digit returns for bonds which once again should provide stability and protection in the portfolio. Within equities, we prefer U.S. exposure for its stability and emerging markets for its growth potential.

ON THE HORIZON

While there are always crosscurrents and bearish arguments casting doubt on the stock market's prospects, the bear camp seems especially strident at present. The concerns are noteworthy – weak earnings outlook, profit margin pressure, a slowing economy, higher interest rates, not cheap valuation, and the belief that the current rally relies on a "Goldilocks" scenario to play out.

It's worth remembering that the stock market is a forward-looking mechanism and the expectation of improved conditions later in the year – for inflation, growth, earnings, and Fed policy – are what is driving the recent rally. Our base case is that these elements come together and lead to a soft-landing, but risks remain that one or more of these ingredients plays out differently than expected. The trajectory is favorable, but uncertainty is above average and calls for a balanced approach to risk-taking.

U.S. Consumer Price Index (Monthly % chg)



Source: Bureau of Labor Statistics (2023), Bloomberg L.P. (2023), BMO Wealth Management (2023)

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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