WHERE WE STAND

MARKET UPDATE MARCH 2023

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Two months into 2023 various market factors have shifted, creating a somewhat changing environment versus where last year concluded. Against this backdrop we continue to believe opportunities remain over the year ahead within both equities and fixed income yet feel investors should take the following points into consideration.

RECESSION RISK: While we continue to believe recession in the year ahead remains more likely than not, recent strength in the economy, in our view, implies a future downturn is not likely to begin until at least 2H23 and is more apt to be moderate in nature as opposed to prolonged and severe. We now assess the probability of recession in the year ahead to be approximately 60% as the central debate seems to have moved from one of severe versus moderate recession to that of moderate recession versus no recession.

INFLATION: Recent inflation data has come in hotter than expected, reminding investors that declining consumer price trends are rarely linear in nature. We continue to believe, based largely on the cumulative impacts of previous and ongoing Fed rate hikes, that core rates of inflation stand a good chance to moderate to or below 4% during 2H23, which could then prove to be a catalyst for the markets.

INTEREST RATES: Expectations have shifted to a higher-for-longer interest rate environment. Given the unexpected strength of economic data since the year began as well as the January inflation reports, we now believe it is now more likely the Fed extends rate hikes into the summer months as opposed to a conclusion by midyear as we had previously anticipated. We now estimate the Fed continues 0.25% increases at upcoming March, May, and June meetings, taking the federal funds rate to 5.25% and thereby officially dispelling previous market consensus of a pivot to rate cuts in 2H23, a notion we never ascribed to. We now also see upward pressure on the 10-year Treasury yield to at least 4.25%.

CREDIT MARKETS: We believe strong opportunities exist in short and intermediate-term corporate bonds. High-yield bonds are now offering close to their highest levels of income since 2020 and investment-grade bonds close to their highest yields since 2009. We see overall credit risk in the corporate markets as more benign than prior to previous recessions, in large part due to opportunistic refinancings during the pandemic and aggregate maturity schedules in the corporate markets more heavily weighted toward the latter parts of the decade.

STOCKS: The next few months will likely be volatile for stocks, however, in our judgment, the equity markets could be well positioned for 2H23 and into next year as risks to the economy and corporate earnings are unlikely to prove as drastic as most have previously believed. History also infers strong potential market returns in years following both peak rates of inflation and conclusions of Fed tightening cycles. We maintain our year-end 2023 S&P 500® price target of 4,400.

Clearly the early months of 2023 have included some twists and turns consistent with the volatility and market uncertainties that have created investor headaches for more than a year now. However, given the current yields on short and intermediate-term bonds and the longer-term opportunities for stocks as the inflationary and interest rate environments ultimately reconcile, we believe both credit oriented fixed income and equity investors have a lot more working for them than against them.

For a more detailed account of these and other factors please see “Here is What’s Different So Far in 2023” at Market Insights and Commentary | Tom Wald | Transamerica.

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Tom oversees investment and mutual fund development and the sub-adviser selection process. He heads Transamerica’s investment thought leadership with advisors, clients, and media. Tom has more than 30 years of investment experience and has managed large mutual funds and sub-advised separate account portfolios. Tom holds a bachelor’s degree in political science from Tulane University and an MBA in finance from the Wharton School at the University of Pennsylvania.

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