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Market Commentary

Weekly perspective on current market sentiment **January 19, 2023**

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Last week's S&P 500 Index: +2.7%

Technical and fundamental resistance

Key takeaways

- The combination of fundamental outlook and technical analysis can be a powerful tool.
- Currently, both are suggesting that market headwinds still exist.

While understanding and projecting economic fundamentals are the foundation of our analytical work, we also use technical analysis as a tool to help confirm that trends are still intact or if the market action is telling us that the environment is beginning to change. Most investors understand that pricing in the equity market is largely based on what market participants believe or expect will happen in the future. In other words, price action in equities, or any financial market for that matter, reflects expectations often well before the underlying fundamental data is reported and confirmed. That alone can make watching price charts an important piece of the forecasting puzzle.

As of the time of this writing, the S&P 500 (SPX) has closed above its 200-day moving average (3,975 today), a frequently watched indicator/level of support or resistance, every trading day since last Friday. But we recommend not getting overly excited just yet. Why? Because more technical resistance exists just above the 200-day moving average at the trendline drawn off the all-time record high set on the first trading day of 2022. That level, today, is in the 4,075 – 4,085 range. Important technical resistance levels or zones often bring sellers into the market. We think this zone of resistance will be hard to break in the near term should the SPX continue on a deteriorating technical trend featuring lower highs on rallies and lower lows on pullbacks.

For strategists who make a living attempting to predict the direction and magnitude of moves in financial markets, the combination of fundamental outlook and technical analysis can be powerful tool. In the current case of the SPX, in addition to the reading on the technical trend mentioned above, our take on the underlying economic fundamentals syncs with the view that, at least in the near term, equity indexes will likely have a tough time marching higher. The fundamentals do not currently favor meaningful equity upside in our opinion.

In terms of fundamentals, to begin, our work suggests consensus earnings estimates for this year are too high. We expect estimate reductions as the fourth-quarter earnings reporting season plays out and companies issue reduced guidance. And, perhaps, at least as important as earnings, the Federal Reserve (Fed) continues to tell markets to expect more rate hikes and that the "terminal rate" or high in the federal funds target rate will be above current market expectations and will stay there longer than fixed-income markets have priced in. Our central bankers continue to signal they are not close to lowering interest rates. The Fed goal of slowing demand and growth appears to be working.

Other fundamentals worth contemplating include sales growth, which over the last year or more came from inflation, not volume growth. This pricing pressure is not likely going to last much longer, and we see profit margins narrowing. In addition, as the economy slows, we expect layoffs and consumer credit delinquencies (autos, credit cards) to rise further. And finally, we do not expect stocks to rally sustainably if the economy is heading into recession. Market headwinds still exist; we recommend staying defensive for now.

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