Bills Asset Management

BAM MARKET NOTE

May 5, 2023

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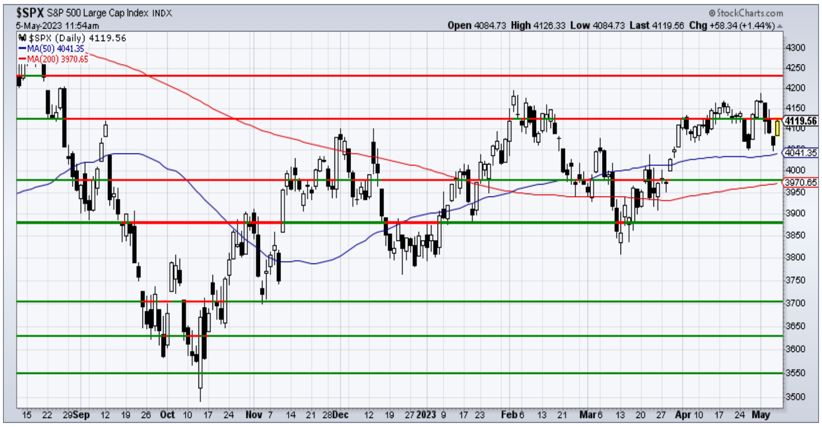
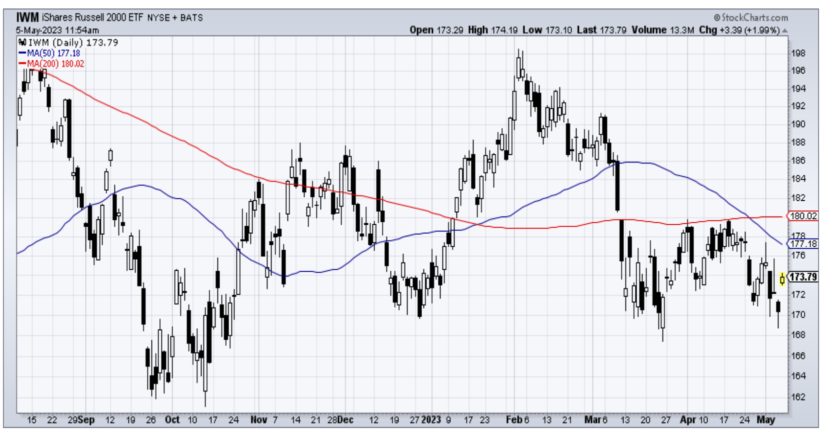


It's been a down and up week. The S&P opened the week with 4 straight down days but is rallying this morning. Net, the index looks to finish the week down over 1%. After falling through support at the 4120 level, the market is testing that resistance this morning. Importantly, the early morning jump has paused right at that resistance. Over the last month the markets are in a tight trading range, and we are right where we started in April. For the bulls, the sideways action is a win with the anticipated weak earnings season in full swing and the market holding its own. Caution remains warranted.



Many market pundits and a few money managers are pounding the table that we are in a new bull market. Perhaps it has started but somebody forgot to tell the small caps! Does the chart look like a bull market? Small caps almost always lead new bull markets, and they are not only lagging but dropping fast. Since the peak in February, the Russell 2000 is down 12%. That is not the look of a healthy market. Much of the early part of earnings season is reserved for the large companies with the small caps coming later. We are now entering that period so small caps will have an opportunity to make up some ground with good earnings (or not).

Our Point

To the surprise of nobody, the Fed raised rates by 25 basis points this week. While many hoped the Fed would turn dovish, Chairman Powell kept open the possibility of further rate hikes though his language did soften a bit. With one single word the Fed gave those wanting a pause some hope. In the previous rate decision, the Fed said they "anticipate" that further rate hikes would be necessary. However, in the current decision they noted that they will "determine" whether further rate hikes are necessary. The substitution of "determining" for "anticipating" sets the stage for the Fed to pause at its next meeting in mid June. However, a pause is a far cry from interest rate cuts which the market is still pricing in for later this year. Inflation remains sticky and this morning's strong job report will be a thorn in Chairman Powell's side as he weighs cutting too much with easing too soon. The rally this morning looked past the strong job numbers to revisions in prior months which do show a softening in the job market. A cooling of the jobs market makes a pause or even rate cuts much more likely as we go through this year. We mentioned a few weeks ago that we did not believe that the regional banking crisis was done yet and, indeed, it is not. This week saw the seizure and sale of First Republic to JP Morgan (the big get bigger is a problem for another note). The news roiled the regional banks as yet another large one was forced to liquidate. It will not be the last as the likes of PacWest and Western Alliance both saw their stock prices fall 50% and 38% earlier this week. Locally, First Horizon shares fell 43% after its proposed merger with TD Bank was scuttled. The influence the banking weakness will have on the Fed is uncertain. Regardless, the banking issues are likely to get worse before they get better and that could lead to another leg down in the market. Every year we get to hear the "sell in May and go away" crowd proclaim their wisdom. This year it may prove to be wise. Risk remains elevated. We liquidated one position this week as it had begun to underperform. We are evaluating a few others and may make more changes over the coming week or two. Our holdings in municipal and emerging market bonds are having a good week. Enjoy your weekend and have a taco and/or a margarita in honor of Cinco de Mayo!