Dudack Research Group
A Division of Wellington Shields & Co. LLC Member NYSE, FINRA & SIPC
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January 11, 2023

DJIA: 33704.10
SPX: 3919.25
NASDAQ: 10742.63

US Strategy Weekly

Get Ready, Go, Get Set

The price performance of the equity market during the first few days of the new year provided a nice respite for investors who weathered a very difficult 2022. But this year's good start will face several hurdles in the upcoming days. Later this week the CPI report for December has the ability to reverse the current optimism on inflation. The consensus view is that inflation is steadily decelerating, but if that does not prove to be true, there will be disappointment. More importantly, fourth-quarter earnings reports begin at the end of the week, and these could set the tone – and the trend -- for earnings over the next few quarters.

<u>In our opinion, while some market commentators believe pessimism is currently too extreme and overdone, investors have not truly come to grips with the status of the current economy, the determination of the Fed to fight inflation and what that means, and the prospect for corporate earnings</u>.

The Economy

It is widely accepted that the real estate sector of the economy is in a slowdown or recession. But we see warnings in recent data releases that the downturn is broadening. For example, for the first time since April and May of 2020, both ISM indices ended below the 50-bench mark denoting a contraction in economic activity. Plus, in both surveys the "new orders" components slipped well below 50, signifying a weakness in future activity. In other words, both the manufacturing and the service segments of the economy appear to be declining. See page 3.

The one positive we found in the two ISM reports is that both the manufacturing and the non-manufacturing survey showed prices falling or decelerating. In the ISM manufacturing report, the price index fell from an already low of 43.0 to 39.4; while in the non-manufacturing report the price component fell from 70 to 67.6 – a sign of deceleration.

There were also encouraging inflation signs in the Small Business Optimism survey for December. The NFIB report indicated that fewer small businesses plan to raise prices in the coming months and the index fell from 34 to 24. However, fewer small businesses plan to increase employment and that component fell from 18 to 17. All in all, the NFIB Optimism index fell 2.1 points to 89.8, in December, recording its 12th consecutive month below the 49-year average of 98. See page 4.

In December, payrolls increased by 223,000 and the unemployment rate edged down to 3.5%. These are actually robust numbers that could have worried investors, but the report was well received since average hourly earnings rose 5.0% YOY, down from November's 5.5% YOY pace. This deceleration in wage gains was viewed by many as a positive thing, but we disagree. First, we do not think the deceleration is significant. Second, we do not believe the current economy is at risk of demand-pull inflation due to rising wages. In fact, the opposite is true. Inflation has had a very negative impact on real weekly earnings and in December real weekly earnings were actually down 2.6% YOY and were

4% lower than their May 2020 peak. In short, households have been losing purchasing power for nearly three years and are not a source of potential inflation. See page 5.

More signs that households are struggling are found in retail sales. In the nine months ended in November, total retail and food services sales grew at an average monthly pace of 8.4% YOY. This sounds healthy, but after adjusting for inflation, total ***real*** retail sales grew only 0.5% YOY. This lack of substantial revenue growth is a hurdle for many retailers and for future earnings. And though auto production has normalized, vehicle sales also declined in November. Weakness in the auto sector is also seen in used car prices which have been on the decline. See page 6. In sum, we have been anticipating a recession this year and recent economic data is falling in line with our theory.

Fed Policy – Too Soon for a Pivot

Many market commentators have suggested that the Fed will end rate hikes, or pivot once the economy shows signs of weakness. In our view, this is naïve thinking for several reasons. First, inflation does not materialize or end quickly. Prices were rising for several years before the CPI peaked at 9% last year. It is apt to take at least several years to get it back to the Fed's target of 2%. Second, Fed tightening cycles have historically ended when the real fed funds rate reaches 300 basis points, or more. See page 7. It may not have to reach a full 300 basis points in this cycle, but the Fed has clearly indicated that a real fed funds rate is its objective. If this is true, the fed funds rate may need to move well above the 5% to 5.25% most economists are forecasting. For example, if inflation falls to 4% this year (our target) the fed funds rate could rise as high as 7% to break the inflationary cycle. There are other scenarios as well. Inflation could fall to 3% and the fed funds rate could peak at 6%. Nevertheless, this suggests the fed funds rate could move higher than most expect this year. In our opinion, nothing above a 5.25% fed funds rate has been discounted by recent equity prices.

Earnings

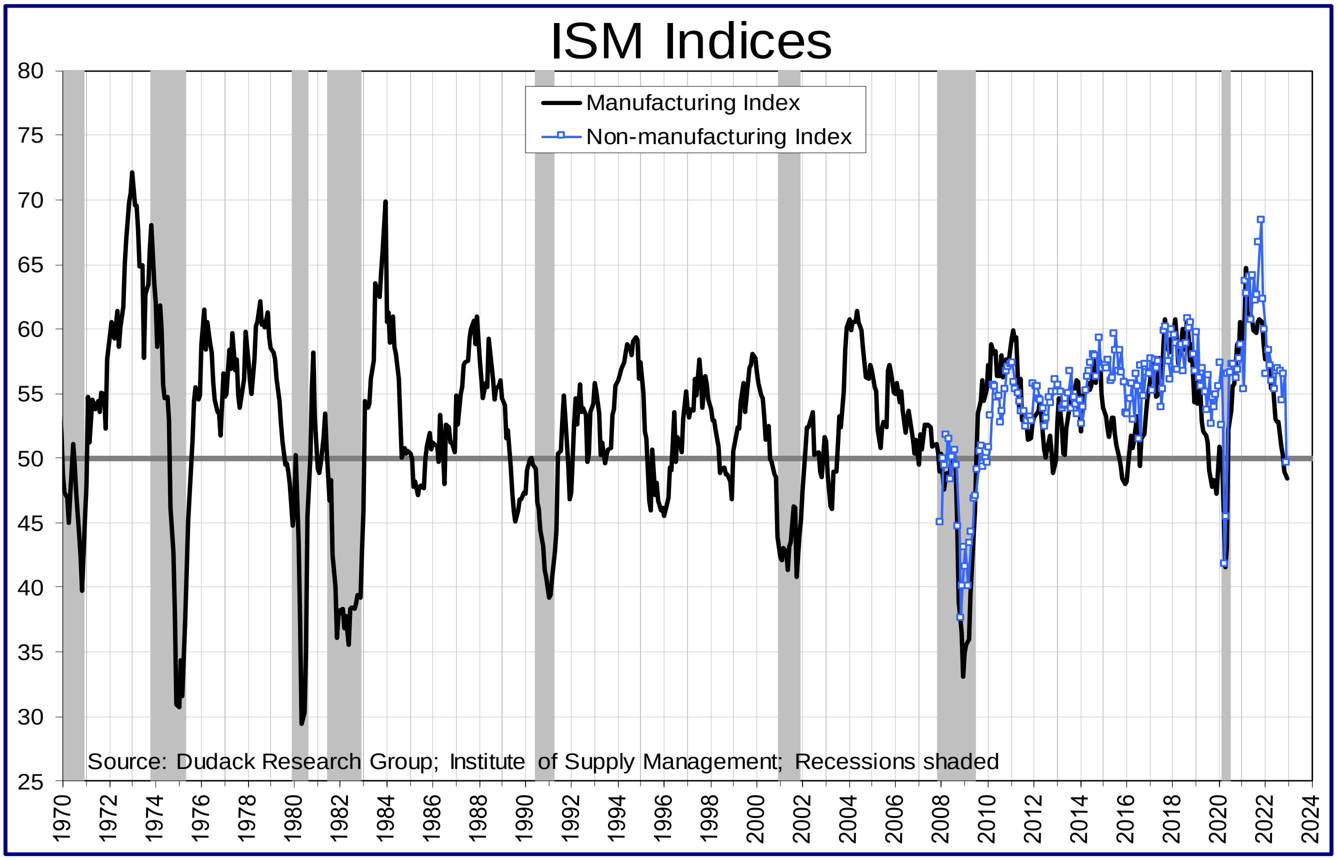
The fourth quarter earnings season could become a disappointment for those looking for a rally, or at least a January rally. Some analysts believe investors will look past an anticipated trough in earnings and actually rally on bad earnings news. But in our view, it is nearly impossible to estimate how weak earnings might be in 2023. The combination of fed rate hikes and a weakened consumer is what led us to reduce our S&P 500 earnings estimate for this year to $180, reflecting a 10% decline from an estimated $200 in earnings in 2022. A 10% decline in corporate earnings is "average" during an economic recession.

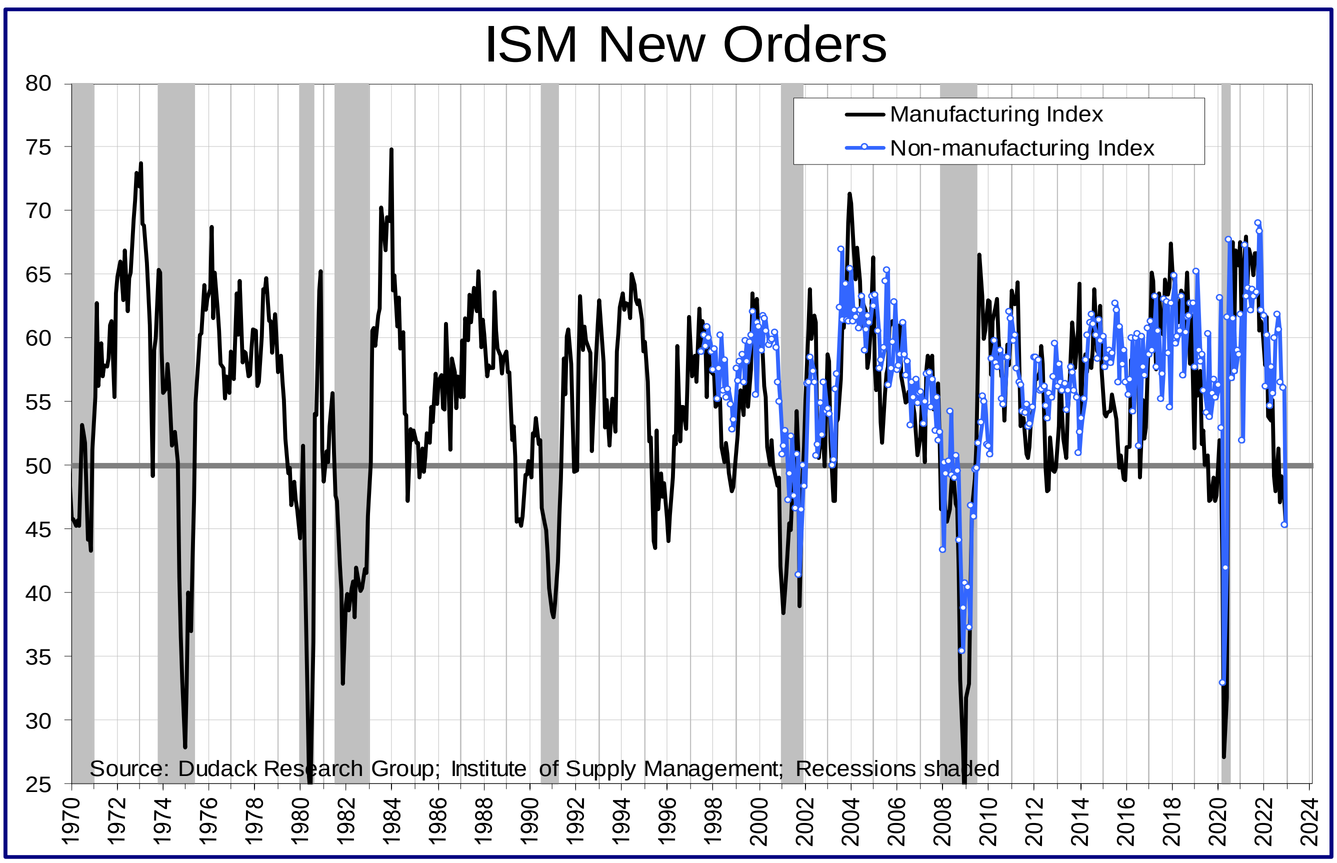
It is important to point out that while S&P Dow Jones is currently estimating 2022 earnings to be $200.19, this is only a preliminary estimate. See page 8. Fourth quarter earnings have not yet been reported and this forecast is likely to move lower. This scenario may explain why the fourth quarter earnings season could become a market moving event. Weak fourth quarter earnings results would not only require analysts to bring their earnings estimates down for last year and this year; but corporate guidance may have a substantial negative impact on this year's forecasts --- which ironically continue to anticipate year-over-year gains, despite expectations of a recession.

Technical Update

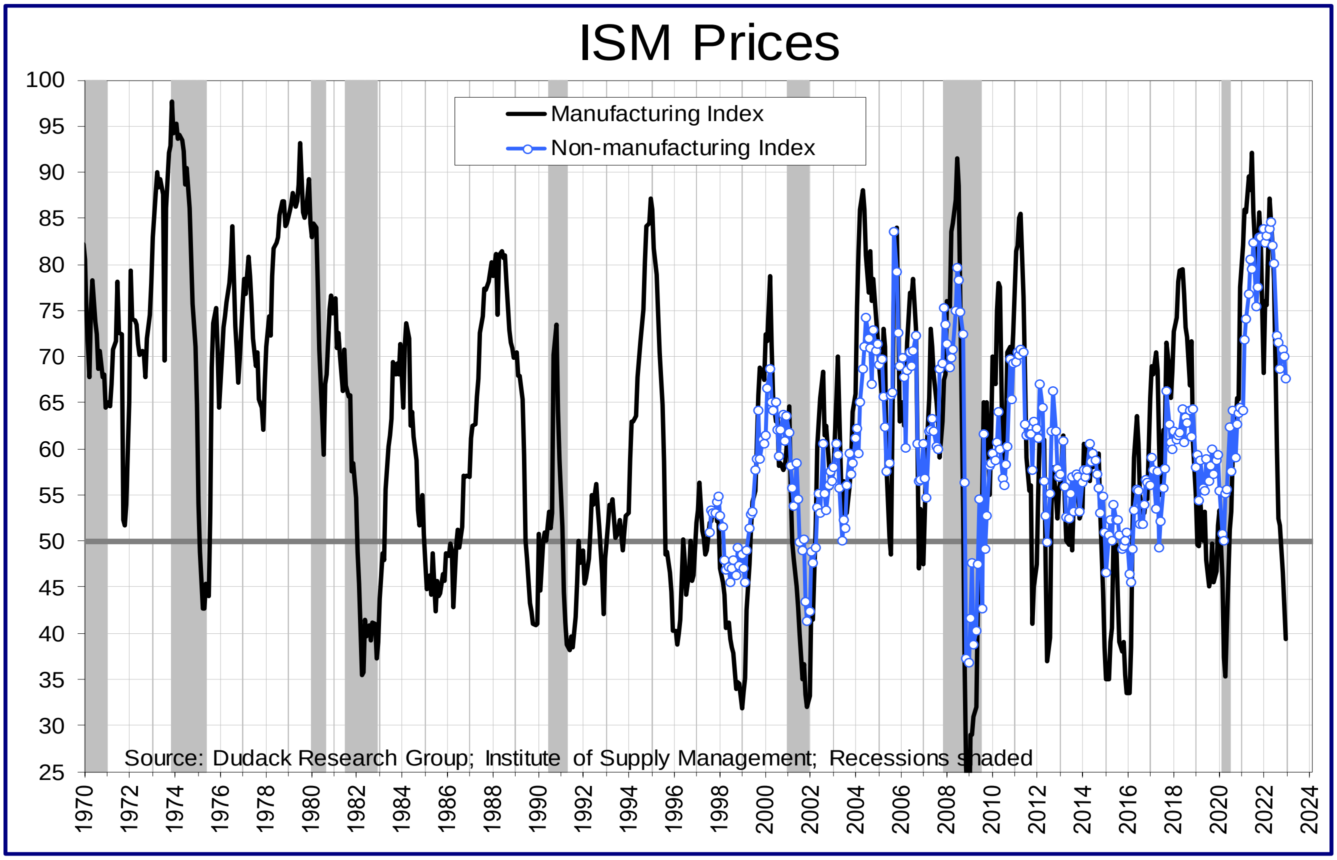
The DJIA is the only index that is currently trading above all its key moving averages and looking positive. Conversely, the Nasdaq Composite is trading below all its key averages and looking bearish. The SPX and Russell 2000 have somewhat mixed pictures in terms of their moving averages. This divergence in performance is a result of a market leadership shift from growth to value that took place in 2022 and which we believe will continue this year. To a large extent, it reflects our thoughts of "follow the earnings" which tend to be clustered in energy, staples, aeorspace, utilities, and stocks that reflect other necessities.

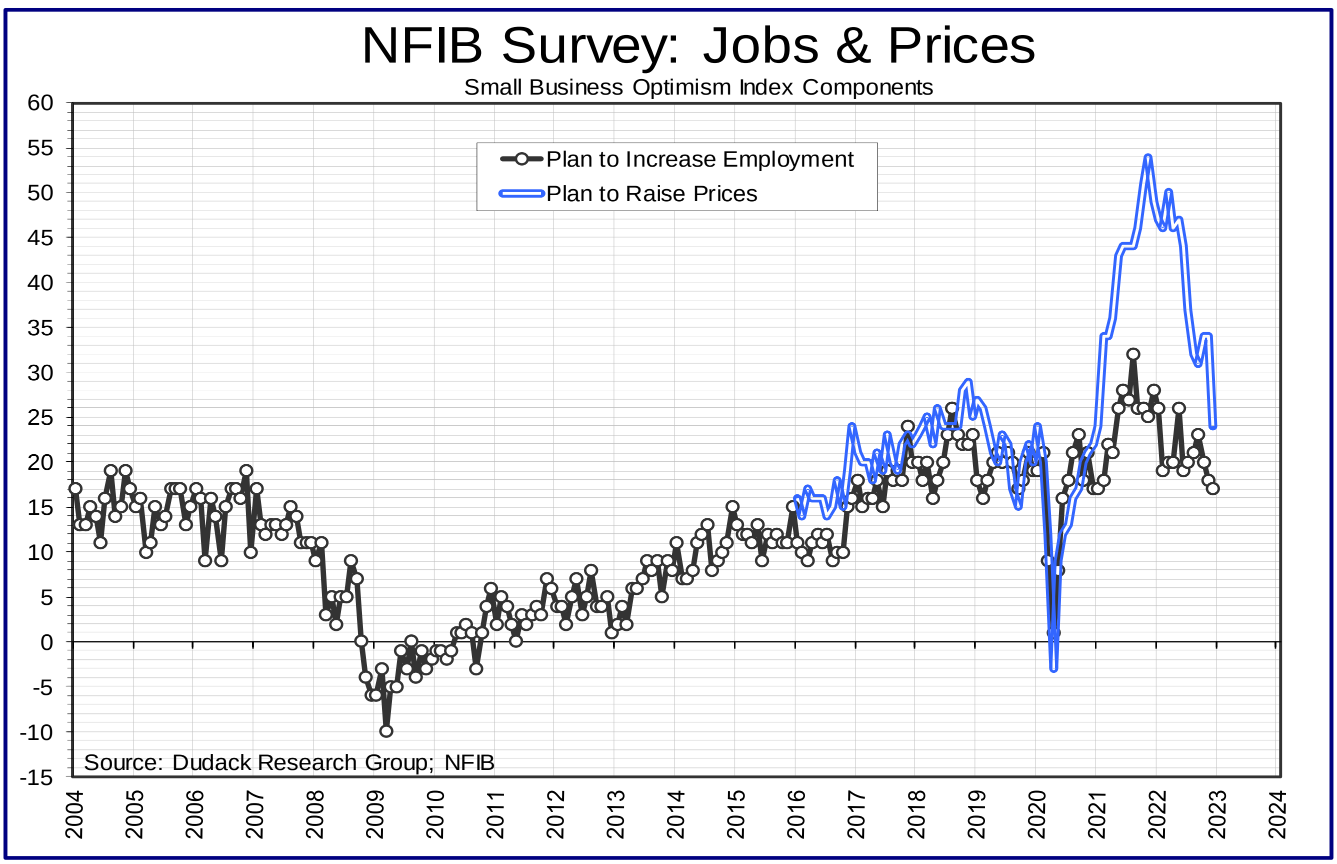
For the first time since April-May 2020, both ISM indices are below the 50-benchmark which denotes a contraction in economic activity. In both surveys the "new orders" components are also below 50. In short, the economy is slowing.



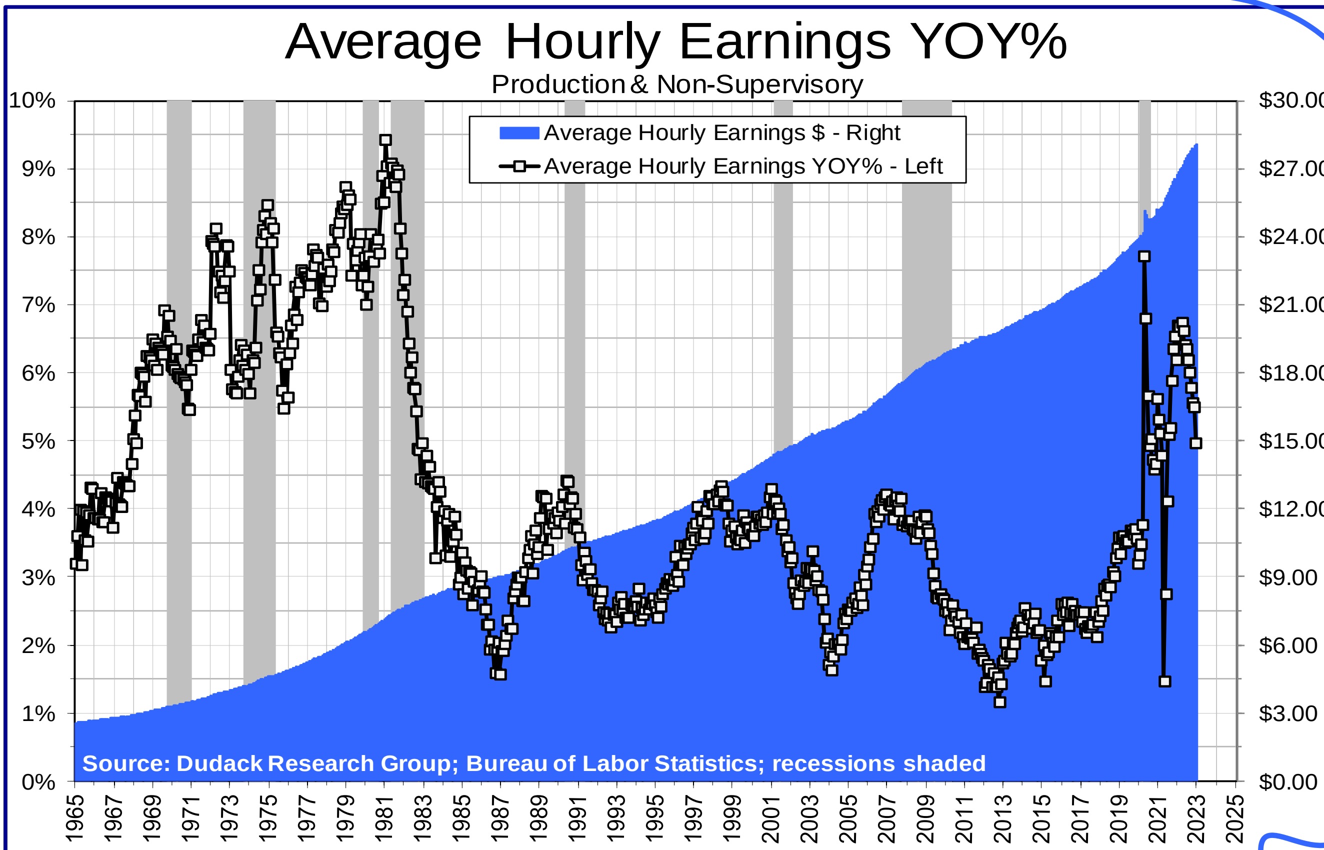


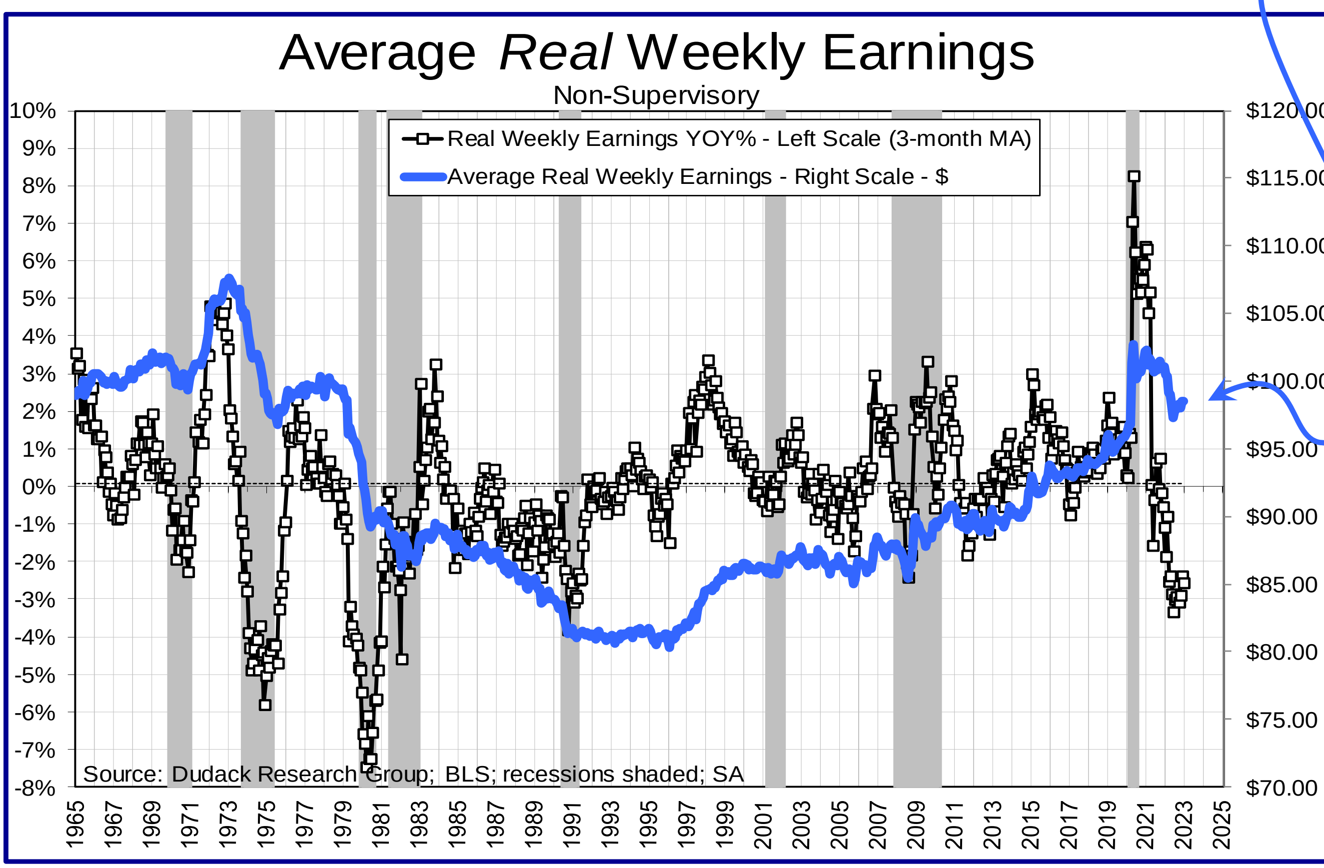
The one positive in the ISM reports is that both manufacturing and non-manufacturing surveys show that prices are falling or decelerating. The NFIB report for December also indicated that fewer small businesses plan to raise prices; however, fewer also plan to increase employment. In December, the NFIB Optimism index fell 2.1 points to 89.8, the 12th consecutive month below the 49-year average of 98.



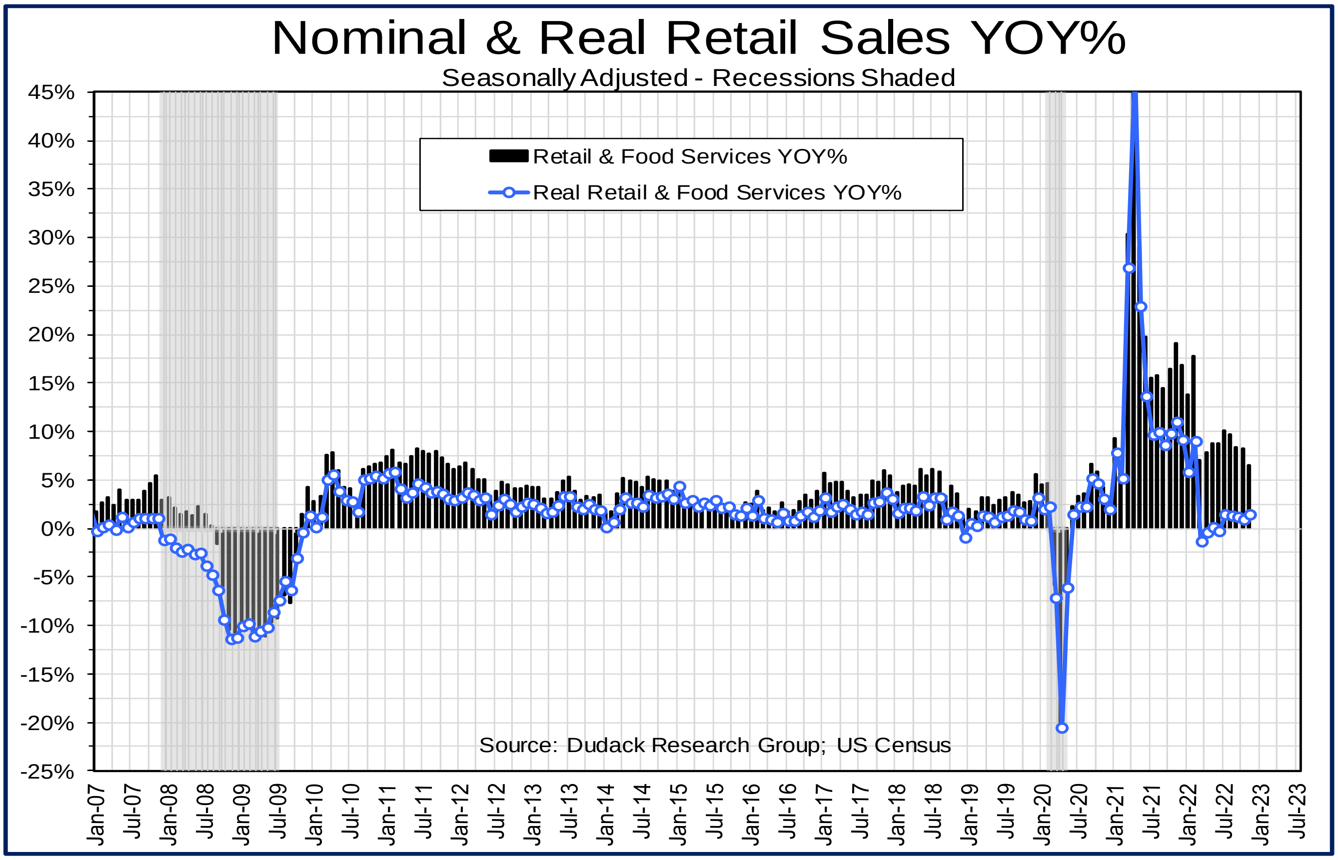


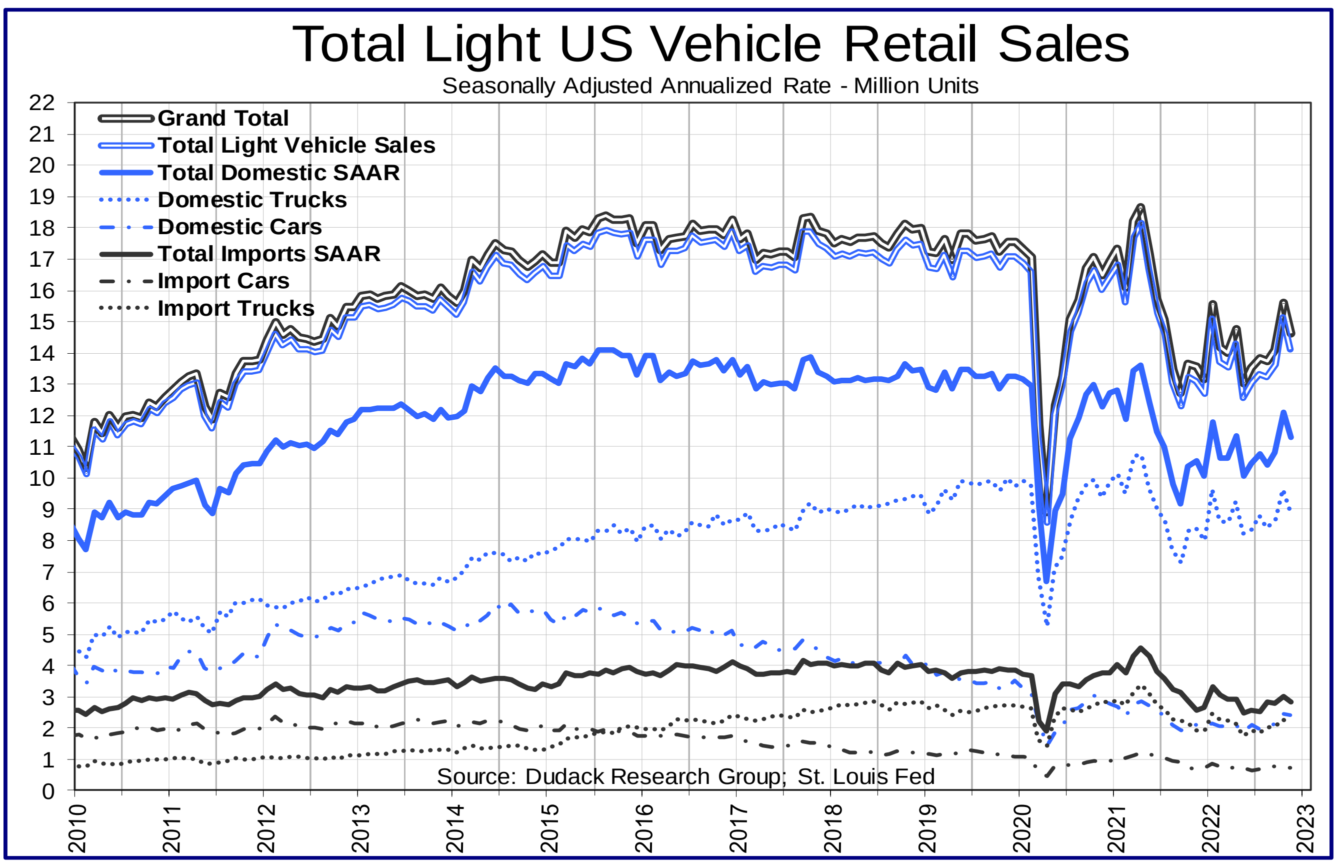
In December, payrolls increased by 223,000 and the unemployment rate edged down to 3.5%. The report was well received because average hourly earnings rose 5.0% YOY, down from 5.5% YOY in November. However, we think it is more important to observe that inflation has had a negative impact on real weekly earnings, and in December real weekly earnings were down 4% from their cyclical May 2020 peak.



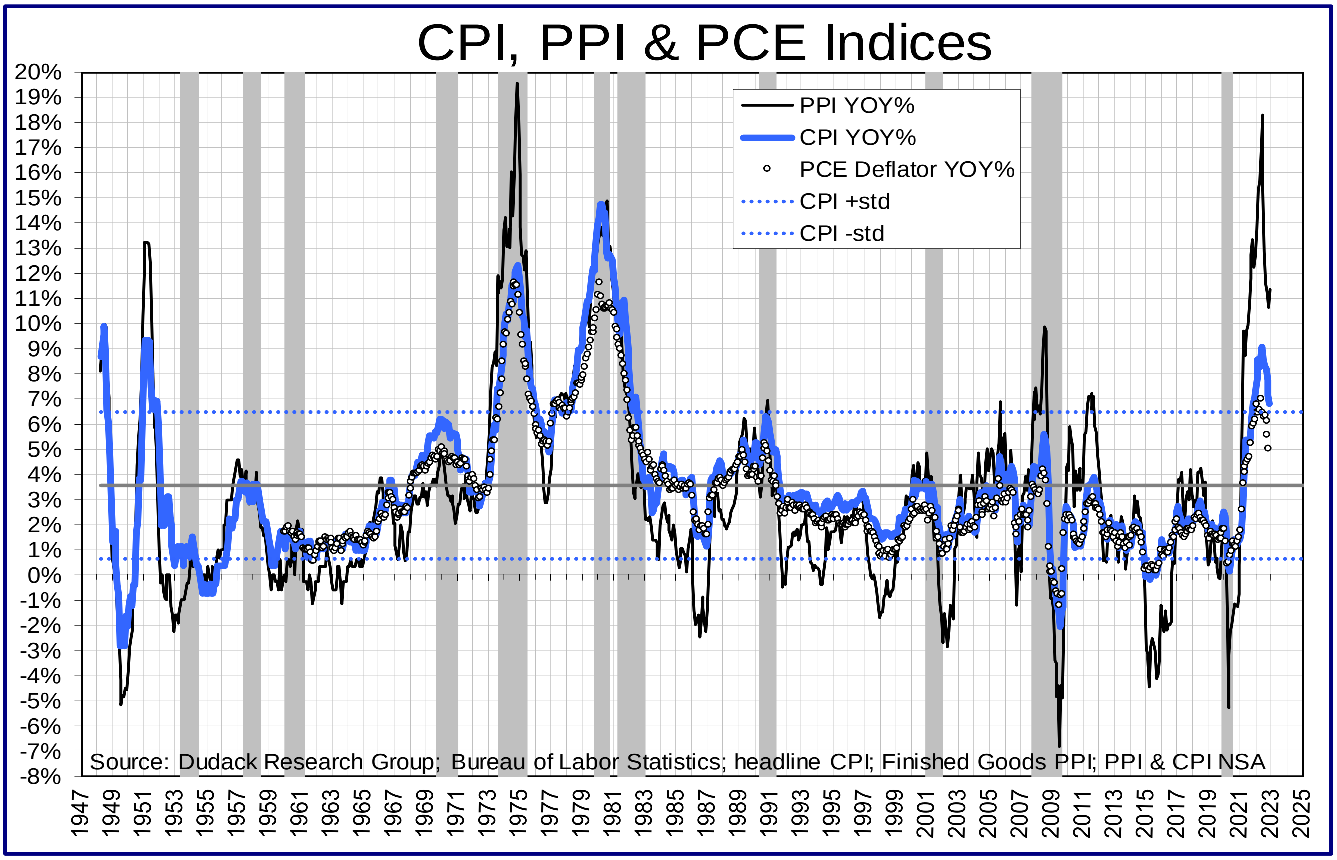


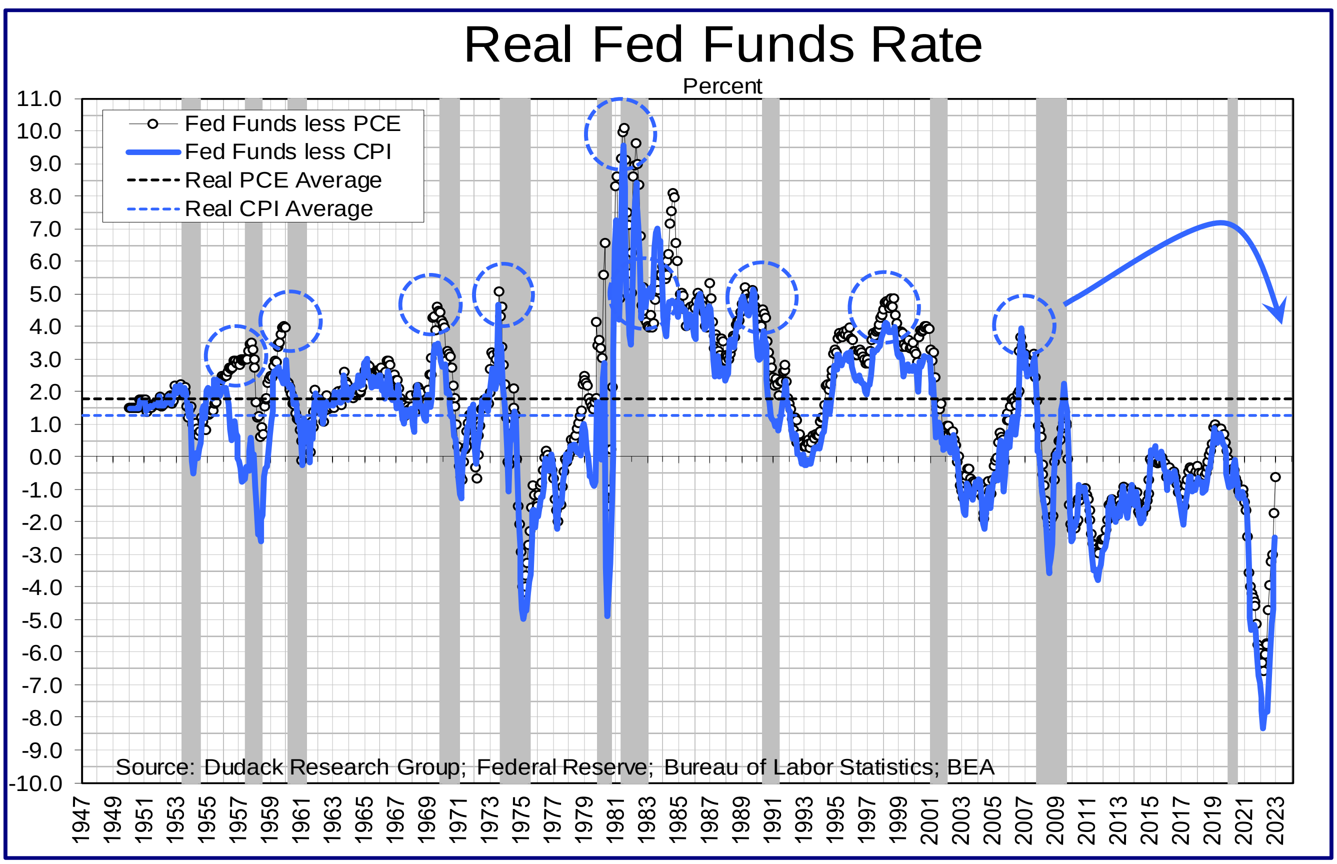
Households were struggling in 2022. In the nine months ended in November, retail sales grew at an average monthly pace of 8.4% YOY, while real retail sales grew only 0.5% YOY. Vehicle sales also declined in November even though production was back to normal. Weakness was also seen in used car prices which have been falling in recent months.



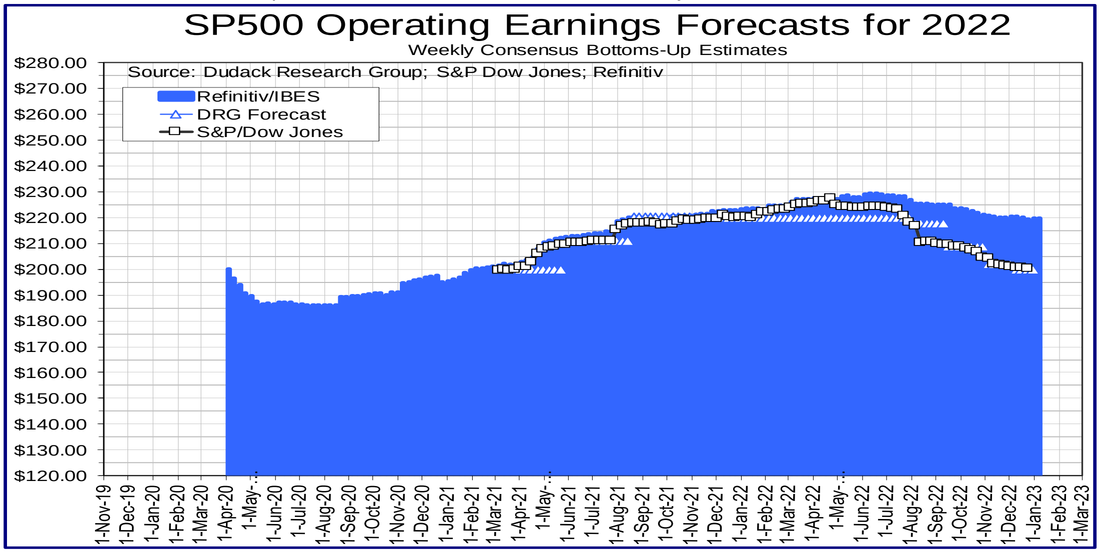


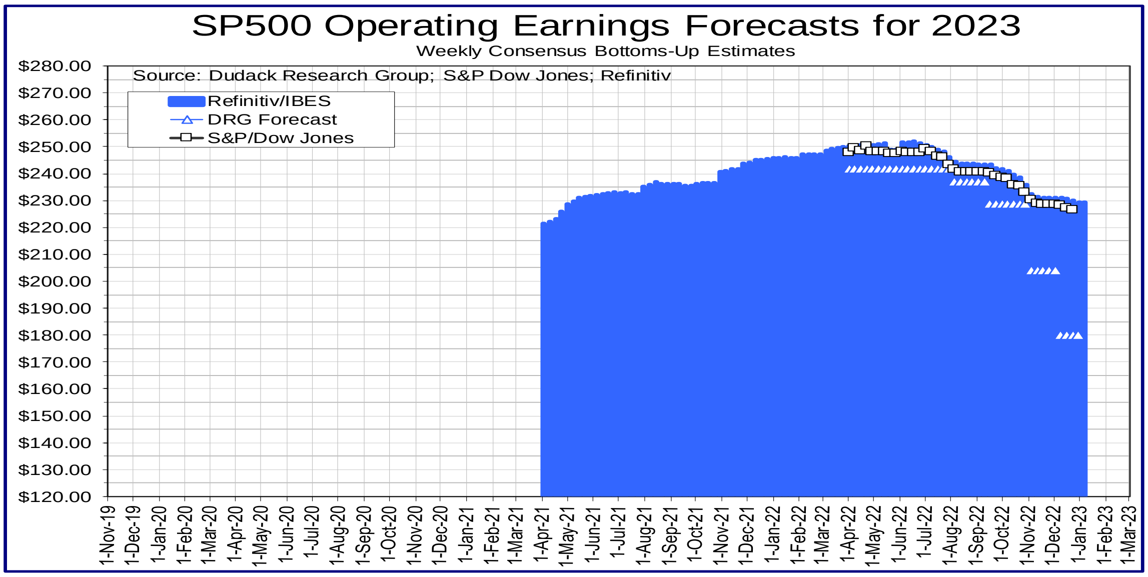
Even if inflation benchmarks are unchanged in December, the CPI will be up 6.5% YOY, the PPI for finished goods will rise 11.4% YOY and the PCE price index will rise 5% YOY. Note also that the Fed has never ended a tightening cycle without the fed funds rate rising at least 300 basis points above inflation, i.e., if inflation falls to 4% or less, the fed funds rate is apt to rise well above 5% before the current tightening cycle is over. Is the market prepared for this?

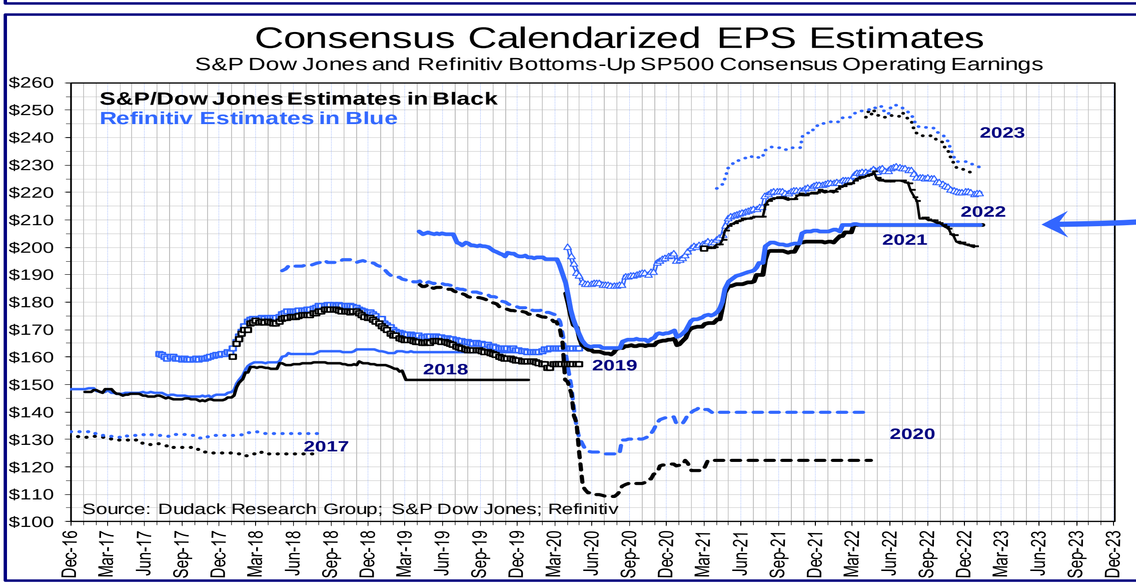




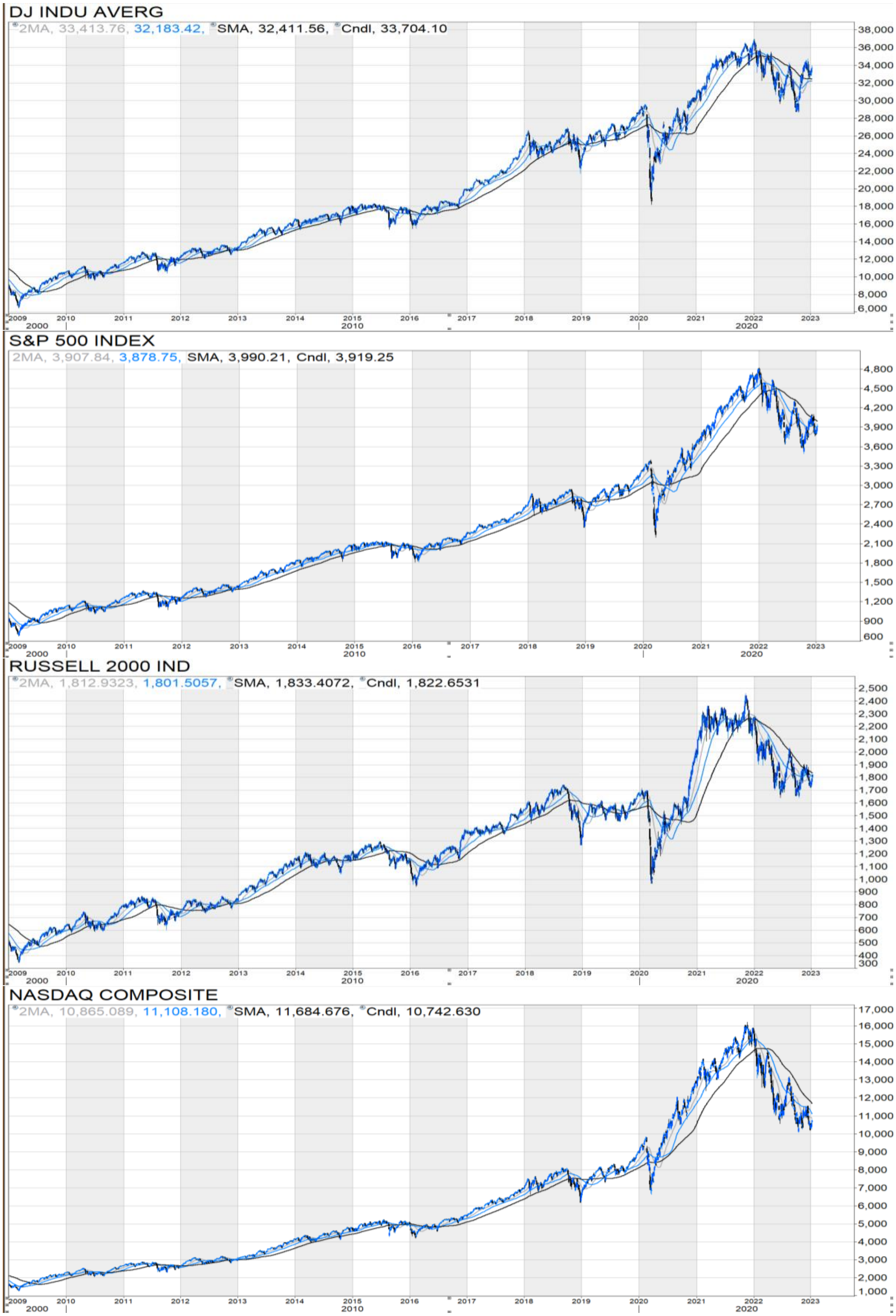
S&P Dow Jones earnings estimates for 2022 and 2023 were not updated this week. Refinitiv IBES consensus earnings forecasts rose $0.07 and fell $0.28, respectively, leaving estimates at $200.19/$219.87 and $226.51/$229.24, respectively. EPS growth rates for 2022 are (3.9%) and 5.6%, respectively. *(Note: consensus macro-EPS forecasts may differ from four quarter analysts' forecast sums seen on page 14.)* DRG's 2023 estimate is $180 to reflect the weakness expected in 2022 EPS and the impact of Fed rate hikes on the 2023 economy.







The DJIA is the only index that is trading above all its key moving averages. Conversely, the Nasdaq Composite is trading below all its key averages. The SPX and Russell 2000 have mixed pictures. This divergence in performance is a result of a market leadership shift from growth to value.

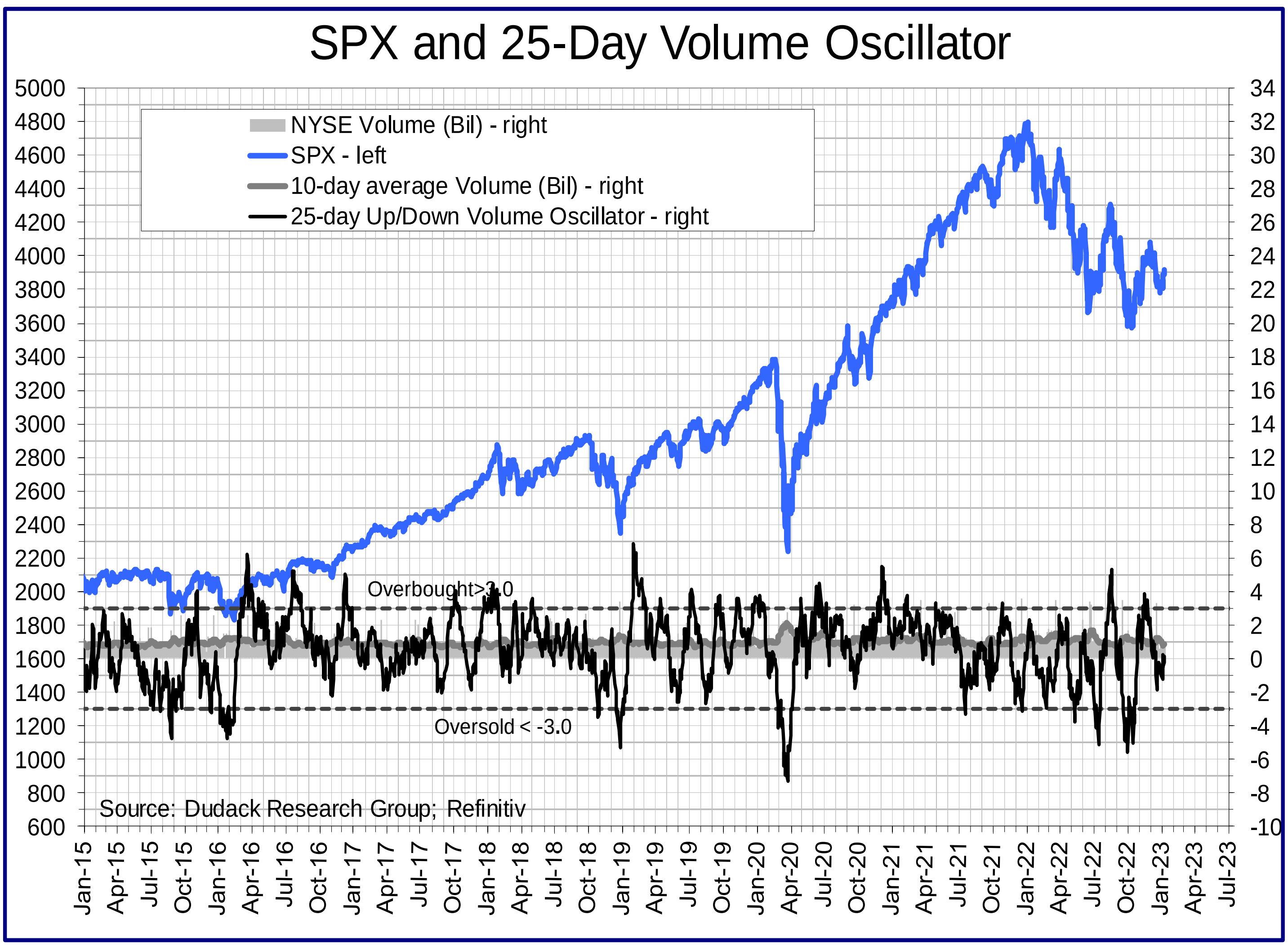


Source: Refinitiv

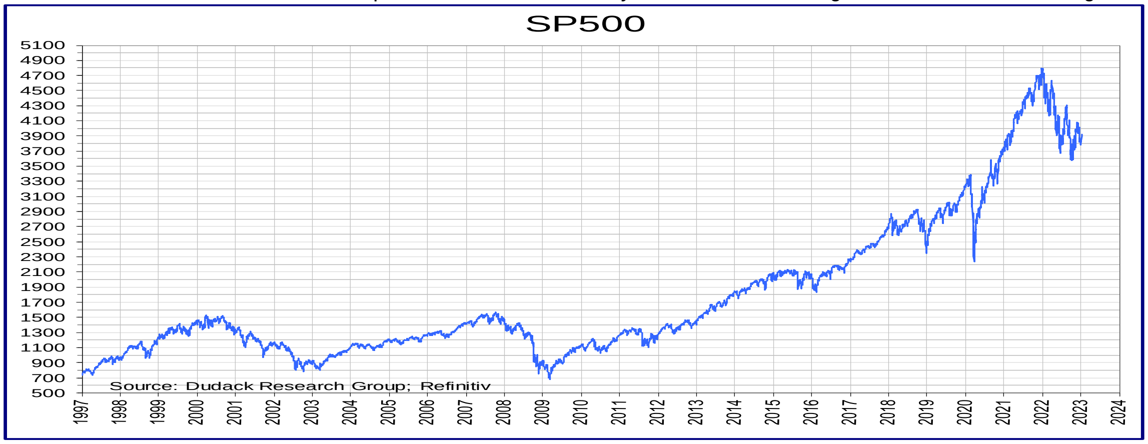
The 25-day up/down volume oscillator is currently neutral with a reading of 0.14, after being in overbought territory for seven of 10 trading days in November. However, even then, it was not overbought for five consecutive trading days, which is a minimum requirement for a positive signal. This action is significant since bear markets rarely reach overbought territory but if they do the reading is brief. A true overbought reading typically persists for at least five to ten consecutive trading days -- hopefully reaching a new overbought high reading -- to be significant. Nevertheless, this will be a key indicator to monitor in the coming weeks to assess the strength of any advance in prices.

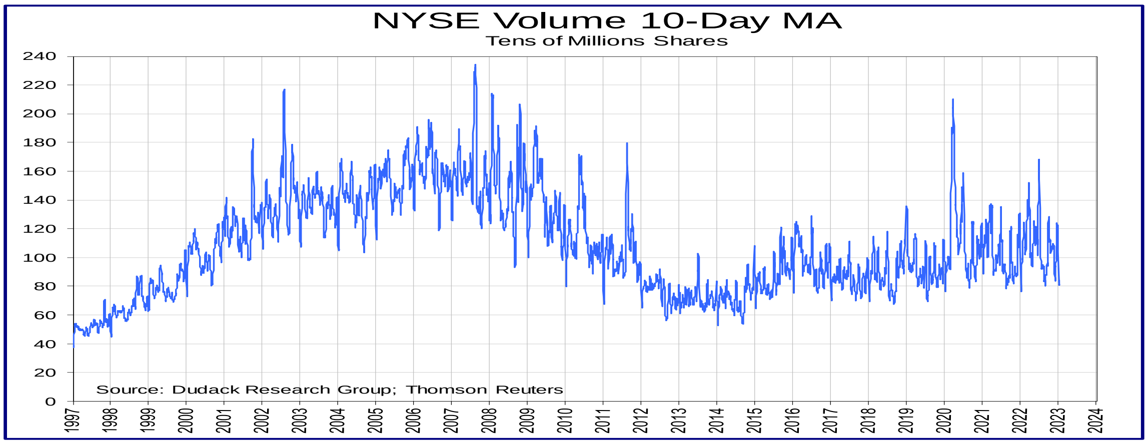
The 25-day up/down volume oscillator hit an oversold reading of negative 5.6 on September 30 which was a deeper oversold reading than the negative 5.17 reading of July 14, 2022. The oscillator was in oversold territory for 8 of 10 consecutive trading sessions in July and oversold for 18 of 24 consecutive trading sessions in September/October. This is much longer than the oversold reading at the previous low which means the test of the June low was unsuccessful by several measures and the bear market continues.

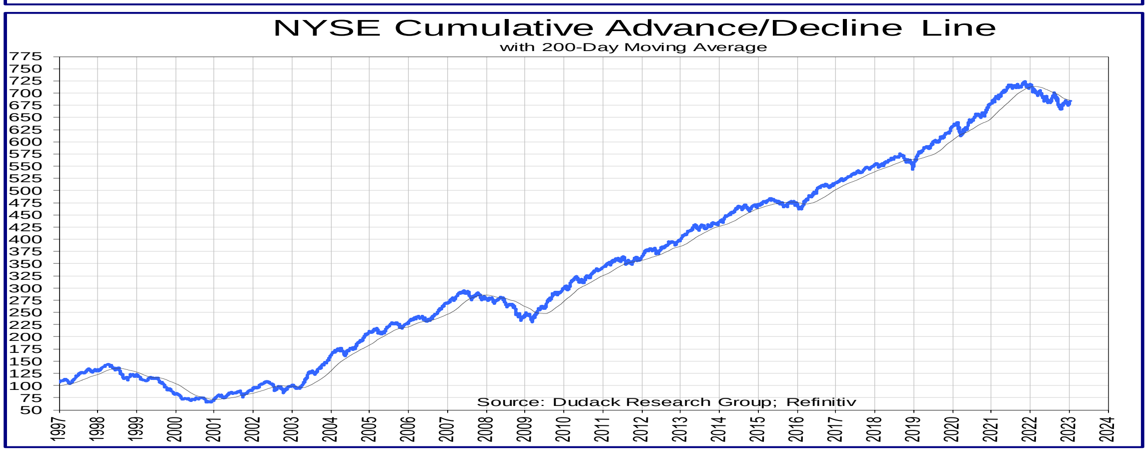
The key to a successful retest of a bear market low is whether or not a new low in price generates a new low in breadth. A successful retest will show there is less selling pressure – a less severe oversold reading -- despite a lower low in price. This "non-confirmation" of a low is a positive and implies that downside risk is subsiding.

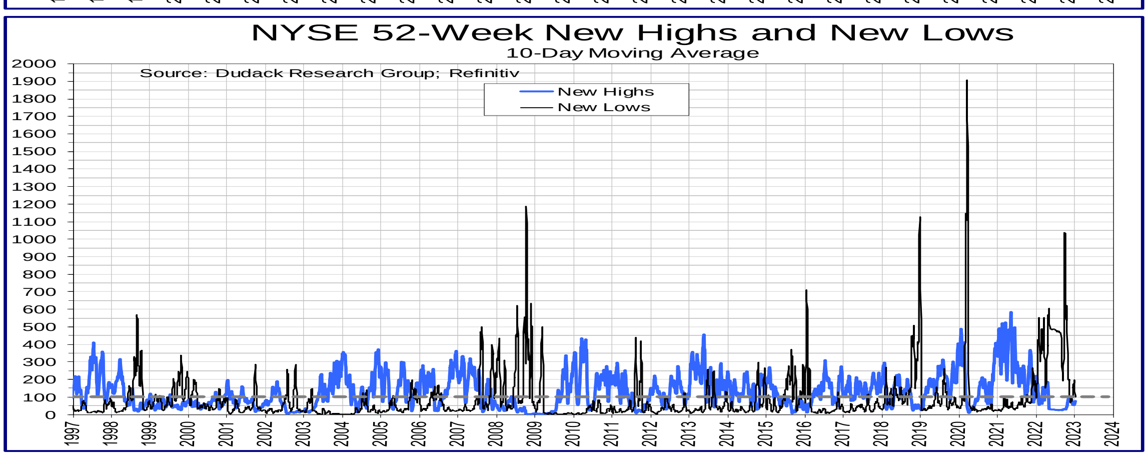


The 10-day average of daily new highs is 77 and new lows are 97. This combination is now neutral since new highs are below the 100 benchmark and new lows are below 100. The 10-day moving average of new lows was 1038 on September 26 and exceeded the previous peak of 604 made in early May. The advance/decline line fell below the June low on September 22 and is currently 39,845 net advancing issues from its 11/8/21 high – a negative sign.

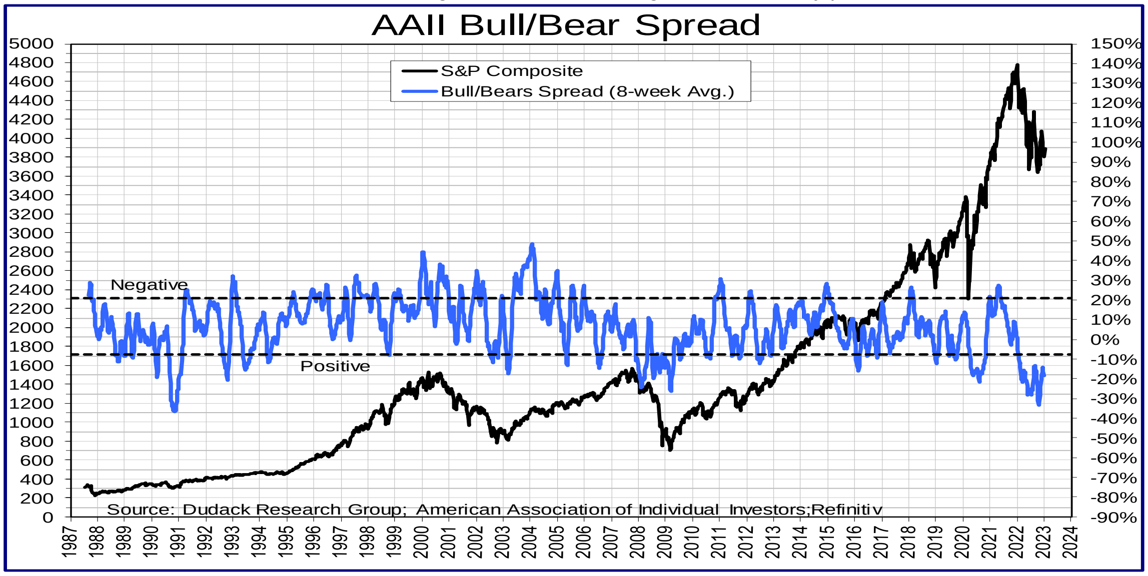


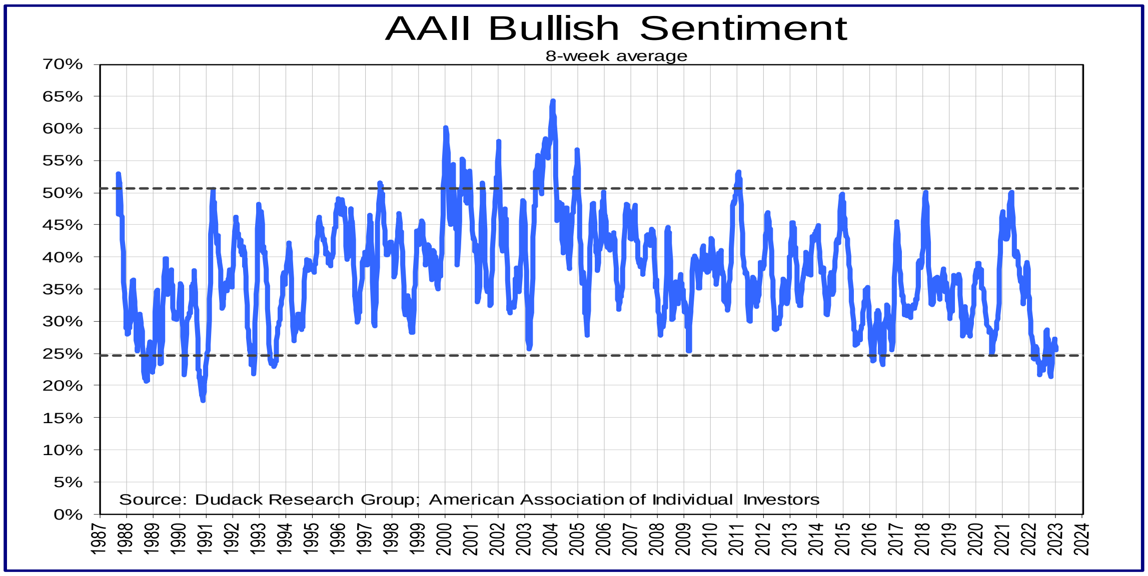


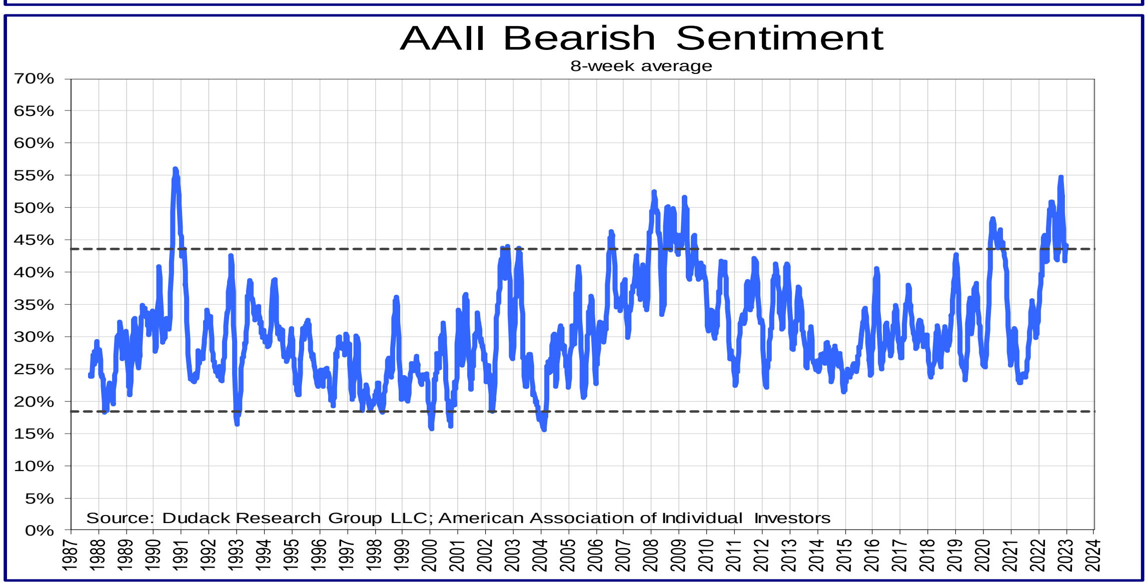




Last week's AAII readings showed a 6.0% decrease in bulls to 20.5% and a 5.6% decrease in bears of 42.0%. Bullishness remains below the long-term average of 37.5% and bearishness is above its long-term average of 40.2%. Sentiment readings were extreme on September 21, 2022, and equity prices tend to be higher in the next six and/or twelve months following such extreme readings. This is the only positive in all our technical indicators.



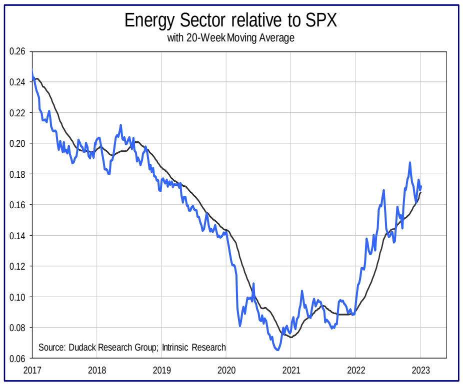


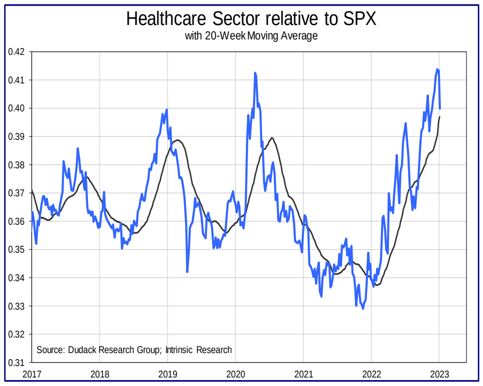


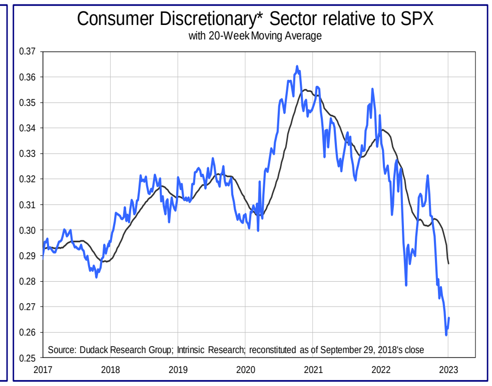
SECTOR RELATIVE PERFORMANCE – RELATIVE OVER/UNDER/ PERFORMANCE TO S&P 500

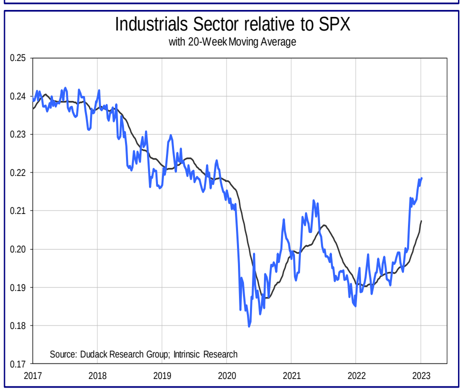
DRG Recommended Sector Weights		
Overweight	**Neutral**	**Underweight**
Energy	Healthcare	Consumer Discretionary
Industrials	Technology	REITS
Staples	Materials	Communication Services
Utililties	Financials	

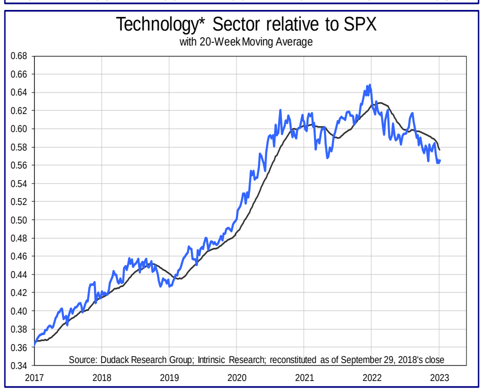
3/8/2022:Materials upgraded from underw eight to neutral/communication service dow ngraded from neutral to underw eight. 3/1/2022 Financials dow ngraded to neutral and Industrials upgraded to overw eight.

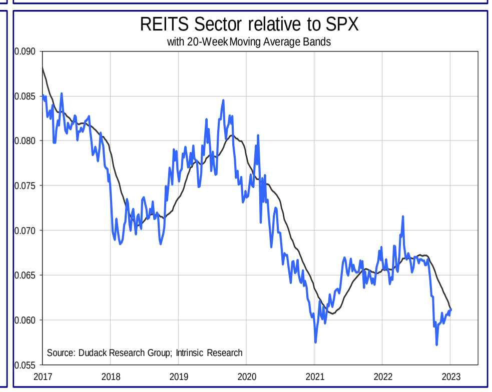


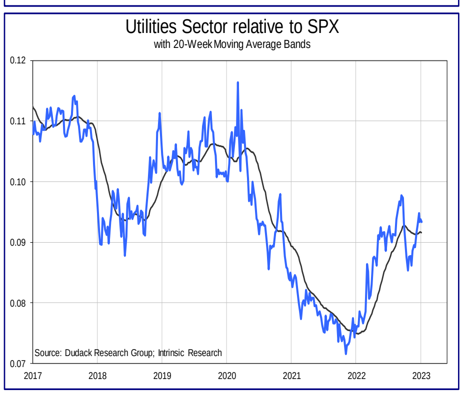


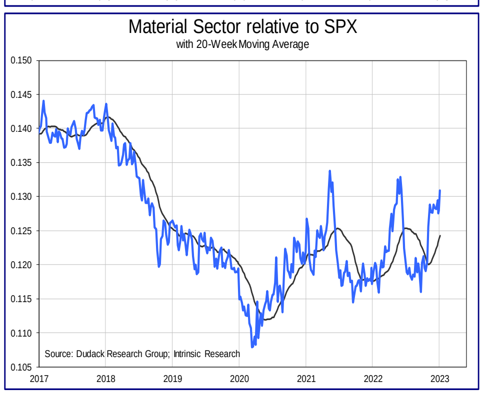


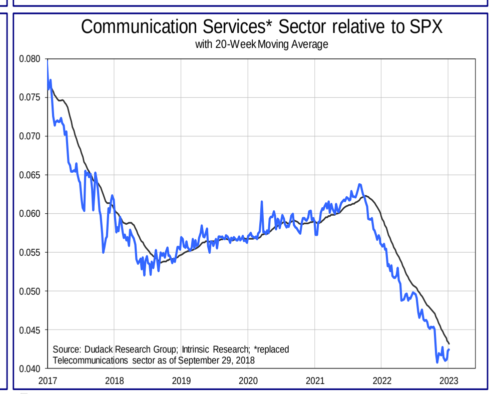


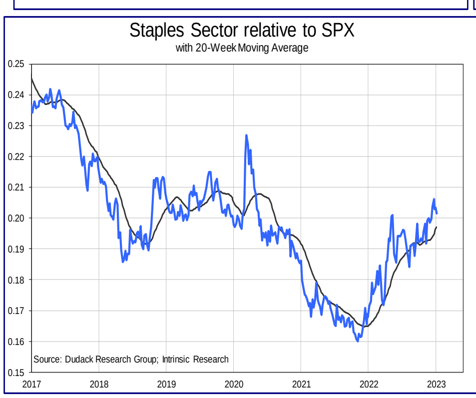












2023 Performance - Ranked	
SP500 Sector	% Change
S&P MATERIALS	5.1%
S&P COMMUNICATIONS SERVICES	5.0%
S&P CONSUMER DISCRETIONARY	4.1%
S&P FINANCIAL	3.6%
S&P INDUSTRIALS	2.8%
S&P REITS	2.8%
S&P 500	2.1%
S&P INFORMATION TECH	1.9%
S&P UTILITIES	1.4%
S&P CONSUMER STAPLES	0.5%
S&P ENERGY	0.3%
S&P HEALTH CARE	-1.0%

Source: Dudack Research Group; Refinitiv; Monday closes

US Asset Allocation

	Benchmark	DRG %	Recommendation
Equities	60%	55%	Neutral
Treasury Bonds	30%	20%	Underweight
Cash	10%	25%	Overweight
	100%	100%	

Source: Dudack Research Group; raised cash and lowered equity 15% on December 21, 2022

DRG Earnings and Economic Forecasts

	S&P 500 Price	S&P Reported EPS**	S&P Operating EPS**	DRG Operating EPS Forecast	DRG EPS YOY %	Refinitiv Consensus Bottom-Up $ EPS**	Refinitiv Consensus Bottom-Up EPS YOY%	S&P Op PE Ratio	S&P Divd Yield	GDP Annual Rate	GDP Profits post-tax w/ IVA & CC	YOY %
2005	1248.29	$69.93	**$76.45**	$76.45	13.0%	**$76.28**	13.7%	16.3X	1.8%	3.5%	$1,108.90	9.7%
2006	1418.30	$81.51	**$87.72**	$87.72	14.7%	**$88.18**	15.6%	16.2X	1.8%	2.8%	$1,216.10	9.7%
2007	1468.36	$66.18	**$82.54**	$82.54	-5.9%	**$85.12**	-3.5%	17.8X	1.8%	2.0%	$1,141.40	-6.1%
2008	903.25	$14.88	**$49.51**	$49.51	-40.0%	**$65.47**	-23.1%	18.2X	2.5%	0.1%	$1,029.90	-9.8%
2009	1115.10	$50.97	**$56.86**	$56.86	14.8%	**$60.80**	-7.1%	19.6X	2.6%	-2.6%	$1,182.90	14.9%
2010	1257.64	$77.35	**$83.77**	$83.77	47.3%	**$85.28**	40.3%	15.0X	1.9%	2.7%	$1,456.50	23.1%
2011	1257.60	$86.95	**$96.44**	$96.44	15.1%	**$97.82**	14.7%	13.0X	2.0%	1.5%	$1,529.00	5.0%
2012	1426.19	$86.51	**$96.82**	$96.82	0.4%	**$103.80**	6.1%	14.7X	2.1%	2.3%	$1,662.80	8.8%
2013	1848.36	$100.20	**$107.30**	$107.30	10.8%	**$109.68**	5.7%	17.2X	2.0%	1.8%	$1,648.10	-0.9%
2014	2127.83	$102.31	**$113.01**	$113.01	5.3%	**$118.78**	8.3%	18.8X	2.2%	2.3%	$1,713.10	3.9%
2015	2043.94	$86.53	**$100.45**	$100.45	-11.1%	**$118.20**	-0.5%	20.3X	2.1%	2.7%	$1,664.20	-2.9%
2016	2238.83	$94.55	**$106.26**	$96.82	-3.6%	**$118.10**	-0.1%	21.1X	1.9%	1.7%	$1,661.50	-0.2%
2017	2673.61	$109.88	**$124.51**	$124.51	28.6%	**$132.00**	11.8%	21.5X	1.8%	2.3%	$1,816.60	9.3%
2018	2506.85	$132.39	**$151.60**	$151.60	21.8%	**$161.93**	22.7%	16.5X	1.9%	2.9%	$2,023.40	11.4%
2019	3230.78	$139.47	$157.12	$157.12	3.6%	**$162.93**	0.6%	20.6X	1.8%	2.3%	$2,065.60	2.1%
2020	3756.07	$94.14	$122.38	$122.38	-22.1%	**$139.72**	-14.2%	30.7X	1.6%	-3.4%	$1,968.10	-4.7%
2021	4766.18	$197.87	$208.17	$208.17	70.1%	**$208.12**	49.0%	22.9X	1.3%	5.7%	$2,424.60	23.2%
2022P	~~~~~	$181.03	$200.19	$200.00	-3.9%	**$219.87**	5.6%	19.6X	NA	NA	NA	NA
2023E	~~~~~	$203.22	$226.51	$180.00	-10.0%	**$229.24**	4.3%	17.3X	NA	NA	NA	NA
2015 1Q	2108.88	$21.81	$25.81	$25.81	-5.5%	$28.60	1.5%	18.9	2.0%	3.3%	$1,706.90	9.2%
2015 2Q	2166.05	$22.80	$26.14	$26.14	-10.9%	$30.09	0.1%	20.0	2.0%	2.3%	$1,689.20	-1.4%
2015 3Q	1920.03	$23.22	$25.44	$25.44	-14.1%	$29.99	-0.2%	18.4	2.2%	1.3%	$1,675.60	-6.6%
2015 4Q	2043.94	$18.70	$23.06	$23.06	-13.8%	$29.52	-3.3%	20.3	2.1%	0.6%	$1,585.20	-11.1%
2016 1Q	2059.74	$21.72	$23.97	$23.97	-7.1%	$26.96	-5.7%	20.9	2.1%	2.4%	$1,664.90	-2.5%
2016 2Q	2098.86	$23.28	$25.70	$25.70	-1.7%	$29.61	-1.6%	21.4	2.1%	1.2%	$1,624.20	-3.8%
2016 3Q	2168.27	$25.39	$28.69	$28.69	12.8%	$31.21	4.1%	21.4	2.1%	2.4%	$1,649.90	-1.5%
2016 4Q	2238.83	$24.16	$27.90	$27.90	21.0%	$31.30	6.0%	21.1	2.0%	2.0%	$1,707.00	7.7%
2017 1Q	2362.72	$27.46	$28.82	$28.82	20.2%	$30.90	14.6%	21.3	2.0%	1.7%	$1,791.40	7.6%
2017 2Q	2423.41	$27.01	$30.51	$30.51	18.7%	$32.58	10.0%	20.9	1.9%	2.0%	$1,803.70	11.1%
2017 3Q	2519.36	$28.45	$31.33	$31.33	9.2%	$33.45	7.2%	21.2	1.9%	3.4%	$1,845.10	11.8%
2017 4Q	2673.61	$26.96	$33.85	$33.85	21.3%	$36.02	15.1%	21.5	1.8%	4.1%	$1,884.60	10.4%
2018 1Q	2640.87	$33.02	$36.54	$36.54	26.8%	$38.07	23.2%	20.0	1.9%	2.8%	$1,968.30	9.9%
2018 2Q	2718.37	$34.05	$38.65	$38.65	26.7%	$41.00	25.8%	19.4	1.9%	2.8%	$1,972.70	9.4%
2018 3Q	2913.98	$36.36	$41.38	$41.38	32.1%	$42.66	27.5%	19.4	1.8%	2.9%	$2,028.40	9.9%
2018 4Q	2506.85	$28.96	$35.03	$35.03	3.5%	$41.18	14.3%	16.5	2.1%	0.7%	$2,087.60	10.8%
2019 1Q	2834.40	$35.02	$37.99	$37.99	4.0%	$39.15	2.8%	18.5	1.9%	2.2%	$2,051.00	4.2%
2019 2Q	2941.76	$34.93	$40.14	$40.14	3.9%	$41.31	0.8%	19.0	1.9%	2.7%	$2,115.30	7.2%
2019 3Q	2976.74	$33.99	$39.81	$39.81	-3.8%	$42.14	-1.2%	19.5	1.9%	3.6%	$2,130.00	5.0%
2019 4Q	3230.78	$35.53	$39.18	$39.18	11.8%	$41.98	1.9%	20.6	1.8%	1.8%	$2,122.70	1.7%
2020 1Q	2584.59	$11.88	$19.50	$19.50	-48.7%	$33.13	-15.4%	18.6	2.3%	-4.6%	$1,965.90	-4.1%
2020 2Q	4397.35	$17.83	$26.79	$26.79	-33.3%	$27.98	-32.3%	35.1	1.9%	-29.9%	$1,746.10	-17.5%
2020 3Q	3363.00	$32.98	$37.90	$37.90	-4.8%	$38.69	-8.2%	27.3	1.7%	35.3%	$2,154.30	1.1%
2020 4Q	3756.07	$31.45	$38.19	$38.19	-2.5%	$42.58	1.4%	30.7	1.6%	3.9%	$2,018.50	-4.9%
2021 1Q	3972.89	$45.95	$47.41	$47.41	143.1%	$49.13	48.3%	26.4	1.5%	6.3%	$2,237.40	13.8%
2021 2Q	4297.50	$48.39	$52.03	$52.03	94.2%	$52.58	87.9%	24.5	1.3%	7.0%	$2,401.70	37.5%
2021 3Q	4307.54	$49.59	$52.02	$52.02	37.3%	$53.72	38.8%	22.7	1.4%	2.7%	$2,456.40	14.0%
2021 4Q	4766.18	$53.94	$56.71	$56.71	48.5%	$53.95	26.7%	22.9	1.3%	7.0%	$2,435.90	20.7%
2022 1Q	4530.41	$45.99	$49.36	$49.36	4.1%	$54.80	11.5%	21.6	1.4%	-1.6%	$2,374.60	6.1%
2022 2Q	3785.38	$42.74	$46.87	$46.87	-9.9%	$57.62	9.6%	18.5	1.7%	-0.6%	$2,522.60	5.0%
2022 3QE	3585.62	$44.41	$50.35	$51.00	-2.0%	$56.02	4.3%	18.5	1.8%	3.2%	NA	NA
2022 4QE*	3919.25	$47.89	$53.61	$52.77	-6.9%	$53.81	-0.3%	19.6	NA	NA	NA	NA

Source: DRG; S&P Dow Jones; Refinitiv Consensus estimates; **quarterly EPS may not sum to official CY estimates 1/10/2023

Regulation AC Analyst Certification

I, Gail Dudack, hereby certify that all the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly related to the specific views contained in this report.

IMPORTANT DISCLOSURES

RATINGS DEFINITIONS:

Sectors/Industries:
"Overweight": Overweight relative to S&P Index weighting
"Neutral": Neutral relative to S&P Index weighting
"Underweight": Underweight relative to S&P Index weighting

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