GARZARELLI CAPITAL, INC.

Elaine Garzarelli
1-212-691-6023
Alida Melkonian
1-800-433-8953

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Fed funds rate	=	4.31%			
3 Mo T-Bill	=	4.32%			
2-Year yld	=	3.96%			
10-Year yld	=	4.47%	Dow	=	40,212.71
30Yr Fixed Mortg Rt	=	6.70%	S&P 500	=	5,363.36
S&P 500 Div. Yld	=	1.43%	Nasdaq	=	16,724.46
High CPI (6/22)	=	8.90%	Russell 2000	=	1,857.67
CPI Y/Y	=	2.40%	Dollar Recent High	=	109.81
High PCE (6/22)	=	7.10%	Dollar Current Level	=	99.90, -9.0%
PCE Y/Y	=	2.50%			

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JUNK BOND SPREAD STILL OKAY

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Two weeks ago we recommended hedging as a safety precaution to protect equity gains. This was due to the economy slowing and the uncertainty surrounding tariffs and other chaotic government activities. The rapid severe decline in stock prices since then has satisfied the overvaluation that existed just a few weeks ago. Protecting gains is important because, as shown in Table 1, a -20.0 percent decline in a stock price requires a +25.0 percent rebound to simply break-even. The greater the decline in price, the greater price recovery is needed just to get back to even. For example, as shown, a -50.0 percent decline in stock prices requires a +100.0 percent price advance to recover the loss.

TABLE 1

% Advance in Price Needed to Break-Even After a Stock Price Decline

STOCK PRICE	% DECLINE	REBOUND NEEDED FOR BREAK-EVEN	BREAK-EVEN STOCK PRICE
$100	-20.0%	+25%	$100
$70	-30.0%	+42.9%	$100
$60	-40.0%	+66.7%	$100
$50	-50.0%	+100%	$100

The stock market drawdown peak-to-trough has been -18.9 percent for the S&P 500, -24.3 percent for the Nasdaq, and -27.9 percent for the Russell 2000. In 2018, Trump Tariff 1.0 and the Fed tightening at the same time caused the S&P 500 to drop by -19.8 percent, the Nasdaq -23.6 percent, and the Russell 2000 -27.2 percent.

Chart 1 shows the striking similarity between the stock market decline in 2018 compared to the current drawdown in duration and degree. We believe, the worst is likely over and the encouraging words of Boston Fed Reserve Bank President Susan Collins assured markets today that the Fed will deploy financial firepower if necessary. For now, she says the Fed believes all systems are in working order. This, combined with Peter Navarro becoming overshadowed by Treasury Secretary Bessent gives us comfort that tariff policy will be more in line with facts than fantasy. We believe a deal with China and a revision of tariffs would restore confidence for the bond market and the dollar.

CHART 1

2018 DECLINE VS CURRENT DECLINE

S&P 500 PRICE INDEX (2018)

-19.8%

S&P 500 PRICE INDEX (2025)

-18.9%

There are some interesting facts concerning some other high velocity drawdowns. First, whenever the S&P 500 reaches levels of down 20.0 percent or more, companies have historically come in and started massive stock buybacks; this generally lifts stock prices. Going back to the 1950s, the only time the markets did not produce outsized returns one year out after having fallen 20.0 percent or more was in 2008 – the Great Financial Crisis. Second, recession or not, the amount that we have already pulled back is scary, but this time it's not much different. Markets fall, in the more recent past, in 1998 it was the blow up of Long-Term Capital hedge
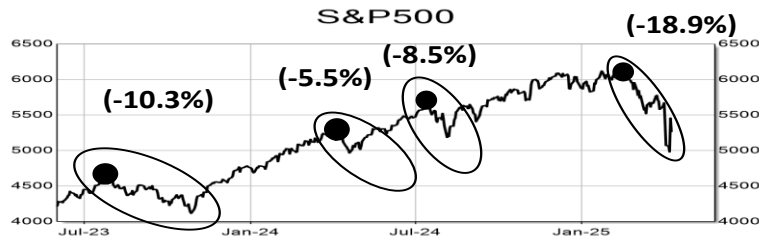
fund causing a -19.3 drop, in 2011 the European debt crisis (Greece) caused the market to drop -19.4 percent - <u>each time, different reasons, but the same result, one year out, the markets were substantially higher.</u>

CORRECTION FACTORS

The number of bullish advisors (contrarian indicator) fell further this week to 23.6 from 28.3 percent, less bulls than at the bear market bottom on October, 12, 2022, when they were 25.0 percent.

Chart 2 shows sentiment along with the other factors that had determined the likely magnitude of S&P 500 corrections in the past. The other factors are the Goldman Sachs Commodity index, oil prices, and the 10-year t-note yield. <u>These indicators are currently in favorable zones except for the 10-year t-note yield</u>. The Goldman Sachs Commodity Index and crude oil prices gave danger signals on January 15th, sentiment turned bearish on December 4th, and the 10-Year T-bond yield hit a danger level on March 27th. Currently the yield has risen form a recent low of 4.01 to 4.5 percent.
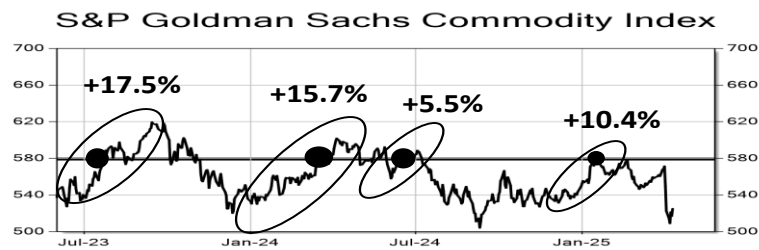
CHART 2

CORRECTION SIGNALS

S&P500

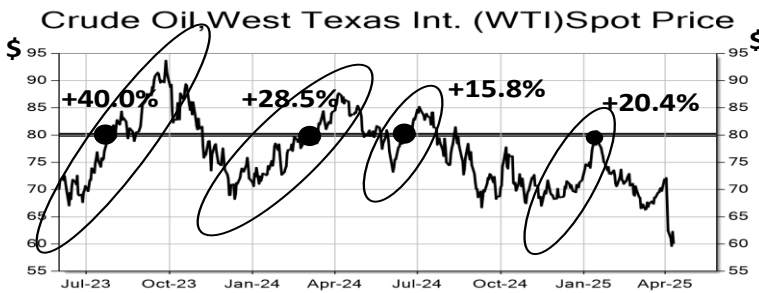(-18.9%)

(-8.5%)

(-5.5%)

(-10.3%)

Current = 5268.05

Bullish Advisors

BEARISH ZONE

BULLISH ZONE

62.5%

46.0%

Current = 23.6%

S&P Goldman Sachs Commodity Index

+17.5%   +15.7%   +5.5%   +10.4%

ABOVE
580
DANGER

Current = 517.04

Crude Oil West Texas Int. (WTI) Spot Price

+40.0%   +28.5%   +15.8%   +20.4%

ABOVE
$80
DANGER

Current = $60.17

10-year yield daily

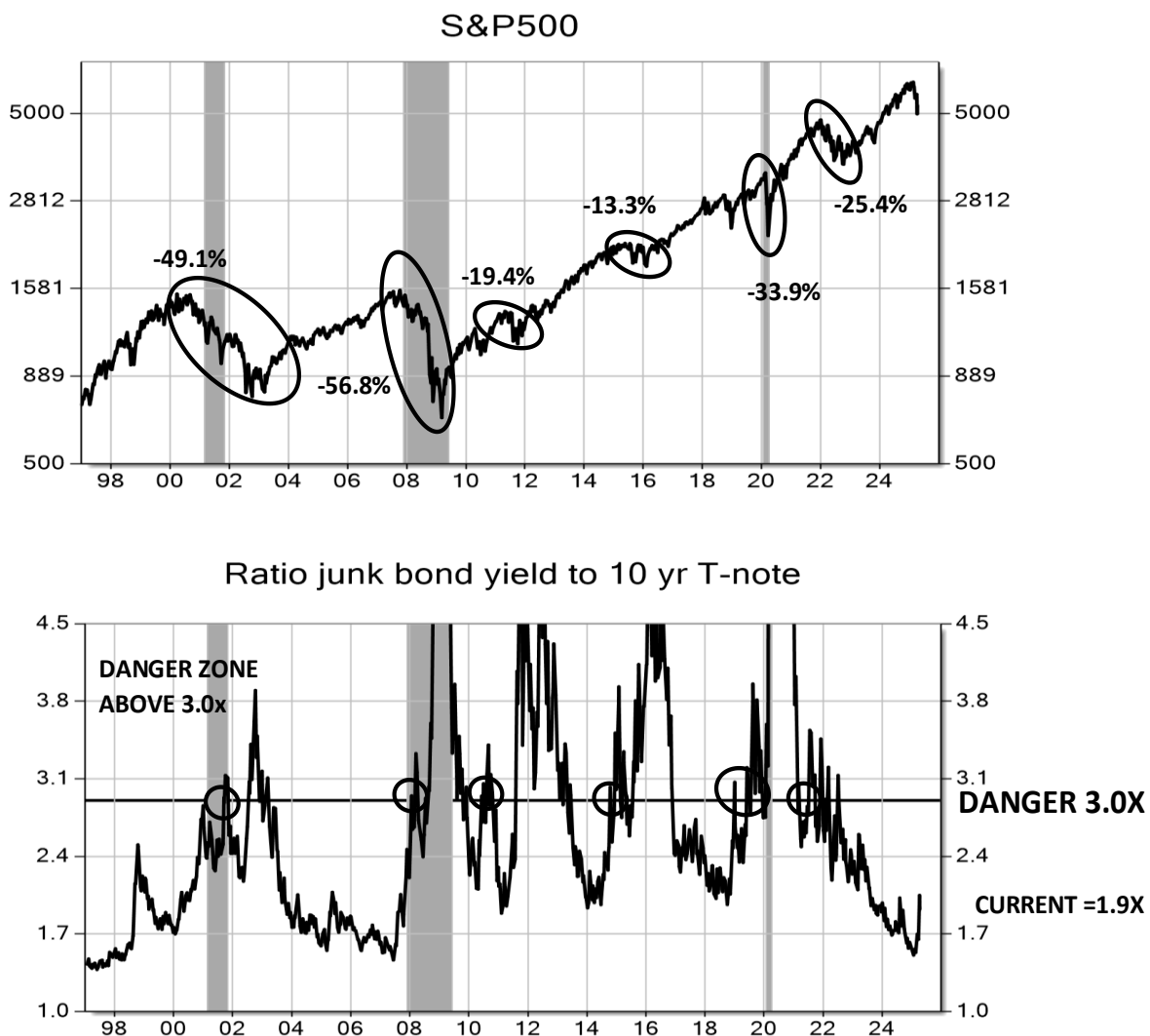ABOVE
4.34%
DANGER

Current =   4.40%

JUNK BOND RATIO RISING, BUT STILL OKAY

The ratio of the junk bond yield to the 10-year t-note yield is inversely correlated with the S&P 500 and remains bullish at 1.9X, but is up 27.0 percent from its recent low of 1.5x in January. Junk bonds yields have risen recently to 8.5 percent from 6.9 percent in late February, but still not pricing in a recession. As indicated in Chart 3, <u>a correction or bear market followed every ratio reading above 3.0x, a sign of default fears</u>. We watch this indicator closely.

CHART 3

S&P500

Ratio junk bond yield to 10 yr T-note

(O) = Danger Signals above 3.0x

LESS INTEREST IN U.S. BONDS IS BAD

When equity indexes were lower across the globe and discussions of a potential U.S. recession were on the rise, U.S. Treasury yields initially declined across the curve which is consistent with the typical patterns under such conditions. However, surprisingly, after declining by over 10 to 20 basis points across the 2-year, 10-year, and 30-year over the second half of last week, yields started this week spiking, especially on the longer end. So, on top of the steep drop in stocks and concerns about a recession, there was concern in the debt market as foreign governments showed little interest in buying U.S. government bonds. This occurred over the backdrop of a weakening U.S. dollar signaling potentially weakened demand from foreign investors. Other markets considered alternative safe havens to the U.S. have gained. For example, yields on German government bonds, which serve as the benchmark for the Eurozone, fell on Wednesday, indicating strong demand.

The probability of a U.S. recession eased slightly due to Trump's trade pivot, but it is elevated by normal standards. The market had been pricing in a recession as the Fed was still looking for more data before deciding which path we are on.

Re-direction of purchases from China to countries like Vietnam might shave a few tenths off fourth quarter core PCE inflation previously estimated at 3.5 percent. But the roughly 13.0 percent of U.S. imports that still come from China are products not easily sourced elsewhere, and ability to substitute this year may be limited. Currently the Fed fund futures show an 84.0 percent probability of no change in policy at the May 7th Fed meeting.

ECONOMY

Consumer sentiment as measured by the University of Michigan fell to the second weakest reading on record showing an 11.0 percent decline in April (fourth consecutive month of decline). The survey results were based on interviews from March 25 to April 8, prior to Trump's announcement of a 90-day pause and the increase on duties on China of 145.0 percent. Sentiment is down more than 30.0 percent since December 2024.

Today's PPI release confirms the low reading from the CPI. The headline PPI fell was up +2.7 percent (y/y). Energy goods prices dropped -4.0 percent (m/m) and

food prices fell -2.1 percent (m/m). We expect to see the PCE deflator (Fed's favorite inflation gauge) to advance in March.

Positively the labor market is in good shape, although uncertainty looms going into the second quarter. The risk of a recession rising is worrisome for business conditions, personal finances, incomes, and inflation.

S&P 500 EARNINGS

Although early with only 19 companies in the S&P 500 reporting earnings for the first quarter, 58.0 percent reported above analyst expectations. This compares to a long-term average of 67.0 percent. Industry analysts have been lowering their S&P 500 earnings per share estimates, but they remain high at 266.35 and 304.53 for this year and next, up 9.4 percent and 14.3 percent, respectively (Table 2). Those estimates are likely to fall over time, as estimates typically do since analysts tend to be too optimistic initially. Earnings will decline should Trump's tariffs cause a recession.

Based on the current 10-year t-note rate (4.47 percent) the S&P 500's fair P/E is 19.5. Thus, the S&P 500 is currently overvalued by 3.5 percent on this year's earnings, but -9.5 percent undervalued based on next year's earnings estimates.

TABLE 2

IBES
S&P 500 EARNINGS CONSENSUS FORECAST

	S&P 500 Quarterly	4-Qrtr	YR-TO-YR % Change
	EPS	Trailing	S&P500 EPS
2023:4	55.56	222.22	4.0%
2024:1	56.49	225.46	6.1%
2024:2	60.55	231.47	11.0%
2024:3	61.23	233.83	4.0%
2024:4	65.21	243.48	17.4%
2025:1 (F)	59.72	246.71	5.7%
2025:2 (F)	64.86	251.02	7.1%
2025:3 (F)	69.54	259.33	13.6%
2025:4 (F)	72.23	266.35	10.8%
2026:1 (F)	70.04	276.67	17.3%
2026:2 (F)	74.43	286.24	14.8%
2026:3 (F)	79.00	295.70	13.6%
2026:4 (F)	81.06	304.53	12.2%

% CH Y/Y ANNUAL

2021	211.05	49.0%
2022	219.86	4.2%
2023	222.22	1.1%
2024	243.48	9.6%
2025 (F)	266.35	9.4%
2026 (F)	304.53	14.3%

RECOMMENDATIONS

HEDGING

Should one want to reduce equity exposure, the ETFs listed in Table 3 can be used for hedging. Hedging can be easily done by purchasing inverse ETFs coinciding roughly with the make-up of one's portfolio. For example, the S&P 500 inverse ETF is SH, the inverse Nasdaq-100 is PSQ, and the inverse Russell is RWM. Using leveraged 3X ETFs to hedge would require a purchase of only one third of the value one is looking to protect. Major 3X ETFs are SPXU, SQQQ, and TZA, respectively.

TABLE 3

Inverse ETFs

ETF (Short)	LEVERAGED			Issuer
	(-1X)	(-2X)	(-3X)	
S&P 500	SH	SDS	SPXU	Proshares
Nasdaq-100	PSQ	QID	SQQQ	Proshares
Russell 2000	RWM	TWM	TZA	Proshares & Direxion

For those who are long term investors, Table 4 lists our favorite sectors.

TABLE 4

ETFs (LONG)	Leveraged ETFs					2025 Year-to	
SECTORS	1x	2x	3x	S&P Weight %	Our Weight%	date % Ch.	Div Yld %
Info. Tech.	**XLK**	**ROM**	**TECL**	**30.7**	**34.6**	**-14.7%**	**0.8%**
Health Care	XLV	RXL	CURE	10.8	8.0	-0.5%	1.6%
Financials	**XLF**	**UYG**	**FAS**	**14.5**	**14.7**	**-3.4%**	**1.4%**
Con. Discret.	**XLY**	**UCC**	**WANT**	**10.5**	**11.0**	**-15.4%**	**0.9%**
Commun. Svsc	**XLC**	**LTL**	**NA**	**9.5**	**12.5**	**-5.7%**	**1.1%**
Industrials	**XLI**	**UXI**	**DUSL**	**8.3**	**9.5**	**-4.6%**	**1.5%**
Con. Staples	XLP	UGE	NEED	5.9	0.5	2.2%	2.5%
Energy	**XLE**	**DIG**	**NRGU**	**3.3**	**3.5**	**-7.9%**	**3.1%**
Utilities	XLU	UPW	UTSL	2.4	0.5	0.8%	2.9%
Real Estate	XLRE	URE	DRN	2.2	2.2	-4.3%	3.3%
Materials	**XLB**	**UYM**	**NA**	**2.0**	**3.0**	**-4.3%**	**2.0%**
	Proshares						
S&P 500 (LONG)	SPY	SSO	UPRO	100.0	100.0	-8.9%	1.3%
	Direxion						
S&P 500 (LONG)	N/A	SPUU	SPXL				
	Invesco ETF						
S&P EQUAL WGT	RSP	NA	NA				
NA - Not available							

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Table 5 shows returns on short and long-term fixed income funds that may be of interest for a portion of one's portfolio.

TABLE 5
FIXED INCOME FUNDS

ETF	Avg Yld to Maturity	Expense Ratio	Investment Objective
SGOV	4.32%	0.05	iShares 0-3 Month Treasury Bond ETF composed of maturities less than or equal to three months.
TBIL	4.30%	0.15	TBIL is a passively managed, single-bond fund that invests in the most recently issued, "on-the-run," 3-month US Treasury Bill.
SHV	4.27%	0.15	U.S. Treasuries that have a maturity of less than or equal to one year.
UTWO	3.87%	0.15	UTWO is a passively managed, single-bond fund that invests in the most recently issued, "on-the-run," 2-year t-note
IGSB	4.98%	0.04	iShares Investment Grade Corporate Bond ETF seeks to track the investment results of an index of U.S. dollar-denominated investment-grade corporate bonds with remaining maturities between 1 and 5 years.
UTHY	4.49%	0.15	The fund tracks an index that holds just the "on-the-run" 30-year US Treasury bond,
TLT	4.96%	0.15	iShares 20+ Year Treasury Bond ETF

Elaine is president of Garzarelli Capital, Inc. and Charles Street Advisors and was a partner and managing director at Lehman Brothers and other major institutional firms prior to starting her own companies. She was ranked first team in Quantitative Analysis and Portfolio Strategy in Institutional Investor's All-Star poll and was inducted into the All-American "Hall of Fame". She was featured as top in her field in Fortune magazine, Business Week, and many other national and international magazines. Her education is in economics and statistics from New York University and Drexel University. She holds a PhD in economics and has a scholarship fund for female students majoring in economics at Drexel University (granted annually).

Elaine initially developed her Sector Analysis methodology for predicting industry earnings and her stock market indicator composite model while working as a corporate profit economist at major brokerage firms. This methodology using econometrics allowed her to predict the major trends in stock prices and the earnings of 25 S&P 500 industry groups. She currently predicts which S&P 500 sectors are attractive, neutral, or unattractive based on these models. She currently uses this mathematical approach for stock market timing and sector selection in running her Sector Analysis Hedge Fund and in producing her Sector Analysis weekly report. She issues this report to domestic and international mutual funds, pension funds, and hedge funds.

Concerning her forecasts of overall stock market direction, her model has predicted extraordinary market turns including the crash of 1987, and the major tops and bottoms in stock prices as indicated on the Track Record page of her website. She was voted top analyst in Market Timing by Institutional Investor magazine and in various other publications also shown on the website.

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To inquire about the "Sector Analysis" fund call 1-800-433-8953