Monday July 17, 2023

SUMMARY-

I. Stocks rallied last week on better reports and earnings.

II. Inflation continues its sharp decline, lessening Fed concerns.

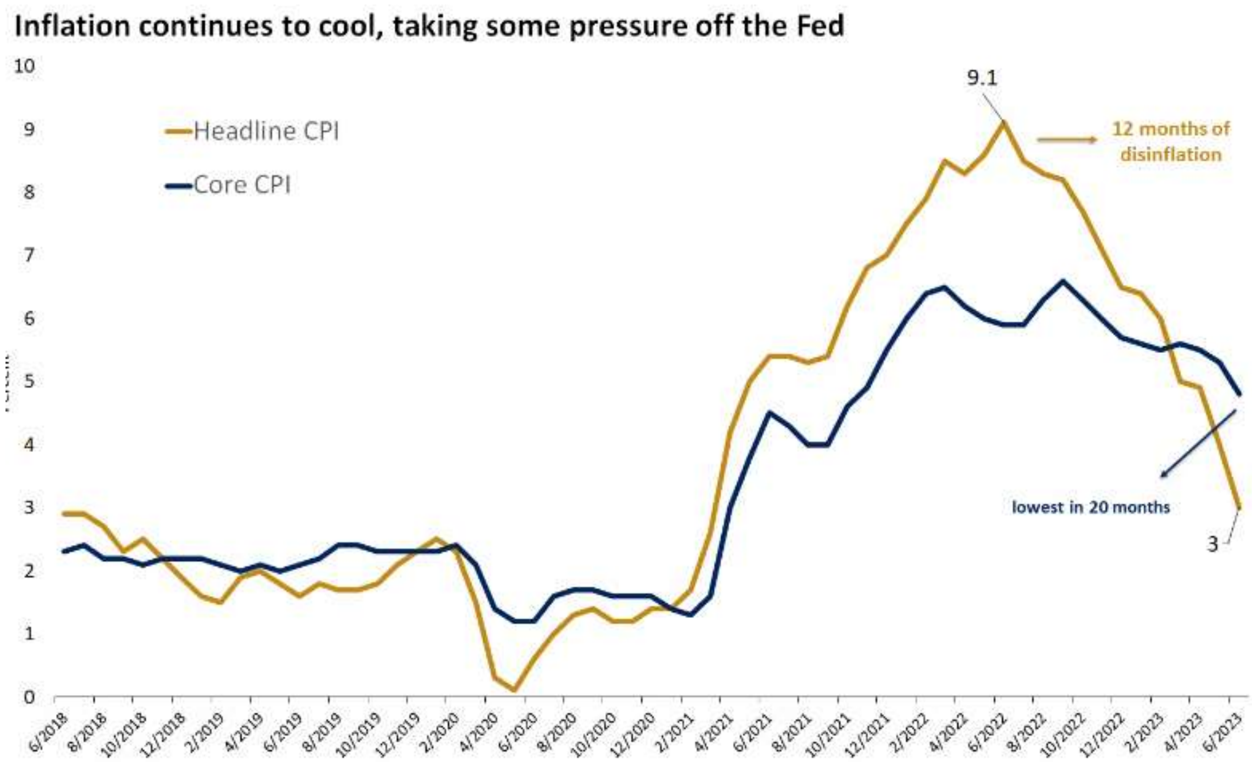
III. Improving consumer sentiment gains momentum.

IV. Upcoming key earnings reports could justify recent price gains and keep rally intact.

Good afternoon:

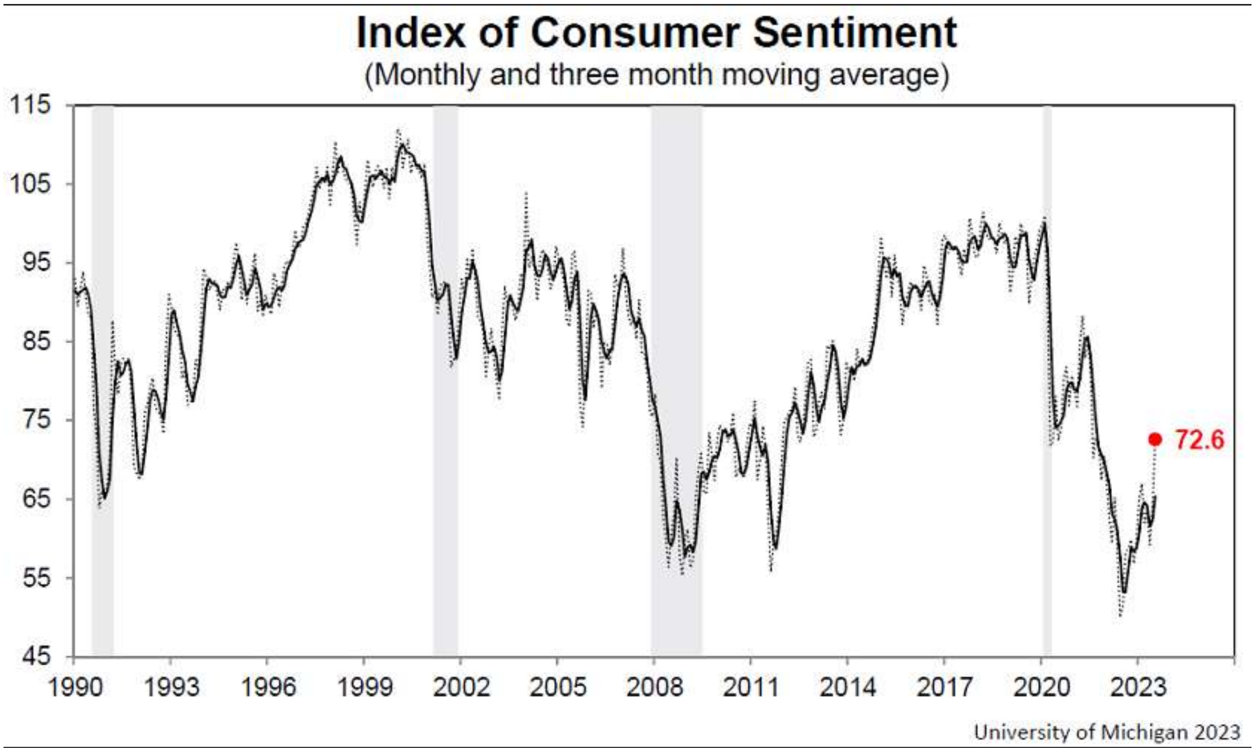
On the heels of lower inflation, rising consumer sentiment, and stronger earnings reports from several major banks, stocks continued their march higher last week. By Friday's close, major equity averages added between 2½ - 3½% while bond yields eased modestly. Although all economic sectors participated in the week's rally, Communications Services, Consumer Discretionary, and Technology stocks took their familiar leadership role.

Critical to the market's continued success is the thesis that inflation is under control and perhaps even on a glidepath to the Fed's 2% target level. Despite the market having priced-in another 0.25% hike later this month, the belief that the Fed is winning the fight against inflation and is therefore nearly done tightening persists. Last week's June CPI data came in cooler than anticipated at 3.1% and much lower than May's 4.0% year-over-year figure. This is down dramatically from the 8.9% peak a year ago. Although some differences exist between Headline inflation, and Core inflation (which removes food and energy prices), both are exhibiting long periods of disinflation (prices increasing at declining rates). Of course, after such dramatic prices increases in the past two years on things like groceries, energy, vehicles, and housing, many consumers would prefer to see price declines, or *deflation*.

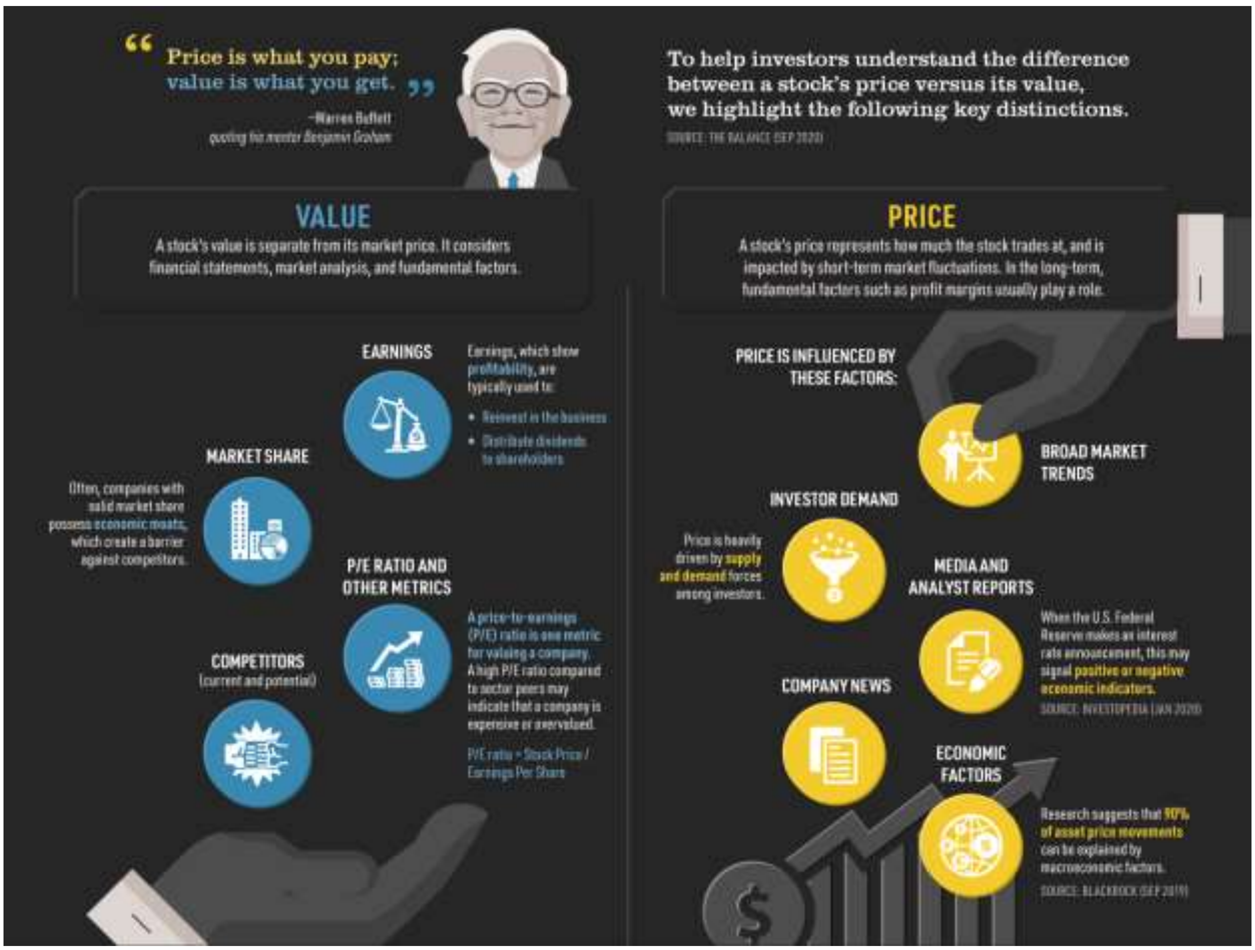


Source: Bloomberg

University of Michigan's Consumer Sentiment Index rose for the second straight month, soaring 13% above June and reaching its most favorable reading since September 2021. All components of the index improved considerably, led by a 19% surge in long-term business conditions and 16% increase in short-run business conditions. Overall, sentiment climbed for all demographic groups except for lower-income consumers. The sharp rise in sentiment was largely attributable to the continued slowdown in inflation along with stability in labor markets. For middle- and higher-income groups, the continued strength in the stock market may also be contributing to improving consumer confidence and attitude. As seen in the chart, sentiment is now about halfway between the all-time historic low of 50 from June 2022 and the February 2020 pre-pandemic reading of 101.



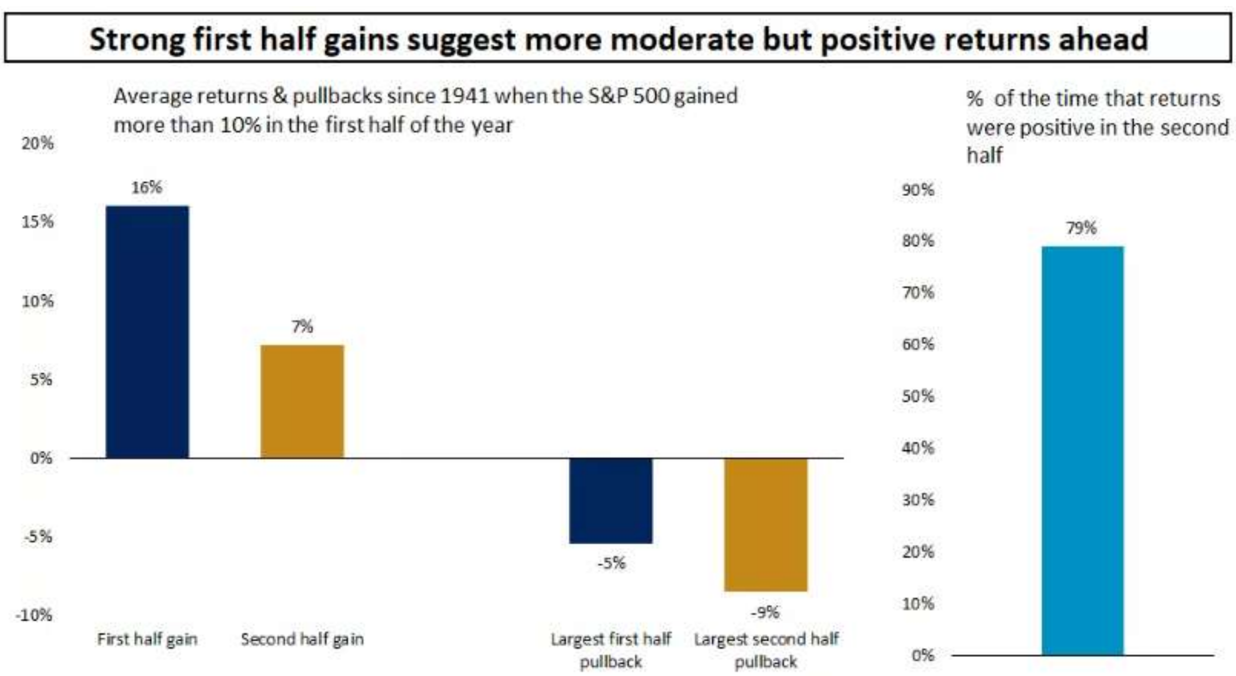
To validate this improving sentiment, corporate earnings will need to remain at or above expectations. Last week's kick-off to Q2 earnings season was marked by several of the nation's largest banks reporting such strong results. Attention will remain on the market's largest companies in the coming weeks to set the tone for the overall market's momentum. In the long run, equity valuations are primarily due to the profits a company can deliver. Day to day, many other factors come together to determine stock prices. Warren Buffet paraphrased is former professor at Columbia and famed economist and investor Benjamin Graham when he said, "In the short run, the market is a *voting* machine but in the long run, it is a *weighing* machine."



Source: The Balance (SEP 2020)

With the Fed nearly done with their hikes, inflation sharply retreating, consumer spending and the labor market still resilient, it is reasonable to expect that if the long-expected economic downturn or recession finally materializes later this year or early next, it may very well be fairly short and shallow. Furthermore, while history would advise betting on it, the possibility also exists that the Fed "sticks the landing" and is able to reset our runaway inflation without triggering a recession at all. Regardless, some investors, both individual and institutional may be reaching similar conclusions and bringing capital back into the equity market in recent weeks. For now, at least, this appears to be more of a "FOMO" (fear of missing out) situation targeting select names and sectors rather than wholesale buying across the equity market.

If earnings growth remains intact in the coming weeks, the pattern of stocks usually delivering positive results in the second half of a year following a gain of 10% or more in the first half seems plausible. Stay tuned!



Source: Morningstar

Have a great week!

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