Monday, July 25, 2022

Good afternoon:

Equity markets resumed their second half recovery last week with solid gains of 2-3% in all major stock indices. As we start this important week of the Q2 earnings season with over ¾ of S&P 500 companies yet to report, expectations still see year-over-year earnings growth of over 4%, and quarter-over-quarter profit growth of nearly 10%. Strongest results have not surprisingly been posted by energy, materials, and industrial sectors as each are highly cyclical and directly benefited from the surge in prices in the first half of 2022.

However, with the makeup of the S&P 500 weighted to the size of its components, it's the mega-cap tech companies that account for significantly more of the movement in the index than any other sector. As a result, with most such technology firms announcing their Q2 results this week, it is likely that markets will prove very reactionary as each company reports. Most of these stocks are already down dramatically from their 52-week highs with very poor sentiment among many investors. Therefore, any evidence in these results that indicates improvement, or even something that is *less bad* than expected *could* spark a positive move in the stock and even the broader market.

While we and others look for green shoots in a very challenging market climate, the confirmation of our economic reality may be soon upon us. Economists have long accepted the definition of a recession as two or more consecutive quarters of economic contraction as measured by the GDP. Since we already know that Q1's GDP was negative (-1.6%), this week's expected negative Q2 GDP of -2.1% should confirm we are in a recession, right? Like everything else these days, this simple definition seems to be up for debate. In recent days, the administration has attempted to preemptively say that if or when Q2 GDP reports another contraction, it still won't indicate a recession.

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What is a recession? While some maintain that two consecutive quarters of falling real GDP constitute a recession, that is neither the official definition nor the way economists evaluate the state of the business cycle. Instead, both official determinations of recessions and economists' assessment of economic activity are based on a holistic look at the data—including the labor market, consumer and business spending, industrial production, and incomes. Based on these data, it is unlikely that the decline in GDP in the first quarter of this year—even if followed by another GDP decline in the second quarter—indicates a recession.

With consumer sentiment at all-time lows, inflation at 40+ year highs and interest rates climbing, the average American already believes we're in a recession. Even economist Art Laffer, architect of the Reagan boom years and famous for his Laffer Curve analysis, was quoted last week as saying, "Recession is here and will last for a while." Rather than fearing a particular label, or trying to alter its definition, we believe it's better to recognize the cyclical nature of economic patterns and how markets tend to behave at each phase.

Recessions, like corrections and bear markets, are regular and inevitable occurrences for all investors to anticipate and traverse. By the time they are acknowledged (universally), they are *usually* very close to their conclusion. Just as economic data is compiled and released in arrears to indicate a recession, the same is true when declaring its conclusion and the resumption of growth. Our approach recognizes this reality and relies on the tenets of professional money management, asset allocation, and diversification amongst a portfolio of high-quality securities to weather varying conditions as we help our clients meet their long-term financial objectives.

Have a great week!

Mark and Jeff

Mark S. Loftus, CFP®

Managing Partner & Founder, LPWP
Registered Principal, RJFS

Jeffrey C. Preusser, CFP®
Senior Partner, LPWP
Registered Principal, RJFS

O: 630.566.9200 // T: 844.890.8750 // F: 630.566.9292
1901 Butterfield Road, Suite 100, Downers Grove, IL 60515
www.loftus-preusser.com

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