HALFTIME

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PRIVATE WEALTH MANAGEMENT

Welcome to July! Every month, we like to impart some perspective on the financial markets or shed light on a current headline or two, all in an attempt to help our clients sift through the noise and become slightly more educated investors. We welcome your comments and suggestions, and as always, we invite you to share this piece with anyone you believe may find it of interest.

Regular readers know we've been keeping an extra-watchful eye on the markets these last few months. As we wrote in May and June, we've been curious whether the S&P 500 would continue its gravity-defying run and broach the 4,292 level, constituting a 20% rally from last October's lows and, at least by some definitions, a new bull market in stocks. With great fanfare it happened on June 8.

Given our overarching concerns, the S&P 500's +15.9% first half performance[1] took us by surprise. Reasons not to be bullish were plentiful and widely held: the economy was about to fall into recession everyone said, then inflation was too stubborn, then the banking system was on the precipice of collapse, then the rally was too narrow. To be fair, the view amongst analysts even today that we're in a bull market or that the rally is sustainable remains anything but universal. Consensus forecasts by market strategists suggest the S&P 500 will be at 4,116 by year-end, which would actually be a 7% decline from current levels[2] and there are a slew of issues casting doubt on the future path of stocks. Most central of these, we remain stuck in a tug-of-war between the economy not sliding into recession and too much inflation that will require further interest rate hikes. Student loan repayments are set to resume in October after a three-year pandemic-induced pause, affecting 44 million individuals and taking approximately $70 billion a year out of the economy[3]. A Teamsters Union strike targeting UPS drivers could significantly disrupt the flow of goods throughout the economy. And Congress still faces an October 1 deadline for a budget deal and another threat of a government shutdown.

On top of this, there remains the issue of valuations. First Trust's Capitalized-Profits Model, which considers corporate profits relative to the 10-year U.S. Treasury Note yield, has been one of our go-to determinants of fair value for years. At present it is telling us that the S&P 500 would be reasonably priced at 3,500 – a full 20% below today's levels (data as-of 7/5/2023).

Notwithstanding the above issues, we're going to go on a limb and pronounce our glass half-full....at least for now.

First and foremost, the path of least resistance continues to be higher because for the past six months stocks have been in a pronounced uptrend. Economically-speaking, the majority of recently reported economic data has come in better than expected. The Citigroup Economic Surprise Index has been positive most of the year and currently sits in its most bullish zone for stocks[4]. From a technical perspective, market breadth – the number of stocks participating in market rallies – has improved considerably, with the percentage of stocks above their 50-day moving averages climbing from 39% to 69% in June alone[5]. And most importantly in our view, the risks of recession seem to have been pushed out once again.

Looking down the road however, we do have concerns that will require both hands on the wheel. We'll continue watching for signs the economy appears headed for recession. We'll continue watching for signs that inflation, which has been in decline for nearly a year, reaccelerates and compels the Federal Reserve to aggressively hike rates again. And we'll be watching investor sentiment, which is currently elevated. If the news turns negative yet investor sentiment remains positive, we'd conclude that most investors interested in buying into the market have already done so.

Bull markets come and go. Going back to 1972, although the S&P 500 has effectively halved on three separate occasions, it has still increased 32-fold in the same time[6]. So really, whether we find ourselves in a bull or bear market this month, quarter or year is wholly irrelevant because we strongly believe, despite the market's periodic - but temporary - setbacks, the goal focused, patient and plan-driven investor will always be better off because of it. In the meantime, we encourage our clients to remain focused, tune out the noise, and call on us if there's any guidance we can offer.

Onward.

[1]Ned Davis Research [2]Birinyi Associates [3]Macquarie Asset Management [4]Ned Davis Research [5]Ned Davis Research [6]Thomson Reuters

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