# MOMENTUM

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*Welcome to August! 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.*

While we were all relaxing at the beach last month enjoying our summer reading, the equity markets continued their work and the bull market that began in October continued its grind higher. Through July, the S&P 500 index is now up 19.5% year-to-date and is off to its best start to the year since 1997, and its 10th best since 1926[1]. At the same time, the VIX – our bellwether measure of volatility and risk – continues to fall.

As much as this year's impressive market advance has come as a surprise to many - admittedly including us - the why behind it makes sense. Very simply it's a story of re-accelerating economic growth and falling inflation pressures. Second quarter Gross Domestic Product (GDP) increased at a 2.4% annual rate, nicely above consensus estimates and ahead of the first quarter's growth of 2.0%[2]. This re-acceleration is a testament to the underlying strength of the U.S. economy since it follows more than a year of Fed interest rate hikes that have brought short-term interest rates to their highest levels since 2001[3]. At the same time, inflation pressures continue to moderate. The Personal Consumption Expenditures (PCE) Price Index rose at a 2.6% annual rate in the second quarter, down from 4.1% in the previous quarter and the lowest rate since the fourth quarter of 2020[4].

Pulled together, all the above suggests that the tug-of-war between inflation and recession about which we've written many times is clearly being resolved in favor of the bulls, and the "soft landing" scenario appears to be alive and well...at least for now.

Economically-speaking, future risks to the growth outlook do exist, largely from the possibility of further Fed rate hikes, tightening in bank lending, increased pressure on consumer spending from the depletion of excess savings, and slower global growth. But from where we sit today, we don't see recession on the near-term horizon.

The more interesting question is whether the next few months in the financial markets will bring us continued positive momentum or a reversion to the mean. As a rule, momentum tends to lead price. And historically, strong gains tend to be followed by further, albeit smaller gains. Looking all the way back to 1927, the S&P 500 has risen at least 15% through July on 22 occasions. While the returns over the remaining five months of the year rose 86% of the time, and by a median of 7%, only once (1935) did the S&P 500 post a larger gain after July than it did before[5]. Further, mean reversion has been the more likely outcome when the year-to-date gains have exceeded 20%. So at +19.5% year-to-date in 2023, the markets appear to be approaching the tipping point.

But for now we're going to keep our glass half-full. With inflation down, growth resilient, and corporate earnings positive, we would be unwise to fight the momentum the markets have established. But at these levels, neither will we advocate ignorance since much of the easy money this year may already have been earned and returns in the months ahead may become somewhat choppy.

As always, there's more to come.

Onward.

[1]Ned Davis Research [2]Ned Davis Research [3]Birinyi Associates [4]Wells Fargo Investment Institute [5]Ned Davis Research

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