



July Corner

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July 2023

Executive Summary

The first half of 2023 had spectacular returns that were not expected as we came into the year. The consensus view was that the first half of the year would not be good for markets – but the second half would be better. So having the S&P 500 up nearly 16% and Nasdaq over 30% through the end of June is almost shocking – especially given the record speed with which the Fed hiked interest rates from 0% to 5%. The manufacturing area of the economy has been negatively impacted by higher interest rates and has been for a while. However, the consumer has remained a spender, keeping the services part of the economy strong. Looking at the Conference Board Consumer Confidence Index shows the consumer is still optimistic. An optimistic consumer spends money – a good sign for the services side of the economy.

Why are consumers still spending?
Because the unemployment rate remains historically low at 3.6%. But recently there's been some weakening in the jobs data with initial jobless claims rising, payrolls coming in below expectations, and JOLTS falling (that's the Job Openings and Labor Turnover Survey). For now there is enough of a runway for consumers to still be spending, but they are becoming more selective in what they purchase.

Markets May Go on Vacation But They're Just Resetting to Charge Ahead Higher



Inflation – Elevated but Falling

The Fed's favorite measure of inflation is Core PCE (Personal Consumption Expenditures Price Index), which remains elevated at 4.6% and above the Fed's target of 2%. Core CPI (Consumer Price Index) is also elevated at 4.8%. Because these inflation gauges remain high, the Fed is expected to raise interest rates later this month by 25 basis points. But we remain in the camp that believes inflation has peaked. Another way to look at price behavior is to look at prices paid for ISM Manufacturing and Services – and both of these indicators are also falling. If we are correct on inflation, then interest rates are in the process of topping. We have technical signals pointing to a topping process for both 2-Year and 10-year Treasury yields.

The Trend Is Your Friend

There are two old competing adages on Wall Street: one is “Don't Fight the Fed” and the other is “Don't Fight the Tape.” We subscribe to “Don't Fight the Tape” because of the current amount of positioning and sentiment that is negative. Add to that (1) the extraordinary amount of monetary stimulus created by the Fed printing money (granted, it has begun to lessen) and (2) the fiscal spending of \$3 Trillion dollars on legislation, such as the Infrastructure Investment and Jobs Act (IIJA), the CHIPS and Science Act and the Inflation Reduction Act – PLUS the Ukraine war commitment of \$1.3 Trillion.

The long-term price momentum stochastic indicator went positive giving the best buy signal since 2008-2009 and more recently the Moving Average/Convergence Divergence (MACD) price momentum indicator just gave a buy signal. [The MACD turns two trend-following indicators, both moving averages, into a momentum oscillator by subtracting the longer moving average from the shorter one.]

Sentiment from the IPO (Initial Public Offering) market is also showing signs of picking up. Increasing IPOs happen in Bull markets, not in Bear markets. The Renaissance IPO ETF (IPO) is perking up and looks to have the ability to rally.

While near-term markets can be choppy, we remain buyers of the Tape!

2Q23 Earnings Outlook

Second quarter earnings are expected to be down around 6%. We believe the market has already discounted this outlook and is already looking out to the fourth quarter when earnings are expected to be up over 10%. But what about 2Q23 earnings? As of July 10, FactSet said that 113 S&P 500 companies have issued EPS guidance for the second quarter. Of these companies, 67 have issued negative EPS (earnings per share) guidance and 46 have issued positive EPS guidance. Again, this data should already be discounted in the market.

It's important to note that FactSet is seeing the highest number of S&P 500 companies issuing positive EPS guidance for 2Q 2023 (46) since Q3 2021 (56). At the sector level, the Information Technology and Industrials sectors have the highest number of companies issuing positive EPS guidance for the second quarter at 20 and 9, respectively. Combined, these two sectors account for more than half (29) of all the companies in the S&P 500 issuing positive EPS guidance for the second quarter (46). Technology and Industrials remain attractive in our view.

Europe: Cheap Versus the U.S.

The relative ratio of Europe versus the U.S. had a significant technical breakout in favor of Europe. This breakout is being tested. When comparing valuations, Europe clearly is much cheaper on earnings, trading at 12x earnings versus the U.S. at 19x earnings. The US Dollar is also trading neutral to weak versus the Euro. Taking a longer-term asset allocation point of view, it makes sense to diversify portfolios internationally, especially Europe.

Summary

Markets peak on optimism not pessimism. Peaking rates are bullish for markets. We continue to believe that the S&P 500 can test the old highs near 4800.



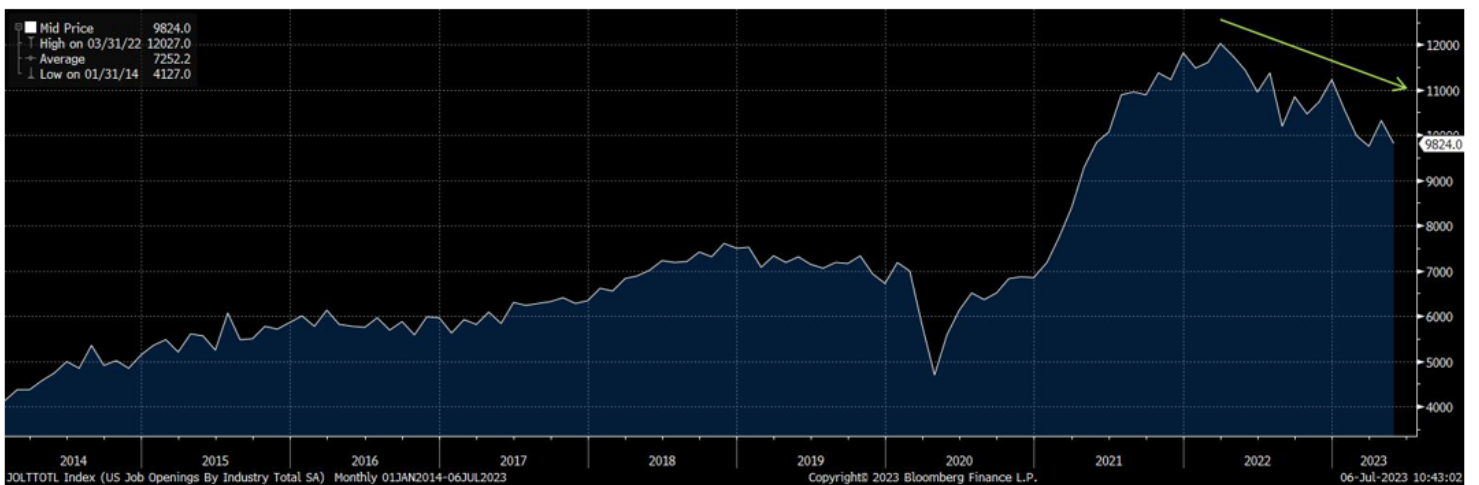
Conference Board Consumer Confidence Index – Consumer Still Positive and Spending



Source: Bloomberg; July 10, 2023

Jobs Are Growing But Growth Is Slowing

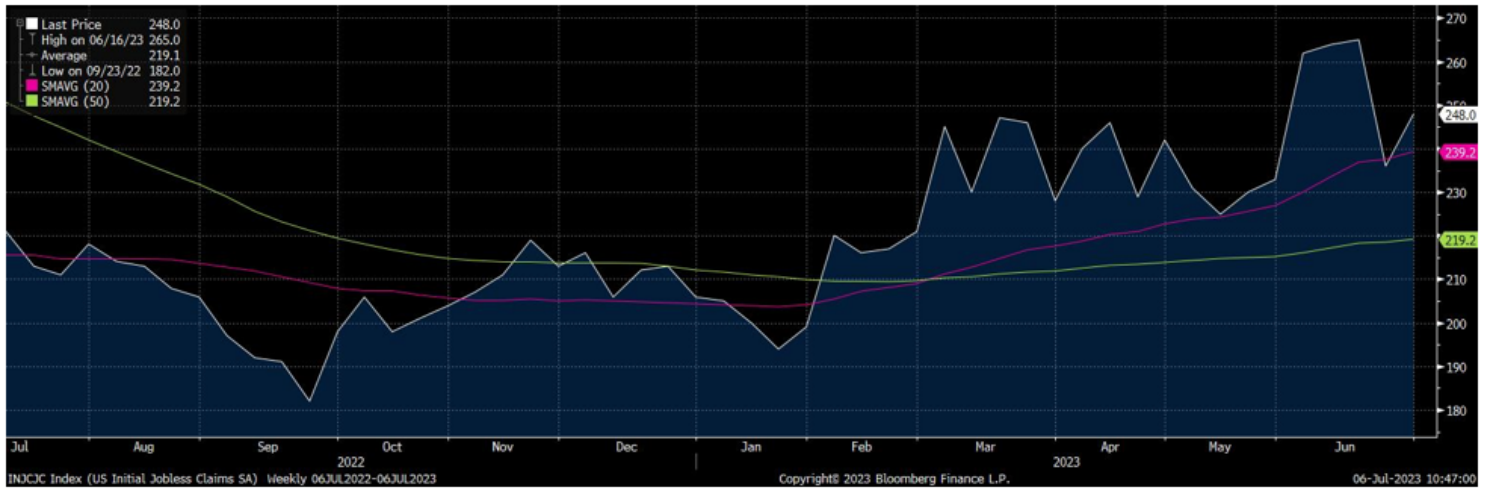
JOLTS Job Openings Are Falling



Source: Bloomberg; July 6, 2023

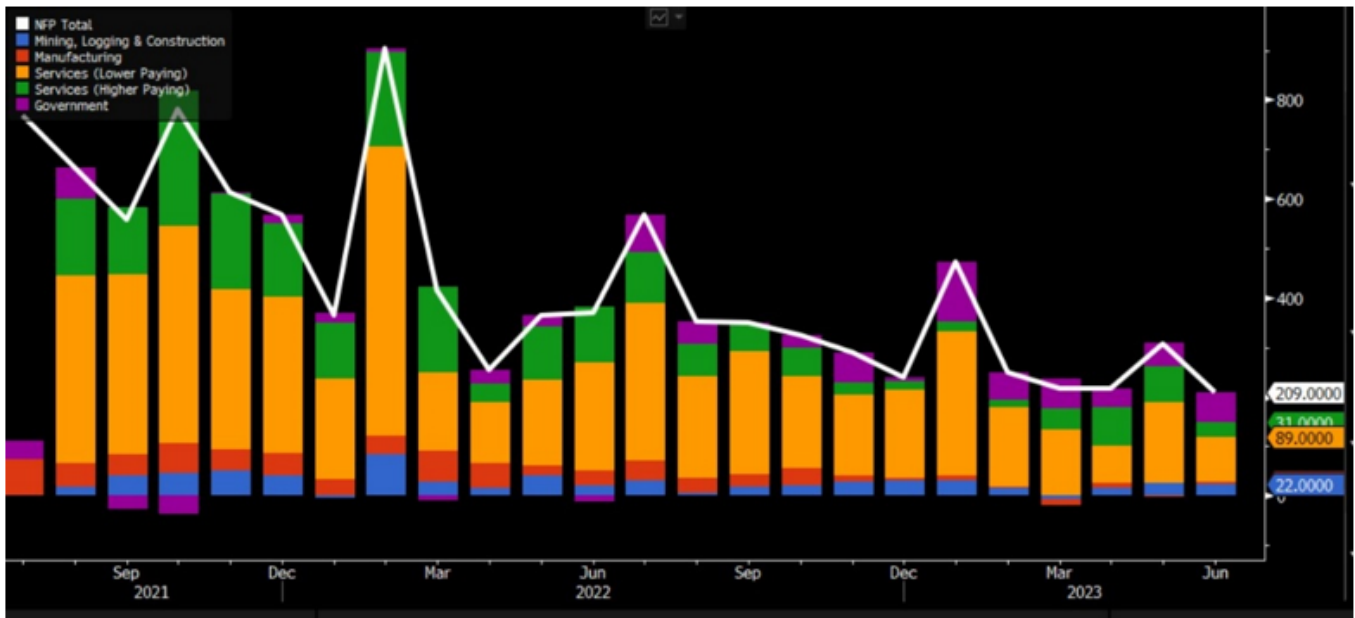


Initial Jobless Claims Continue To Rise And Are Above Their 20- And 50-Week Moving Averages



Source: Bloomberg; July 6, 2023

Non-Farm Payrolls Are Weakening



Source: Bloomberg; July 7, 2023

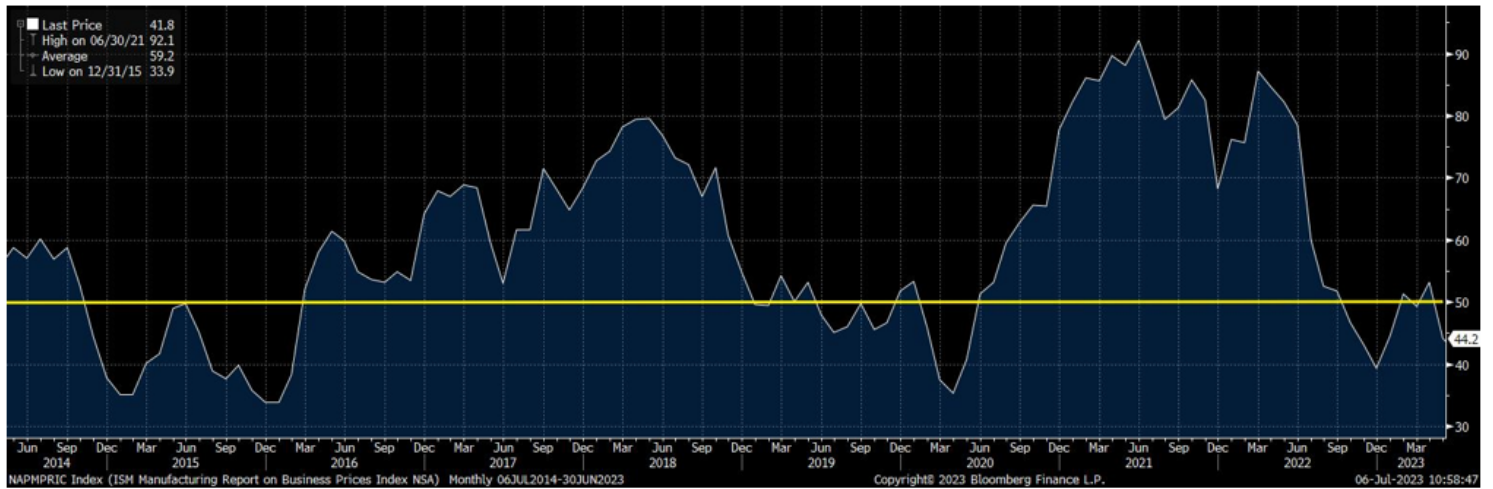


ISM Manufacturing (Purchasing Managers Index – PMI) Remains Below 50 in Recession Territory



Source: Bloomberg; July 10, 2023

ISM Manufacturing Prices Index Remains Below 50 – Pricing Still Falling



Source: Bloomberg; July 6, 2023

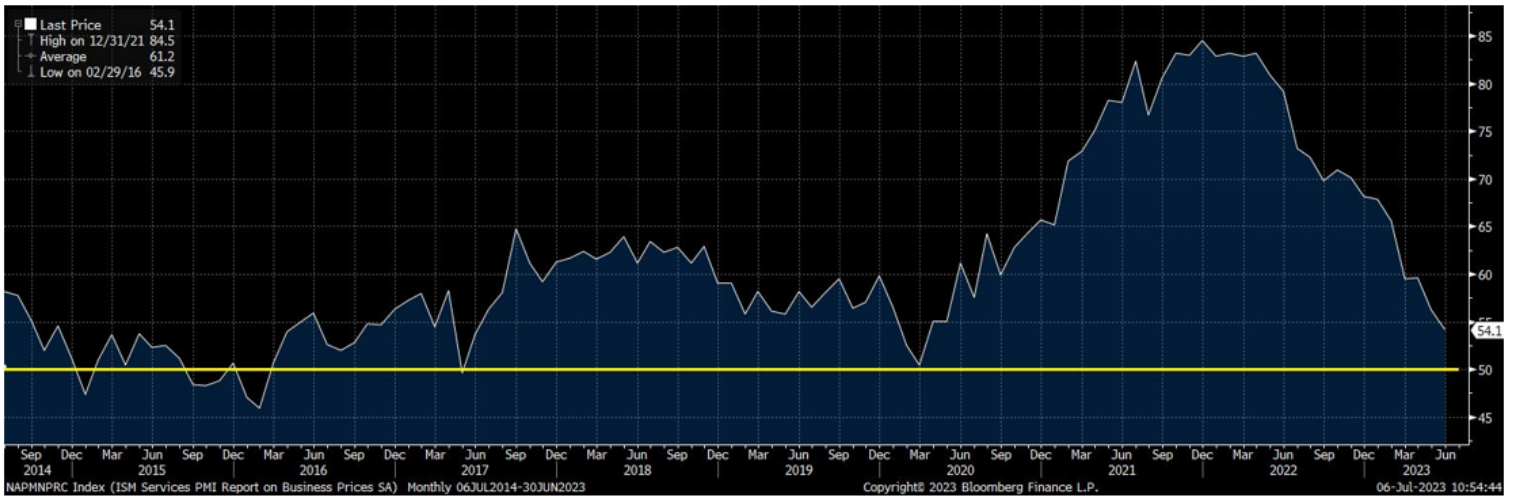


ISM Services PMI Remains Strong Above 50



Source: Bloomberg; July 6, 2023

ISM Services Prices Falling Sharply But Still Above 50 At 54

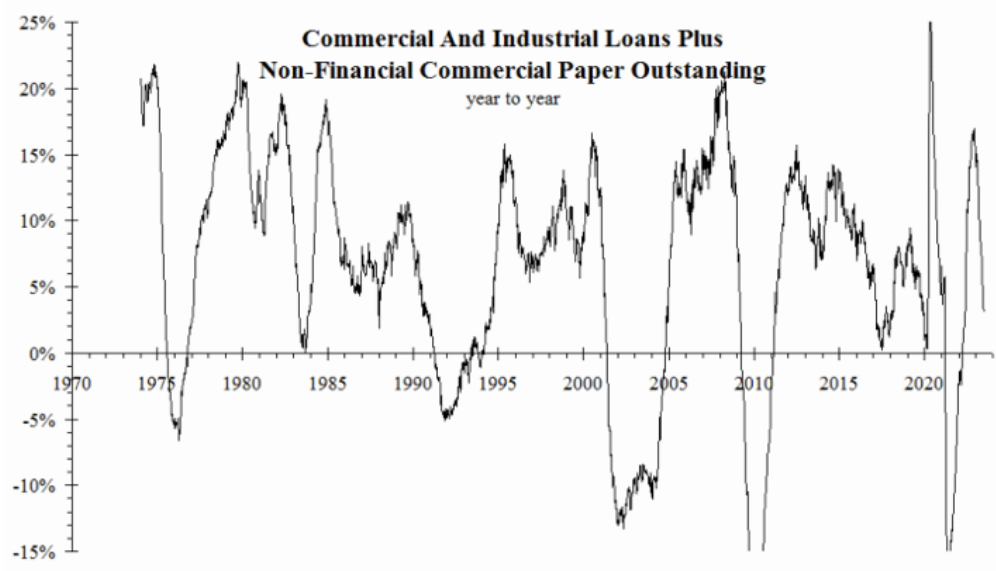


Source: Bloomberg; July 6, 2023



Bank Lending is Slowing – Commercial & Industrial Loans Falling – Tighter Credit

Credit Is Tightening – Negative For Banks And Should Slow The Economy



Source: C&I Loans St Louis Federal Reserve, last update June 21, 2023. Commercial Paper Federal Reserve Board Release H.8, last update June 28, 2023

Financials Can Rally But No Leadership – Still A Value Trap



Source: Stockcharts.com, July 11, 2023



BofA Sell Side Indicator – Strategists Still More Bearish Than Bullish...

Exhibit 1: Equity sentiment ticked up in June

Sell Side Indicator, 8/1985-6/2023



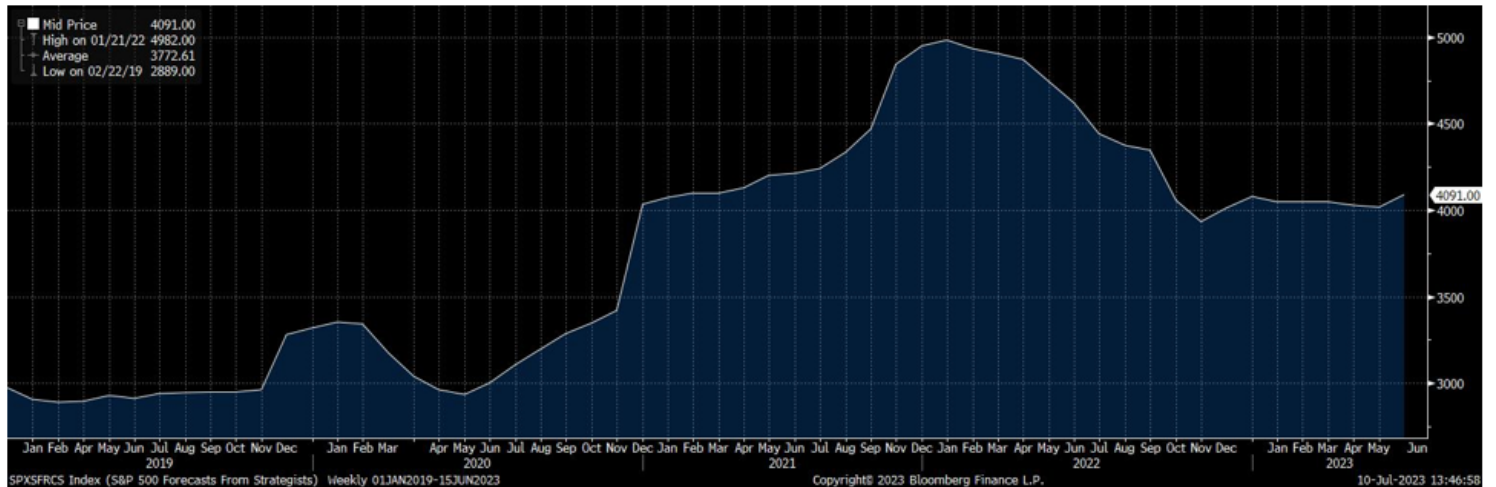
Source: BofA US Equity & Quant Strategy. Note: Buy and Sell signals are based on rolling 15-year +/- 1 standard deviation from the rolling 15-year mean. A reading above the red line indicates a Sell Signal and a reading below the green line indicates a Buy Signal

BofA GLOBAL RESEARCH

Source: Bank of America, July 1, 2023

...And S&P 500 Year-End Forecasts Confirm Lack of Bullishness

S&P 500 Forecasts Year-End Target from Strategists Does Not Look Like Excessive Bullishness



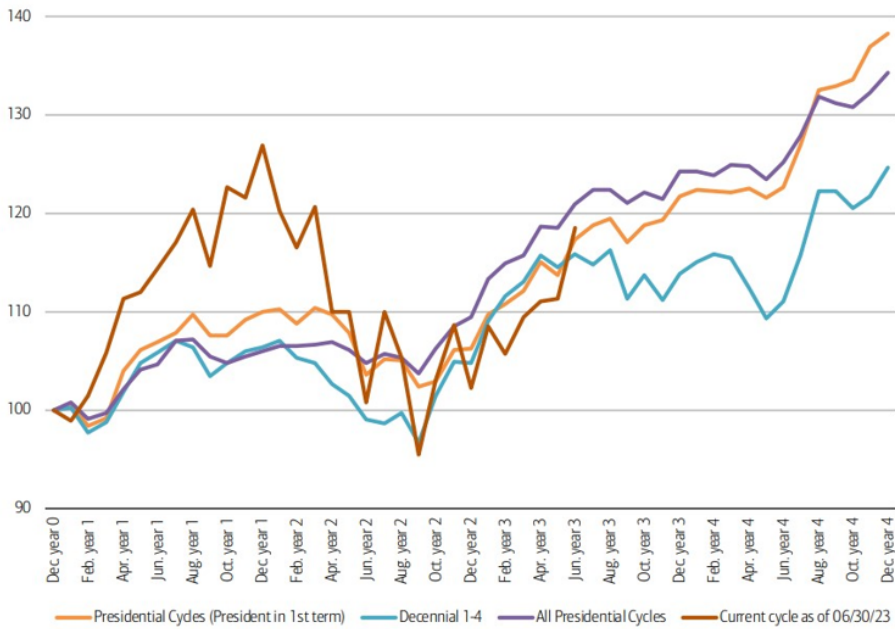
Source: Bloomberg, July 10, 2023



Presidential Cycle Bullish for the Market

Chart 1: S&P 500 Presidential Cycle and Decennial Pattern from years ending in "1" through years ending in "4".

Investors who doubted the best part of the Presidential Cycle from 4Q of the midterm year through 3Q of Year 3 paid dearly from 4Q 2022 through 2Q 2023.

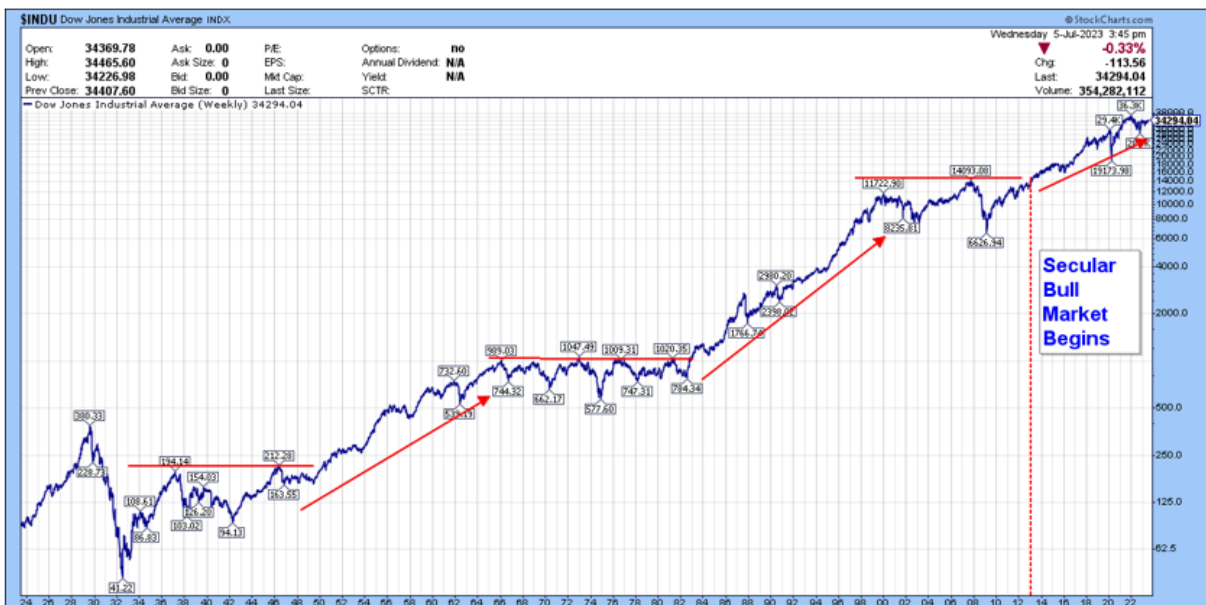


Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Source: Bank of America, July 3, 2023

Market Remains In A Secular Bull Trend

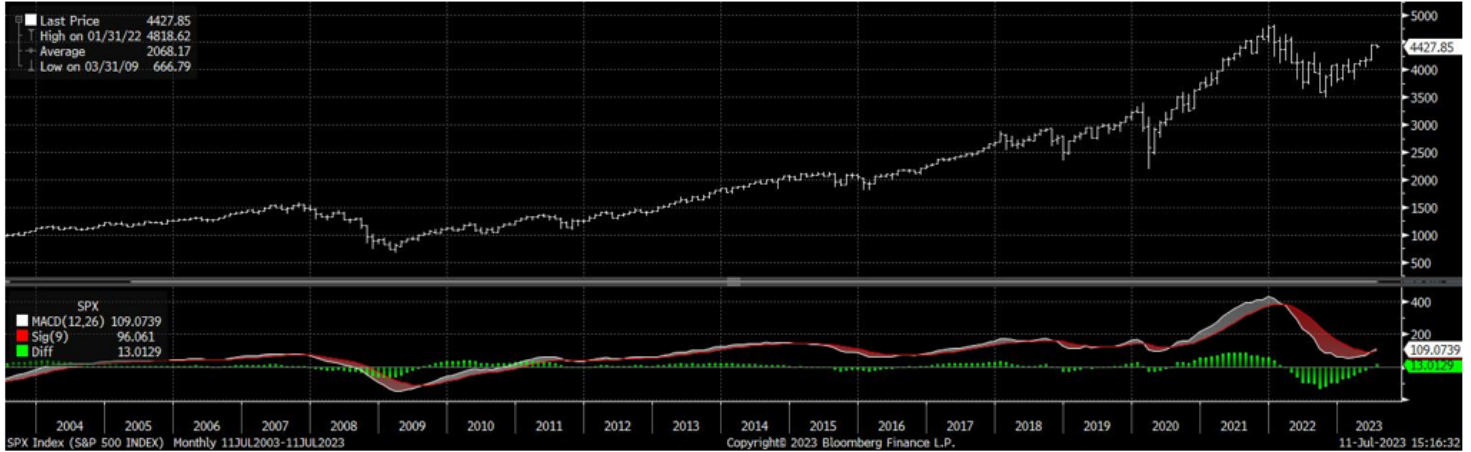


Source: Stockcharts.com, July 5, 2023



Monthly MACD Gives Buy Signal For S&P 500, Joining Monthly Stochastic Buy Signal Earlier This Year

S&P 500 With Monthly Moving Average Convergence/Divergence Price Momentum Indicator



Source: Bloomberg, July 11, 2023

Sentiment for Intial Public Offerings Are Increasing

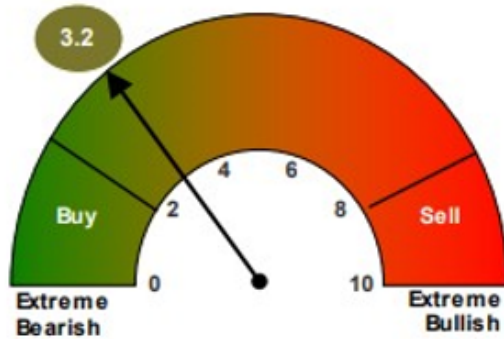
Renaissance IPO ETF (IPO) With 14-Month Stochastic – Buy Signal



Source: Bloomberg, July 9, 2023

BofA Tactical Bull/Bear Model Still Bullish – Any Corrections Should be Shallow

Chart 1: BofA Bull & Bear Indicator
Stays at 3.2



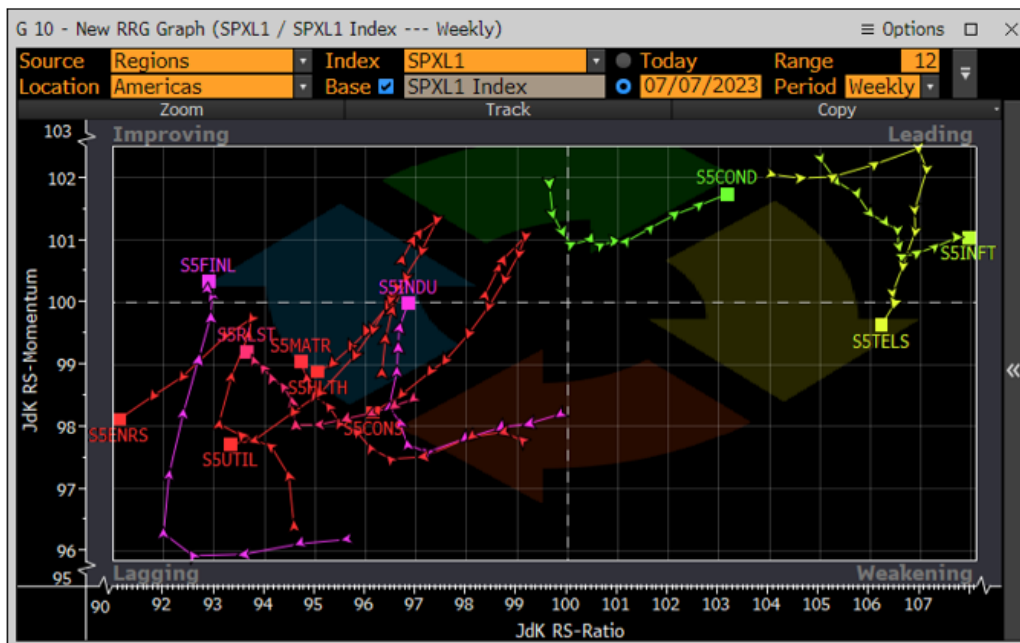
Source: BofA Global Investment Strategy
The indicator identified above as the BofA Bull & Bear Indicator is intended to be an indicative metric only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise relied upon by third parties for any other purpose, without the prior written consent of BofA Global Research. This indicator was not created to act as a benchmark.

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Source: Bank of America, July 6, 2023

Industrials & Financials Are The Sectors Improving – We Favor Industrials

S&P 500 Weekly Relative Ratio Graph Of S&P 500 Sectors



Source: Bloomberg, Federal Reserve



Industrial Sector SPDR ETF (XLI) – Hits Record All-Time High

A Bull Breakout!



Source: Stockcharts.com, July 11, 2023

First Trust RBA American Industrial Renaissance ETF (AIRR) – Breakout!



Source: Stockcharts.com, July 10, 2023

Semi Stocks Correcting – A Buy on the Pullback

VanEck Semiconductor ETF With Relative To S&P 500



Source: Stockcharts.com, July 7, 2023

Yields Still Peaking

10-Year Treasury Yield Breaks Out With A Negative Divergence Signal



Source: Stockcharts.com, June 8, 2023

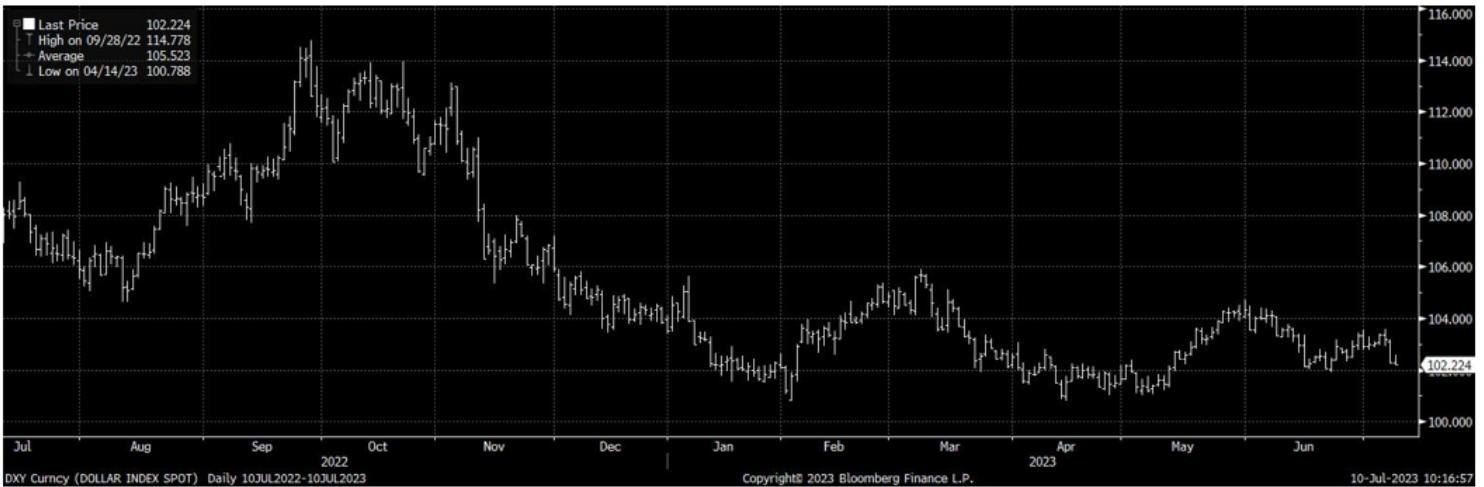


2-Year Treasury Yield Breaks Out With A Negative Divergence Signal



Source: Bloomberg, July 10, 2023

US Dollar Fails To Break Out On Spike In Rates



Source: Bloomberg, July 10, 2023



Major Breakout Of Europe To The World

Testing Breakout: Europe Trading At 12x Earnings Compared To US At 19x Earnings

iShares MSCI Eurozone (EZU) Vs. MSCI All Country World ETF (ACWI)



Source: Stockcharts.com, July 10, 2023

BRICS Looks to Introduce New Currency Backed by Gold

According to Investing.com: "Brazil, Russia, India, China and South Africa, a coalition of nations going by the moniker BRICS, is set to introduce a new currency backed by gold, Russian English news channel RT reported. An official announcement in this regard will be made at the bloc's summit in Johannesburg, South Africa, in August. 'With the growing initiative, more and more countries are lining-up to join the group,' RT said." Source: Investing.com July 8, 2023

Gold Range-Bound And Underperforming The S&P 500



Source: Stockcharts.com, July 7, 2023



Last Words

We are currently experiencing contrarian investing – meaning that equity markets tend to perform the opposite of what most investors are expecting. Despite prevailing negative sentiment and the bearish positioning on stocks, the markets have been consistently rallying. It is important to remember that markets peak on optimism not pessimism. Although volatility indicators are declining and short-term technical readings suggest an overbought market, it is worth noting that significant corrections can still occur. Our assessment indicates that the markets will likely maintain their upward trajectory throughout the summer months. However, we anticipate a period of seasonal weakness in September and October, followed by a year-end rally that is traditionally observed. As a result, we expect the markets to conclude the year with a double-digit return. Given this concentrated market, we adopt a balanced approach to our investments, prioritizing quality in both equity and fixed income assets.

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