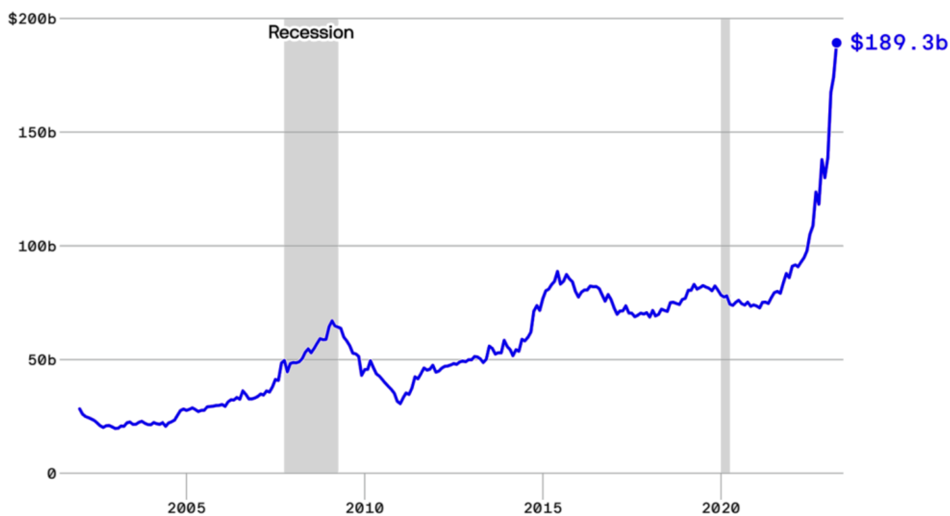
MARKETTREND[SM]
ADVISORS

July 2023

Dear Clients and Friends,

Investors have come a long way in the six months of 2023. We entered the year amid a bearish market period with the Federal Reserve having raised interest rates at the fastest pace ever (albeit from zero). The economy remained very uncertain with the effects of the pandemic lingering. Recall for a moment what a few of those effects were: 1) dislocated supply chains led to product shortages which fueled sharply rising prices in some areas (inflation wave #1), 2) labor markets shifted dramatically as the bottom fell out for workers in certain covid-hit industries while other sectors saw a surge in hiring, 3) real estate changed dramatically with more people working remotely, offices vacant, but house prices leaping by the most in history, 4) an aggressive federal government push to lessen the economic impact of the pandemic pushed interest rates to zero fueling excessive asset valuations (houses, stocks, startup companies). Fast forward three years and some of these effects have completely flipped. Tech workers have been "right-sized" as companies can no longer raise money for free. The covid-hit areas of the economy are ramping up hiring leading wage inflation to remain "sticky" (inflation wave #2). Startups have hit a funding wall leading to a drought of companies going public. Supply chains have normalized while a fresh AI-driven thrust has caused companies of all sorts to examine how they might incorporate this game-changing technology. The supply chain shock of the pandemic led companies to rethink their strategies and bring more manufacturing back onshore. This, coupled with huge Federal government programs, has fueled a renaissance in domestic manufacturing plant construction (chart below).



MARKETTREND Advisors
9508 Topridge Drive
Austin TX 78750
www.markettrendadvisors.com
512-255-8722 PH
512-335-9996-FX
info@markettrendadvisors.com

Yet economists have consistently been calling for a full-blown recession this year. It's not happening. While inflation remains too high for the Fed's liking, it's dropped by half over the past year and looks likely to continue easing. The banking crisis of the first quarter seems to have been brief and contained to a very small number of banks who got too far out ahead of their skis in the free-money era. Consumers keep spending. Labor markets remain tight. It seems very hard to have a recession when unemployment remains at record low levels and the building of housing and manufacturing plants is surging. And that's how investors have come to view the world through the second quarter of this year - increasingly comfortable with the state of things. And increasingly returning to the stock market despite the highest return on straight up cash in decades.

It's been a rollercoaster few years for investors. The pandemic created a panicky plunge in stocks in March/April 2020. But just as quickly, investors bought into the government's aggressive economic support that summer and brought stocks right back throughout 2021. By the end of 2021, however, stock investors had become unnerved by the Fed's attack on inflation – how far and how fast would interest rates rise? The yield curve became hugely inverted with short-term rates well above longer-term rates, a frequent harbinger of a looming recession. Stocks and bonds both suffered major declines in 2022. A strong January 2023 was dismissed as a one-off month as the bank crisis reminded investors of the risks that remained. But the Fed quickly stamped out the fire. Investors have not looked back, delivering four straight months of gains, with those gains accelerating in June as investors began to fear missing out on a new bullish phase.

While many economists still call for a recession, the timing keeps getting pushed out. Further, the depth of the recession and potential for stock market pain keeps getting reduced, with most analysts calling for a normal 10-15% stock downdraft. It has been yet another case of what legendary economist Paul Samuelson said, "the stock market has called nine of the past five recessions." The massive wall of worry built in 2022 for stocks and bonds has led to the strongest first half of the year ever for the NASDAQ, a blistering +32% gain, though the index still remains almost -10% below its 2021 highs. The S&P500 has also failed to put in new all-time highs but the Dow is close, on the back of the relentless climb in Apple shares. Within the sectors, the technology and industrial sectors have recently hit new all-time highs.

The few remaining bears will point to stock valuations being too high, a lack of rally participation from small and midcap stocks, the inverted yield curve, falling earnings, and falling readings in the Purchasing Manager's Index (PMI), an indicator of economic activity. All true. But the market has shown a willingness in this second quarter of doing what bull markets do – rotating from sector to sector, moving money from expensive to cheap stocks as the rally goes along. June saw a fire lit under a wide swath of consumer stocks. All eleven sectors of the stock market registered gains in June. Clearly, in 2Q the tone of the market changed and was no longer bearish.

Second quarter U.S. earnings are expected to fall over 5% from the same period last year. However, first quarter earnings had also been expected to fall over 5% and ended up flat year over year. Will companies be able to pull a rabbit out of a hat again this earnings season? Analysts are skeptical - which may be a good thing for stocks if analysts have once again set the bar too low. Still, recall falling earnings often precede falling revenues and notably foretold the tech bust and Great Financial Crisis recessions (see graphic below).

Third quarter earnings guidance will likely determine the direction for share prices. Analysts have overwhelmingly modeled earnings bottoming in 2Q23 and rising throughout the second half of the year and into 2024. If that comes to pass, this time might indeed be different.

To future profits,

Don Lansing
Chief Investment Officer
512-289-0620

Garrett Beauvais
Portfolio Manager
512-796-0233

MARKET TREND Advisors
9508 Topridge Drive
Austin TX 78750
www.markettrendadvisors.com
512-255-8722 PH
512-335-9996-FX
info@markettrendadvisors.com