KINGSVIEW
INVESTMENT MANAGEMENT

Nolte Notes

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Wishin' and hopin' and thinkin' and prayin' that the markets will turn around and investors can once again embrace the bull market. The inflation figures out last week tossed some cold water on that thought as well, coming in a bit "hotter" than expected. The markets initially shook off the data, however succumbed by the end of the day. Fed officials continued with their rate hiking mantras, making sure to keep anything more than 50 basis points off the table. There are still two weeks to go before the Fed begins reducing their balance sheet and four weeks until their next meeting. The markets will get to react to consumer spending this week, which could remain relatively strong given all the money for nothing that is still in the economy.

One big concern that has gotten little press over the past few months is not so much the supply chain issues, but the massive amount of money that has been tossed at the economy since the beginning of Covid. The discussions have been around "fixing" the supply chain as if that could make things better. One of the highlights of the past earnings season were comments by various banking officials about the health of the consumer. They pointed to the higher bank balances that are being carried vs. balances prior to the pandemic. Chatting up various folks in the services and travel industry, and it is very evident that consumers have shifted from "stuff" to "experiences" following nearly two years of not going anywhere. The most recent retail sales report was nearly 25% above the highest month pre-pandemic and has been growing at a 12% annual clip for those two years. There has never been a period when retail sales have jumped by more than 10% vs. a year earlier (using data that started in 1992). Inflation will likely be with us much longer than many expect, even as the Fed ramps up interest rates. It is not a lack of supply problem, but an excess demand issue.

The bond market saw a bit of reprieve last week, as yields fell back across the yield curve. Commodity prices have flattened out a bit, albeit at higher levels. One concern is the difference between high yield (junk) bonds and treasury (safe) yields. Historically, the relationship has been relatively stable, hanging out between 2-5 percentage points different. However, in periods of stress, that difference can go well over eight percentage points. Today it is getting toward the upper end of the 3-5% range and the recent trend has been higher. When investors get worried, they ditch their low-quality bonds for the safety of the treasury market. Bond investors tend to sniff out problems well ahead of their equity counterparts. Meaning this equity market "freak-out" may be in the process of at least a short-term reversal.

The more defensive parts of the markets continue to show relative strength, if not always absolute. Technology was the star of Friday's recovery, as investors flocked back into the sector after having fallen by more than 20% so far this year. A disappointing part of Friday's action was the lower overall volume, as it was the lowest on the week. If there is hopin' that a few weeks bounce is in the offing, higher volumes should be accompanying the price recovery**.** Yet, earnings estimates for the next quarter have not come down much, as investors expect companies to be able to pass on higher costs. However, the difference between producer prices (over 10%) and consumer prices (just under 7%) indicates margin pressures for companies. One notable difference last week was the bond market did provide its "normal" cushion for declining stocks. Whether that can continue will remain to be seen, but a few weeks of a normal market would be welcomed.

There are not many ways left to describe the start to the year in either equities or bonds. After six weeks of declines, expectations are now for a bit for repair and recovery. If the markets struggle putting together a few positive days, the markets could be in a very precarious situation.