May 30, 2022

At last, the skies above are blue, and the blues have left Wall Street for at least a week. The end of the week rally that saw the broad market rise by 4% may be enough to entice the bulls to dip their toe back into the waters of Wall Street. What changed? Interest rates didn't move much, the economic data was a bit less than stellar, but the reading of the Fed minutes pointed to a possible ending of the rate increases in the fall. As we have seen in the past, there is a very long way between how things look today and what they may be looking like some three months from now. The Ukrainian war and the impact upon food and energy prices may still be with us, the initial impacts of the Fed's rate increases may start being felt by then and the election rhetoric will be full throated. The inflation data, while strong, eased a bit last week. The coming week will be the employment report along with another Fed meeting in a couple of weeks. Summer has arrived with the long Memorial Day weekend, but it is a bit early to pack the beach bag and "retire" to the shore.

Do as we say, not as we do have been an admonishment from parents and politicians alike for eons. The markets have been doing as the Fed has been saying most of this year. Without lifting interest rates "officially" very much, the Fed has talked up interest rates from their near zero levels to something resembling a real interest rate. The three-month Treasury is up a full percentage point over the past year, while the 10-year rose over two full percentage points from its low to peak in nine months. The very close reading of the Fed's May minutes, to some, indicate an ending to the rate increasing cycle in the fall. For some this is the "all clear" signal to buy stocks once again. While the equity market merely touched bear market territory a few weeks ago, investors now believe the worst is now in the rear-view mirror and the markets are once again ready to roar. Earnings will have to improve next quarter and a meaningful decline in inflation from the recent peak rates would need to be a true catalyst to get the markets going. This week's employment report is likely to continue the string of strong job gains and should not push the Fed toward hitting the pause button.

The backdrop of the equity market has been bolstered by the improving bond market. After hitting cycle highs, a month ago, interest rates have been declining and acting more like they usually do, rising when stocks rally and falling when stocks drop. That counter relationship was missing much of this year as both stocks and bonds fell through April. The thought that a "Fed pause" is close at hand is also bolstering bond buying. Commodity prices, after taking a two-month rest are once again showing a bit of strength, but not yet at cycle highs. Commodity prices, driven by a variety of issues, should continue to rise during the summer. However, their recent pause may allow inflationary pressures to ease, at least temporarily. Everyone will be watching gas pump prices for signs of slower/lower inflation in the months ahead.

Some of the poorer performing sectors got a reprieve last week. Outside of the still robust energy sector, the most beaten down sectors were the performance kings last week, with discretionary stocks leading the way. Is this the beginning of a market turnaround or merely a bounce in an ongoing market decline? Bear market rallies tend to be very sharp/strong, but also short. The SP500 has been in a rather well-defined declining channel since the start of the year and the bounce happened at the bottom of that channel. A rise toward 4300 on the SP500 would be the top end of the channel. The recent decline in stocks has improved the valuation of the market, however it remains far from "cheap" and could be hurt further if the July earnings reports come in below expectations. A welcomed respite from the persistent decline, however reading too much into the rally could be detrimental to overall portfolio health. The market has been following the typical mid-term election cycle path, which would mean a market "bottom" sometime over the next couple of months and the start of a rally to the Presidential election in 2024. Fingers crossed!

The well overdue market rally showed up and was strong all week. Whether the beginning of a long-term rally or a short-term fast and furious rally that burns out is not yet known. The coming week is loaded with the usual beginning of the month economic data and a few comments from Fed governors. Gas pump prices and bond yields may provide a clue to whether last week's rally is short and sweet or has some legs.