KINGSVIEW
INVESTMENT MANAGEMENT

Nolte Notes
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It has been said for millennia, sometimes for little comfort. “It is the darkest before the dawn”. Yet another huge drop in the equity market, now down in ten of eleven weeks and well into bear market territory. The Fed meeting did little to assuage inflationary fears as investors believe the Fed has little in their arsenal to fight rising food and energy prices. Powell’s comment at the press conference that another 0.50 or 0.75% rate hike is on the table for July and likely another 0.50 in September. It was only nine months ago that inflation was seen as transitory. What a difference a few months can make! To be sure, the rate increases are impacting parts of the economy, like housing, where mortgage rates are getting over 6%, when they were merely 3% at the start of the year. Housing activity has waned, lumber prices have cratered. One other part of the economy could see some bargains in the months ahead: retail stores. Comments from the biggest retailers about excess inventory could lead to sales during the summer to cut the inventory back to more normal levels. It is not the price cutting that many consumers need to see, but it is a start.

How bad has this year been for stocks? There have been only a handful of times that the markets have dropped by 15% in one quarter (assuming the market finishes close to current prices in two weeks) AND have dropped by 20% over two quarters since WWII. The good news is that, except for 2008, the next quarter was positive. In all cases the markets were higher a year later. When looking at the post-war bear markets, of the 14 prior bear markets, only three saw the markets lower a year later: 1974, 2001 and 2008. Based upon the historical trading record, the markets are likely to bottom within the next six months or so. This lines up well with the pattern of mid-term elections. The markets generally trade poorly into mid/late summer and then rallies strongly to the Presidential election. If there was a fly in the ointment, it is that the markets are still historically priced richly, especially if inflation and interest rates remain high. Fed Chair Powell will get another shot at explaining the Fed’s decision and outlook this week when he visits Congress. Keep your seatbelts fastened.

Interest rates were all over the map last week. The yield on 10-year treasury notes started out at 3.15%, rose as high as 3.50% and ended the week at 3.22%. Commodity prices fell 5% on the week, with oil prices (not at the pump!) dropping 7% just on Friday. Worries early in the week of an impending recession seemed to give way to the belief we are currently IN a recession. This would explain the funk that the stock market is in as well. For now, rates seem destined to rise, especially if the Fed is good on their word that they will be hiking rates through Labor Day.

One other part of the market that is “signaling” that better days are indeed ahead is the various asset classes and sectors within the SP500 are all at or near momentum lows. This has occurred close to market bottoms in 2020, 2018, 2015, 2009 and 2002. It doesn’t mean the markets will go straight up from here, but a bit of nibbling on a broad basket of stocks may be rewarding over the coming 12 months. Given the fall from grace over the past six months, growth stocks could bounce back the strongest in the months ahead. That said, the case can be made for international stocks that could benefit if the dollar weakens. Very broadly, the incredible rise in bond yields have made bonds an interesting sector as well. Everything is cheap, but for a very good reason, higher interest rates and inflation. If either of those can subside or at least stop their meteoric rise, investors may once again return to the stock market. It may be hard to see from here when smoke gets in your eyes.

The daily large swings in the markets are not likely to calm down anytime soon. Fed Chair Powell will be in front of Congress this week and many other Fed officials will be explaining their economic views. The hard economic data will be thin until after July 4th, but that does not mean stocks will be enjoying the summer wind.