Nolte Notes

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What's it gonna be Powell, inflation, or growth? The hysterics that Washington is going through proclaiming we are not in a recession after two quarters of negative GDP readings is cringe worthy. By the same token, Wall Street is sure that Powell will cave to rising recessionary fears and stop hiking rates by fall and begin cutting them sometime in the first half of 2023. Unless inflation rates begin falling rapidly over the coming months, the interest rates are likely to be below that of inflation. Historically, short rates needed to be above inflation to begin slaying the beast. The Fed's favorite measure of inflation, Personal Consumption Index, came in higher than expected, but down a bit from last month. Wage growth of 5.7% over the past year is likely to provide fuel for inflation to stay above expectations. So, Wall Street's rally on the "pivot" to easing in 2023 may be a bit premature. The Fed may have more hiking to do to quell inflation, which could deepen any recession that we may be in or heading toward. Employment is a lagging, not leading economic indicator and Friday we will see if payrolls continue to expand at a brisk clip. If the weekly jobless data is any indication, the risks may be toward the downside.

Earnings on the SP500 are driven by the largest companies in the index and all of them reported their numbers last week. The response was a standing ovation for the group, even though revenue numbers showed less than spectacular sales. The decline in interest rates provided a catalyst for investors to rotate back into large technology stocks, pushing the stocks further still. For the week, tech added over 5%, while the more mundane portions of the markets added merely 3.5%. The markets have been driven by the Fed, the direction of interest rates and perceived easy monetary policy. Many of the financial "stress" measurements are still showing "easy" policies that are not likely to stem inflationary pressures. Commodity prices jumped 4% last week with oil up nearly 4.25%. The yield curve remains negative and slowly getting "more negative" as a warning sign of impending recession. Here we are with slowing economic growth and still persistent inflationary pressures. The Fed has been late to the inflation fight and they are not likely done just yet, which could put pressure on stocks over the next few weeks. There will be plenty of Fed officials chatting about the economy, so we should know more about their thinking on the directions of both the economy and rates over the next two weeks.

The decline in rates along with a shrinking of "spreads" between junk bonds and treasuries are an indication that the bond market believes the Fed will "pivot" to a more accommodative policy early in 2023. This may only be accomplished IF the Fed is willing to live with higher than "normal" inflation rates. Some of the Congressional legislation making its way through the legislative process will push additional dollars out the door to businesses over the next few years, which is likely to add to the inflationary fuel. Keep an eye on oil prices as a "quickie" gauge of rising commodity prices. Further strength could hurt the bond and stock rally.

The best month in stocks since just after the pandemic low has investors in a giddy mood. Inflation has rolled over, and the Fed will be cutting rates soon goes the narrative. Unfortunately Wall Street tends to fool most of the people most of the time. The reversion back to growth by six full percentage points during July indicates Wall Street has not yet given up on growth at any price. Small stocks, a very inexpensive part of the market, did well, however international, especially emerging markets suffered as the dollar continues to plod ever higher. Within the SP500 and away from technology, industrial and services were respectable, however the former darlings of healthcare, utilities and staples were barely higher. Is this a "bear market rally" that ultimately will end in tears or the beginning of another leg higher for stocks? We will know more in a month or so, but the direction of interest rates will be a guide. Higher rates, buy the safety, lower rates, buy technology is the only decision being made.

The employment report on Friday could be a surprise to the downside, if the poor weekly jobless claims figures are to be believed. The Fed officials will be out in force discussing interest rates and the economy. Those comments could be market moving depending upon the strength of the comments and who is talking. Oh, and earnings are still a thing this week as well. Never a dull moment on Wall Street!