

Mid-Year Market Update: June 19th, 2022

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Transcript:

This is Tom Hulick i am the CEO of Strategy Asset Managers we are here today on the 19th of july for the mid-year market update and what you can expect for the second half of the year Joe Traba our portfolio manager Alex Hagstrom and myself we will cover also why the second half of the year could be better and I'm going to turn it over to Joe right now and we'll get started Joe thank you Tom so like Tom said before we go into why we think the second half of the year will be better than the first half i like to recap and kind of go over what happened in the first half of the year now most of you know we did enter a bear market and we'll go into that a little bit but the market reset growth expectations and this is due to higher inflation rising interest rates and obviously the global supply disruptions what happened while the market entered a bear market and that just means the s p was down more than 20 percent nasdaq was down more than 30 percent even had international markets down over 20 and bonds were down over 10 percent this doesn't include the crypto and momentum types of stocks which are down considerably more but i want to know let you know that what this market so far has experienced is part of the market cycle and we did talk about resetting of expectations and this is as it relates to global central banks not being as accommodative when they were during the government lockdowns now the headline news is out there oh this is the worst start of the year since 1970 but we also want to know let you know that sentiment is correct it is at all time lows and i want to share with you why this is good for future returns and more importantly we've said this before sentiment controls short-term price movements but long-term drivers of the stock market remain corporate earnings so why is the market down well the risk of surging inflation and the unwinding of the stimulus policies that is discontinuing to create uncertainty now we also got these cpi numbers that did rise again in may and again this is the fastest growth since 1981. it just means all of us know this inflation is high the cost of goods when you go shopping has high when you go fill up your tank for those of you that have gasoline that's up so the worry is inflation is out of control and that the central banks are going to have to do significant rate increases to slow economic growth this is kind of putting brakes on the economy and we just started to see the federal reserve again this year raise interest rates but what's interesting

unemployment rates have not you know gone up that means we have a tight labor market so we are seeing some positives that are coming from this market but again the market is a discounting mechanism and what it's doing is discounting the fear and panic of people getting out of the market because of the unexpected now we talked about briefly what is a bear market and that just means when a market is down by 20 the next question we get just because we have a bear market does that mean a recession is imminent and we'll go into details why that's not necessarily true so you can have a bear market and actually it's happened 13 times since world war ii and nine of those did not coincide with the recession so i like to look at history and sometimes you can find some similarities so again the good news is that when you do have a bear market is much shorter when it's not in a recession so for the question now is are we in a major recession or a mild slowdown so for right now we are seeing it's a slowdown we do not think this is 2008. in 2008 was a lack of confidence in the financial system nor was it 2020 when the governments shut down the economy again we continue to see the u.s economy is healthy and it's not deteriorating now inflation data recent data I know the cpi numbers are high but we are starting to see some lower price points coming online and we'll go into detail for that so what we really want to focus in on and want you to come out of this meeting is why the second half of this year could be better and one first note I like to go again is history and every time we look at the s p when it suffered a big first half loss which we saw this year what does history show us what happens during the second half of the year so when the s p has fallen at least 15 percent in the first six months of the year it did this in 1932 39 40 62 and 1970. it has risen an average of 24 in the second half okay so maybe it's not one of those years but again that's what history is showing us now we also look at again some of the cyclical and seasonality patterns and again the market we've said before it's already repriced future rate hikes and has done a lot of work that the fed was expected to do we'll go into why the commodity prices are coming down and that has been a really strong correction over the last several weeks in fact you saw gasoline prices dropped for almost 25 days in a row so we do think you're going to see inflation cool as the summer months go on and that's going to help the fed not be as aggressive in raising interest rates now these two components will help companies but also households plan for their future so with that i want to go into why we're seeing some signs of moderating inflation and again commodities that's one thing that we look at that has fallen significantly in the last couple of months and we actually got some housing data today that's showing some building permits which are forward indicator cooling off I'm gonna have alex jump in to go over some more of the details so we're in the midst right now a very significant commodity price deflation this happened extremely quickly in some cases but at this point basically every commodity is down 20 to 50 percent this is very encouraging since

commodity prices right now are the largest component of headline inflation inflation with energy and food stripped out which is called core inflation has actually decreased for three months in a row we've seen basically every commodity except for oil sell off but oil had remained strong due the war in ukraine that's now reversed oil's down nearly 20 percent in the past month and gas prices which are already down 10 percent on a national basis should follow if oil remains where it is commodity prices basically always revert to the mean over long time horizons one way or another it tends to just be a matter of time it can be hard to determine exactly when but it looks to me like this natural mean version is happening right now gasoline demand in particular has fallen a lot in the past month it's close to where it was in july of 2020 when we were in the heart of the lockdown and outside of kovid this is actually the lowest demand we've ever seen in modern history that's actually positive in the long run the natural part of the economy healing itself it's supply and demand adjusting and trying to find a price that makes sense that natural healing process is also happening with the us budget as all of you know the policy response to covid resulted in a massively spiking budget deficit the deficit reached levels we'd only ever seen around the second world war however that's completely reversed now the budget deficit's basically right where it was in february of 2020. i think given the inflationary consequences of the policies enacted during kovid that policy makers are going to be reticent to ever run a massive deficit like that ever again now don't expect the u.s government to run a surplus or cut spending or anything like that that's just not something that happens in america but the really really massive deficits are gone for the time being the deficits today is roughly where it was in the early 1980s which as we know was a time of great prosperity for america now don't get me wrong the debt's definitely unsustainable in the long term but at the moment america should be fine on that front and is certainly in much better shape than the rest of the world especially china and europe the strength of our currency and the capital flows from foreign investors are really expressing that right now and again that's a key point is we do think the final total of rate hikes will be still historically low and that's what when we look at interest rates at a yield curve that's what it's showing so my next point is what if stocks already priced in and this is a great segue into what's happening right now it's quarterly earnings reports so every quarter we hear from companies reporting their earnings and that's happening really in just this week and next week so we will get a better picture over the next few weeks how companies are coping with these headwinds now this backdrop it actually paints a better than feared environment so this is where you're hearing companies coming out and actually lowering their guidance and again they are still growing they're just not growing as fast as they did last year in which we had the post pandemic recovery but again the fact is they're still growing and again that's when we get supply chains back to pre-

shutdown levels that's also going to help corporates corporations manage excuse me manage their navigation much better and that's just what we saw with the supply disruptions and consumer spending changes so what a positive sign is when we start seeing companies lower guidance and some did this morning and yet the markets rally that means they're better than feared expectations and that's something that the market can rally off of or at least find a bottom and we'll see in the preceding quarter how things go so guidance has been lowered but we're still seeing growth and again that's what happens when expectations have been lowered so much it actually can now beat those estimates another thing that we look at or indicator is bearish sentiment now negative sentiment that continues to remain at extremely high levels and it's actually interesting you have a couple of indicators that are low levels since they've started tracking this um it's another bank of America um the American associate individual investors all of these are just showing that consumer sentiment and how people are positioned is extremely defensive in fact cash levels are at the highest level since 9 11. so you have people very defensive oriented and set up going into the second half that brings us to what happens if the markets normalize and what happens if we get we start hearing positive news that's a shift in sentiment as the sentiment improves that short term and earnings again growing will still be positive for the market so when we've seen this type of repricing in the first half of the year again we are painting a picture where inflation pressures will start to ease and again gasoline demand is one of the key components that we all feel at the pump and that's going to start slowing especially after the summer months and again demand for houses which we saw today that's also confirming a slowdown for me it's what happens when we get china fully reopened that's going to lock a lot of the supply chain disruptions so yes covid 19 is still in the news and that is also adding some fear with this backdrop what does that mean for you and for your portfolio what areas of the market may be positioned to do well and again the us when we look at the globe the us is still in an expansion phase this is by measuring manufacturing levels so we are in a much better shape than in Europe and also in china what do we like to own now we invest in companies with strong cash flow we like companies with pricing power what does that mean that means companies that can raise their prices to combat inflation some of the sectors healthcare energy and some technology now we know the markets had a very rough first half and our outperformance in our strategies that's our worldwide dividend plus our worldwide equity and our worldwide balance all are significantly outperforming the s p and even our growth is outperforming the growth benchmark a question that we get asked well if I'm sitting in cash what can i do now we do think there are some tactical investments that we've done but it's also because interest rates have risen so much you can actually buy really short term instruments and get a two to three percent yield so there are places not just to hide

but to take advantage of as we go forward so with us the bottom line we do think there's been heavy selling there's been a tremendous lack of conviction in the markets and that's where we get a bear market cycle that's developed but you should know you could see the markets trade sideways it's going to take some time to base and rebuild but historically when we see this much negative sentiment what do the markets do in six to 12 months they are higher and i hope we pointed that out so you could see where optimism comes from now we do see inflation slowing down and this is going to help the fed not over tighten meaning not raise rates as fast or as high as some people have expected that'll allow companies and us to better plan for our future and again we will see some negative news with earnings coming out profit margins will be lower that's going to hurt some valuations but our view is that the fed because of what the market's done already you'll start seeing these concerns dissipate and that's going to give us a better outlook not just for the end of the year but also as we position for 2023 so we do think there's a lot of optimism that's out there it's not what the headlines are telling you some of the key points for us again why we are optimistic for the second half of the year that has to do with inflation cooling off interest rates still being at historical low levels and earnings continue to grow now the backdrop for that is sentiment is extremely negative which is actually a positive catalyst because now you get a relief rally things aren't as bad as fear and that's something that you can grow off of we do get a few questions about Ukraine and I'm going to ask you what happens if we get a cease fire in Ukraine lower prices means lower demand for potentially Russia and maybe we see Putin come back to the table so that could be a positive that we'll see and the markets just not positioned for that in return we could also see again with earnings coming in still positive that does lead the markets to higher and same thing with 2023. now there are risks out there and a policy overstep meaning they raise rates too fast too soon and inflation continues to remain out of control but our optimism is based on the u.s consumer and we continue to see strong retail numbers for interview that's shopping you're going to see a number of discounts out there because of the large inventories from the supply disruptions so that's good for the consumer so we do see positives out there and we do want you to remain optimistic for what we're seeing for the second half of the year Tom did you want to open it up to some questions i i would Joe i think I'm going to ask a couple of questions just to to start things off there are two ways that you can ask ask a question if you're capable of navigating the chat feature on the bottom of your toolbar feel free to ask that way we could actually open it up to open up the mute button for people to to ask questions but the first is is that you know in summary we're focused on earnings and there is quite a bit of optimism that you talked about and that leads me to believe are we too optimistic are we too optimistic Joe that's a good question so what we've seen is again revisions started the beginning the year

high single digits they were revised slightly higher and then we've just seen a steady of lower revision and yes we're seeing profit margins get hit but these companies are still reporting you know positive earnings so you can kind of think of people that were staying at home maybe they're not watching Netflix or binge watching on tv but they're going outside and we've talked about the experience and that's just another type of the market that's doing well you know energy companies are having huge earnings and you are seeing a pullback in the discretionary so it's a re-shuffling of the market but overall it still points toward higher earnings in the u.s do you think that there are favorable returns right now in the fixed income area in comparison to as you said in the last six months rates have become into a more favorable position for people who are looking for more income would you talk again about that and that's a key component because we've talked about before the end of last year sitting in cash you were lucky if you earned a couple pennies well you now have cash instruments or short term instruments where you can get a two to three percent yield you know for me that's pretty compelling and you hold these bonds or short-term instruments to maturity you're going to get a two to three percent yield that is something good but in the big picture it that's not going to keep up with inflation and that's why i do like dividend-paying stocks sure that'll be higher than the inflation rate we discussed you know just to summarize some of the the the the negatives out there the fears of of inflation continuing out of control you address that we're seeing signs of of inflation kind of peaking and actually backing up we also fear um the how long the recession will last are we in a recession um technically we're not in a recession we've talked about that in the last couple of calls but whether we are or we aren't in a recession a technical recession which are two negative consecutive course of GDP growth we are in a bear market and there are the investors and the um are are feeling it um I'm optimistic about the second half of the year you've talked about it the timing of it is interesting how we see the market up two percent today and we we can talk about the the importance of being invested Joe would you talk about the importance of being invested and it's twofold one typically when you're a bear market if you this is when you get these days that are just outliers some of the strongest market performance is during a bear market and you kind of look back this year what did we see in march the end of the march we had one of the best weeks in stock market history then we saw this again in may you had a three four day period where you had this huge you know increase in in the markets so that's kind of where we're at it's important to you know not bail when you're in a bear market because you get these gains and then like we said looking at historical performance when you've had this type of returns meaning to s p down more than 15 what's happened in the second half of the year so and i do think it's worth mentioning you know if your time horizon is is longer than six to 12 months of course it's it's a good

time to get invested the timing of it if you're trying to market time that's pretty darn hard but we do think the markets are settling down here and we'll see that with our technical analysis that we've performed and again that's looking at the bearish sentiment as well so you could see again cash come back in as people get more confident but a lot of people are looking for this magical signal and you're not going to get it and the markets will go up before you find something like that right are we in a self-fulfilled recession prophecy are we are we gonna think our way into a recession Joe that's a good that's a good question and again i try to be very fundamental about this we are seeing a slowing economy for sure the leading indicators are not pointing yet to a recession i think a lot of us already feel like we're in one and as Tom mentioned we potentially do already have had two negative GDPs but again a slowing economy i think that's that's the way i would phrase what we're going through right now i agree slowing economy is better than a recession more accurate keep going and that's that's what happens for me it's always what happens next you know and and that's what you have to look at can't be backwards looking you have to understand what happened but how you position going forward so again a lot of people have been very defensive oriented and again that's why cash levels are so high and what typically happens you you do see some of the growthier components and that's some of the tech and that's really recently starting to perform better so you could see the cyclical side and again led by tech and maybe we like health care as well um have some good performance where it's significantly underperformed in the first half of the year so that's something to pay attention to Alex I'm going to ask you just to give a couple of key closing comments and then I'm going to have Joe summarize the call absolutely so i think the most important thing to understand about this inflation spike is that it was a consequence of government policy this was not a natural inflation spike this was first the coven policies and now the war so given time the economy does naturally heal itself supply and demand adjusts and inflation comes back down and we will eventually see that happen it's been delayed because of the war right just as Covid was healing we had the war on top of it so it's kind of hidden that this natural process is occurring but it you know it is occurring it will occur and inflation will normalize great great comment Joe why don't you summarize the call for the audience again we want to have why there's optimism for the second half of the year and why it could be better than the first half interest rates we see that not going as high we start seeing inflation cool off you're still seeing a healthy consumer spending and that's anyone traveling we didn't touch on the u.s dollar that's been extremely strong we know a number of our clients have traveled overseas and they've been able to save quite a bit of money so it's a good time even though it's really hot and the tour is almost coming to a close but these are positives spending good interest rates not going up as high you get better clarity which helps sentiment and that's

the short-term driver for the market where we can start seeing a shift from overly negative to positive and then we get earnings coming out and they're going to be better than expected so better than feared so those are the reasons why we see optimism for the second half of the year this is Tom Hulick the ceo of Strategy Asset Managers and we are signing off today have a great rest of the week