Weekly Market Commentary
July 26th, 2021

Perspective On Monday's Market Pullback?

1. Conditions ahead contain correction catalysts.

- Rising uncertainties related to the ongoing pandemic, a high bar for growth expectations, and the expectation for an upcoming shift in Fed stimulus raise the odds that a more noticeable stock-market pullback will emerge this year. Recognize the potential catalysts can be useful in setting realistic expectations for market volatility, which can better prepare and position investors to react (but not overreact) to larger market swings.

- The increased spread of the delta variant captured the spotlight last week, but inflation and the implications for Fed policy will take center stage over the balance of the year. With the Fed likely to soon begin discussing plans for tapering its bond purchases, stock-market dips could have slightly more teeth ahead. That said, the real bite will come when Fed policy moves from loose to tight amid sustained rate hikes, the first of which is doubtful to happen before 2023.

- Increased worries that the economy has passed its peak are also likely to contribute to bouts of market anxiety.

Markets have been positive, but more volatile, as the economy passes peak growth.

- Market breadth has deteriorated recently, with gains being more concentrated among a smaller number of stocks, as outperformance of the mega-cap tech names (i.e., Microsoft, Google, Amazon, Facebook) has lifted the overall S&P 500 Index. This does not signal a breakdown in the broader bull market, but it has been a signal of potential temporary volatility ahead. Looking further out, you should expect this measure to improve as cyclical investments (value, small-caps) benefit from renewed optimism around the health of the economic recovery.

Declining market breadth, driven by gains in a more concentrated number of stocks, often accompanies temporary bouts of volatility.

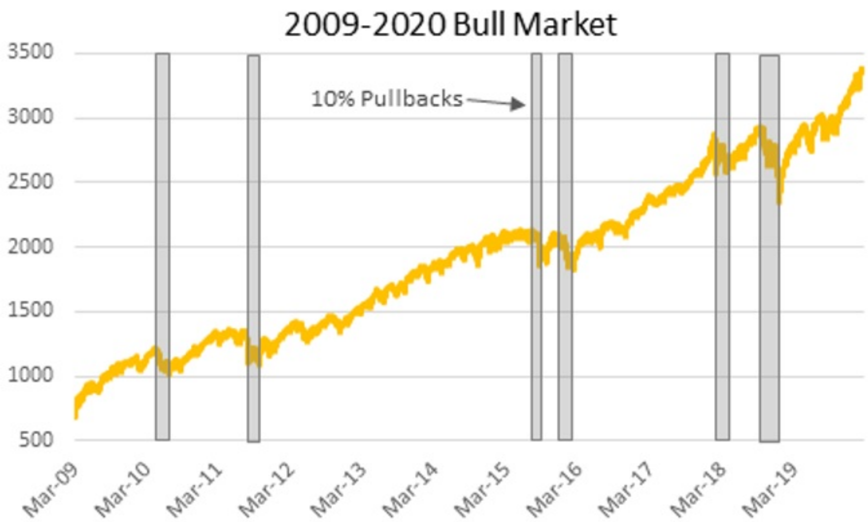
2. Even good markets have bad stretches.

- No bull market is completely devoid of setbacks. Even the second-longest bull market on record (2009-2020) had its share of blemishes. During that period, there were six 10% corrections driven by a variety of factors, including growth scares, trade wars, oil prices, and shifts in Fed policy.

- The average decline in the corrections mentioned above was 15%, lasting an average of 46 days. Patience and discipline were rewarded, however, with an average return of 18.3% over the following six months.

- Last week's sizable swings in interest rates are a reminder that volatility is not reserved just for stocks. Fortunately, bonds are typically on the other end of that seesaw, offering protection for diversified portfolios. During the stock-market corrections above, bonds delivered an average return of 2.9%.

The Prior Bull Market Experienced Several Corrections Amid Its Run



Source: Bloomberg, S&P 500 Index. Past performance is not a guarantee of future returns.

This chart shows the trajectory of the S&P 500 through the years since 2009.

3. Check the foundation, not the paint.

- Market declines often emerge without warning. It's less about timing the gyrations and more about understanding what lies beneath the surface to support prudent long-term decisions. Put another way, chipped paint or loose shingles may taint the view of a passer-by, but the lasting strength of a house is best determined by its foundation.

- The proverbial bones of this market remain healthy, in our view.

1. The Fed is still accommodative – Despite the likelihood that the Fed will begin winding down its bond-buying stimulus in the not-too-distant future, Fed policy will remain historically positive for an extended period.

2. The economy still poised to grow at an above-average clip – GDP growth, though moderating from the best level in eight decades – should continue at an above-trend pace through next year.

3. Corporate profits are rising – Earnings growth is a powerful driver of long-term market performance. Expectations for double-digit earnings growth this year and next should, in our view, keep the wind at the market's back.

- The important note here is to talk to your Private CFO® to guard against complacency. While the probability of a pullback has risen, favorable fundamental conditions mean a pullback or correction can be treated as a buying opportunity.

(source: oXYGen & Jones)

Markets For The Week

INDEX	CLOSE	WEEK
Dow Jones Industrial Average	35,062	1.08%
S&P 500 Index	4,412	1.96%
NASDAQ	14,837	2.84%
MSCI EAFE	2,298	-.61%
10-yr Treasury Yield	1.28%	-1.54%
Gold	$1,802	-.44%
Bonds	$116.21	.27%

Source: Reuters/Wall Street Journal

Worried About Inflation…Here's How Investments Did In the 1970s?

In the 1990's movie The Shipping News, an old newspaperman explains to Kevin Spacey how to cover the news. If there is a storm visible anywhere, he explains, you write "Storm threatens the town," even if the storm is nowhere near and is unlikely to hit. If—as expected—the storm never hits, you just write the follow-up: "Town spared by storm."

Readers may be excused for thinking something similar about the latest stories about looming, threatening, surging, terrifying inflation. Yes, the inflation forecasts were surging months ago and hit 8-year highs. Had they continued there would be grounds to worry.

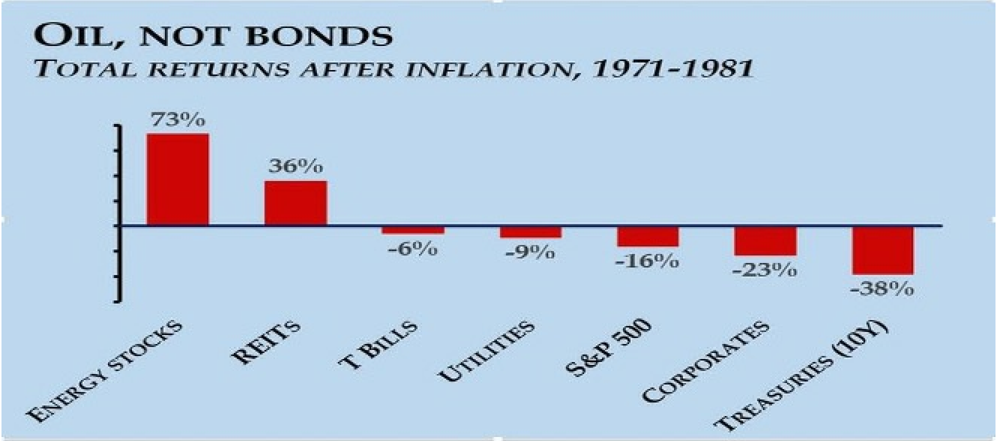
But they haven't continued. On the contrary, they've been falling for two months. The bond market's 5-year inflation forecast is now lower than it was in mid-March. The market sees five-year inflation running at around 2.6%. That's higher than we've been used to for a decade, but it's nothing to cause any significant alarm.

That can change, of course. Maybe it will. We'll see.

But with all this talk I got to thinking about the obvious question. If serious inflation really does hit, what can we do about it? How can we protect our investments?

That's an especially key question for today's retirees and those expecting to retire soon. When we're older we're generally advised to keep most of our money in more "conservative" investments, meaning things like bonds, that involve less risk. Someone in their 20s or 30s may not worry unduly if their retirement savings plunge 30% in a market rout or an inflationary spiral. For someone in their 60s, let alone older, that can become a major financial crisis.

So, if you dig up information from the last infamous inflationary spiral in the 1970s, when consumer price inflation often topped 10% a year. The Greek philosopher Heraclitus pointed out that no one ever walks through the same stream twice, because the second time it's not the same stream, and we're not the same person. Everything changes. There is no guarantee the next inflationary boom, even if it happens, will look anything like the last one — any more than we should assume that it will be accompanied by outbreaks of disco music and flared jeans.



Nonetheless, the chart above shows the total returns, after adjusting for inflation, of various asset classes from December 1971 to December 1981. This is what happened to your purchasing power if you invested in these assets and hung on for 10 years.

The key standout is that you really didn't want to own Treasury bonds. The near 40% loss of purchasing power over 10 years is somewhat notional—it is derived from the compound annual returns on 10 Year Treasury's compiled by New York University's Stern School of Business, divided by the consumer-price index—but tells a story, nonetheless.

You could argue that the danger today is even greater, simply because the yields on long-term Treasury bonds are so low. Federal Reserve quantitative easing, bond buying, and zero-interest-rate policies have left Treasury yields at their lowest on record—which means the turns would be a disaster if inflation reared its head.

Corporate bonds and the S&P 500 were also terrible investments. It's worth remembering that these are real term losses over a decade, which means investors didn't just lose a lot of money—they also lost a lot of time.

Utility stocks weren't great, but they held up better. And Treasury bills—short-term paper—did better still. But once again you were going backward when you needed to be going forwards.

No one who remembers the 1970s will be surprised that energy companies boomed. Less well-remembered, maybe, is that REITs also did well. These numbers, incidentally, represented property-owning REITs and excluded mortgage REITs, which own loans.

But there are two caveats to this. The first is that of course energy stocks did well because a key driver of inflation in the 1970s was the rise of OPEC and two oil embargoes it imposed on the West for political reasons. Cue Heraclitus. There is no particular reason to assume that the next inflationary surge will be the same.

The second caveat is that although REITs ended up doing well, they were volatile along the way. In particular, REIT prices collapsed in the OPEC-driven recession of 1972-4. And according to FactSet, U.S. REITs today already look pretty expensive on some measures. So it may be that REITs offer less inflation protection today than we would hope.

One key difference in the 1970s is that there were no "inflation-protected" Treasury bonds to keep investors protected. So-called TIPS are in theory almost the perfect investment for retirees. They are issued by the U.S. government and their coupons are safe against default. Meanwhile, their coupons effectively adjust to reflect changes in consumer prices.

The problem today is that TIPS—like almost everything else in the bond market—look incredibly expensive. Most TIPS already lock in an actual loss of purchasing power if you buy them today. For example, if you buy 5-year TIPS bonds and hold them for 5 years you'll end up losing 9% of your purchasing power. And 30-year TIPS bonds offer the same 9% loss, though stretched out over 30 years.

It's not very compelling. And it shows the risks that the government's policy responses have created for those in retirement and near it.

(source: marketwatch)

Market News, Corporate Earnings, and News & Notes

(source: CNBC)

Median Home Prices Hit A Record High Topping $363,000. (source: CNBC)

After four straight months of declines, sales of previously owned homes rose 1.4% in June month to month to a seasonally adjusted annualized rate of 5.86 million units, according to the National Association of Realtors.

These sales represent closings, so they are based on contracts signed in April and May.

Sales were 22.9% higher compared with June 2020. That annual comparison, according to the Realtors, is still slightly skewed due to Covid pandemic lockdowns in certain parts of the country that lasted into summer last year.

The inventory of homes for sale at the end of June was 1.25 million, representing a 2.6-month supply at the current sales pace. That is a slight improvement from May's 2.5-month supply.

"We may have turned a corner on inventory," said Lawrence Yun, NAR's chief economist. "There is some softening in the demand."

Low inventory continues to put pressure on prices. The median price of an existing home sold in June hit an all-time high of $363,300. That was 23.4% higher than the price in June 2020. Much of that gain, however, is skewed due to the types of homes that are selling. Sales of homes priced between $100,000 and $250,000 fell 16% annually. Sales of homes priced between $750,000 and $1 million jumped 119%.

"At a broad level, home prices are in no danger of a decline due to tight inventory conditions, but I do expect prices to appreciate at a slower pace by the end of the year," Yun said. "Ideally, the costs for a home would rise roughly in line with income growth, which is likely to happen in 2022 as more listings and new construction become available."

Price gains could start to cool. New listings spiked 9% last week, compared with the same week one year ago, according to Realtor.com. Inventory saw its 15th straight week of tapering declines.

"Although more sellers entered the market last week, homebuyers may understandably feel frustrated with the continued shortage of affordable homes for sale," said Danielle Hale, Realtor.com's chief economist, in a release. "The uptick in new listings offers a ray of hope for buyers trying to find a home and lock in still-low mortgage rates. With the public widely in agreement that now is a good time to sell, we may see even more new sellers in the coming weeks and the end of inventory declines before we finish out the year."

Mortgage rates in April and May, when these contracts were signed, were slightly lower than in March. They moved within a very narrow range during the months, so they would likely not have played a role in prompting buyers to get in or pull out of the market.

Buyers are also seeing more competition from investors. They represented a 14% share of all sales, compared with just 9% one year ago. In addition, all-cash purchases, which are large investors, rose to 23% of sales, up from 16% one year ago.

Earnings Highlights This Week

(source: CNBC)

Twitter- Twitter's revenue growth accelerated and surpassed analysts' expectations. The social media company introduced its first subscription service in the quarter.

Snapchat- Snap on Thursday reported its second-quarter earnings, beating expectations across the board for earnings, revenue, and user growth. Snap's net loss narrowed 53% to $152 million, from a loss of $326 million a year ago. Snap reported 293 million daily active users, up nearly 5%

from the 280 million the company reported in April.

Domino's- Domino's reported 3.5% same-store sales growth in the United States for its second quarter, even as it faced tough comparisons to last year's skyrocketing pizza demand. On a two-year basis, U.S. same-store sales climbed 19.6% during the quarter. CEO Ritch Allison said that the company will hike wages for workers at company-owned restaurants in certain markets and positions.

Southwest- A jump in travel demand this summer boosted revenue for Southwest and American Airlines. Costs rose as the carriers ramped up operations.

Crocs- Crocs reported adjusted earnings per share of $2.23, which beat analyst expectations. The shoemaker also reported record revenue of $640.8 million. Crocs raised its full-year revenue guidance, anticipating growth of 60% to 65%. However, the company is facing supply chain disruptions due to Covid. The shoemaker also committed to transition to net-zero emissions by 2030.

News and Notes:

Why Are 4 Million Checks Going Out To Taxpayers?

- **Why is the IRS now sending out additional checks to taxpayers?**
    - Normally unemployment income is taxable.
    - As part of the American Rescue Plan signed in March by President Biden, up to $10,200 of your unemployment income is exempt from tax on now your 2020 tax return. Thus, people will be getting a check from the IRS.
    - For individuals and married couples, your modified adjusted gross income needed to be below $150,000 to qualify.

- **How much should people expect to get for a refund check?**
    - Refunds by direct deposit started July 14th and paper checks began being delivered yesterday July 16th.
    - The amount of your refund will depend on your personal tax situation.
    - The average refund thus far has been $1,265.

- **Do taxpayers need to file a new tax return?**
    - For most taxpayers no. The IRS will either refund the overpayment or apply the refund to outstanding taxes or debts that are owed.
    - Some taxpayers in special circumstances may have to file a 1040-X which is an amended federal tax return. Check with a local CPA.

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free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market. The Bloomberg Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998. The DJ Equity All REIT Total Return Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones. The Dow Jones Industrial Average (DJIA), commonly known as "The Dow," is an index representing 30 stock of companies maintained and reviewed by the editors of The Wall Street Journal. The NASDAQ Composite is an unmanaged index of securities traded on the NASDAQ system. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets. Yahoo! Finance is the source for any reference to the performance of an index between two specific periods. The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage is often obtainable in commodity trading and can work against you as well as for you. The use of leverage can lead to large losses as well as gains.

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