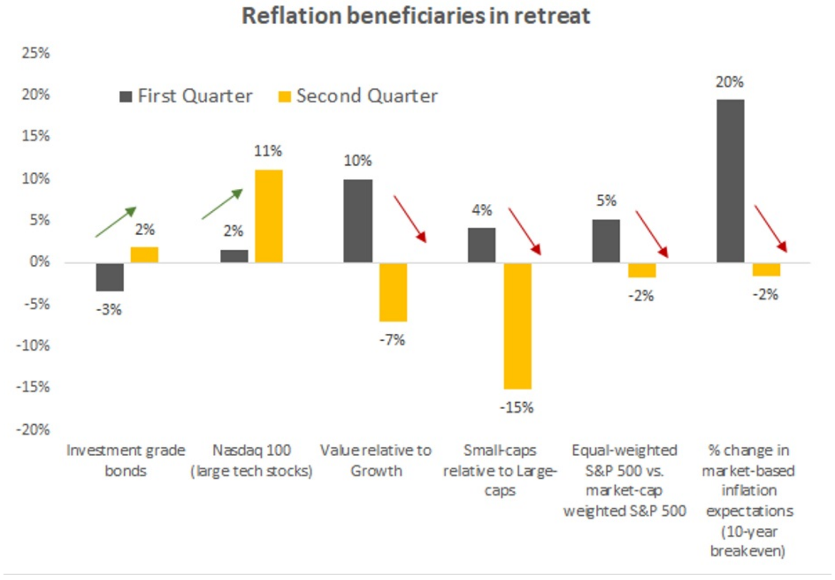
Weekly Market Commentary
July 19th, 2021

Big Tech Is Back With A Vengeance?

Stocks lost some ground last week yet remain in a steady and mostly uninterrupted uptrend since the beginning of the year. Despite the smooth sailing, a look under the hood reveals some major reversals in the second quarter from the first, with the market suggesting a more cautious undertone:

1. 10-year yields are once again below pre-pandemic levels
2. Big tech is back with a vengeance
3. The rally in cyclical sectors, small-cap stocks, and value investments has fizzled
4. Market pricing suggests more confidence that inflation will quickly subside
5. Central banks have started debating policy shifts

The about-face in many of the first-quarter trends raises questions about what the evolving landscape means and whether the rotation away from economically sensitive investments will persist.



Source: Bloomberg. Past results are not a guarantee of future returns.

The graph shows that asset class performance and inflation expectations reversed in the second quarter.

Peak growth concerns fuel rotation, but economic activity is likely to stay robust

Reversals: Long-term yields dropping; Big tech is back; Economically sensitive investments lag

- Markets are sensitive not only to the direction of the economy and earnings but also to the rate of change. The GDP estimate for the second quarter, scheduled to be released later this month, will likely show that following a rapid recovery, economic activity reclaimed its pre-pandemic peak. Naturally, as the economy returns to a steady-state, the market transitions from the early recovery to the midcycle phase, and the pace of improvement in economic and corporate fundamentals unavoidably slows.

- A timelier indicator and proxy for economic activity, the Purchasing Managers' Index (PMI), peaked in May and slipped slightly in June, marking the first decline in five months. Even so, business activity is still expanding, albeit at a slower pace, and the PMI is hovering around its highest level on record[1]. In the past 50 years when the PMI peaked, the 10-year yield declined on average about 0.3% six months later and 0.6% one year later, in the ballpark with the 0.45% decline witnessed since March.
- More recently, uncertainty around the COVID-19 delta variant has clouded the near-term global outlook and contributed to the reversal of the outperformance of asset classes and sectors that benefit from the reopening and strong economic growth. As a result, the "average" stock has underperformed over the last month, and the mega-cap technology stocks have taken the lead, carrying the S&P 500 higher.
- This is not the end of the line for cyclical and value-style investments, but rather a pause as expectations recalibrates following the fastest and strongest start of a bull market in modern history. Despite dipping below its pre-pandemic level, the 10-year yield will move moderately higher, potentially triggering some volatility along the way and pressuring valuations of high-growth, unprofitable companies.
- Investors can gain confidence that the expected downshift in growth rates will not mark the end of the cycle. Economic growth will remain robust and above-trend at least for the rest of 2021, growing 6.6%, and 2022, growing 4.1% if consensus estimates prove correct[1].
- Even though fiscal stimulus will fade, creating drag to growth in 2022, a lot of the government income transfers have been saved by households instead of spent. More reasons why we think the outlook for consumer spending will remain strong include our expectation for a faster-than-historical-average improvement in the labor market and the positive wealth effect from rising real estate and stock prices. The unexpected increase in retail sales last Friday adds one data point supporting this view.
- Despite the solid year-to-date gains for value investments, the valuation discount relative to growth investments remains as large as it has ever been, near last year's pandemic record lows[3]

Reversal: Central banks have started debating policy shifts

- In his semiannual testimony to Congress last week Fed Chair Powell stood firm, saying that inflation is transitory and that the U.S. economic recovery still hasn't progressed enough to begin scaling back the bank's asset purchases. The commentary that "substantial further progress still a ways off" helped alleviate some concerns about premature tightening.
- After reining in the pace of credit growth since the start of the year, policymakers in China signaled a reversal in their stance. Effective on July 15 the country's central bank reduced the reserve requirement ratio by 0.5%, which is expected to unleash about 1 trillion yuan ($154 billion) into the banking system. This comes as the economy slowed more than expected in the second quarter from the record first-quarter expansion.
- Central-bank policy will be front and center in the second half of the year as the Federal Reserve starts to contemplate adopting a less accommodative stance over the next couple of years. These shifts can trigger short-term volatility but can also create opportunities, as central banks' policies around the world diverge at times.

(source: oXYGen & Jones)

Markets For The Week

INDEX	CLOSE	WEEK
Dow Jones Industrial Average	34,688	-.52%
S&P 500 Index	4,327	-.98%
NASDAQ	14,427	-1.87%
MSCI EAFE	2,312	.65%
10-yr Treasury Yield	1.30%	-4.41%
Gold	$1,810	.11%
Bonds	$115.90	.19%

Source: Reuters/Wall Street Journal

Will Big Tech Stocks Continue To Roll On For The Rest Of 2021?

Given the relief in bond yields, that makes intuitive sense. Tech stocks struggled when the yield on the 10-year Treasury rose as high as 1.75%, which by Thursday's close had fallen to 1.30%. The knee-jerk expectation in markets is that when interest rates rise, tech stocks fall, and vice versa. There are two reasons why that relationship should hold. The first is simply that higher interest rates choke off economic growth, raising the cost of borrowing for consumers and businesses alike. The second is that, if a stock is the sum of its discounted future cash flows, then those flows are worthless, as the rate at which they are discounted increases. For growth stocks in the technology sector that are banking on future profits more than current ones, a higher discount rate is bad news.

The thing is, that relationship while sounding logical, isn't borne out by historical data. Andrew Berkin studied the relationship for a paper, “What Happens To Stocks When Interest Rates Rise.” Looking at 90 years of data, the S&P 500 rose, on average, 10.8% when bond yields fell and rose 12.2% when bond yields rose. Even separating periods by quintiles when yields rose the most, the S&P 500 still gained 9%, on average. The relationship, or non-relationship as it were, also held outside the U.S., though it covered a shorter time period.

Rising rates shouldn’t really affect the investment process. Growth stocks in particular aren’t negatively affected by higher interest rates. Most people haven't experienced sustained rising interest rates, and nobody knows exactly how people will react. But history doesn't necessarily suggest that rising interest rates mean slumping stocks.

(source: marketwatch)

Market News, Corporate Earnings, and News & Notes

(source: CNBC)

Inflation Climbs Higher Than Expected In June Up 5.4% (source: CNBC)

Inflation surged in June at its fastest pace in nearly 13 years amid a burst in used vehicle costs and price increases in food and energy, the Labor Department reported Tuesday.
The consumer price index increased 5.4% from a year earlier, the largest jump since August 2008, just before the worst of the financial crisis. Economists surveyed by Dow Jones had been expecting a 5% gain.

Stripping out volatile food and energy prices, the core CPI rose 4.5%, the sharpest move for that measure since September 1991 and well above the estimate of 3.8%.

On a monthly basis, headline and core prices rose 0.9% against 0.5% estimates.

“What this really shows is inflation pressures remain more acute than appreciated and are going to be with us for a longer period,” said Sarah House, senior economist for Wells Fargo’s corporate and investment bank. “We are seeing areas where there’s going to be ongoing inflation pressure even after we get past some of those acute price hikes in a handful of sectors."

A separate report from the Labor Department's Bureau of Labor Statistics noted that the big monthly hike in consumer prices translated into negative real wages for workers. Real average hourly earnings fell 0.5% for the month, as a 0.3% increase in average hourly earnings was more than negated by the CPI increase.

Inflation has been escalating due to several factors, including supply-chain bottlenecks, extraordinarily high demand as the Covid-19 pandemic eases, and year-over-year comparisons to a time when the economy was struggling to reopen in the early months of the crisis.

Policymakers at the Federal Reserve and the White House expect the current pressures to begin to ease, though central bank officials have acknowledged that inflation is stronger and perhaps more durable than they had anticipated.

Much of the price pressures have come from sectors particularly influenced by the shutdown — used car prices, airfares, and transportation costs, to name three.
That was the case again last month, as used car and truck prices leaped 10.5%, accounting for more than one-third of all the price index's gains. For the 12-month period, used car and truck prices have burst 45.2% higher.

Food and energy prices also were up substantially, 0.8% and 1.5% respectively. The gasoline index rose 2.5% in June and is up 45.1% over the past 12 months. Food has increased 2.4% in the past year.

However, housing and shelter prices continue to climb, adding fuel to the belief that inflation could stick around for a while.

Shelter makes up nearly one-third of the CPI and increased 0.5% for the month and 2.6% from June 2020.

Consumers see prices overall up 4.8% in the next 12 months, according to a New York Fed survey released Monday, though a separate survey from Bank of America out Tuesday indicated that professional investors are more inclined to believe that inflation will be temporary.

Earnings Highlights This Week

(source: CNBC)

Wells Fargo- Wells Fargo on Wednesday reported second-quarter results that topped Wall Street's expectations. Wells Fargo's results were boosted by a $1.6 billion decrease in its allowance for credit loss reserves. CEO Charlie Scharf said in a press release that demand for the bank's loans remains somewhat muted despite the economic recovery.

Delta- Delta reported its first quarterly profit since late 2019 thanks to federal payroll aid. Domestic leisure demand has fully recovered, and corporate travel also rose in the quarter. Delta said its third-quarter revenue would likely come in down up to 35% below 2019 levels.

Blackrock- BlackRock, the world's largest asset manager, reported a better-than-expected quarterly profit on Wednesday as investors poured more money into the company's funds, driving robust fee growth and boosting its assets under management to a record high. BlackRock's assets under management jumped to a record $9.49 trillion in the second quarter from $7.32 trillion a year earlier. Net inflows for the quarter stood at $81 billion, driven by higher investments in BlackRock's various funds, including its exchange-traded funds.

ConAgra- Conagra lowered its full-year profit forecast on Tuesday. The packaged foods company expects to take a hit from higher commodity prices and shipping logjams. Shares of the Slim Jim beef jerky maker fell 3.2% in premarket trade as the company also lowered its annual outlook for adjusted operating margin to about 16%.

Bank Of America- Bank of America said revenue declined from a year earlier because of a 6% drop in net interest income due to lower interest rates. While an industry-wide decline in trading revenue was expected, Bank of America appears to have underperformed. The bank's fixed-income trading operations generated $1.97 billion in revenue, well below the $2.71 billion estimates of analysts surveyed by FactSet.

News and Notes:

How Much Has 13 Years Under Conservatorship Cost Britney Spears?

- How does the conservatorship process work when it comes to money…and Britney's situation?
  - The courts deem that Britney Spears is not capable to manage her own finances.
  - Jamie Spears becomes the legal court-appointed conservator (2008) in part to handle her finances.
  - A conservator makes sure the bills are paid, taxes are filed, and investments are overseen.

- So, just how much money has Britney Spears lost?
  - Since 2009, her father Jamie Spears got $16,000 a month in payments or a total of $2.4 million as a conservator.
  - Jamie Spears took 1.5% of the gross ticket and merchandise sales from Piece of Me Las Vegas residency ($2.1 million)
  - Reported that Jamie Spears got a 2.95% commission off the 2011 Femme Fatale tour. ($500,000)
  - Add in hundreds of thousands + legal fees, and we could be talking more than $6 million alone just from her father.

- Should Britney be able to handle her money and what can people learn from this
  - Absolutely. If Britney can earn money and pay people, she should be able to control her finances.
  - Who knows how much she lost from the way Jamie Spears invested her money over the years.
  - Have a will done and have instructions as to what happens if you become incapacitated.

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