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Weekly Market Commentary
July 25th, 2022

Is This Rally The Like Coca-Cola….The Real Thing?

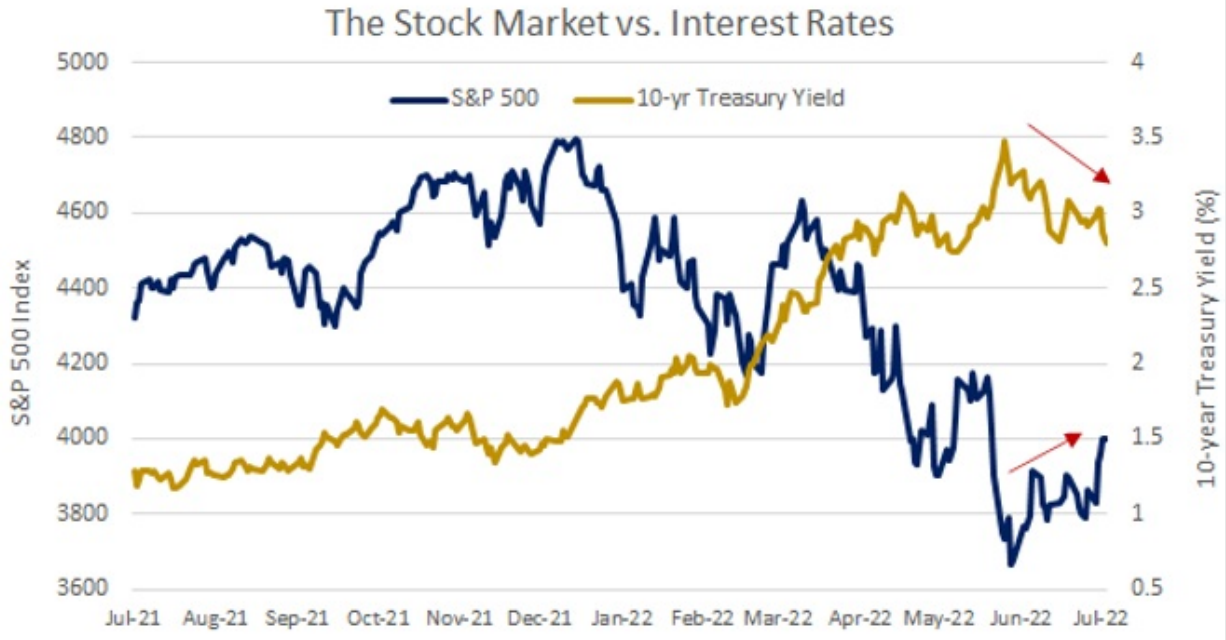
Don't look now, but we have a nice little market rally on our hands. Stocks rose last week, adding to a run that put the S&P 500 up 9% over the last month. Equities are still down roughly 17% for the year, but in a bear market, let's not look a gift horse in the mouth.

While this is an encouraging sign, the coast is completely clear. With stock and bond market declines already pricing in a lot of bad news, investors can be opportunistic but should expect more bumps along the way.

Healthy rallies often occur within bear markets

U.S. equities have rallied solidly off the June lows. This is not, however, the first such burst of strength in this downturn. The S&P 500 rose 7.1% in late May and 11.1% in March. The current rally has coincided with a meaningful pullback in longer-term interest rates, with the 10-year yield falling from 3.5% to 2.8% during this period.

Equities rally despite rising recession risks



Source: Bloomberg, past returns are not a guarantee of future results. Indexes are unmanaged and cannot be invested in directly.

This chart shows the S&P 500 and the 10-year treasury yield. The two are inversely

correlated in the short term with the S&P 500 rising as yields fall.

Prior bear markets have featured noteworthy rallies. While they didn't mark the end of the broader pullback, they did provide a sound reason to remain invested and a compelling opportunity for opportunistic rebalancing. In the past, rallies occurring toward the end of bear markets also saw a meaningful drop in 10-year yields and marked the middle of the recessionary period.

The upcoming second-quarter GDP report will provide the latest read on the state of the economy, and while a recession is not assured at this stage, we think the risk of a mild contraction has risen appreciably. In any event, this most recent rally suggests to us the bear market is maturing and an appetite for risk may be slowly returning, as a faint light at the end of the Federal Reserve's tightening tunnel begins to emerge.

Prior bear market rallies

Bear Market	Bear Market Rallies	Gain	# of Days Until Eventual Market Bottom
Oct '07 - Mar '09	Nov '08 - Jan '09	24.2%	42
	Mar '08 - May '08	12.0%	202
Mar '00 - Oct '02	Jul '02 - Aug '02	20.7%	33
	Sep '01 - Jan '02	21.4%	192
	Apr '01 - May '01	19.0%	346
Nov '80 - Aug '82	Mar '82 - May '82	11.3%	67
	Sep '81 - Nov '81	12.0%	177
Jan '73 - Oct '74	Feb '74 - Mar '74	10.0%	143
	Dec '73 - Jan '74	8.3%	190

This rally has fuel but not a full tank

The current rally has been supported by several catalysts: signs of peaking inflation, relief from rising yields, and, most recently, corporate earnings announcements.

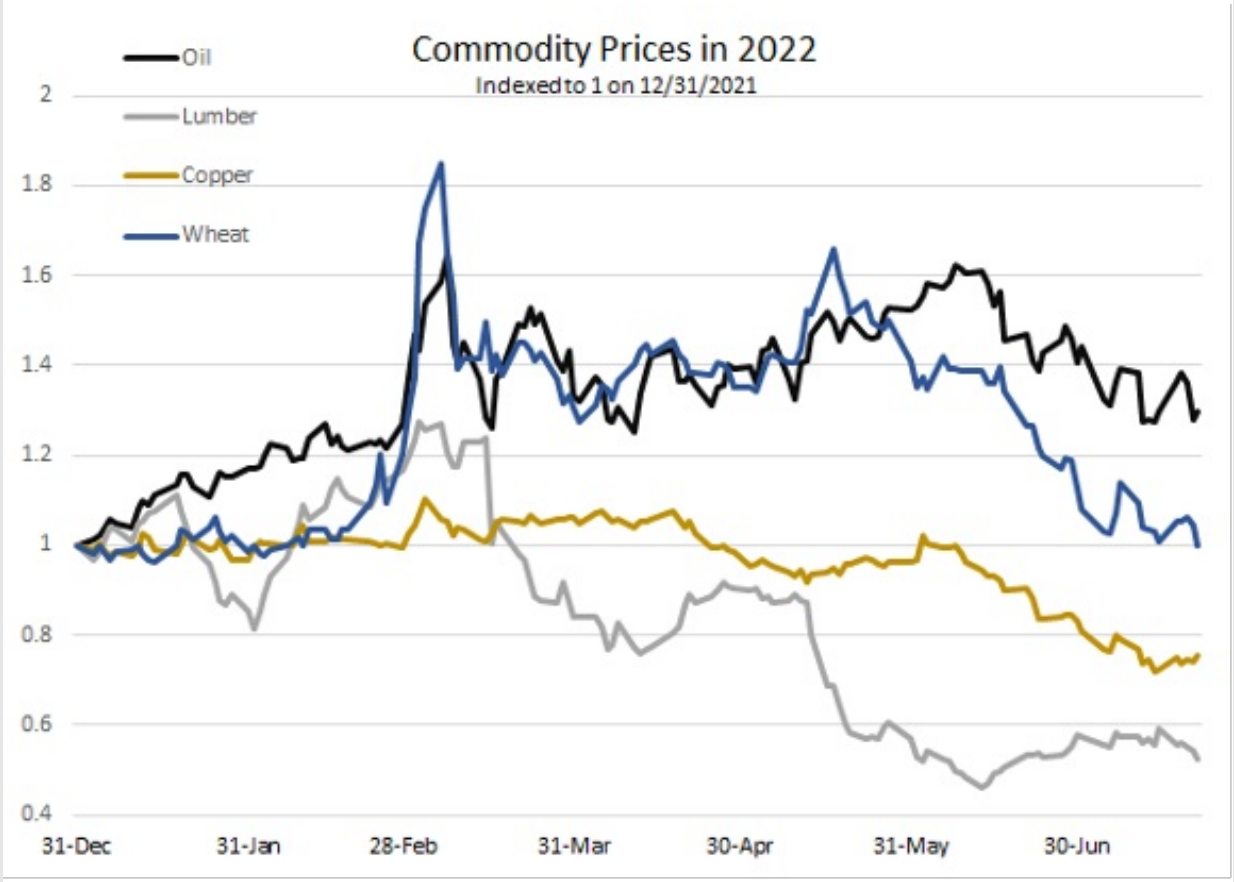
Commodity prices have fallen sharply in recent weeks, which will provide much-needed relief on the inflation front. Oil prices are down 20% from their recent peak, and copper and lumber prices have fallen 32% and 60%, respectively. Agricultural commodities such as wheat, corn, and soybeans are also down materially. Ukraine and Russia signed an UN-supported deal last week that will allow Ukrainian grain exports to resume through the Black Sea. This can potentially boost the global food supply, given Ukraine is one of the world's largest agricultural exporters.

Inflation pressures won't subside immediately, but additional data are signaling better news for consumer prices. Wage growth is still healthy but has moderated. Historically, this has influenced inflation levels. Supply chain measures are showing further improvement in bottlenecks, while PMI readings have dipped to levels consistent with lower cost pressures.

Second-quarter corporate earnings season is underway, with the results reasonably positive so far. With about one-fifth of the S&P 500 reporting, profit growth has exceeded consensus expectations by roughly 4%. Earnings are showing some margin wear and tear from rising input and labor costs, but revenue growth remains healthy,

supporting bottom lines.

Falling commodity prices



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

This chart illustrates the drop in commodity prices in recent weeks as demand dynamics have weakened.

It is not likely the equity markets rally in a quick way as they have in the past. For a sustained recovery to take place, there is a list of conditions that must be met. On the plus side, sentiment appears to be bottoming, and valuations have dropped precipitously. Markets are generally priced for bad news already. We'll need several months of declining CPI (inflation) readings before the Fed can begin taking its foot off the brake. This is the most critical element before this bear market can shift to a bullish stance. While earnings growth will help the market find some footing this year, anticipate earnings growth estimates being revised moderately lower in coming quarters, reintroducing some stock price volatility.

The bottom of this bear will be a process, not a point

The current view has been that a durable market recovery will take on a "U" shape rather than the "V"-shaped rebounds we've seen for much of the last decade, which were backstopped by loose Fed policy. But intermittent rallies like this one may transpire as markets handicap the degree of aggressiveness the Fed will need to take in the coming months. Equities could begin forming the bottom of the "U" as we advance, but the eventual bull market recovery will take some time to materialize.

Expect a U-shaped recovery vs. a V-shaped rebound

Source: Bloomberg, past returns are not a guarantee of future results. Indexes are unmanaged and cannot be invested in directly.

(Source: oXYGen & Jones)

Markets For The Week

INDEX	CLOSE	WEEK
Dow Jones Industrial Average	31,900	2%
S&P 500 Index	3,962	2.6%
NASDAQ	11,834	3.3%
MSCI EAFE	1,881	3.5%
10-yr Treasury Yield	2.77%	-.2%
Gold	$1,727	1.17%
Bonds	$103.28	1.0%

Earnings Highlights This Week

Verizon: Verizon shares closed down nearly 7% Friday after the company released its second-quarter earnings report. The phone company cut its full-year forecast.

Twitter: Twitter reported earnings for the second quarter on Friday that missed analyst estimates on earnings, revenue, and user growth. Twitter blamed the revenue miss on ad industry headwinds and "uncertainty" tied to the pending acquisition of the company by Elon Musk.

Snap: Snap missed on the top and bottom lines in its second-quarter earnings report. The company authorized a stock repurchasing program of up to $500 million. Snap said it plans to "substantially slow our rate of hiring, as well as the rate of operating expense growth."

AT&T: AT&T shares fell after the phone company's second-quarter earnings. AT&T's cash flow took a hit for the quarter, which CEO John Stankey attributed to greater expenses and late payments on phone bills.

Domino's: Domino's Pizza missed Wall Street's expectations for its second-quarter earnings but beat estimates for its revenue. The pizza chain raised its outlook for food prices for fiscal 2022. The ongoing shortage of delivery drivers hurt the chain's sales again this quarter.

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