Marketline July 2022

Stocks:

July brought relief from what has been a relentless downward movement in stocks so far this year. For a change, prices rose. Reflecting a renewed interest in tech stocks, the S&P 500 was up 9.1% and the Nasdaq rose 12.3%. Both these indices are constructed with a heavy helping of technology. The Dow, with more industrial and consumer exposure, advanced 6.7%. Overseas, results were positive but pale compared to US returns. The Mexican Bolsa returned 1.3%; Europe managed 3.5%, and Canada had a respectable result at 4.4%.

Mexico - our neighbor and major trading partner to the south - is slowly becoming more nationalistic. One current thought promulgated by its president is that American energy companies should give up their assets and development work to the Mexican government. Other political objections have been raised concerning factories located in Mexico but operated by US companies. These maneuverings threaten the terms of trade agreements struck just a couple of years ago. Inevitably, the results of making it tough to do business in a country/state/county/town are that business doesn't get done there. It will get done somewhere more friendly. Mexico is developing as a slow-motion train wreck. Perhaps there's time to belay this development; perhaps there is not. In the meantime, we're happy to have nearly nil exposure to Mexico.

Last month we wrote: "As far as how long this downturn might last, the next month might tell us more. Earnings season is upon us, and we will shortly find out how accepting investors will be if profits don't match expectations." In fact, despite so-so earnings reports, investors seemed willing in July to look to the future, beyond the recession or slowdown bearing down upon us. We don't want to use the "B-word" – i.e., "bottom" as in "stocks have bottomed" – because the bottom of a bear market is never neat and tidy. It's generally a process, not a moment. Most bear markets contain several head-fake rallies that bring prices up substantially, only to see them fall back again. Don't be too disappointed if July's good results melt away. You can blame that on the bottoming process.

Meanwhile, we have jettisoned a few stocks that have either been moribund while we've held them or have produced only small profits. To replace these, we are adding to real estate investment trust stocks here and there. The only new stock we have drafted into our buy list is Columbia Sportswear. COLM, with its sterling balance sheet and strong sales and earnings records, has sold off recently. We think the stock has substantial potential, for the right portfolios. We also placed Freeport McMoran on our watch list – FCX mines copper, among other materials. Copper is crucial to the green energy transition that is underway worldwide.

Bonds:

In step with stocks' rally – actually, if you want to be picky, slightly before stocks rallied – bonds also rallied. This rally brought down yields in bonds due beyond five years. Short-term interest rates kept rising of course, since that's what the Fed wants. But the market sent a signal in July – a signal that perhaps the Fed will finish its rate hike rounds sooner rather than later. This bullish news redounded to stocks and helped explain why both markets were up.

Everyone who reads this piece regularly knows what I am going to say next: in July, the yield curve flattened markedly, *again*! The one-year note came up to a yield of 2.9%, and the thirty-year declined to 3.0%, a sharp reversal from the prior uptrend. This is about as flat as you can get, without inverting. Alas, from one year to ten years, the curve IS inverted – a bad sign for the economy, but not necessarily for stocks. Remember, the sooner investors can get over angst about increasing interest rates, the faster stock prices can stabilize and even show positive returns.

In terms of buying bonds now, things are a little tricky. Yields are in a price-finding process, just like stocks. It is entirely possible that two weeks from now we'll be back to fear over inflation and yields will rise again. While we can maneuver among various sectors, looking for the best deals, it's not a great idea for the average investor to plunge into bond exposure wholeheartedly now. We'll be reinvesting proceeds from called bonds in a day or two, and the plan is to canvass the muni market first; if that doesn't provide satisfactory results, we'll default to corporate bonds where yields are still might close to 4.9% in mid-range maturities.