

Marketline July 2023

Stocks:

In July, the market indices lined up like soldiers: the Dow was up 3.3%; the S&P posted 3.1% and the NASDAQ rose 4.0%. Okay, the NASDAQ was a bit out of line, but in a good way! Overall, the market was healthy, with plenty of stocks participating in the rally – good ones, bad ones, big ones, small ones. Everyone was in the pool. As August opened, though, stocks have taken a turn for the worse, with worries about rising interest rates coming to the surface (see *Bonds*, below). As we write this, because of the shift in sentiment, it's somewhat anachronistic to focus on July, when August is bringing a new tune.

Still and all, we'll finish off comments about July by noting that foreign stock returns were more subdued than what we enjoyed in the US. The FT-SE index of European companies was up 2.2%. Mexico rose by 2.4%. Canada, our largest trading partner, rose 2.3%. That's as close a cluster as I have ever seen in these three regions. Makes you wonder about diversification, right?

While inflation has continued to moderate, the pesky job market remains strong. The Fed's fondest wish is for job growth and wage increases to moderate and even turn down. Alas, the Fed's reminder in June that inflation could prove very sticky, resulting in a multi-year fight against rising prices has merit. Many signs around the world point to the end of cheap labor, cheap energy, and cheap commodities. Those conditions do not amount to a repeal of the business cycle however: a recession could still occur. Recent earnings conference calls have highlighted softening business conditions in retail, communications, even air travel. It appears that price resistance is surfacing. On the other hand, industrial suppliers are benefiting from enormous expenditures by the federal government on infrastructure improvements, manufacturing subsidies, and clean energy. Those businesses have growing backlogs. That is where we want to be: robotics, factory floors, energy suppliers, housing, and the commodities that service those industries. We are following the money, which is as simple as looking at the budget bills passed at the federal level, where winners are chosen these days.

Bonds:

The one-year Treasury note yield remains right around 5.38%, with some shorter paper yielding 5.45%. The long bond finally popped above 4% and remains there today as we write this. The yield curve is shifting to a slightly positive slope out at the longer end: the ten-year is at 3.96%. We are still far from a normal curve, however. This inversion has lasted about sixteen months now without a recession surfacing - and no end is in sight yet. The Fed's last meeting resulted in another hike, after a respite in June. Stock investors have not appreciated the latest action, as higher rates keep biting away profits.

In terms of sectors, pundits have loved the municipal bond market after its soft performance of the first half, declaring that supply will be limited and budgets are improving. I am not convinced. Offsetting the better budgets are higher expenses, including higher interest rates. It's hard to get anything done these days, with inflation raising project costs. Meanwhile, the slow-motion train wreck of falling commercial property values will eventually hit tax receipts. In Portland, Unico is appealing market values for several of its large properties downtown, including Big Pink, the US Bank tower. While tax bills have a convoluted relationship to market values, this is likely a first step toward challenging assessments. In other cities, Blackrock and REITs are simply defaulting on loans. It's a good bet that a building with a defaulted loan is worth less than it once was. For now, we are staying out of Oregon for most of our bond purchases, and heading to cheaper states where rates are well over 4% - better compensation for emerging risks.

Corporate bonds are substantially attractive. We have purchased several and will continue to pursue other new names in the weeks to come. We welcomed Timken to some portfolios, and we are actively looking at Stanley Works. We'll also be selling the occasional bond to fund these purchases – mostly from the lesser-quality population of issues owned.

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