Rochester Financial Services

Fee-Only Financial Management Services*

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Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Bitcoin	Gold	Crude Oil
32,899	4,123	12,145	1,838	3.12%	35,977	$1,838	$110.49

Investment Strategy Report

Stock Sell-Off Intensifies as Concerns Mount About Inflation and Interest Rates

April was an ugly month for investors. There is no other way to put it. Stocks were punished, with the Nasdaq especially hard hit, suffering its worst month since 2008. While the primary concern several months ago was the war in Ukraine, the primary concern now appears to be inflation and surging interest rates; and what the Federal Reserve will do to fight these issues. The rise in interest rates has been unprecedented, with the yield on the 10 year Treasury rising from 1.51% at the beginning of the year, to 3.12% at Friday's close, more than doubling. My main point in my letter last month was to argue that the 10 year yield, which had risen to 2.56%, was probably not going to go much higher. Well I got that wrong. Rates have gone much higher. And these higher rates are spooking stock investors.

The cure for higher rates, it turns out, is higher rates. This means that as rates rise, the economy will slow down, which means that there will be downward pressure on interest rates. Mortgage rates, which were under 3% not too long ago, are now approaching 5 1/2 %. This will slow down the red hot housing market. The same can be said for vehicle sales. So while the concern now is about an overheating economy, at some point soon, the concern will shift to worries about a slowing economy and possible recession. The initial reaction to this shift should be that interest rates should stabilize, if not begin to come down. And at that point, rates can fall substantially. As Brett Eversole (StansberryResearch.com) put on April 21st, "The largest decline (of bonds) on record wasn't much worse than today's ... And that was during the worst economic downturn of our generation (2008-2009). Simply put, we're likely darn close to the bottom for (bonds). And when prices reverse, a double digit gain is nearly certain". And if interest rates drop, that can be bullish for stocks.

I listened to a webinar last Tuesday (5/3) by one of my favorite economists, Fritz Meyer. Here are a few points that he made. 1) Based on the economic fundamentals, don't expect too much more stock downside. 2) Based on underlying strength in consumer and business spending, economic growth will resume. 3) The rise in the Index of Leading Economic Indicators suggests no sign of recession. 4) The ISM numbers for manufacturing and services show continued strength. 5) New job formation is very strong. 6) S&P 500 earnings estimates this year and next are being revised higher. 7) Inflation should come down as supply chain problems subside. Plus Inflation Protected Treasuries (TIPs) are indicating a 2.9% inflation rate over the next 10 years, substantially lower than today's 6-8% levels. In summary, he doesn't see any indications that the economy will fall into a recession any time soon. And because of the drop in stock prices, stock valuations are now much more reasonable.

Bob Brinker, in his May letter, suggests that while this market choppiness can continue for quite a while, he expects the S&P 500 to challenge the 5,000 level by next winter. That would be a 21% increase from its current level. Tom Lee of Fundstrat, while admitting that his bullish view of the market has been wrong up until now, is now saying that the market is very much oversold, and that he is expecting a relief rally, a rally that can be led by technology. His view is that growth companies are at the centerpoint for enhancing productivity. He adds that faster growing companies are trading at a discount to slower growing companies, which is a complete inversion of what is logical. As this normalizes, large cap tech can be the biggest movers. He also states that the 3.1% yield of the 10 year Treasury should be the high for the year, which I've have stated above, should be bullish for stocks.

All of us, myself included, are scared right now. The 1,000 point moves in the market are very unnerving and the losses we have all sustained during the past few months have been very unsettling. Dr. David Eifrig (StansberryResearch.com) points out (4/22) that "lots of fearful investors are hiding in cash". According to Bank of America's monthly survey of global fund managers, fund managers are holding the highest levels of cash since April 2020, which was the worst time to hold cash as stocks began to recover. "Investors are being too cautious. And it's a bullish signal for us" he adds.

The sell-off in stocks is indeed scary, and the downward momentum can very much continue. For those of you who are having trouble sleeping during this time, there is nothing wrong with getting more defensive and lightening up on some of our positions. Please call me if your are concerned. However, I do feel that longer term, we should be OK *Jeff Feldman*

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