August 4, 2022

Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Bitcoin	Gold	Crude Oil
32,727	4,152	12,721	1,907	2.68%	22,494	$1,907	$88.42

Investment Strategy Report

Stocks Surge As Inflation Fears Ease and Interest Rates Fall

I can imagine the sigh of relief that most of you had as you opened up your July monthly reports. After an abysmal first half of the year, not only did stocks stop dropping in July, but they surged higher, as the S&P 500 gained 9.2%. Many of our growth funds were up double digits and even my favorite balanced fund was up 8.4%. Bonds also had a strong month, as many funds had a year's worth of gains, in the neighborhood of 2-3%, in just a few weeks time. This turnaround in stocks and bonds occurred at the same time that fears of 40 year highs in inflation, and a technical indication of a recession, was uppermost in the minds of many investors. How can we explain the financial gains of the past month while our economy seems to be in such turmoil?

Well I must admit that in last month's letter, I did signal that there did appear to be signs for hope, saying that the 3 day rally that started the month of July did have some substance to it. I mentioned that the drop in interest rates, with the yield of the 10 year Treasury falling from 3.48% to 2.91%, was an indication that inflation pressures were beginning to subside. Today, the 10 year yield closed at 2.68%, continuing its downward trend and further demonstrating that inflation is now less of a threat. And to reiterate the major point of the letter, it is the threat of high inflation, along with the Fed's aggressive reaction to it, that poses the biggest threat to any stock market uptrend.

A month ago, the price of oil had dropped from over $120 per barrel to $98. The price has continued to drop, and now sits at $88.42. And the price of gas at the pump has dropped 20%, to below $4 a gallon at many locations. This past Tuesday (8/2), Jim Cramer on his Mad Money show went on a tirade about how so many financial "big shots" like Fed governors, business commentators, and hedge fund managers have complained that inflation was too high, and that the Fed had to be more aggressive in fighting it. He stressed how ignorant they were of the reality that inflation was in fact dropping precipitously. He pointed out that the prices of commodities are going down, grain prices are falling substantially, and the prices of cars will fall dramatically once an adequate supply of computer chips are obtained. Aluminum and copper prices are down double digits and the price of lumber is down from $1,400 to $524 per unit. Appliances are now in glut, and container shipping costs have been cut in half. There is a surplus of merchandise at retail stores, as Walmart announced in its last earnings report. And the 25% rise in the money supply in the last 2 years, which the Fed caused in response to the pandemic, and which has been blamed for the inflation spike, will soon be erased. This easing of inflation fears is one of the major reasons why stocks are rallying.

Another reason is that corporate earnings reports continue to be strong. Last week (7/25 -7/29), tech earnings were solid, as both Amazon and Apple beat estimates. Amazon is now almost 40% above its June lows and Apple is up almost 30%. This rebound among the tech leaders has enabled growth stocks to once again resume their market leadership role. And energy stocks, the market darlings of the first half of the year, have fallen substantially from their highs as the price of energy has fallen.

Technical indicators are pointing to a continuation of this uptrend. Sentimentrader.com (8/2) summarized the recent surge: "The setup was ripe for at least a bear market rally in late June. Sentiment was about as bad as it gets. And dip-buyers stepped in, and they did so aggressively. That triggered some thrusty signals a month ago, and unlike others over the past 6 months, buyers persisted and triggered even more compelling signals. It's another sign that this recovery should have legs".

As inflationary pressures continue to ease, hopefully the Fed will realize that the backward looking CPI numbers are not a true measure of real world inflation. The true measure of inflation is the yield on the 10 year Treasury note. With the yield currently at 2.68%, the markets are telling us (and the Fed) that inflation is under control and the Fed funds rate does not have to be raised significantly higher than its current level of 2.45%. If the Fed gets the message, this rally can have a lot more room to run. *Jeff Feldman*