August 3, 2023

Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Bitcoin	Gold	Crude Oil
35,216	4,502	13,960	1,961	4.19%	29,174	$1,961	$81.90

Investment Strategy Report

As Markets Enter A Difficult Time of the Year, Any Pullbacks Should Be a Buying Opportunity

Who said that it's easy to make money in the financial markets? It's not. We've been told to buy low and sell high. But falling markets can fall a lot further than we expect ("trying to catch a falling knife"), and rising markets can defy logic and rise parabolically. The past 2 years of stock market performance are illustrative of each of these examples. 2022 shocked many of us in the extreme losses that many areas of the market sustained, and 2023 has been a pleasant surprise as stocks seem to levitate higher while analysts struggle to explain why. While this might lead investors to conclude that buying and holding presents the optimal strategy, those of us who try to manage risk, seek clues to divine stock market trends to help fine tune portfolio allocation.

The general consensus for the explanation of the rise in stock prices in 2023 has been that a stronger than expected economy together with declining inflation has produced a very favorable environment for stocks. But at what point do we begin to worry that stocks have risen too much too quickly? Are stocks too expensive now? Is it time to take profits? And will the recent spike higher in interest rates throw a wrench in the bullish views for the stock market?

Every bull market provokes concerns like these, as investors get increasingly nervous the higher prices go – generating the proverbially "wall of worry". And yes, we are in a bull market as stock prices have climbed in excess of 20% from their lows last fall. While a healthy measure of caution is always prudent, avoiding an appropriate level of stock market exposure can hurt long term investment returns.

The stock market is currently in an uptrend, and despite some recent volatility, staying the course is the best strategy. The analysts at Sentimentrader.com are the best at determining market trends and investor sentiment. A series of studies they have performed over the last few weeks all indicate that the stock market uptrend should continue. Dean Christians published a study today (8/3) that concluded "The odds of a sustained uptrend in the S&P 500 look likely now that the 200-day moving average for the index has risen for 40 consecutive trading days. When the long-term moving average increases after a 1-year low, the index rallied 92% of the time a year later. With market participation broadening, two composite models that measure market breadth suggest an imminent correction is unlikely".

Dean also published a study on July 24th that looked at margin debt (when investors borrow to invest). He concluded that "After reaching one of the lowest levels in history, margin debt growth, a gauge of market sentiment, has reversed, suggesting investors are now more optimistic about the stock market. After similar recoveries, the S&P 500 was higher a year later every time. When the trend for margin debt is rising, the backdrop for stocks is bullish".

Brett Eversole of StansberryResearch.com (True Wealth Systems) pointed out in his July 19th column that "Companies are beating earnings estimates, helping to drive stock prices higher". He discussed the Citigroup Economic Surprise index and cited that the index reached "the highest reading we've seen since March 2021. And it's a level that's darn rare." "Similar setups have led to 6.3% gains in 3 months, 6.9% in 6 months, and 14.7% gains over the following year. Even more, stocks were higher a year later in every case".

Stocks and Interest Rates – Rising interest rates are a headwind for stocks, and the yield of the 10 year Treasury has recently reversed course and has begun to move higher. In the past 3 months, the yield has surged from a low of 3.4% on May 11th to a current yield of 4.2%. The question now is, can stocks move higher faced with this unfavorable interest rate environment? My answer is yes for the following reasons: 1) Stocks have managed to move higher despite the rise in rates – that is a good sign. 2) Rates are approaching the 4.25% level that they peaked at back last fall. Given that the economy is due to slow at some point during the next year due to the restrictive Fed policy, there is a good chance that 4.25% will prove to be a ceiling for rates. Once rates resume their decline, this will provide a stimulus that will allow stocks to continue their push higher.
Jeff Feldman