



CAPITAL INVESTMENT COUNSEL

The Columns

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I love to hear to the market's song. It's not always pleasant listening, but it's full of hints and innuendo. Like a person, the market never tells you *exactly* what it has in store, but if you listen carefully, you sometimes get an idea of which way it may go next.

What's the market saying currently? In our social media driven world, investors seem obsessed with the next 5 minutes instead of the next 5 months. I'm not knocking it, but that approach can miss the forest for the trees. If I were negative on the market, I'd concentrate on the market's 4% decline since late last week. It's still a drop no matter how you view it, but I see it as a potential opportunity.

I prefer the longer view and concentrate on the market's 13% gain since bottoming in mid-June. Dig a little deeper and we hear the market's whispering more potentially encouraging signs. The Transportation Index was up greater than 1.75% for 3 days in a row.

(Source: Conor Sen) The other 7 times ended up being turning points (higher) for the economy and maybe this 2022 version will be as well. Looking back at the other 7 occurrences, we find the market was higher a year later -- 7 out of 7.

Why do the Transportation stocks matter? The positive effect is two-fold. It can indicate that companies still feel strong enough about the future to make and ship products. It can also mean that the supply chain issues the economy struggled with may be over. The Transports are like your body's temperature – solid Transport stocks mean the economy is likely alive and kicking.

We saw a shift in late October 2020. Interest rates ticked higher, value stocks rallied and big growth stocks (think Apple & Google) began their decline. Growth was still in the race, but Value was accelerating ahead and slowly running out of sight. This summer has seen the beginning of a shift back into growth. Compare year-to-date performance and nothing seems to have changed. The S&P is down 12% versus 20% for the NASDAQ 100.

But, shorten the time frame and we see a different picture. Off the June lows the NASDAQ 100 is up 17% versus only 13% for the S&P 500. Before last week's selloff, the difference was even broader with the NASDAQ up 23% against the S&P's 17%.

The NASDAQ's outperformance tells me investors are likely rediscovering their mojo. Like a stock market version of the late 90's classic: How Stella Got Her Groove Back. When investors are optimistic about the future, they tend to pile into growth stocks and the biotech sector often leads the charge. The SPDR Biotech ETF (XBI) had a stunning recovery off the June lows with a 30% gain. The gain peaked as high as 45% before our late August selloff. That tells me investors people are likely starting to feel bullish about the remainder of 2022.

Inflation still dominates the headlines but I feel we've seen the worst. On August 10th, the CPI came in at 8.5% - relatively much lighter than the previous month's reading of 9.1%. The market responded with a 5% rally before embarking on our current selloff. Slowing inflation is the backbone to my positive market outlook.

The market has a good track record for months when CPI inflation is greater than 8%, but less than the reading a month before. Stocks have done well in the past when extreme inflation has moderated. We only have five occurrences going back to 1916, but stocks were higher two years later in all five instances with an average gain of 31%.

Pullbacks are never pleasant - even when you know they're coming. Let's use our 2022 mantra: flip the script. Use the lower prices to your potential advantage. As they say in yoga, life doesn't happen to you, it happens for you and these lower prices may prove to be a good

investment if the market follows its historical mid-term election script. If you have any comments, feel free to contact me at heddins@capital-invest.com or call me at 919-656-0836.

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