CAPITAL INVESTMENT COUNSEL

The Columns

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How best to describe 2022? Bruising? Disorienting? Those are accurate, but I think grinding might be best. The Dow peaked on January 4th at nearly 37,000 and hit the skids not long after. It's been tough ever since – every upward move seems to be followed by a grinding selloff. But maybe this week's rally will be different.

The market has behaved in ways we don't often see but there's a potentially happy ending if we're patient. More of that below. Our first warning sign was the Dow breaking its December low on February 22. I've found this to be a reliable indicator (it's happened 37 times) and the average drop in the past was 11.25%. The market bottomed (so far so good) last week at 29,653 for a drop of 12%. History doesn't necessarily repeat but it often rhymes: the market's 2022 low came with .75% of what history whispered it would. Pretty good stuff. We use a wide variety of research, but I find history provides a framework to what *might be* coming around the bend. Picture the Barefoot Contessa on the Food Network when she seasons a dish without measurements. Sometimes a little finesse is just what you need. The Dow has since recovered to roughly 31,400 so maybe we're finally on our way.

This market is a never-ending source of "fascination" and that's the PG-13 version. Just as stocks pick up a head of steam, they get hit with a selloff. The S&P 500 made a short-term low on May 20th at 3812 and embarked on a multi-week rally that gained 9%. After such a relatively large gain, the odds showed that prices were going to pull back. It's just the rhythm of how prices typically move. Not many people thought stocks would drop 9.3% in only three trading days, and that's where prices ended Friday, June 17th. Amazing how much can change in a week. Interest rates dropped, and the S&P responded with a 6% gain this week.

During my talk at the Capital Investment company conference in May, I posed the question, "Are we in a recession?" I posed that maybe it didn't matter because stocks seemed to have already priced one in. I still feel that way and it's important to remember that we invest in companies and not the economy.

We hear a lot of talk about the economy or how the government is affecting things. I've always felt that the government and economy are like a sports stadium. It's fun to watch a game in nice stadium. Look at that giant screen. These seats are amazing! Can you believe the beer selection here? But we ultimately want to watch the players do their thing during the game. The players are what the game is all about. Case in point is FedEx. They (along with UPS) are the two big players in package delivery. Every product needs to find a way to the consumer, and they typically travel through one of these two firms. When UPS and FedEx are doing well, I find the economy does too.

FedEx reported fresh earnings this week. Going into the report, FedEx traded at only 10 times earnings. That's extraordinarily low and FDX has only traded there 4 times in the last 20 years. Let's skip to the numbers: FedEx nailed it: they beat their targets and raised the guidance for the rest of 2022. They also said that wage inflation may be topping out. Yes, wages were higher than last year but no longer accelerating. That's a welcome sign and another indication that inflation may have peaked.

We're seeing signs of waning inflation across a wide range of commodities. Wheat and oil are back to where they were *before* the Ukraine invasion. Copper, corn, and soybean prices are all breaking down. David Rosenberg found that if you strip energy related inflation from the CPI, (flights, vehicles, etc.) you find inflation is running at 4% and not 8%. With oil back to pre-war levels, that's a good sign. Government stimulus was one of the largest drivers of inflation and those payments have stopped as well. Have we seen the worst? Next month's CPI reading should let us know, but I'm optimistic.

Let's finish on a positive note. A few weeks back, the market endured a torrid time. Prices dropped 12% in only 10 days. That's only happened three previous times and all three were important turning points higher for the market. I was around for all 3 (2020, 2011 & 2009) and feel a rally may be coming. Ryan Detrick at LPL came up with the following gem. The S&P will finish this quarter with a 15% drop. That's happened 7 times before. What happens next? Six months later, the market was higher 5 out of 7 times with an average gain of 14%. One year later, the market was higher 6 out of 7 with an average rally of 28%. Let's see what 2022 brings but I like those odds. If you have any comments, feel free to reach me at heddins@capital-invest.com or call me at 919-656-0836.

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