



CAPITAL INVESTMENT COUNSEL

The Columns

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In my dad's military days, he loved to STABO. So, what exactly is a STABO? For starters, STABO is the acronym for STAbilized Body. It's is a rope extraction via helicopter. One minute you're standing on the ground and the next you were flying through the air at 110 mph, hanging by a rope (with 3 other guys) from the belly of a helicopter. Nothing like a helicopter to get you out of trouble in a hurry. Google Ranger STABO extraction and the video gives you the full flavor.

After a grinding summer, the market feels like a STABO extraction is (finally) underway. One minute the market is grinding sideways and the next we're enjoying a solid rally. We'll see if the rally has staying power but I like what I see so far. The market is up 8% over the last month and up 5% since the start of July. The Nasdaq 100 tends to lead market moves, and it closed over its 50-day moving average for the first time since April 5th. That's a constructive move and may begin to tempt the technically-oriented traders back into the market.

Has inflation peaked? Stocks and bonds are both potentially acting like it has. After peaking at 3.47% last month, the 10 Year US Treasury only yields 2.9% now. That's a big move and a statement that maybe inflation is waning. July's super-hot CPI number came in at 8.9% and while we had a few nasty down days afterwards, stocks ultimately reacted with an 8% rally. The reaction to the news is more important than the news itself. We'll talk more about that below on Netflix.

I also like to use my proprietary Costco inflation indicator. I drive by Costco every Saturday morning on the way to the gym and typically swing by around 7:15. Gas prices have

been bad through most of the year and even at that early hour, the lines were long. \$4.99 a gallon was the max I paid and like everyone else, I've been glad to see prices plummet over the last month. Last Saturday, Costco's price had dropped to \$4.10 and there were only 4 people there in total. I guess people aren't worried about gas anymore. Maybe inflation is dead, and next month's CPI report should give us some hints.

We may see a continuation to the rally if the CPI comes in lower. The market has a good track record for months when inflation, as measured by the CPI, was greater than 8% but less than the reading a month before. July CPI measured inflation at a hot 8.9%, but the silver lining may occur if the August CPI comes in lower.

Stocks have done well when extreme inflation has moderated in the past. 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%. We should be glad there are only five instances. As we've all found out, 8% inflation is no joke.

Is the bottom in? I think so but we'll need to get through earnings season to be sure. I like using the Bank of America fund manager survey to see how warm (or cold) the water is. The most recent survey showed fund managers in an extremely conservative mode. Fund managers are more risk averse now than they were during peak Covid and that's surprising. The only other similarly low reading was late 2008--right before market's bottomed during the housing crisis.

I use the survey as a contrary indicator – the more negative the better in my opinion. I sometimes find that people who answer negatively to the poll may have already sold and the worst may be behind us. Let's look at this week's action in Netflix stock to display what may be going on.

Netflix stock is familiar to most. A media darling who has fallen on hard times since the Covid peak. This week's headlines showed Netflix had the terrible trifecta: they lost almost another 1 million subscribers, their profit margins slipped and they warned that margins

might slip again next quarter. You may think NFLX stock tanked hard on the news. You would be wrong. Netflix traded at \$190 a share Tuesday morning, July 19, 2022, and rallied to \$220 plus by Thursday afternoon. So, what just happened? Netflix isn't my kind of stock but the reaction shows that maybe the bad news is priced into the tech sector. Tesla had a similar reaction later in the week and we'll have plenty of examples to see over the next few weeks. In the meantime, the trend seems to be higher: right on time for the mid-terms and their favorable 4th quarter tailwind. 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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