CAPITAL INVESTMENT COUNSEL

The Columns

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It's a relief to have this month's CPI report out of the way. Despite what it feels like at the grocery store, inflation is actually dropping. The May CPI was flat, which was a surprise since most economists expected a .1% gain. Economics is a game of inches, and that small CPI win feels huge right now.

The CPI was released at 8:30 on June 12th and almost everything rallied as expected. Stocks, especially small caps, responded enthusiastically. The drop in bond yields meant you could get a 30-year mortgage that started with a "6" for the first time since July of '23. The current average 30 year is 6.8%. That's not the 3% we had during COVID (Spoiler alert, those probably aren't coming back), but it beats nearly 8% we saw last Halloween.

Here's where my frustration comes into play. For the first time since 2020, the CPI coincided with a Federal Reserve Open Market Committee meeting. I was hopeful because the CPI release showed progress in fighting inflation. But then Fed Chair Jay Powell spoke that afternoon, and things took a turn. Look at the economically-sensitive Russell 2000 small cap index. From its June 12th peak before Powell's press conference to midday June 17th, it dropped 4.5%.

The Fed, which told us in 2021 that inflation was "transitory," seems stuck in the past, keeping rates higher than needed even as inflation drops. I fear the Fed's insistence on high rates could drive the economy off the road into recession. I don't think that will happen, but I wish the Fed would let the data speak for itself and leave the drama to reality TV.

I actually like 90% down days, though they feel awful at the time. They occur when 90% of the trading volume is on the downside, indicating a lot of selling pressure and potentially washing out weaker market players.

There have been 270 of these days in the last 50 years. I track where the market closes and check back two months later. Since 1978, out of 94 such days, the market was higher two months later 81% of the time with an average gain of 4.7%.

We've had nineteen 90% down days since 2022 due to the inflation fight. These selloffs have been great buying opportunities, especially in the last 2 years. The last time the market was actually *down* 2 months after the 90% day was August 2022. Other than that hiccup, the average gain for the market 2 months later was 5.5%. Time will tell.

On April 12, the market overreacted over a hot CPI, marking the latest 90% day. Stocks celebrated the two month "anniversary" recently with a 6% gain as of June 12th. Many investors focus on winning the day without considering the longer picture. Time is the ultimate advantage enduring short-term discomfort for potential long-term potential gains.

The tech sector has been seemingly unstoppable lately. Just when it looks like there might be a rotation, tech surges higher again. I'm still long-term positive on stocks, especially tech, but I wouldn't be surprised by a pullback. I saw the following stat from Sentiment Trader that captures my feelings about tech.

The S&P 500 has 70% of its companies over their 200-day moving average, a sign of a long-term uptrend. But, on the tech-heavy NASDAQ, only 40% of stocks are above their 200-day moving average. This indicates that the gains are coming from a few companies.

It’s not a huge issue, but it could cause a short-term dip. This pattern happened only five times in the last 15 years, and the last three were 2019, late2021 and early 2022 -stocks fell all three times. I wouldn’t mind a pullback to buy some few stocks we’ve been eyeing.

May 2024 was the best “May” for the market in 15 years. What happens for the rest of the year? Ryan Detrick at Carson found that after the top 10 Mays, the market was up 70% of the time for the remainder of the year with a 10.5% gain. Nice to have a potential market tailwind in your pocket if we do see that pullback. If you have any comments, feel free to contact me at heddins@capital-invest.com or call at 919-656-0836.

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