Good morning. As a follow up to our previously published article, What Is Going On With The Stock Market – Part I – we are going to cover what we believe investors need to worry about in the second half of 2023 and in to 2024. As we covered yesterday, the big fears at the beginning of the year were: 1) Recession 2) High Inflation 3) A too aggressive Fed 4) Earnings declines. These risks never came to pass and the equity markets rallied. Going forward, however, these risks very much remain, they simply may not show up on schedule as expected. Go figure! If these worries do creep into the economy, and show up in the data, then be on the lookout for:

Risk One – It's Not Different This Time

- Historically, just about every Fed Rate Hike campaign has ended in a growth slowdown which in turn takes down earnings. The current multiple on the S&P 500 is 19x, per Factset. In a typical recession, the multiple often falls to a range of 15x – 17x. which would bring the S&P 500 result in a 11% - 22% decline from today's levels and put a target on the S&P 500 of 3432 – Below the October lows of 2022[1].

Risk Two – Stagflation

- What happens if inflation stops declining AND growth slows. If you are up for a history lesson, look at the experience of the United States in the 1970's for a preview. Last Friday's jobs report showed that wages ticked up but hiring decelerated. While one report does not establish a trend, this is the type of data to look for. The data point to look out for is the decline in CPI. The next CPI report is due tomorrow, 7/12/23.

Risk Three – Disinflation Hurts Corporate Earnings

- As inflation cools and prices drop, companies are seeing increasing margin compression and corporate profits may suffer. In this case, earnings could decline and the market multiple may increase even if the market stays exactly where it is. In other words, if earnings decline 3%, the market would decline 3% just to stay where it is. Rarely does the market trade at a 19x level when earnings are in decline.

Bottom line here is just because the market hasn't realized the risks that were front-and-center at the beginning of 2023 doesn't mean the risks aren't still there. As we have done throughout this difficult market that began in early 2022, we will follow the data and react accordingly if necessary. Our goal with these two write-ups was simply to give you both sides of the glass being half full or half empty. I hope you found the analysis to be thought provoking.

Regards,

Tim

PS – We got some great inflation data on 7/10/23 with the Manheim Used Vehicle Value Index -4.2% month over month and -10.3% year over year. This is a little known inflation gauge that is monitored by the Federal Reserve.

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Sources: The Sevens Report[1]

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