WEEK AHEAD August 15-19, 2022

MARKET COMMENTARY by Sowell Management

[TACTICAL] Equity and bond markets posted another week of solid gains as the market consensus of both CPI and PPI expectations is softening. Inflation concerns remain as U.S. unit labor costs rose higher than consensus while labor force participation rate remains below pre-pandemic levels. With the market's momentum, Sowell's tactical signal for the week moved into neutral territory.

Markets. This past week opened on a positive note, and stocks edged higher as investors anticipated positive results in the latest round of quarterly reports. The CPI (Consumer Price Index) release on Wednesday morning surprised the market with an 8.5% 12-month-growth in inflation, down from the 9.1% reported in June, signaling that inflationary pressure may be easing. Stocks jumped on the news, with S&P500 and Nasdaq up 1.78% and 2.36%, respectively, in the early morning and closing even higher. On Thursday, the latest PPI (Producer Price Index) release showed that, in the last month, suppliers had raised prices at the lowest rate since October 2021, bolstering the thesis that economic activity is cooling down. On Friday, the market closed higher, marking a fourth weekly gain driven by investors' positive reaction to the two inflation-tracking reports.

The week marked a second consecutive month of declining gas prices in the United States. The national average price for a gallon of gasoline fell to $3.99 on Thursday, down from the high of more than $5 a gallon in June, driven by a decline in global oil prices in recent months and a tax break on gasoline enacted by a number of states.

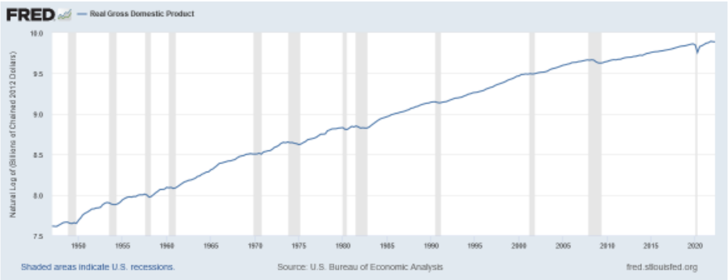
Stocks. Disney posted strong earnings after adding 14.4 million subscribers in Q3, overtaking Netflix as the world's largest streaming service. The Japanese giant SoftBank announced a cut on its Alibaba Stake after reporting a striking $23 billion loss for the quarter, driven by the global sell-off in tech stocks. An early investor in China's Behemoth, SoftBank will see as much as $34 billion in gains from the trade.

Politics. On Friday, the House passed a climate, tax, and healthcare program dubbed the Inflation Reduction Act that will impose new taxes on shares' buybacks for large corporations, provide some $80 billion to the IRS, and allow Medicare to negotiate drugs prices directly. Additionally, it will fund hundreds of billions in tax subsidies to fight climate change, targeting a 40 percent reduction in greenhouse gas emissions from 2005 levels by 2030.

After last week's encouraging CPI and PPI reports, Wednesday's Federal Open Market Committee (FOMC) Meeting will offer detailed insights regarding the FED's stance on monetary policy. Despite the more promising inflation outlook, San Francisco Federal Reserve Bank President Mary Daly suggested this week that the Central Bank's monetary tightening is not likely to end soon. Daly hinted at a 50 basis points hike in September that could easily grow to 75 points in the event of unpromising economic data in the coming weeks. On Wednesday, investors will also be paying careful attention to the most recent U.S. Retail Sales report, a gauge of goods and services demand, that will show whether consumer spending remained robust in the past month or began to slow down. Retailer Stocks will also be on watch, with Walmart, Home Depot, and Target revealing their quarterly results next week.

To Be or Not To Be? A Recession Case

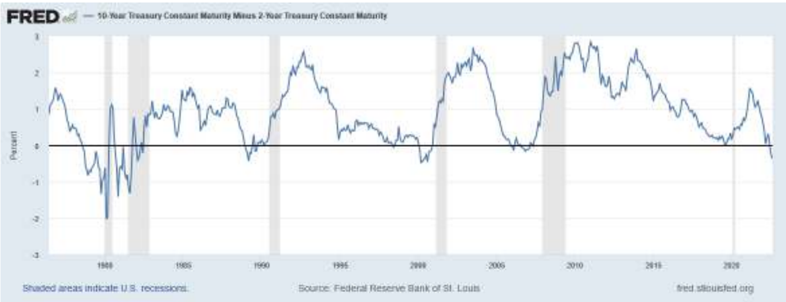
A recession is a significant, widespread, and prolonged decline in economic activity, usually lasting six months or more. Technically, a recession has traditionally been defined as a period during which real GDP (Gross Domestic Product) declined for two consecutive quarters. This definition has worked for most U.S. economic downturns since the Great Depression. See chart below.



But is this single indicator right today? Let's start our analysis by looking at what constitutes GDP and why the decrease in Q1 2022 may not be as significant as you think. The four major components of Gross Domestic Product are: personal consumption, investment spending, government spending and net exports (value of exports minus value of imports). These components don't move in lockstep with each other. Investment spending and net exports are extremely volatile, while government spending and personal consumption are highly stable. This is reflected in their quarter-to-quarter change following important monetary policy decisions: Investment spending and net exports quickly react to changes in interest rates. In contrast, government spending and personal consumption adjust over time.

In the first half of the year, the decline in GDP was driven by a decline in net exports (likely caused by the steep appreciation of the U.S. dollar against foreign currencies). Personal consumption increased during the same period. This highlights how demand remained quite strong despite an overall decrease in GDP in the first half of the year. Other indicators like industrial production and the consumer price index have been trending up until recently, and unemployment levels have touched a half-century low at 3.5%. Therefore, on the one hand, the economy appears to be more solid than described in the media. On the other hand, however, some other important economic indicators appear to be supporting the recession claim.

A negative 10-2y yield spread on U.S. Treasuries often referred to as an inverted yield curve, has historically been a leading indicator of an economic downturn. As shown in the chart below, the curve inverted this year in June as a result of the market reaction to the FED tightening policies.



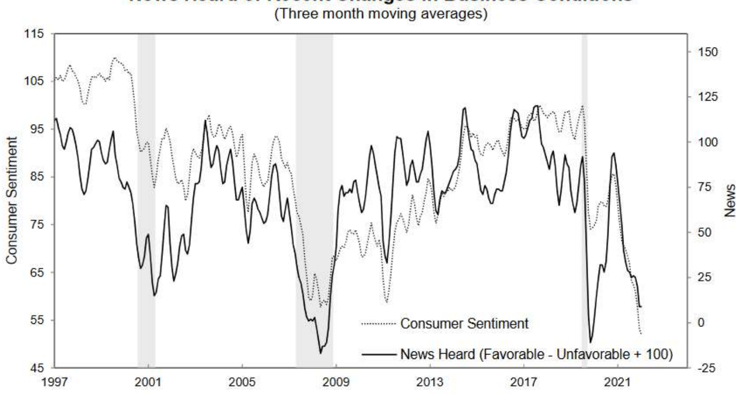
MON AUGUST 15, 2022	
US Foreign Buying, T-bonds	
NAHB Housing Market Index	
TUE AUGUST 16, 2022	
Redbook	
Housing Starts	
Industrial Production	
Agilent, Home Depot, and Walmart earnings	
WED AUGUST 17, 2022	
Mortgage Market Index	
Retail Sales	
Business Inventories	
Analog Devices, Bath & Body Works, Cisco, Krispy Kreme, Lowe's, Synopsys, Target, and TJX earnings	
THU AUGUST 18, 2022	
Initial jobless claims (weekly)	
Continuing jobless claims	
Existing Home Sales	
US Leading Index	
Euro Zone CPI and Core CPI	
Applied Materials, BJ's Wholesale Club, Estee Lauder, Kohls, Madison Square Garden Sports, and Ross earnings	
FRI AUGUST 19, 2022	
Deere, and Foot Locker earnings	

SELECT INDICES

	YTD Daily	1 Wk Daily	1 Mo Daily	3 Mo Daily	1 Yr Daily	2 Yr Daily	3 Yr Annualized Daily
S&P 500 Index	(9.34)	3.31	12.23	9.38	(2.61)	14.24	15.98
S&P 500 Growth Index	(14.73)	3.13	15.73	14.61	(6.13)	12.42	18.39
S&P 500 Value Index	(3.35)	3.49	8.96	4.63	0.87	15.89	12.32
NASDAQ Composite	(16.21)	3.10	15.89	14.98	(11.31)	9.63	19.35
Bloomberg US Agg Bond	(8.89)	0.24	1.25	0.52	(9.23)	(5.15)	(1.06)
Bloomberg Long Term US Treasury	(20.28)	(0.74)	0.74	(0.94)	(18.80)	(14.55)	(4.96)
Basic Materials	(8.97)	5.21	13.58	1.57	(3.04)	17.57	16.61
Communication Services	(24.66)	4.44	7.32	4.55	(28.74)	0.09	6.48
Consumer Cyclical	(17.25)	3.78	20.15	16.87	(9.79)	11.76	18.19
Consumer Defensive	(1.84)	1.29	4.77	0.07	5.02	12.01	12.98
Energy	44.58	7.63	15.59	3.48	64.99	50.68	17.56
Financial Services	(8.81)	4.68	12.38	9.29	(9.05)	16.75	11.48
Healthcare	(5.97)	1.69	4.57	7.29	(1.53)	11.39	15.02
Industrials	(5.64)	4.06	15.73	10.71	(3.61)	15.62	12.22
Real Estate	(10.86)	4.39	11.36	9.04	(1.08)	14.18	7.13
Technology	(16.24)	2.61	17.62	15.40	(5.13)	15.09	25.37
Utilities	8.62	3.47	9.87	9.55	15.96	15.58	10.86

Likewise, the index of consumer sentiment, a gauge of people's sentiment about the status of the economy, has been declining steeply in the past year, suggesting that people's propensity to consume is decreasing.

Index of Consumer Sentiment and News Heard of Recent Changes in Business Conditions
(Three month moving averages)



So, are we in a recession?

Our view is that the economy is still growing but at a slower pace than in previous months. Although the risk of recession is "alive and well," we are not there just yet, and consumer demand is too strong and employment levels too high to call this environment recessionary. But even if we are not in a recession now, we cannot ignore what multiple economic indicators suggest. A slump in economic activity will likely materialize eventually, and we expect this to be in early 2023 when the FED rates' hikes start taking effect.