



Week Ahead

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 Week of **August 28, 2023**

Jackson Hole Commentary: Hawkish Powell Ready to Ruffle Feathers

Federal Reserve Chair Jerome Powell's speech from Jackson Hole last Friday did not have any sign that interest rates would be coming down any time soon. In our view, the bias in his speech was clearly hawkish. He ended where he began at last year's meeting, "We will keep at it until the job is done." This is a nod to former Fed Chair Paul Volker and the title of his book, Keeping At It. The Fed has been extremely transparent on where it stands on monetary policy and has delivered on its promises to fight inflation with rates rising the fastest in history, from 0% to 5.25%. What we take away from Fed Chair Powell's speech is that if the data does not support a slowdown in inflation, the Fed will not hesitate to continue to raise rates. Powell said, "We intend to hold policy at a restrictive level until we are confident inflation is moving down."

The risk here is rates on both the front-end and back-end of the yield curve remain elevated and can move higher. With the short-end above 5% and the long-end looking to push up into the 5% area pressure on equities will continue, especially since stocks are priced rich with a price-earnings ratio at 20x.

10-Year Treasury Yield – Risk To 5% Area



Source: Stockcharts.com August 24, 2023

2-Year Treasury Yield Already At 5%



What Does This Mean For Investors?

It is clearly painful to have fixed income with negative returns so far for a third year in a row – which historically has never happened before. But we also never had zero interest rates for a sustained period of time before either. Trying to fight inflation while trying get back to a normal interest rate environment is a painful situation, but there is no other way. Yet what this does for portfolios in the future is provide a long-term 5% risk-free rate, something which has not happened in 16 years. This is happening at a time when we have Baby Boomers moving into retirement. Did you know that, on average, there are 10,000 Baby Boomers reaching retirement age every day!

James Bullard, Former Fed Governor, Remains Ultra Bearish on Rates

James Bullard, former President of the Federal Reserve Bank of St. Louis, said a pick-up in economic activity this summer could delay plans for the Fed to wrap up interest-rate increases. “This reacceleration could put upward pressure on inflation, stem the disinflation that we’re seeing and instead delay plans for the Fed to change policy,” Bullard said Thursday during an interview with Bloomberg Television. Bullard, who resigned last month to become Dean of the Mitchell E. Daniels, Jr. School of Business at Purdue University, was an influential voice at the Fed, where he called for aggressive interest-rate hikes to fight the recent inflation surge. Bullard has questioned for months whether the Fed needs to move the policy rate to as high as 6%, and he reiterated this level in a Wall Street Journal article last week. This confirms to us that Fed Chair Powell and the Committee will remain steadfast, “keeping at it”, to get inflation down -- which is bullish for the long-term for the economy and portfolios.

Stocks to Remain in a Correction

Despite the improvement in earnings, higher interest rates continue to put pressure on equities, particularly with rich valuations at 20x price-earnings multiples within the S&P 500. But equities have been extremely overbought with significant gains. Markets don't keep marching straight upward, they correct to adjust for excesses that take place. As we have talked about, seasonal weakness is normal in late summer and into the fall. Markets tend to have important bottoms in October. We still expect markets to remain choppy with potentially more downside, with the S&P 500 correcting 5%-10% now, leaning more toward 10%, and Nasdaq correcting 10%-16%, leaning toward 16%. We remain buyers of this pullback.

Growth vs. Value: Where Is the Long-Term Leadership?

What if Growth and Value investing doesn't matter as much as it has historically? Market structure has changed dramatically, with a handful of mega-cap companies dominating market indices. Maybe good old-fashioned stock picking or factor-based investing matters more now. The market is moving more toward looking at equally weighted indices to have a better idea of how the broader areas of the market are truly behaving.

But with so many investors investing based on Growth and Value, let's review what drives this segment of style investing. Growth does better in a scarce earnings environment as investors are willing to pay up for earnings growth. NVIDIA (NVDA) is a very good example of this. Value investing comes into vogue when earnings are abundant, so investors are not willing to pay up for earnings, since there is an abundance of earnings available in the market.

Looking at market cap indices of Growth and Value would indicate Growth could be in a super cycle, meaning the secular trend favors Growth with Value underperforming from time to time. Fundamentally this makes sense. We have a hard time believing Value can now take leadership with negative fundamentals working against the Banks, particularly the regional banks, which are a significant part of Value investing. Energy is split between Growth and Value, and this is the area of Value we like longer-term. That leaves Growth leading the pack, and fundamentally this makes sense since we are in the Digital Era, which began in 1990s with the birth of the internet.

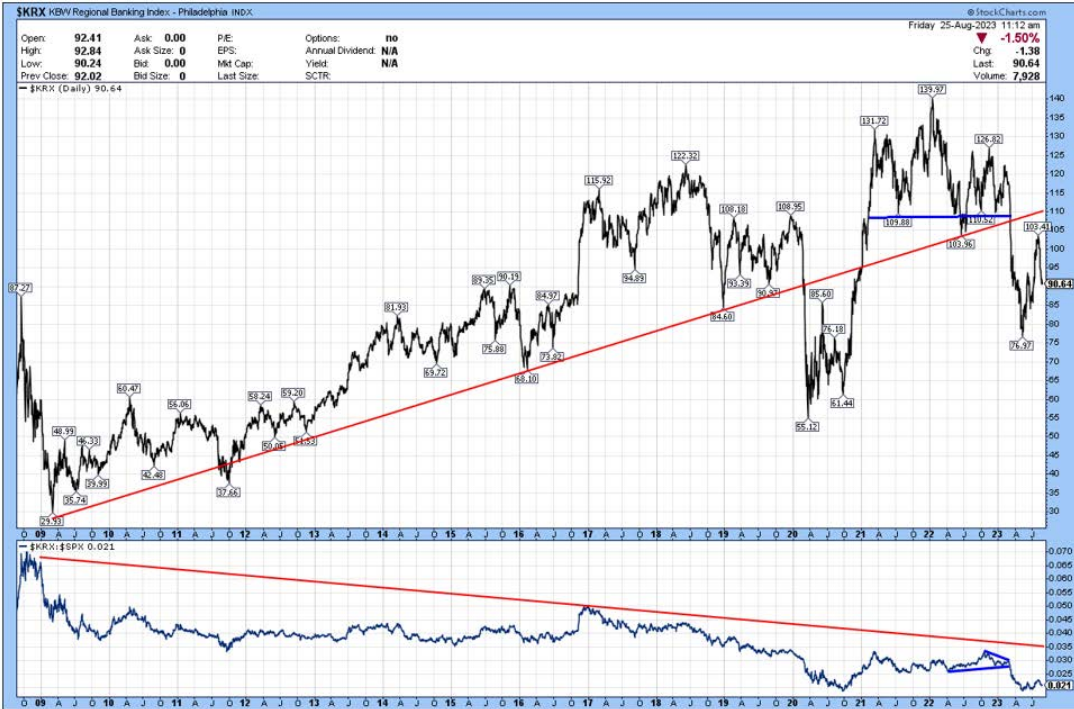
The next level of growth for the economy is Artificial Intelligence. We know this is a real transition in the global economy based on the blow-out earnings produced by NVIDIA (NVDA) and the demand it is getting for its chips. NVDA has a lead and significant competitive advantage making graphics processing unit chips (GPUs) – which do parallel processing (multiple computations at the same time) and a closed software (meaning it does not work on other chips). Other competitors are trying to enter the market, but this will take time. How long? Well, one example is Advanced Micro Devices (AMD), who has said its chip is not expected to be available until 2025.

Other companies, such as Amazon (AMZN) and Microsoft (MSFT), are trying to develop their own GPU chips, but the key here is that those delivery dates are way out in the future. This will give NVDA a long competitive lead. The NVDA stock is not grossly expensive based on this fundamental fact. It trades at a 40x-ish price-earnings multiple, which is where the stock has traded at historically. This certainly is not the bubble of 2000 when multiples were in the 100-200x. We have favored Semiconductors and continue to believe they are a high conviction investment.

Russell 1000 Growth Vs. Russell 1000 Value



Regional Banks Have A Secular Breakdown



Source: Stockcharts.com August 24, 2023

Energy Vs. Regional Banks: Energy To Outperform

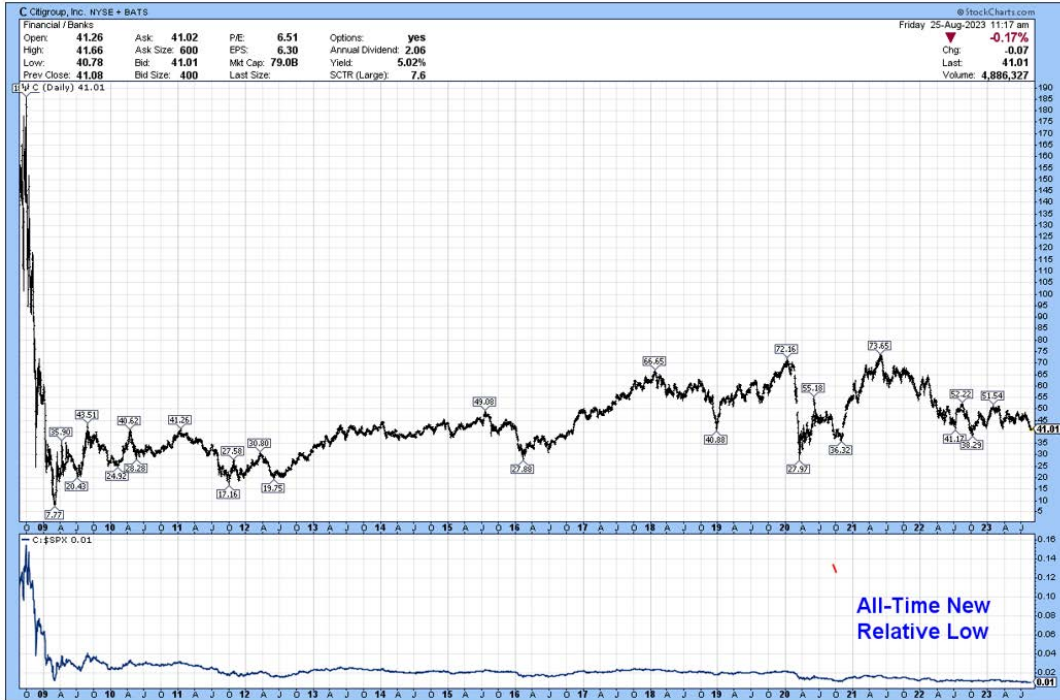


Source: Stockcharts.com August 24, 2023



Week of **August 28, 2023**

Citi Bank (C): Stock At All-Time Relative Low



Source: Stockcharts.com August 24, 2023

Positioning

We remain balanced within asset classes as we focus on quality, which has done very well this year. Within the equities market, we favor Technology, with a focus on Semiconductors and Software & Services, Industrials and Energy. We also focus on companies with positive cash flow and low debt. Within fixed income, we suggest a barbell approach of a combination of the short- and long-end of the curve. Consider select municipals for tax aware accounts. All Eyes on Jobs, Housing and Especially Inflation.

This is another week when thin trading volume will be vulnerable to continued volatility due to the ongoing data parade. As summer winds down, so does daily trading volume. But there's no end to the litany of data coming our way this week. From the Job Openings and Labor Turnover Survey (JOLTS) to pending home sales to inventory data for retail and wholesale, we'll get a lot. And sitting on top of all that will be the Core PCE data (Personal Consumption Expenditures Price Index), which is the favorite inflation indicator of the Fed and a topic Fed Chair Powell addressed in Jackson Hole. So, if any of these numbers rock the boat during a low volume week, expect a splash.



Calendar

Mon.

Earnings
HEICO

Tue.

9:00 am
10:00 am
Earnings
S&P Case-Shiller home price index (20 cities)
Job openings, Consumer confidence
Ambarella, American Woodmark, Best Buy, Big Lots, Box, Catalent, Donaldson, Hewlett Packard Enterprise, HP, J.M. Smucker, Malibu Boats, Nio, Pinduoduo, PVH, ZTO Express

Wed.

8:15 am
8:30 am
10:30 am
Earnings
ADP Employment
GDP (Revision), Advanced U.S. trade balance in goods July, Advance retail inventories, Advance wholesale inventories
Pending home sales
Brown-Forman, Chewy, Conn's, Cooper, CrowdStrike, Five Below, MasterCraft, Okta, Patterson Companies, Veeva Systems, Victoria's Secret

Thu.

8:30 am
9:45 am
Earnings
Initial jobless claims, Personal income (nominal), Personal spending (nominal), PCE index, Core PCE index, PCE (year-over-year), Core PCE (year-over-year)
Chicago Business Barometer
Academy Sports + Outdoors, Broadcom, BRP, Caleres, Campbell Soup, Dollar General, Genesco, Hello Group, Hormel Foods, MongoDB, Nutanix, Ollie's Bargain Outlet, Signet Jewelers, Titan Machinery, UBS

Fri.

8:30 am
10:00 am
U.S. nonfarm payroll, U.S. unemployment rate, U.S. hourly wages, Hourly wages year over year
ISM manufacturing, Construction spending

Source: MarketWatch/Kiplinger

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