Stirling Bridge
Wealth Partners, LLC

MARKET COMMENTARY – August 1, 2023

Every tub must stand upon its bottom. ~ John Bunyon

No matter how high his throne a king must still sit upon his rump. The same goes for our own benches and bottoms, as well as skyscrapers and market cycles. Well, for tall towers, they sit on foundations. And for markets, they build up from recessions.

It seems clear to many observers a light recession occurred in 2022 (and perhaps before). We'll leave it to our astute readers to conjure reasons why two negative quarters of GDP, runaway inflation, terrible labor force participation, a 25% drop in broad stock prices, and the start of a multi-quarter streak of falling earnings did not tempt Business Cycle Dating Committee members to call a spade a spade.

Today, we focus on the last set of data points in the list above. Earnings for S&P 500 companies began dropping in 1Q 2022. As of the end of the quarter just reported (2Q 2023), profits remain well below the peak. But markets try to overcome one aspect of our natural human condition. They attempt to look forward and not merely remain mired in the present. With that in mind, was 2Q 2023 the nadir for earnings? Was it a new bottom, upon which future earnings (and stock prices) may build?

Thus far in 2Q earnings season, over half of companies have reported. And while the vast majority of those companies are churning out better results than expected, those results are 7% lower on average than 1Q. This drop in bottom-line figures occurred despite slightly positive top-line growth. It is clear the inflation that tormented the consumer last year finally caught up with the big boys. Expenses for companies have grown faster than their revenues can cover.

But that wicked trend appears to be in the process of forming a trough. Corporate earnings calls have consistently mentioned they are seeing an end to rapid cost inflation. And labor statistics show that employee wages recently grew at the lowest rate in over a year.

The slow improvement in ballooning costs and the steady emergence from a recession that was never so named, means that corporate managements and independent analysts now forecast earnings for 3Q 2023 to improve by 5-10% over 2Q results.

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And, at the risk of being labeled a cheerleader, we must also admit that inflation data has improved in the aggregate. From a peak of over 9% in July 2022, the most recent reading of the CPI for June 2023 fell to 3%. It seems likely that the easiest improvements in inflation are behind us, and so we expect the results for coming months to bounce between two and three percent. Even the stubborn "Sticky Price" subset of the CPI has rolled over and is growing at a slower rate (still too high).

Before we move on to stock and bond returns, let us remember one important thing. Inflation data falling does not mean prices are dropping. They are still expanding, albeit at a slower pace. So, let us not think we will head to the car lot or grocery store anytime soon and see cheaper SUVs or snacks.

And so, given that hard data proves a decrease in inflation and forecasters think earnings will begin to rebound very soon, what are markets saying? It is mixed.

The bond market yield curve remains inverted, meaning long rates are lower than short rates. This is typically a mark of a coming recession as investors buy long-dated bonds, driving down yields. It might certainly be again this time, especially if the Fed pushes rates too high when their job is mostly done. However, recall that we think we are emerging from a shallow recession. If that is the case, longer rates should soon increase to flatten the curve as investors take incremental dollars from bonds into stocks.

The stock market clearly thinks a "soft landing" and an end to the earnings recession is nigh. It has rallied with gusto since the farce that was the US "default" risk was resolved at the beginning of June. As measured by the S&P 500, stock prices have jumped about 10% since late May.

And though we are not beating drums or pounding tables, we think reasons remain for a slow recovery in returns to continue. Perhaps our tub has found its bottom.

Stirling Bridge Wealth Partners, LLC is fortunate to count many of you as clients. In the good times and bad, we remain committed to providing customized investment solutions and robust financial planning wrapped in a package of exceptional service. We thank each of you for your dedication to us and for your trust.

Sincerely
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