

Good morning,

What's in this week's Report:

- Is This An "Earnings vs. Everything Else" Market?
- Weekly Market Preview: A Sneakily Important Week for Earnings, Economic Growth and Iran
- Weekly Economic Cheat Sheet: Does May Economic Activity Stay Resilient?

Futures are extending Friday's declines and are moderately lower as there was no progress on a U.S./Iran ceasefire over the weekend.

The UAE and Saudi Arabia reported limited drone attacks on energy infrastructure, and while markets still expect a ceasefire, the chances of a resumption of fighting are rising.

Economically, Chinese data was soft, as Industrial Production (4.1% vs. (E) 6.0%), Fixed Asset Investment (-1.6% vs. (E) 1.7%), and Retail Sales (0.2% vs. (E) 2.0%) all missed estimates by wide margins.

Today's focus will remain on geopolitics, as President Trump meets with his national security team. While not the majority expectation, the chances of a resumption of direct U.S. attacks on Iran are rising (and if that happens, markets will drop). Away from geopolitics, the only notable economic report is the Housing Market Index (E: 34), which shouldn't move markets.

Market	Level	Change	% Change
S&P 500 Futures	7,419.25	-13.00	-0.18%
U.S. Dollar (DXY)	99.00	-0.20	-0.21%
Gold	4,558.50	-3.50	-0.09%
WTI	101.10	0.08	0.08%
10 Year	4.597%	-0.002	-0.04%

## Stocks

### **Last Week (Needed Context as We Start a New Week)**

Stocks continued to power to new highs last week as AI enthusiasm grew amid strong semiconductor earnings and resilient U.S. economic data that overshadowed no progress towards a ceasefire and suddenly surging yields. The S&P 500 rose 0.17% last week.

Equities stumbled to start last week as oil rallied beyond \$100/barrel amid continued failed attempts to secure a ceasefire. Still, a resilient bid in AI-sensitive tech and semiconductor names offset geopolitical angst and the related rise in oil and bond yields. The S&P 500 rose 0.19%.

Stocks opened lower on Tuesday thanks to the hot CPI report, which showed inflation pressures building. The S&P 500 pulled back to support at 7,350 before stabilizing, helped by a Reuters article on resilience in corporate bond markets. Treasury yields leveled off, allowing the index to recoup intraday losses and close down just 0.19%, ending just above 7,400.

Tuesday's afternoon rally extended into Wednesday's open despite another hot inflation report (PPI). Robust earnings from AI-infrastructure company NBIS, paired with optimism over the list of mega-cap tech executives accompanying Trump to China, buoyed tech and lifted the S&P 500 by 0.58%.

The market marched to new highs Thursday, with tech again leading thanks to strong earnings and upgraded guidance from tech giant CSCO. Largely Goldilocks economic data supported the broad advance until news broke that the AAPL-OpenAI business relationship was "fraying," with a high-profile lawsuit potentially looming. The S&P 500 hit a record 7,520 before closing just above 7,500 for the first time, up 0.77%.

Stocks fell sharply on Friday as a lack of tangible takeaways from the U.S.-China summit, combined with a sizeable rally in oil prices and a jump in Treasury yields, weighed on the major indices. The S&P 500 attempted to rebound in the afternoon but rolled over, closing just off the morning lows, down 1.24%.

#### Earnings vs. Everything Else?

Last week was a perfect representation of this market since the U.S./Iran conflict started, as the majority of the headlines were "negative" including 1) No progress on a ceasefire, 2) Higher oil prices, 3) Rising bond yields, and 4) More evidence of extreme optimism/exuberance in tech, but they were all offset by very strong tech-related earnings (CSCO, AMAT) and solid economic data.

Friday also provided a warning that, at these stretched valuations, the headwinds are getting stronger, and if we get disappointing earnings or hints of stagflation, a sharp pullback will follow. Put differently, this market is facing real problems. High energy prices, rising inflation, possible rate hikes, extremely thin leadership, tech stock exuberance, and higher yields are all factors that could cause pullbacks on their own. And just because the market has rallied doesn't mean there aren't problems.

However, those problems have been overshadowed and offset by extreme earnings growth and solid economic data, and that was true last week as well, until Friday when spiking yields and oil were too much. With this many headwinds for stocks, a sustainable path higher is hard to imagine unless it's driven by sheer irrational exuberance in tech names. Instead, investors should hope that continued strong earnings (and there are many this week) can help support stocks at current valuations until those headwinds are reduced, which would then free the way for higher prices.

Bottom line, there are problems facing this market, but earnings and growth have offset them. If either of those two disappoints, this market will pull back (likely around 5%). However, if earnings and economic growth remain stable, investors can wait for the headwinds to ease, and as that happens, the path higher for the broader market (and not just tech) will open up.

### Important Earnings to Watch This Week

NVIDIA (NVDA), which is still the most important stock in the market, reports earnings on Wednesday night, and that report needs to be strong to support the broader market. But NVDA isn't the only important company reporting this week. Key consumer names HD (Tue), LOW, TGT, TJX (Wed), WMT, DE (Thu), and BJ (Fri) will give us important anecdotal insight into the state of the consumer, while software names (INTU on Wed, WDAY on Thu) could exacerbate or push back on software concerns.

It's not an exaggeration to say strong earnings are the most important reason the S&P 500 is up so strongly YTD. So, earnings this week need to stay strong to help keep these gains amidst building headwinds.

### Economic Data (What You Need to Know in Plain English)

#### Last Week

Data last week pointed to rising inflation risks. While that was partially offset by still-solid economic data (implying a run-hot economy rather than stagflation), the bond market reacted to the inflation data on Friday, and rising yields ultimately pressured stocks, telling us the market is not immune to rising inflation risks.

There were two key inflation reports last week, and both showed higher-than-expected inflation. Tuesday's CPI report showed a headline jump of 3.8% y/y, while the more important core CPI, which excludes food and energy prices, also rose sharply to 0.4% and 2.8% y/y, the highest level since September. While none of those numbers are that alarming by themselves, they are much higher than pre-war readings and, most importantly, are moving steadily away from the Fed's 2% target.

Wednesday's PPI was even worse, as headline PPI jumped sharply to 6% y/y, well above the 4.3% estimate, and that 6% jump is the highest level since 2022. Meanwhile, Core PPI, which again excludes energy prices, rose 4.4% y/y. The fact that higher energy prices are boosting headline inflation isn't a surprise. The problem is that if those higher energy prices begin to push inflation up across the rest of the economy, there is evidence that's already starting to happen. We know this because core services inflation in both the CPI and the PPI was higher than expected. This matters because when oil prices eventually decline (and they will at some point), it may not reverse the inflation impact—and that could lead to rate hikes and slower growth.

Turning to growth data—it was strong and further underscores that we are in a run-hot economy. The key report was retail sales, and they were solid. The headline met expectations, rising 0.5% m/m, and the more important control group, which excludes gas, cars, and building materials, beat expectations, rising 0.5% vs. (E) 0.4%. This number is important because it helps us tell whether high gas prices are impacting discretionary consumer spending, and so far, that does not appear to be happening (which is a good thing, because if it does start to happen, that would signal rising stagflation risks).

Other growth data was similarly strong last week as jobless claims rose to 211k, slightly above the 208K estimate. Meanwhile, the first look at May economic activity via the Empire Manufacturing Index was red hot. The headline reading was 19.6, while the leading indicator in the report, New Orders, was 22.7. It's just a regional metric, but it is our first look at May activity and still implies solid growth.

Finally, the price indices in the Empire Manufacturing Index also jumped, which is one of the reasons yields popped on Friday and pressured stocks. The Prices Paid index rose to 62.6 from 51, while the Prices Received index jumped to 31.8 from 21.8. Both numbers are the highest since 2022.

Bottom line: last week's data clearly showed that inflation pressures are building and that inflation could become a problem for this market in the medium term (coming months). So far, solid growth has helped offset that inflation risk, and it needs to stay that way, because if growth starts to slow, stagflation worries will rise, which would be significantly bad for stocks and bonds.

### **Important Economic Data This Week**

There are only a few notable economic reports this week. Still, they will give us broader insight into the pace of economic growth, which is now even more important as inflation pressures rise and growth needs to stay solid to push back on stagflation risks.

The key report this week is Thursday's flash PMI, which is important because it's the first look at national economic activity in May. Simply put, it needs to stay solid to keep pushing back on stagflation worries. That said, the price indices, which usually aren't followed closely, will also be in focus because if they jump, as we saw in the Empire report, it'll put upward pressure on yields, which is now a headwind for stocks.

Finally, the minutes from the May Fed meeting will be released on Wednesday, and the key will be how many Fed members favored becoming more hawkish (either by changing forward guidance or openly discussing rate hikes). Qualifiers such as "many, most, some, the majority of" will be key, and if the minutes imply that most Fed members are becoming more hawkish, it'll boost rate-hike chances and yields. And as we saw last Friday, that can weigh on stocks directly.

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**Richard Rose AIF®**  
917-597-7432  
rrose@nationwideplanning.com