WELLS TRECASO

FINANCIAL GROUP

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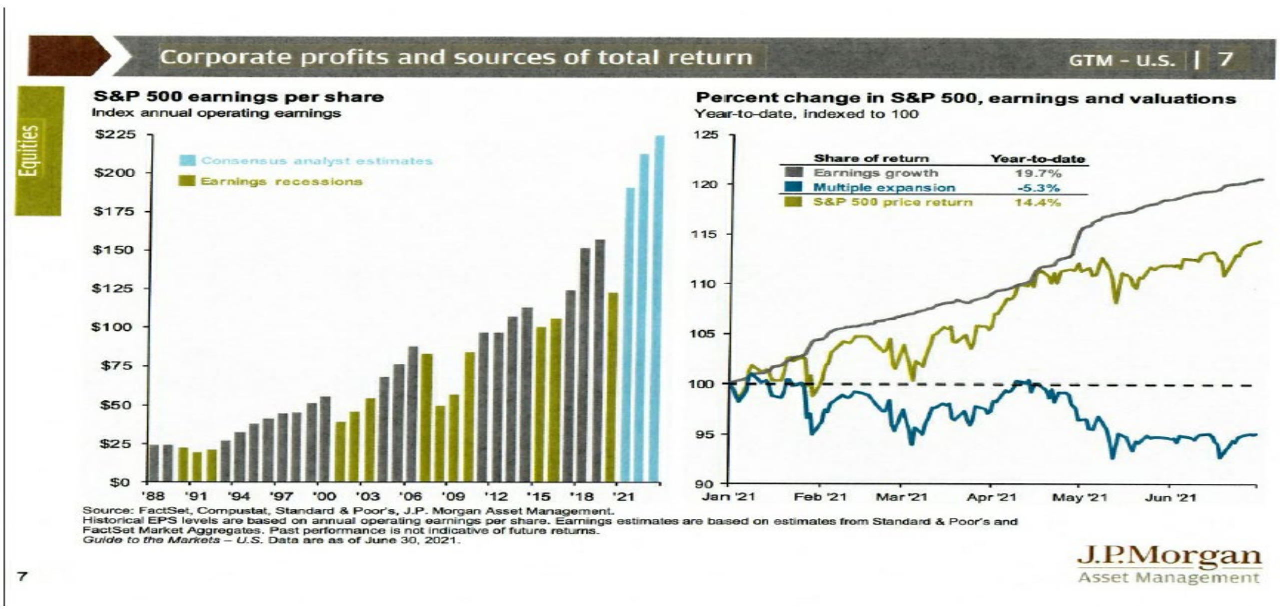
Portfolio Talk

Market Update 9/3/2021

In the words of the great Wayne Gretzky, “I skate to where the puck’s going to be, not to where it has been!” Sage advice that actually works well in the investment world. We often get caught chasing the hot stock given where the stock has come from, not to where it’s going. It’s hard to shelve the “greed factor” and focus on the longer-term fundamentals. But the stories that are behind the momentum stocks are sometimes so compelling that our belief in the “what if” takes over and we buy what we refer to as the sizzle instead of the steak. You can’t eat the sizzle, but it just sounds so good! So how do we avoid these “sizzle traps”? Focus on the fundamentals. We are in a bull market that is rarely seen. The cause and effects of COVID has accelerated a transition in our economy that’s reminiscent of our transition from agriculture to industrial, industrial to technology and now technology to AI (artificial Intelligence) and VR (Virtual Reality) where working remotely from any location has been made possible. Along with advancements comes opportunities. These opportunities will give us wave upon wave of new investments that could be profitable, but not all of them. The sizzle vs. the steak….we need to see where the puck is going!

Is the market in the sizzle zone? Some speculate that we are based on the markets continued rise. But is price alone a reliable indicator? Some believe it’s not. Why, because of earnings. As of June 30th, earnings growth was 19.7% year-to-date. The S&P 500 price return was 14.4%. That means the multiple on the S&P 500 actually contracted 5.3%, meaning the market was cheaper on June 30th than it was on January 1st.[i] See the chart below.



Impressive, right! Look at how the earnings have grown since the 80's, up 10-fold! Price alone doesn't always tell the full story on whether markets are cheap or expensive. Earnings are accelerating as we've discussed in previous updates. The question is, how will earnings compare to those after the reopening of the economy. We are hopeful they will return to the normal 4-6% per annum experienced in the past or better.

Geopolitical risks seem to be more in focus this week with the final evacuation from Afghanistan and China playing hardball with larger companies headquartered there, making them toe the line with employee pay and hours worked. The overriding theme is to share the wealth. I guess there are a lot of emotions tied to the evacuation. Questions arise as to whether it was worth the loss of life of some 2,300 American service men and women? The reasoning for going in was founded on getting the terrorists who perpetrated the horrific act on 9/11, but were we there too long? Two decades seems like a long time given we got Osama bin Laden on May 2, 2011, not to mention the $2 trillion we spent on the effort ($300 million per day). It's now hopefully behind us. China, on the other hand, may be backtracking, making their economy less capitalistic and more communistic. We do believe their number one concern is holding on to power. They announced this week their intent to establish a stock exchange in Beijing to help small to mid-sized companies find capital. Could this be an effort to prevent Chinese companies listing on our exchanges? Maybe, you have to start a journey with the first step and the steps they have taken recently lead us to believe they are consolidating power. And lastly, concern over their population's use of social media, in their view a tool used to spread discontent. I guess they should be scared, one only must look back to 2010 in the Middle East, and especially Egypt, to see how fast things can change when the populous rises up against dictators. Hosni Mubarak thought he had a firm grip on Egypt until he didn't. Some 61,000 individuals gave up their lives before he was forced out of power. Some credit social media for being the weapon of change. Could that be the reason China has limited the amount of time individuals can spend playing video games to three hours a week, one hour per day on Friday, Saturday, and Sunday evenings! They already monitor and prevent viewing some social media sites. And we think big brother is limiting our freedoms! However, it always starts with the small things and progresses to the bigger ones. Thank God we have our media, even though it's often biased in either direction, but it's still information where we can gather and analyze leading us to make up our own minds as to what we read/watch or not. China is not the Middle East and their military is strong. We need to watch them closely. They are the potential enemy that whether economically or militarily we may have to face down in the future. More about this later…….

Economic News

- Monday:
  - Pending home sales for July, -1.8% vs. 0.5% expected and -1.9% previously…inventory issue, not a demand!
- Tuesday:
  - Case-Shiller national home price index (year-over-year) for June, 18.6% vs. 16.8% previously…still hot!
  - Chicago PMI for Aug., 66.8 vs. 69.4 expected and 73.4 previously…slowing, but still very good. Above 50 indicated expanding economy.
  - Consumer confidence index for Aug., 113.8 vs. 123.1 expected and 125.1previously…the thought is the Delta Variant has weakened confidence. This is a more emotional indicator.
- Wednesday:
  - ADP employment report for Aug., 374,000 vs. 600,000 expected and 326,000 previously…look at Friday, some weakness!
  - Markit manufacturing PMI (final) for Aug., 61.1 vs. 61.2 expected and 61.2 previously…hanging tough!
  - ISM manufacturing index for Aug., 59.9% vs. 58.6% expected and 59.5% previously…very good.
  - Construction spending for July, 0.3% vs. 0.2% expected and 0.0% previously…good.

- Motor vehicle sales (SAAR) for Aug., vs. 14.8 million previously…shortage of chips causing a delay in delivery.

- Thursday:
  - Initial jobless claims (regular state program) for Aug. 28, 340,000 vs. 345,000 expected and 354,000 previously…shrinking!!!
  - Continuing jobless claims (regular state program) for Aug. 21, 2.75 million vs 2.91 million previously…well below 3 million!
  - Trade balance for July, -$70.1 billion vs. -$70.9 billion expected and -$73.2 billion previously…balance of trade came down a little, still more imports than exports!
  - Productivity (revision) for Q2, 2.1% vs. 2.4% expected and 2.3% previously…slowing, supply chain issues?
  - Unit labor costs (revision) for Q2, 1.3% vs. 0.9% expected and 1.0% previously…slightly higher.
  - Factory orders for July, 0.4% vs. 0.3% expected and 1.5% previously…very good.
  - Core capital goods orders (revision) for July, 0.1% vs. 0.0% previously…okay.
- Friday:
  - Nonfarm payrolls for Aug., 235,000 vs. 720,000 expected 943,000 previously…we need to look at the three-month average to flatten the curve. Extended benefits from the Cares Act roll off this month, let's see what happens in the next four weeks.
  - Unemployment rate for Aug., 5.2% vs. 5.2% expected 5.4% previously…inline.
  - Average hourly earnings for Aug., 0.6% vs. 0.3% expected and 0.4% previously…we are starting to see the wage increases due to the short supply of workers show up in the data. Is this permanent inflation? Yes, but technology could replace some of these workers down the road. More later….
  - Markit services PMI (final) for Aug., 55.1 vs. 55.3 expected and 55.2 previously…great, above 50 is economic expansion!
  - ISM services index for Aug., 61.7% vs. 61.6% expected and 64.1% previously…validates the number above.

While we continue to show progress in our economy, the Delta Variant is cause for concern. Several companies have announced a delay in bringing workers back to the office. Schools are opening with a few having to close until after Labor Day due to outbreaks. These are issues that are not major currently but need to be watched closely. It appears that the Delta Variant has peaked and is on the decline in the South and Southwest. However, the East and Northeast is expected to peak in the next week or two, according the Dr. Scott Gottlieb, former Commissioner of the FDA under the Trump Administration. Earnings season will be upon us in about 5 weeks. Whisper numbers should start filtering out in the next week or two and that should give us an indication as to what the 3rd quarter will look like. Morgan Slaney just took their 4th quarter GDP estimate down to 2.9% from 6.5% due to the Delta Variant. Time will tell if they're right. We believe that's a little much!

Have a warm a peaceful Labor Day weekend and let's hope an Indian Summer lasts until June! That may be asking for a bit much……

Stay Safe!

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[i] JPMorgan Asset Manager dated 6/30/2021