THE DANA VIEWPOINT

June 26,2024
Dow: 39,128

Good News/Bad News

Let's just start by postulating that the stock market is not cheap, as valued by price to earnings. Markets that are at all-time highs never are, and markets normally get to new highs by having price gains outpace earnings gains. The title of this Viewpoint might lead you to believe that we are going to equivocate, an unpleasant habit of many market prognosticators, which ends up offering no help to the investor. The goal is to offer insight as to what factors are most important to the markets right now and how they might influence future market returns.

Earnings are one of the most important factors in moving the markets. It is not their absolute level or rate of growth that moves markets, but their levels and rate of change relative to consensus expectations. The consensus does not always end up being predictive of actual results. Our portfolio managers can be most positively impactful to portfolios when their opinions differ from the consensus and they are correct.

First quarter earnings reports provided the largest magnitude of positive surprises in over two years. These reports came out in late April and early May, during a time when the market was in a sideways consolidation following a 23% gain in the previous two quarters. The slight market downturn of about 5% in April was no doubt softened by the strong earnings reports relative to expectations. As these reports have been digested, the equity market has moved on to new all-time highs.

Let us restate that the market never looks cheap when it is at all-time highs, and it gets there by having some future potential gains pulled forward. The bar only gets higher for investable companies. One factor that makes us optimistic is that the rate of inflation has moved to a rate that is below the rate of income growth. Buying power is increasing, and employees should expect to recover most of what they lost to inflation.

Asset prices should also provide a boost to consumer sentiment, even though they also increase inequality. Over the last five years, the S&P 500 is up 15% annually, and home prices across the nation are up about 50% in total. This should continue to provide a sentiment boost to spending. For those that have owned their current home for a number of years, it also provides a large spending reservoir that can be tapped through home equity loans.

(CONTINUED ON REVERSE SIDE)

Although it is only at 4%, the unemployment rate is at its highest level since early 2022. An unemployment rate that moves up slightly from historic lows can actually be a good thing for the economy because it helps reduce the scarcity and cost of labor. It also typically represents people reentering the labor force and looking for work - a sign of economic optimism.

As inflation continues to stabilize or move lower in fits and starts, and concurrent economic indicators do not continue to strengthen, pressure increases on the Fed to begin to reduce rates. Market interest rates have stabilized or drifted lower this quarter, beginning to anticipate Fed rate reductions. This has reversed the negative returns that most bond investors experienced in the first quarter and offers bond investors a wonderful opportunity to earn attractive returns well above inflation. Money market rates have likely peaked, so we see value in extending maturities to lock-in higher yields longer.

The good news is that the economy has remained relatively strong despite higher interest rates and somewhat stubborn inflation. The bad news is that growth may be plateauing or slowing, and the lagged monetary effects of the Fed tightening may be in their early stages. The best news may again be the resiliency of the American economic machine. American innovation leads the world, and the current advances taking place could mark a continuation of the current prosperous era.

Random Thought: "The sun illuminates the world, knowledge illuminates a man."

-Mongolian proverb

20700 SWENSON DRIVE • SUITE 400 • 53186 • P.O. BOX 1067 • BROOKFIELD, WI • 53008-1067 • 262.782.3631 • FAX 262-782-0581
365 ERICKSEN AVENUE.N.E. • SUITE 312 • SEATTLE, WA • 98110-1888 • 206.855.8781 • FAX 800.560.6227

E-Mail: dia@danainvestment.com
Web Site: www.danainvestment.com