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INVESTMENT COMMENTARY & OUTLOOK

July 2022

Despite a horrible start to the year and all the talk about a recession, amazingly there is no "earnings recession." The top-down strategists are completely out of sync with the boots on the ground analyst community, which is more positive. Frankly, the analyst community is smarter than the macro strategists that keep calling for a recession.

As always, we are entering the second-quarter announcement season "locked and loaded" with strong forecasted sales and earnings. Furthermore, in the past three months, the analyst community has revised their average consensus earnings estimate significantly higher, so we are expecting another round of earnings surprises in the upcoming weeks. Here is a link on www.navellier.com that shows our forecasted sales and earnings:

https://navellier.com/sales-and-earnings-projections/

Our strong forecasted sales and earnings are the good news. The bad news is the stock market made a new low on June 16th based on higher market interest rates and inflation fears. However, since June 16th Treasury bond yields have fallen significantly and there was a big short-covering rally that often marks a market bottom. Subsequently, there was a flight to quality, and institutional window dressing has helped to boost many of our fundamentally superior stocks that will announce strong second-quarter results. Finally, the annual Russell realignment is over, which boosted the stocks that were added to the Russell 1000 and Russell 2000 indices.

Our friends at Bespoke documented that during the past seven times when the S&P 500 has declined over 20% for two consecutive quarters, the average gain in the next quarter, next two quarters, and next year is 8.51%, 21.47%, and 31.36%, respectively. Nonetheless, the stock market and the financial media remain in a very poor mood and keep saying that we may already be in a recession. The bottom line is fear sells, so negative news continues to overpower positive analyst comments.

The most negative news continues to emanate from Europe, where inflation is running hotter than the U.S., since the euro has declined 8% against the U.S. dollar this year. Since commodities are priced in U.S. dollars, Europe is in the midst of hideous inflation. European Central Bank (ECB) President, Christine Lagarde, recently said, "The era of ultra-low inflation that preceded the pandemic is unlikely to return." While the Fed is in the process of raising key interest rates to get more in-line with market rates, the ECB is planning to change its key interest rate for the first time in a decade from -0.5% to -0.25% in July and then to 0.25% by September. Obviously, like the Bank of Japan, if the ECB continues to severally lag the Fed in hiking key interest rates, the euro will remain weak and likely reach parity with the U.S. dollar in the upcoming months.

Here in the U.S., the core rate of inflation on both the consumer and wholesale level has been steadily declining since March. The fact that the U.S. dollar is strong is also helping to put downward pressure on commodity prices, like metals and lumber, which have declined substantially in recent months. We should add that the Fed's favorite inflation indicator, the Personal Consumption Expenditure (PCE) index rose 0.6% in May and 6.3% in the past 12 months. However, the best news is that excluding food and energy, the core

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PCE rose only 0.3% in May and just 4.7% in the past 12 months. Here is a link to a WSJ article where Louis discusses the inflation environment:

https://www.wsj.com/articles/falling-commodity-prices-raise-hopes-that-inflation-has-peaked-11656811949?page=1

The Fed has essentially "pricked" a few asset bubbles out there and is trying to engineer a "soft landing." As an example, pending home sales through May declined 13.6% in the past 12 months, so the housing market is apparently in the midst of a soft landing. Another example is that the prime broker's desk that the hedge fund industry utilizes told them to get off margin earlier this year, which triggered deleveraging in both stocks and the cryptocurrencies that many hedge funds speculated in. Here is a link to a recent white paper on this year's deleveraging:

https://navellier.com/wp-content/uploads/2022/05/What-Happened-to-Risk-Assets-in-2022.pdf

Interestingly, consumers are apparently planning their trips more carefully, since gasoline consumption has fallen in June compared to a year ago according to multiple surveys. We will also be very curious if gasoline consumption also declined over the Fourth of July holiday.

In the meantime, U.S. crude oil production has risen to over 12.1 million barrels per day in late June, compared to 11.18 million barrels per day in 2021 and 11.28 million barrels per day in 2020. Back in 2019, the U.S. produced 12.29 million barrels of crude oil per day, so due to moderating demand, the U.S. is now energy independent again. However, any excess crude oil and refined product in the U.S. is typically exported, so we expect crude oil prices to remain high through September due to strong seasonal worldwide demand.

One culprit behind extraordinarily high diesel prices is that some existing refineries have been retooled to make cleaner-burning green diesel from animal fats, food waste, and plant oils. Additionally, California's Low Carbon Fuel Standard has been rewarding refiners with tradable fuel credits for producing green diesel. There are now 12 renewable green diesel projects under construction, plus another nine projects planned. According to the Energy Information Administration (EIA), the U.S. is producing 80,000 barrels a day of green diesel and there are plans to produce 135,000 barrels per day by 2025. Since 2019, about 400,000 barrels of distillates capacity (diesel, heading oil, and jet fuel) have been lost. Since an existing refinery cannot produce as much green diesel as regular diesel, output is naturally curtailed as the green push continues, so diesel prices are expected to remain higher than gasoline for the foreseeable future.

Regarding the probability of a soft economic landing, the Atlanta Fed recently slashed its annual second-quarter GDP estimate to -1%. The estimate of private economists is much more optimistic and ranges from an annual pace of 1.5% to 4.7%, so according to private economists, it appears that the U.S. economy is indeed in the midst of a "soft landing." We should also add that the Commerce Department made its final revision to first-quarter GDP and revised it down to a 1.6% annual contraction. The primary catalyst for the first-quarter GDP decline was a big drop in worker productivity as well as trade disruptions.

Despite a significant rally in Treasury bonds, the Fed is still below market rates, so we are expecting that the federal funds rate will be raised 0.75% at the Federal Open Market Committee (FOMC) on July 27th. The real key for the Fed will be the FOMC meeting on September 21st, since if inflation and Treasury yields moderate, then the Fed may only raise key interest rates 0.5% instead of 0.75%, which Wall Street will likely celebrate as potentially the last Fed key interest rate hike. We should add that the Fed is not expected to raise key interest rates at its FOMC meeting on November 2nd, since it is within a week of the mid-term elections. If the Fed has to fine-tune its monetary policy further, any key interest rate increase will likely happen at its FOMC meeting on December 14th.

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The other catalyst that could spark a market rally would be a ceasefire in Ukraine and an eventual peace agreement between Ukraine and Russia. Such a ceasefire or peace agreement is possible in the upcoming months, since both sides are losing troops and becoming exhausted. It would be wonderful if the Russian invasion of Ukraine could cease by the winter and remove much of the uncertainty impacting commerce around the world. However, in the wake of (1) an escalation of Russian attacks on civilians, (2) the Russian default on foreign debt for the first time in over 100 years, and (3) a strong Russian ruble, I suspect that Vladimir Putin is going to continue to torment Ukraine, the West, and anyone that interferes with his vision for Russia.

All the central bank talking heads at a recent finance minister meeting in Portugal cited the war in Ukraine as the primary inflation catalyst, but also admitted that some of the pandemic stimulus may have also sparked inflation. The bottom line is the war in Ukraine will be cited for some time, especially as food inflation ripples through Europe. If the war in Ukraine can cease before the winter as President Zelensky wants, we would expect a massive relief rally for both stock and bond markets around the world.

Overall, the negative sentiment has caused the S&P 500 to have its worst annual start in 50 years, yet there is no "earnings recession" because the analyst community continues to revise their earnings estimates higher. As an example, in the past three months, the analyst community has revised their average consensus earnings estimate 19.9% higher for our Large Cap Growth portfolio. As a result, price-to-earnings ratios (PE) have been compressed severely, since our Large Cap Growth portfolio average PE is only 11.68 times forecasted earnings. This means the best buying opportunity in decades is now at hand, since we expect that both our dividend and growth stocks will post wave after wave of stunning second-quarter sales and earnings results!

SUMMARY

Many of our dividend and growth stocks remain poised to profit from the current inflationary environment. While most stock market strategists have turned into "chicken littles" and caused the financial media to predict that a recession was inevitable, the "boots on the ground" analyst community continues to revise their consensus earnings estimates higher. Naturally, many of our stocks are profiting from high inflation, especially our energy, fertilizer, food, and shipping stocks.

What is really going on is we now live in an era where Google Analytics controls the media, so only outrageous predictions get the hits on the Internet, no matter whether the topic is the economy, politics, sports, or entertainment. As an example, JP Morgan recently predicted that global oil prices could reach a "stratospheric" $380 per barrel if Russia imposed retaliatory crude oil price cuts, just like Russia cut off natural gas to inflect damage on Europe for its retaliatory sanctions from the invasion of Ukraine. The JP Morgan analysts said that due to Russia's robust fiscal position from high energy prices that Russia could cut crude oil production by 5 million barrels per day without damaging its domestic economy. Excuse us, but unless JP Morgan has an informant in the Kremlin, we find this $380 per barrel prediction on crude oil prices ridiculous, even though it would certainly help our big bet in energy stocks. So that is the world we live in now, where outrageous predictions now dominate the news and Internet thanks to Google Analytics.

We are not denying that there have been some inflammatory stories, such as President Joe Biden severely criticizing the Supreme Court, which is undermining the Biden Administration pushing its agenda through regulatory agencies. Essentially, the Supreme Court wants to enforce laws made by Congress, not the executive branch or unelected federal bureaucrats. The Supreme Court's decision against the Obama Administration's Clean Power Plan that was not approved by Congress is now expected to be a major boon for domestic energy production.

Heading into the mid-term elections, the media will do its best to inflame and exaggerate the differences that divide America. However, after the mid-term elections, the media will likely focus more on the holidays,

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which should help folks cheer up. Interestingly, the Conference Board recently announced that its consumer confidence survey declined to 98.7 in June, down from 103.2 in May. The good news is that the present situation component barely budged to 147.1 in June, down from 147.4 in May. The bad news was the expectations component fell sharply to 66.4 in June, down from 73.7 in May.

The Conference Board is much more upbeat than the University of Michigan's consumer sentiment survey, which is at a record low. By comparison, the Conference Board's consumer confidence survey is now back at the same level as in 2020 during the pandemic, but its expectations component is at the lowest level since March 2013. Since the Conference Board's present situation component remains high, we suspect that retail sales may come in better than expected, since consumers tend to spend based on the money in their pockets.

Right now, it is a close call whether or not the U.S. will officially be in a recession. All we can tell you is that inflation peaked in March, long-term Treasury bond yields peaked in June, the Supreme Court neutered the EPA and other federal agencies enacting policies not enacted by Congress, and President Biden is very frustrated. Big changes are coming and the biggest change this year may be a cease-fire or peace agreement between Ukraine and Russia, which will likely trigger a big rally in both stock and bonds, since it would remove uncertainty. Regardless of these changes, we expect energy stocks to continue to prosper, especially if ESG strategies follow S&P Global and begin to add more energy stocks.

Essentially, it remains every stock for itself this earnings announcement season and as always, we are "locked and loaded" with fundamentally superior stocks. Our friends at Bespoke are expecting the S&P 500 in the next quarter, second half of 2022, and next year to rise 8.51%, 21.47%, and 31.36%, respectively, if history repeats after a 20% pullback due to S&P 500's poor start this year.

In our opinion, the stock market does not need to retest its recent lows. However, we are not sure if the "spark" that will ignite the stock market will come from earnings, a new $2,000 folding 5G iPhone announcement, the Fed, or even President Biden cheering up! A cease-fire and peace agreement between Ukraine and Russia right now would provide the biggest spark. Worst case, we can wait until the mid-term elections and the holidays to cheer us up.

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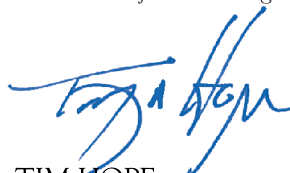

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