CORRIGAN FINANCIAL, INC.

Market Update: July 2021

Domestic stocks ended July with modest gains, as the S&P 500 Index registered its fifth straight monthly advance. Foreign markets were slightly negative, hurt mostly by sizable losses in Chinese equities. Overall, a globally diversified portfolio finished the month in positive territory … but only by a whisker.

> There are so many crosscurrents going on at the moment influencing markets. We've entered a more volatile period for markets, but markets will continue to move higher because we're still seeing economic growth.
>
> Sebastian Mackay, Invesco – WSJ 7/30/21

Earnings growth of 78% for S&P 500 companies is expected for the second quarter … coming after a 53% growth rate during the first quarter of 2021. The second quarter should represent *the peak in earnings growth*, as the growth rate is expected to moderate to 27% in the third quarter.

> Market behavior could become choppier as earnings growth slows; with continued, large swings in sector leadership (on a day-to-day and week-to-week basis). Investors' best protection against volatility continues to be diversification across and within asset classes, and discipline around periodic rebalancing.
>
> Sonders/Gordon, Charles Schwab & Co. – July 2021

During 2020, the S&P 500 declined by 5% or more on eight separate occasions. The last such decline, where the index fell 7.5%, occurred from October 12 through October 30. We have not experienced a decline of 5% or more so far this year. In the past 50 years, there has only been 3 years without such a pullback – it happened twice in the 1990s and then in 2017.

> Markets don't go up in straight lines. There are periodic pullbacks, and they are healthy because they remove the frothiness associated with the market and excessive optimism.
>
> It does create a longer, more sustainable advance when you don't have these periods of excessive optimism, and that's what the pullbacks help prevent.
>
> Leo Grohowski, BNY Mellon Wealth Mgt – WSJ 7/27/21

According to Ned Davis Research, American's had nearly 60% of their investment assets allocated to stocks in March. This is just below the all-time high of 61.7% reached during the technology (dot-com) bubble. When stock allocations have risen to 54.6% or higher … like they did during the technology crash of 2000 or just before the great recession of 2008-2009 … the S&P 500 has returned on average only 4.1% annualized over the following ten years.

U.S. gross domestic product grew at an annualized rate of 6.5% in the second quarter, as the domestic economy exceeded its pre-pandemic levels. Wages and spending advanced in June, and the personal-savings rate remained relatively high.

Still, increasing coronavirus cases, driven by the spread of the Delta variant, are fueling investor concerns about the economic outlook. Those concerns were reflected in the bond market, with yields on the U.S. 10-year Treasury tumbling to 1.239% … the largest one month decline since March 2020.

> The spending report reflects that the economy is still very much on track. Any potential impact of the Delta variant's spread is difficult to predict, but it would pose a significant risk to economic growth if consumers curtail activities such as traveling and dining out.
>
> Scott Brown, Raymond James – WSJ 7/30/21

Market gurus have been quick to point out that the U.S. economy has technically passed its *peak growth*. In other words, investors should anticipate economic growth to moderate over the next few years. Goldman Sachs, for example, now expects 2022 GDP growth to look more like the prepandemic range of 1.5% to 2%.

> Goldman's concern is a handoff from goods to services spending will be delayed or thwarted, especially as a slower return to offices continues to keep a lid on workers' spending for commuting, work clothes and dry cleaning, and food away from home.
>
> Alex Eule, Barron's – 7/27/21

Economists believe that the global economy returned to its pre-pandemic size sometime during the spring … no small accomplishment considering the speed and size of the downturn. However, global growth rates have been uneven, with low vaccination regions showing lagging growth rates.

> It's like no other recession and no other recovery.
>
> Neil Shearing, Capital Economics – WSJ 7/30/21

The International Monetary Fund (IMF), the global lender of last resort for 190 member countries, just updated its twice-yearly World Economic Outlook report. While the IMF still expects the world economy to expand by 6% in 2021, improving conditions for developed countries were offset by downgrades to emerging markets. For example, the U.S. and the U.K. both received upgrades, while growth projections were reduced for Southeast Asian economies that are struggling with the coronavirus.

> Vaccine access has emerged as the principal fault line along which the global recovery splits into two blocs.
>
> IMF, World Economic Report – WSJ 7/27/21

The Fed's preferred measure of inflation, excluding food and energy, rose 3.5% in June from a year earlier. Inflation expectations can be self-fulfilling, since prices and wages are generally set based on the expectations of individuals and businesses. But after soaring from October through May, inflation expectations are starting to ease.

> What the markets are saying is: We think there's inflation in the near term, but eventually it's going to ease and go back to the Fed's 2% target – maybe a little above, but it will certainly not remain elevated.
>
> Kathy Bostjancic, Oxford Economics – WSJ 7/26/21

July also came with a wake-up call for investors in Chinese stocks. Many investors were caught napping by China's crackdown on some of its fastest growing companies, which resulted in losses of hundreds of billions of dollars.

The Hang Seng Tech Index, which includes Hong Kong's growing tech shares, closed down 17% in July alone. The Invesco Golden Dragon exchange-traded fund, which invests in U.S.-listed Chinese companies, is off 44% since mid-February.

> When a government comes to believe it can snap its fingers and create – or destroy – whole industries at will, things can easily go awry. There is a Chinese saying, favored by official spokespeople, that comes to mind: picking up a stone to smash one's foot. In English, there is another: shooting oneself in the foot.
>
> Nathaniel Taplin – WSJ 7/30/21

Beijing's latest focus was on the $100 billion private-tutoring industry. Concerned that high costs were hurting the push for families to have more children, Chinese officials demanded the companies operate as nonprofits, adhere to fee standards, and have no foreign ownership.

China's draconian crackdown on the tutoring sector upended their businesses and painfully illustrated how even fundamentally sound investments can quickly turn into losers when the state steps in.

Reshma Kapadia – Barron's 7/30/21

Political uncertainty is forcing many investors to reevaluate the risks imbedded in their Chinese holdings. TAL Education Group's American depository receipts were down 70% in just days, while shares of New Oriental Education & Technology Group, Inc. were down roughly 66% last week alone.

This is unprecedented. A whole industry was almost wiped out overnight. And it just underscores how hard it is to quantify risks to investing in China.

Alex Au, Alphalex Capital Management – WSJ 7/30/21

Economists often refer to data on risk-taking as a contrarian indicator. In other words, when the majority of investors are buying or selling aggressively, the smart money should be doing just the opposite. So, we should be careful not to join the herd when they plow money into the markets … or when they frantically sell during a downturn.

In places where speculation has been rampant, you have seen massive drawdowns – in cryptocurrencies, special-purpose acquisition companies (SPACs), nonprofitable tech companies, and meme stocks.

Liz Ann Sonders, Charles Schwab & Co. – WSJ 7/18/21

The Delta variant of the coronavirus is currently casting a wide shadow over the global economic recovery. About 40% of the population in advanced economies has been fully vaccinated, but emerging-market economies are vaccinated at less than half of those levels … and rates are even lower in many southeast Asian countries. The Delta variant has also been detected in more than 26 cities in China.

Even if the immediate threat of the virus subsides in a few, short months, its economic impact may linger for quite some time.

Frederic Neumann, HSBC – WSJ 8/2/21

It's pretty amazing that the U.S. economy, with seven million fewer workers, has returned to pre-pandemic levels of output. Many businesses have become much more efficient during the pandemic. Some of this was forced change … modifying business models and embracing new technologies.

> Looking ahead, growth is expected to remain strong, fueled by job gains, pent-up savings and continued fiscal support. However, stickier inflation, the Delta variant, supply chain disruption and a shortage of available workers all have the potential to slow this so-far very robust recovery.
>
> J.P Morgan Market Insights – 8/2/21

There are still many potholes to deal with on the road to recovery. Let us know if we can help with any of your questions or concerns.

Daniel G. Corrigan, CPA/PFS, CFP®