



CAPITAL INVESTMENT COUNSEL

The Columns

June 2021

It's June, temperatures are rising, and the beach is calling. Alice Cooper said it best: school's out for summer! For stocks though, exams are just beginning. The second quarter ends in week and earnings come thick and fast in July. Personally, I can't wait. I think the market may be setting up a pleasant surprise.

In 2021, it's difficult to use interest rates to get a read on the economy. In the past, you could almost use rates like a thermometer. As the economy heated up, rates would rise along with it. Now, the Fed is so involved with keeping rates artificially low that it's tricky to see exactly where the economy stands.

2021's leading stock sectors have been ones that benefit from an improving economy. Think energy, financial and cyclical stocks. You all know the names, Exxon, Bank of America, FedEx, etc. However, these leaders hit a slippery patch in the last week. Over the last ten days, the financials sold off 8%, energy has dropped 5% and the cyclicals peeled off 6%.

The market enjoyed a solid start to the year, but we've been expecting a pullback at some point. Even so, the severity and speed of last week's drop grabs your attention. The 50-day moving average is a good measure for stocks in an uptrend. When a stock is above its 50-day, things are typically good and heading higher. In early June, Bespoke Investments reported that 85% of the financial stocks were trading above their 50-day average. That's technical speak for everyone in the group was happy and not worried about much, but things change in a hurry. By Friday, June 18th, the financial selloff reduced the number of stocks trading above the 50-day to only 24%. The drop was similar in energy and the other cyclical stocks.

I see this has a potential silver lining on the buy side. After their big run, the group needed a break to consolidate their gains. Many of these companies had run into resistance and their upward trajectory had slowed. We still feel the economy is in excellent shape and the cyclical group could show solid earnings next month. If the cyclicals do report good earnings, we could see this group lead the market higher in the second half of 2021. Here's why.

Let's say you have a child who brings home straight A's on their report card. The first time they do, it's great! The second and third time excite you as well. By the fourth or fifth time, you move from excitement to expectation. Your child has raised the bar and you start to demand/expect straight A's every time.

The market can be similar. The latest cyclical selloff has potentially lowered the bar for expectations. These stocks now have more potential wiggle room for their results. They don't necessarily have to knock it out of the park in order to move their price higher. I noticed at the end of the first quarter than many companies produced excellent earnings, but their stock price actually went down. The good news was likely baked in.

I believe that our current market weakness could be a buying opportunity. The market was up 10% plus at the end of May and that coincides with day 100 of the trading year. Using history as a guide, I see that when this occurred in the past, the market finished the remainder of year higher 85% of the time with a 9% average gain. I like those odds.

If the market was going to sell off, June is a obvious candidate, especially late June. Looking at past Junes, we find that the market peaks around the 16th before sliding down through the end of the month. It's interesting that while June sells off, the drop is usually not large. I would not be surprised to see the S&P 500 close above 4204. Here's why, over the last 51 years, the market's low was equal to or higher than the market's close for May. The market finished May at 4204 and is trading at 4215 as I write this. (Note, it did dip as low as 4186 on the 18th) So, put your wish list together. Think about companies you want to own and the price you'd like to pay for them. That way, if the selloff continues, there might be some nice bargains to be had.

July 4th is next week. It's great to see America come back to life post-Covid. It's wonderful to be out and about with everyone doing their thing again. Dining out this past Saturday, I noticed it marked the first time that our server wasn't wearing a

mask since February of 2020. It's nice to see everyone's faces again. With our nation's birthday coming up, it brings up the question, what does it mean to be American? Try this one on for size. I came across this from 2015 and it hits all the right notes.

A Jewish man, Abe Saperstein, born in London, starts an all-black basketball team. Every member of the team is from south Chicago, yet they persist in calling themselves the Harlem Globetrotters. Their most famous member was born in Wilmington, NC in the depths of the great depression. As an adult, Meadowlark Lemon spent 22 years as the clown prince of basketball and played 16,000 games to audiences around the world. That's about as American as it gets. Bonus points to whoever names another somewhat famous basketball player from Wilmington. Happy Birthday America, it's nice to see you back! If you have any comments, feel free to contact me at heddins@capital-invest.com or call me at 919-656-0836.

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