



Market Commentary

Weekly perspective on current market sentiment

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Last week's S&P 500 Index: +1.4%

The roller coaster ride continues

Key takeaways

- Stocks, oil prices, and Treasury yields have been on a roller coaster ride since the U.S. attacked Iran.
- The jump higher in inflation and a continued lack of progress in Iran negotiations will likely keep markets volatile.

Some of our regular readers may look at the title of this week's issue and question what this author is talking about. After all, it seems the S&P 500 Index (SPX) is setting new all-time record highs regularly with few large downside days. If you are invested at the index level, you are likely not complaining when you open your monthly statement. But there is plenty of churn if you look underneath the hood.

The Information Technology sector, after performing poorly the first three months of the year when the Energy sector was the star of the show, has rallied a robust 45.2% since the beginning of April and has been the best performer while Energy is dead last over the same time frame. From last place in the first quarter to first place in the second. And, importantly, tech companies are expected to post strong earnings results in coming quarters. Now that is what you call a performance roller coaster ride.

Oil prices and Treasury yields have also been on a roller coaster ride since the U.S. attacked Iran. West Texas Intermediate (WTI), the U.S. benchmark, has experienced multiple 5% to 10% moves up or down in a single day and on a couple of days even more. Traders are tied to the headlines, trying to decipher whether a peace deal is near or not. The world has largely been operating on oil reserves since the conflict began, and global stockpiles are declining. The International Energy Agency projects the crude-oil supply restriction to become sharper and more economically damaging globally by July and August. Shortages and rationing are more a problem for the developing world, but the longer the diplomatic impasse is drawn out over the next month or two, the more persistent U.S. and global inflation should be.

How about U.S. Treasury yields? On the day prior to U.S. military action, the 10-year yield was sitting right at 4%. The initial move in price when the attack began was up (yields down), but that was short-lived as investors quickly concluded that higher oil would likely quickly lead to higher inflation. By the end of March, the yield was up near 4.5% and traded as high as 4.67% in mid-May before falling back to the current 4.45%. We believe the jump higher in inflation and a continued lack of progress in negotiations could easily push yields noticeably higher.

We do see pressure building quickly on both the U.S. and Iran to make a deal that reopens the flow of energy to the world, but, even with a deal tomorrow, inflation figures to be part of the outlook for the rest of the year. In our view, investors may consider adding money to industries that can pass on higher input costs to their business customers, including the Industrial Gases and Machinery & Equipment industry groups. And we favor Aerospace & Defense, anticipating a restock of the U.S. arsenal. Meanwhile, we believe the technology spending trend has persistence but may become expensive as it did last year. It is for this reason that we favor Utilities, Industrials, and Financials to follow the technology trend at a lower cost per dollar of future expected earnings.

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