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Delta Insights
a weekly commentary on investing

June 29, 2018

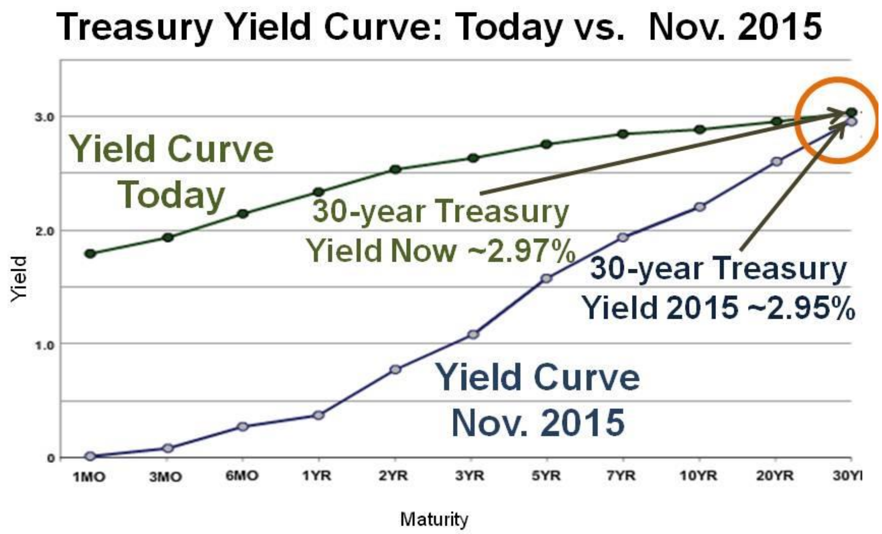
Making the Jump to Earnings Season

Roughly two weeks from now on July 16, second quarter earnings season will begin with Bank of America (BAC) and BlackRock (BLK). That week, we will hear from many of the largest banks and many of the largest industrial firms including Lockheed Martin (LMT), Textron (TXT) and Danaher (DHR). We will also hear results from notable companies like Netflix (NFLX), Microsoft (MSFT), Johnson & Johnson (JNJ) and Grainger (GWW). By July 20, we should have a much better understanding of the health of corporate earnings and the impact of tariff actions and Fed Fund rate hikes on profit outlooks.

Between now and then, stock buyback programs will subside (to protect against insider trading before earnings), many traders will go on July 4 holiday and news flow and trading volumes should be light. Investor anxiety is current elevated with the CBOE volatility index approaching 20. The combination of light trading volume, fewer stock buybacks and elevated uncertainty create a trading landscape fraught with the possibility of whipsaw trading.

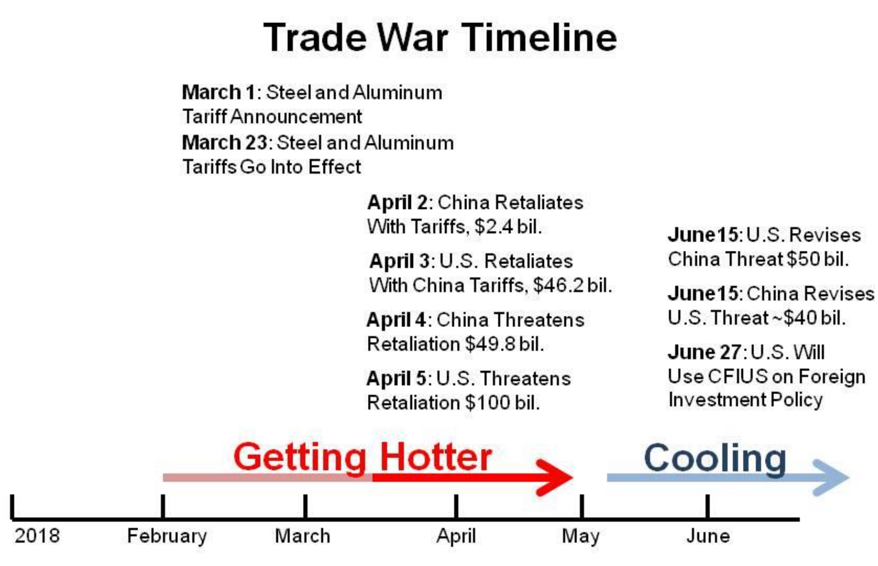
If significant buying opportunities present themselves in the next two weeks (sharp market sell-offs), it may be a good time for long-term investors to increase their stock exposure. There are three reasons for this: 1) long-term interest rates are not rising and 2) the trade war may have already peaked and 3) second quarter earnings should be strong.

The Federal Reserve has moved the Fed Funds rate up by about 2% over the past two and a half years. During this time of rising short-term rates, the 30-year treasury rate has barely moved. It is roughly right at about the same place it was in November of 2015, the start of Fed Funds rate increases.



The lack of long-rate appreciation suggests two possibilities: 1) the Fed may not raise the Fed Funds rate as much as they are currently suggesting and 2) the discount rate used to calculate stock values today may be lower than current market expectations. Both of these possibilities should be positive for stock valuations.

The next chart shows key milestone events in the developing global trade war. It began in earnest in March when the U.S. imposed global steel and aluminum tariffs. It really escalated in the first five days of April with back and forth threats between the U.S. and China. Since June 15, the trend has been mostly a backing-down process, especially between the U.S. and China.



From March 1 through April 5 (the apparent peak in trade war rhetoric), the S&P 500 was down by about -3%. Since April 5, the S&P 500 has advanced by about 6%.

Factset reports that the S&P 500 consensus earnings forecast for the second quarter is up 19%. In advance of first quarter earnings, the consensus forecast was up 17% but actual earnings growth was up 25%. The S&P 500 is up less than 2% year-to-date. Possible market weakness in the next two weeks may offer a value buy opportunity.

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"I say let's wait for the next one."

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