In this 07-30-21 issue of "Market Rally Continues As Earnings Beat Estimates."

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Are you worried about the potential for a market correction, a surge in inflation, or are you unsure how to invest for your retirement? We can help. *If you are not yet a client and would like to discuss your portfolio construction, please schedule a time to meet with one of our advisors below.*

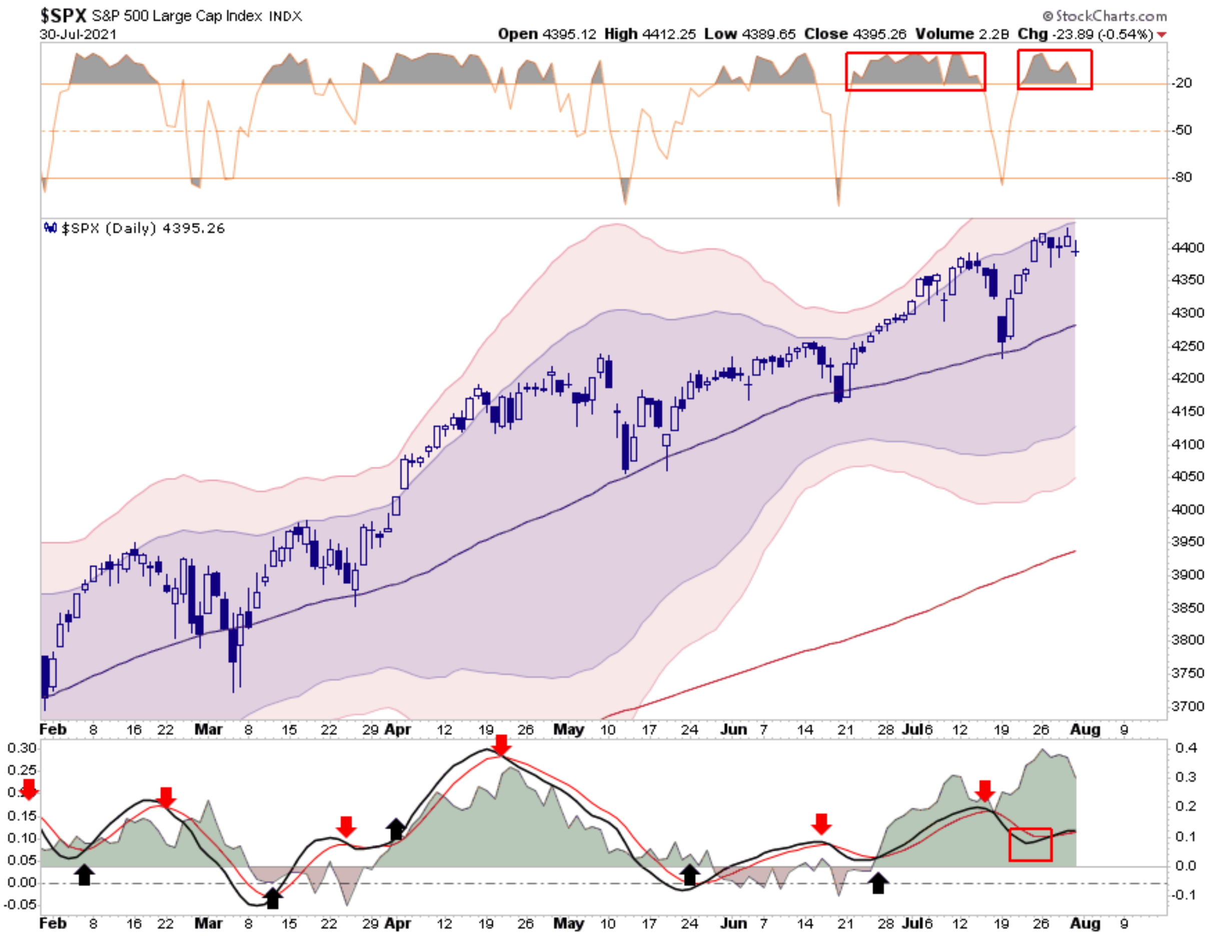
Market Rally Continues

Last week, we discussed that as the market hit new highs, further upside was likely limited. To wit:

> *"While the upside remains somewhat limited, given the already substantial advance this year, the rally will alleviate downside concerns momentarily. However, with that said, the extremely low level of volatility this year is reminiscent of 2017.* ***The reason is that "stability" is fragile. In other words, stability ultimately leads to instability.****"*

For more information on the *"instability of instability,"* read ***"The Next Minsky Moment."***

Not surprisingly, the market didn't make much headway this past week, given the current extended and overbought conditions. For now, "buy signals" remain intact, which likely limits the downside over the next week. However, a retest of the 50-dma is certainly not out of the question.

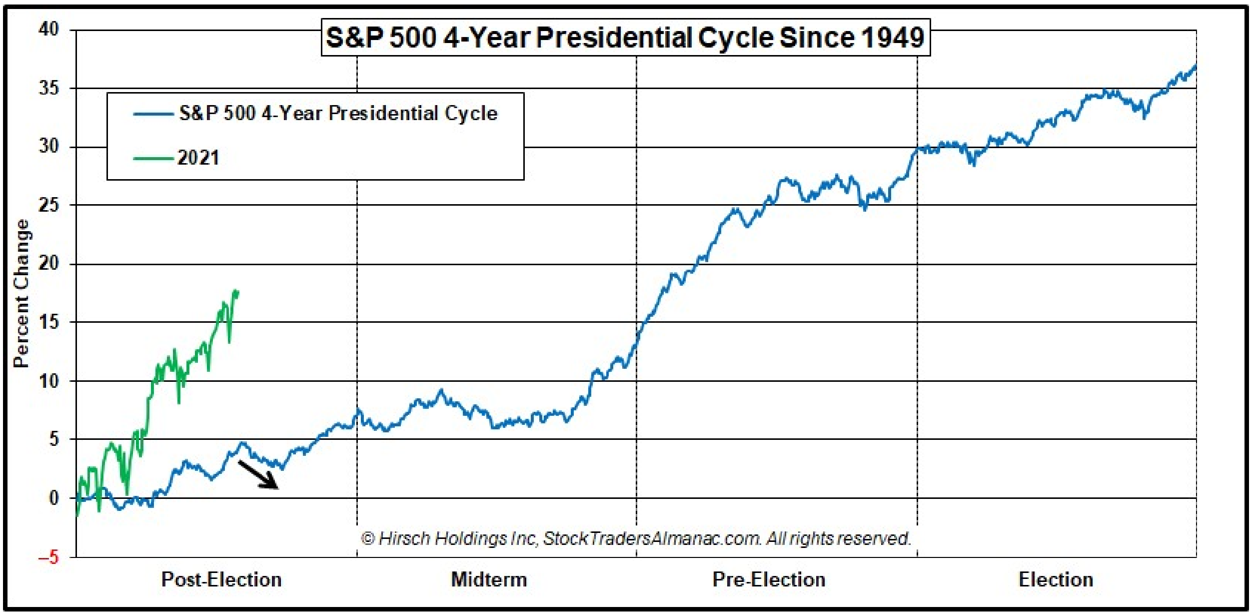


With that said, we are entering into the two weakest trading months of the year. Stocktrader's Almanac had a good note on why the rally could experience a "pause" over the next two months.

> *"For the past 33 years from 1988-2020 August and September are the worst two months of the year for DJIA, S&P 500, and NASDAQ.* ***August is the worst for DJIA and S&P 500 and September is worst for NASDAQ.***
>
> ***Despite the persistence and resilience of this bull rally market internals and technicals are showing some signs of fatigue.****"*

- *Advancing issues have barely outpaced decliners in recent weeks.*
- *New highs have been shrinking while new lows remain high.*
- *Technical indicators are struggling to break through resistance.*
- *Relative Strength, Stochastics and MACD are breaking down again.*

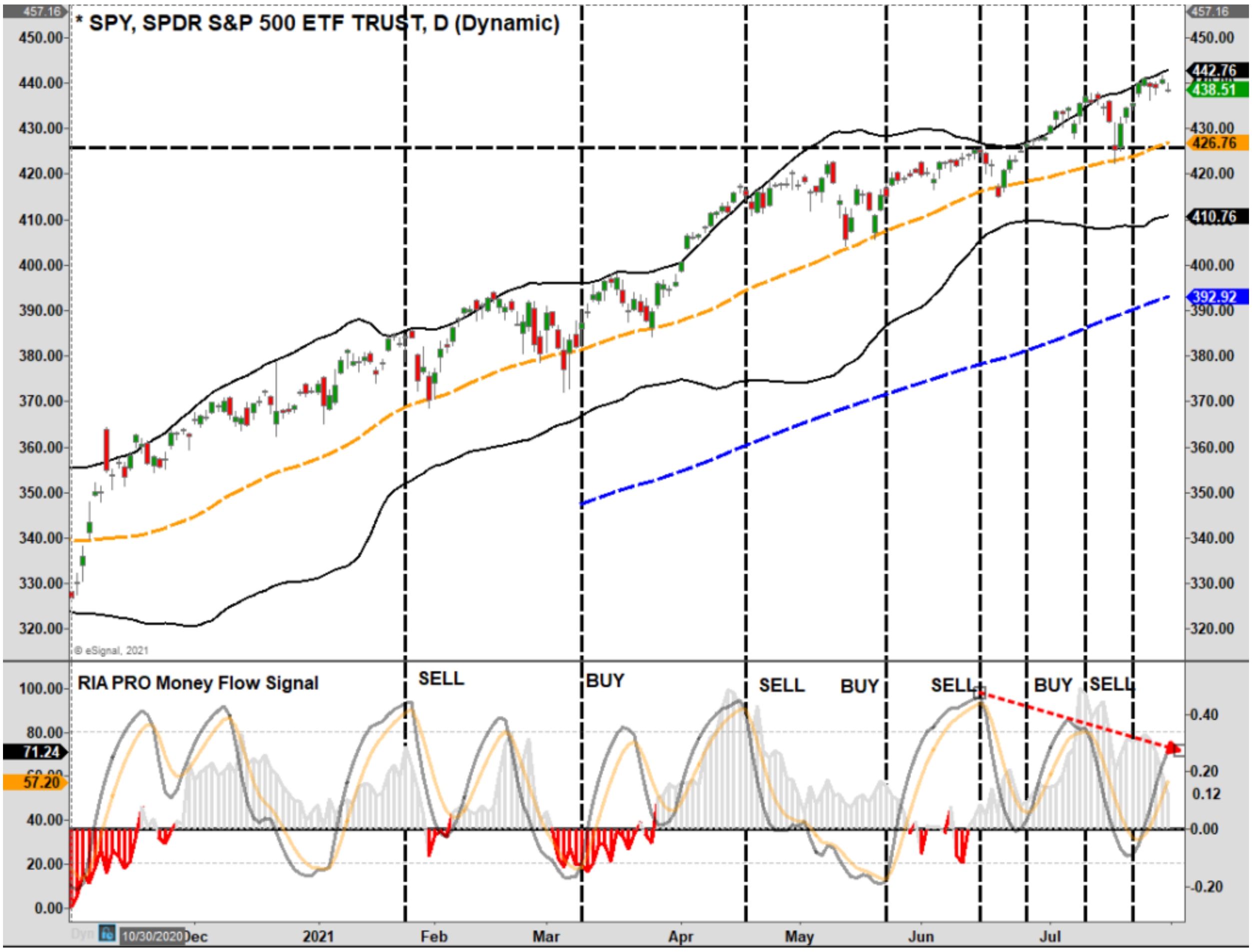
> *"The timing of a pause coincides with the weak seasonal patterns mentioned above during the worst months of the year August and September (not to mention Octoberphobia) as well as the 4-Year Presidential Election Cycle."*



6-Month Advances Are Rare

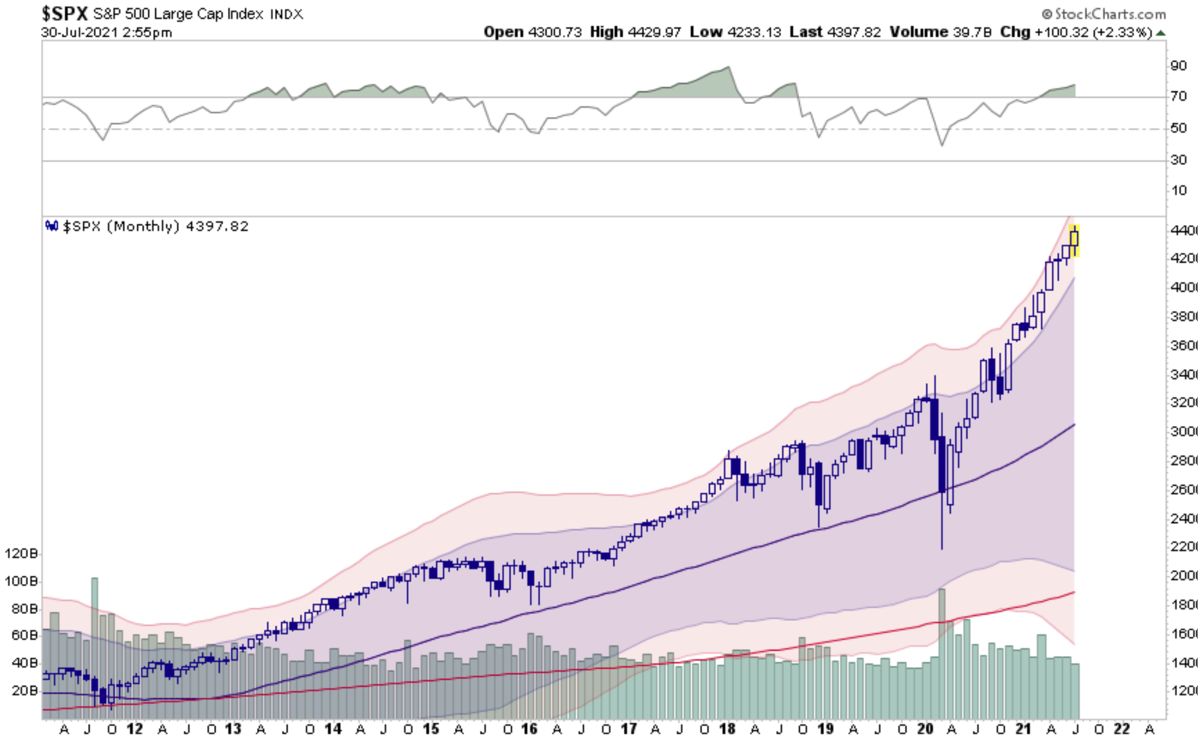
Given the bullish bias currently remains unfettered, and the Fed is still applying $120 billion a month in liquidity, there is no reason to be overly *"bearish"* at this juncture. **Thus, while we are carrying slightly reduced exposure currently and have increased our *"risk hedges"* as of late, we remain nearly fully invested.**

With our *"money flow buy signals"* triggered, such suggests there is support for stocks currently. Such means two things over the next week or so: 1) there is not a great deal of downside, and 2) there is not much upside either. Thus, a sideways consolidation and a pickup in volatility are likely. **One concern is the *"negative divergence"* of money flows (bottom panel) against an advancing market.** Such corresponds with the technical weakness we will discuss momentarily.



Therefore, given this backdrop, we increased portfolio hedges.

An additional "red flag" is the S&P 500 has had positive returns for 6-straight months. **As shown in the 10-year monthly chart below, such streaks are a rarity, and when they do occur, they are usually met by a month, or more, of negative returns.**



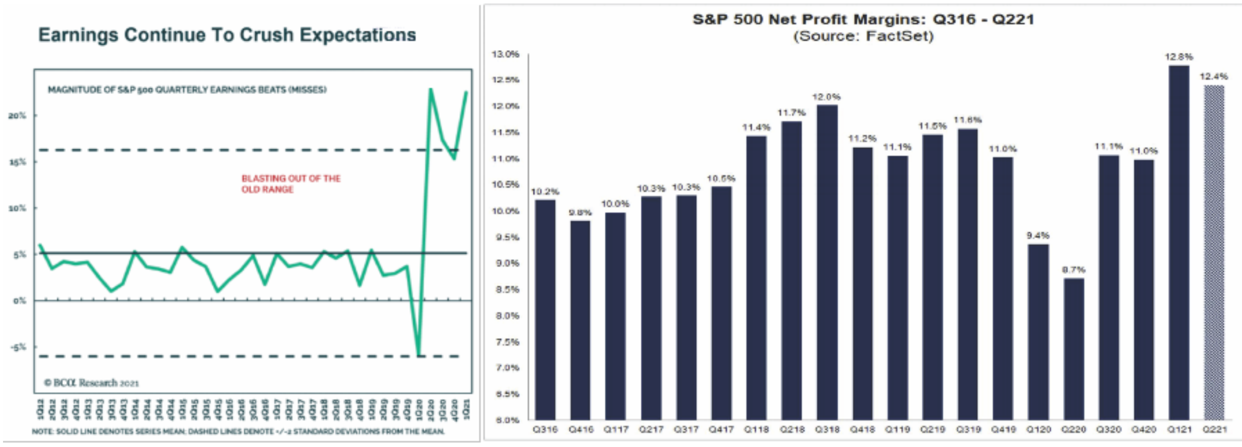
(It is also worth noting that when the 12-Month RSI is this overbought, larger corrective processes have occurred.)

While prices have advanced sharply, the bullish mantra remains that *"earnings"* support the increase. **While that *"rationalization"* may seem to have merit, investors are paying more today for the same expected earnings from January of 2020.**

The Mirage Of Strong Earnings

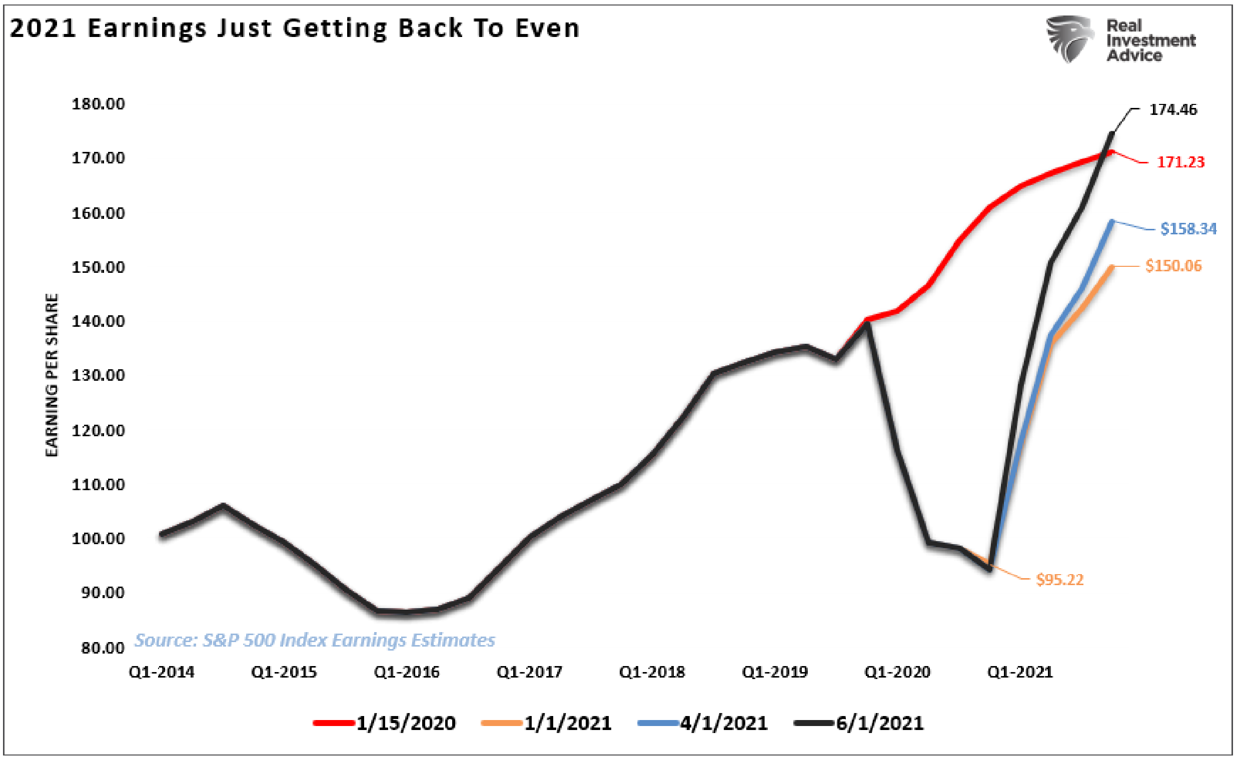
The second-quarter earnings season started with a bang, with several companies reporting earnings *"knocking the cover off the ball."*

> ***"Overall, 24% of the companies in the S&P 500 have reported earnings to date for the second quarter. Of these companies, 88% have reported actual EPS above the mean EPS estimate.*** *Another 1% have reported actual EPS equal to the mean EPS estimate, and 11% have reported actual EPS below the mean EPS estimate.* ***The percentage of companies reporting EPS above the mean EPS estimate is above the 1-year (83%) average and above the 5-year (75%) average.***" - *FactSet*



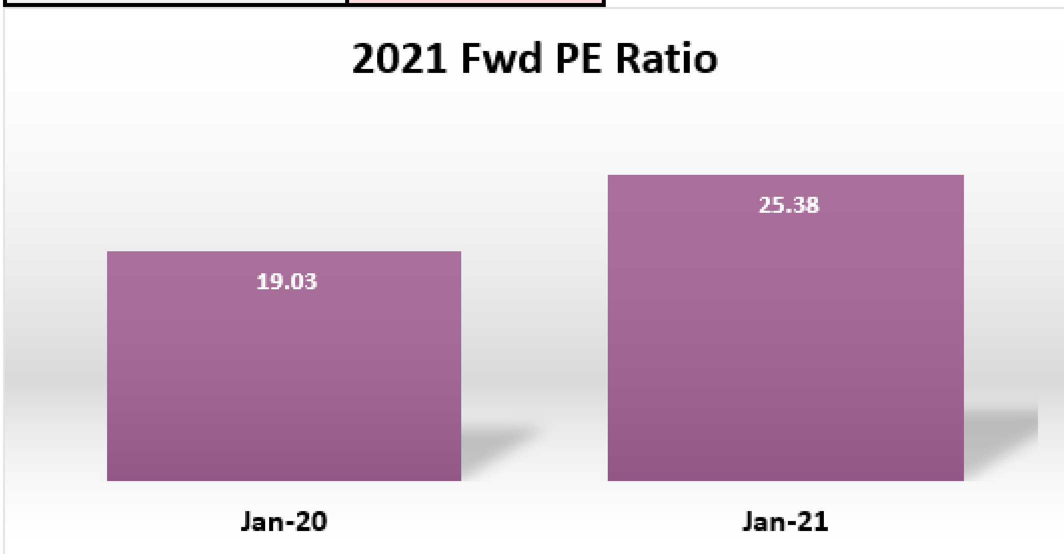
It is not surprising that stocks are rallying to new highs again this week with those kinds of numbers.

However, the longer-term problem for investors is that while the earnings were strong, they are only getting back to levels where they were supposed to be at the beginning of 2020. As shown, in January of 2020, the earnings estimate for the end of 2021 was $171/share. Currently, before estimates get downwardly revised, it is presently estimated that earnings will be just $174/share at the end of 2021.



As noted, the problem for investors comes down to valuations. **For example, in January of 2020, investors were paying 19x for 2-year forward earnings.** Today, they are paying 25x earnings for essentially the same dollar amount of earnings.

	Jan-20	Jul-21
Index Price	3,257.85	4,427.03
12/21 Earnings Est.	171.23	174.46
2021 Fwd PE Ratio	19.03	25.38



While it gets lost in the daily media, the reality is the price of the market is outpacing actual earnings growth. More importantly, when looking back historically, we see that earnings growth isn't as strong as headlines suggest.

We certainly understand that valuations have very little importance in the short term. For now, all that matters is price momentum. However, as investors, it is essential to remember that valuations have great importance longer-term.

Sales Are Worse

Of course, such doesn't even come close to premiums paid for each dollar of *"actual sales"* generated by the underlying companies. As we noted in [***"Priced For Perfection,"***]() sales will decline this quarter, driving the price-to-sales ratio to historical levels. To wit:

> https://twitter.com/LanceRoberts/status/1414936653441945606?s=20

> *"Investors should not dismiss the above quickly. Revenue is what happens at the top line.* ***Secondly****, revenue CAN NOT grow faster than the economy. Such is because revenue* ***comes from consumers, and consumption makes up 70% of the GDP calculation.*** *Earnings, however, are what happens at the bottom line and are subject to accounting gimmicks, wage suppression, buybacks, and other manipulations.*"

Currently, the price-to-sales (revenue) ratio is at the highest level ever. As shown, the historical correlation suggests outcomes for investors will not be kind.

Currently, there are more than 70 companies in the S&P 500 trading above 10x sales. That is 14% of the entire index, one of the highest levels ever on record. *(How many of these companies do you own?)*

Company (1-30)	Symbol	Price / Sales		Company (31-71)	Symbol	Price / Sales
Norwegian Cruis	NCLH	261.33		Edwards Lifesci	EW	15.29
Carnival Corp	CCL	157.61		Alexandria Real	ARE	15.17
Moderna Inc	MRNA	51.34		Amer Tower Corp	AMT	15.05
Paycom Software	PAYC	27.3		Paypal Holdings	PYPL	14.88
Msci Inc-A	MSCI	26.44		Essex Ppty Tr	ESS	14.76
Marketaxess Hld	MKTX	25.3		Avalonbay Cmmty	AVB	14.2
Nvidia Corp	NVDA	25.24		Align Tech Inc	ALGN	14.17
Enphase Energy	ENPH	23.02		Copart Inc	CPRT	13.95
Mastercard Inc	MA	22.84		Cadence Design	CDNS	13.84
Intuitive Surg	ISRG	22.37		Crown Castle	CCI	13.79
Live Nation Ent	LYV	22.32		Zoetis Inc	ZTS	13.76
Servicenow Inc	NOW	22.27		Udr Inc	UDR	13.35
Dexcom Inc	DXCM	21.95		Equity Resident	EQR	12.95
Average		21.89		Microsoft Corp	MSFT	12.83
Visa Inc-A	V	21.24		S&P Global Inc	SPGI	12.65
Prologis Inc	PLD	21.01		Etsy Inc	ETSY	12.59
Idexx Labs Inc	IDXX	20.76		Mid-Amer Apt Cm	MAA	12.58
Illumina Inc	ILMN	20.69		Twitter Inc	TWTR	12.54
Adobe Systems	ADBE	20.56		Resmed Inc	RMD	12.52
Monolithic Pwr	MPWR	18.96		Moodys Corp	MCO	12.22
Verisign Inc	VRSN	18.74		Equinix Inc	EQIX	11.82
Public Storage	PSA	18.53		Host Hotel&Rsrt	HST	11.75
Ansys Inc	ANSS	18.17		Arista Networks	ANET	11.68
Autodesk Inc	ADSK	17.69		West Pharm Svc	WST	11.24
Sba Comm Corp	SBAC	17.6		Fed Rlty Inv	FRT	11
Duke Realty Cp	DRE	17.56		Regency Ctrs Cp	REG	10.9
Abiomed Inc	ABMD	17.32		Synopsys Inc	SNPS	10.86
Cme Group Inc	CME	16.62		Mettler-Toledo	MTD	10.68
Realty Income	O	16.3		Verisk Analytic	VRSK	10.65
Fortinet Inc	FTNT	16.28		Digital Rlty Tr	DLR	10.41
Booking Holdngs	BKNG	16.18		Monster Beverag	MNST	10.4
Extra Space Stg	EXR	16.09		Xilinx Inc	XLNX	10.32
Intuit Inc	INTU	16.08		Texas Instrs	TXN	10.29
Tyler Tech Inc	TYL	15.93		Salesforce.Com	CRM	10.11
Tesla Inc	TSLA	15.3		Facebook Inc-A	FB	10.1
				Paychex Inc	PAYX	10

A Lesson From 2000

Why is that important? For that answer, let's revisit what Scott McNealy, then CEO of Sun Microsystems, said in 2000.

> *"At 10-times revenues, to give you a 10-year payback, **I have to pay you 100% of revenues for 10-straight years in dividends.** That assumes I can get that by my shareholders. It also assumes I have zero cost of goods sold, which is very hard for a computer company.*
>
> ***That assumes zero expenses, which is hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that expects you pay no taxes on your dividends, which is kind of illegal.** And that assumes with zero R&D for the next 10-years, I can maintain the current revenue run rate.*

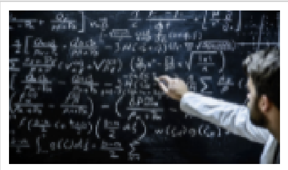
__Now, having done that, would any of you like to buy my stock at $64? Do you realize how ridiculous those underlying assumptions are?__ You don?t need any transparency. You don?t need any footnotes.

What were you thinking??

Of course, much of this is ?*forgotten history,?* as many investors today were either a) not alive in 1999 or b) still too young to invest. **However, for the newer generation of investors, the lack of ?*experience?* provides no basis for the importance of ?*valuations?* to future outcomes.**

That is something only learned through experience.

In Case You Missed It



Krugman’s Delusion: The Difference Of Theory Versus Reality.

Written by Lance Roberts | Jul 30, 2021

In a recent interview with Business Insider, Paul Krugman’s delusion was evident as the difference between economic theory and reality was on full display.

>> Read More

GDP Eclipses Pre-Pandemic Level

On Thursday, CNBC ran the following headline:

MARKET INSIDER

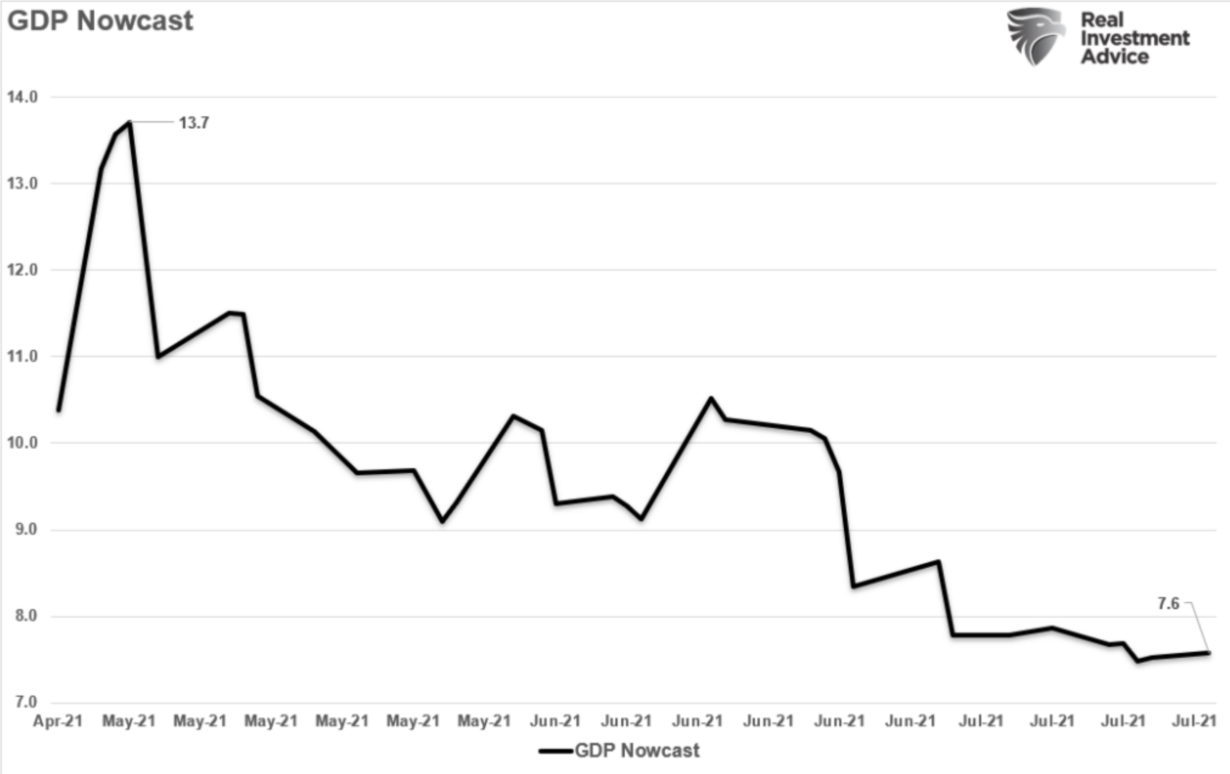
The U.S. economy is bigger than it was pre-pandemic, but Covid could still decide what happens next

To wit:

> *"The U.S. economy is now larger than it was before the pandemic, but its growth rate may have peaked this year at a much slower pace than expected." - Patti Dom, CNBC*

Patti is correct; economic growth just peaked.

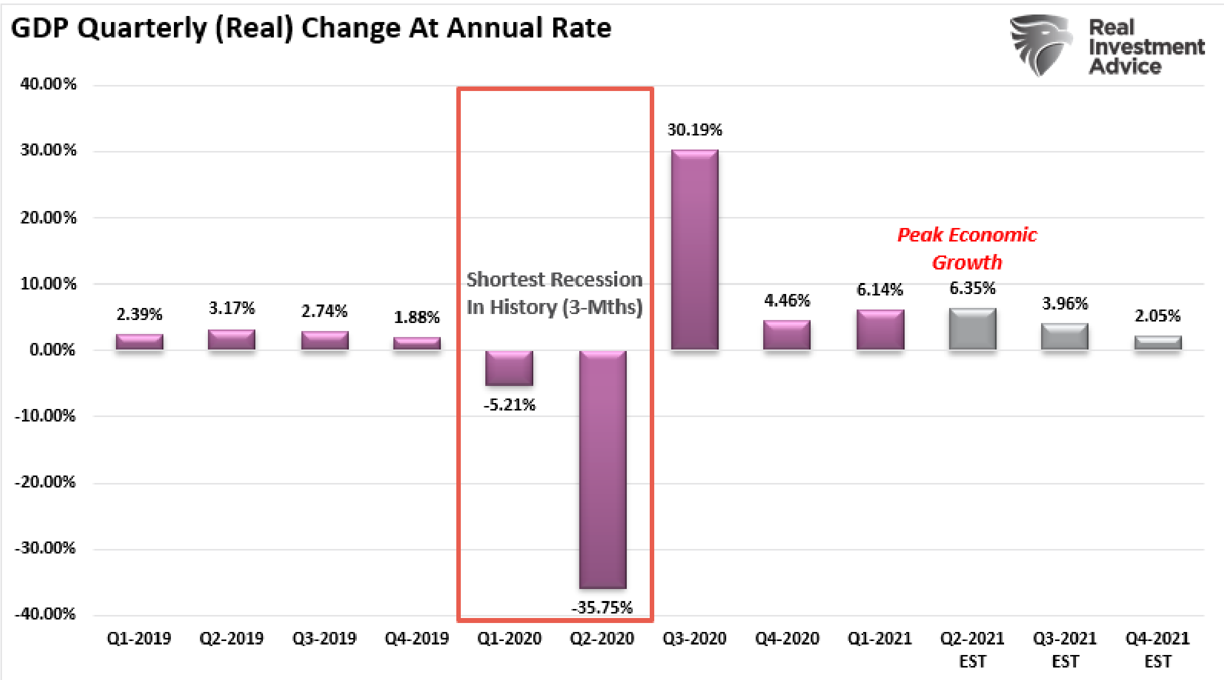
The problem with the 6.5% annualized rate is it was more than 50% lower than the original estimates of 13.5%. More troubling was the report was even lower than the Atlanta Fed's much-reduced 7.6% estimate.



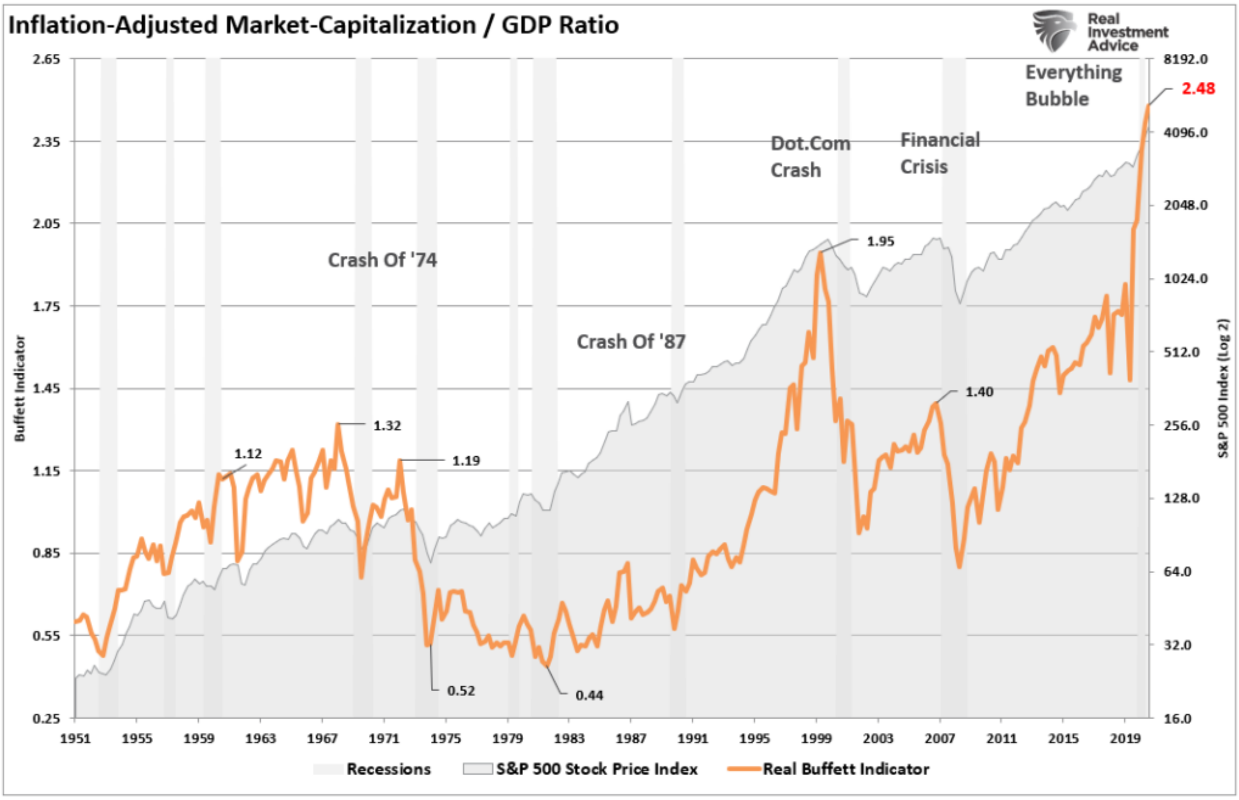
What was missed by the mainstream media are two very critical factors.

1. ***The sharp decline in expected GDP growth rates suggests that "deflationary" pressures are present; and,***
2. ***Given the relationship between economic growth and earnings, current estimates will be revised lower.***

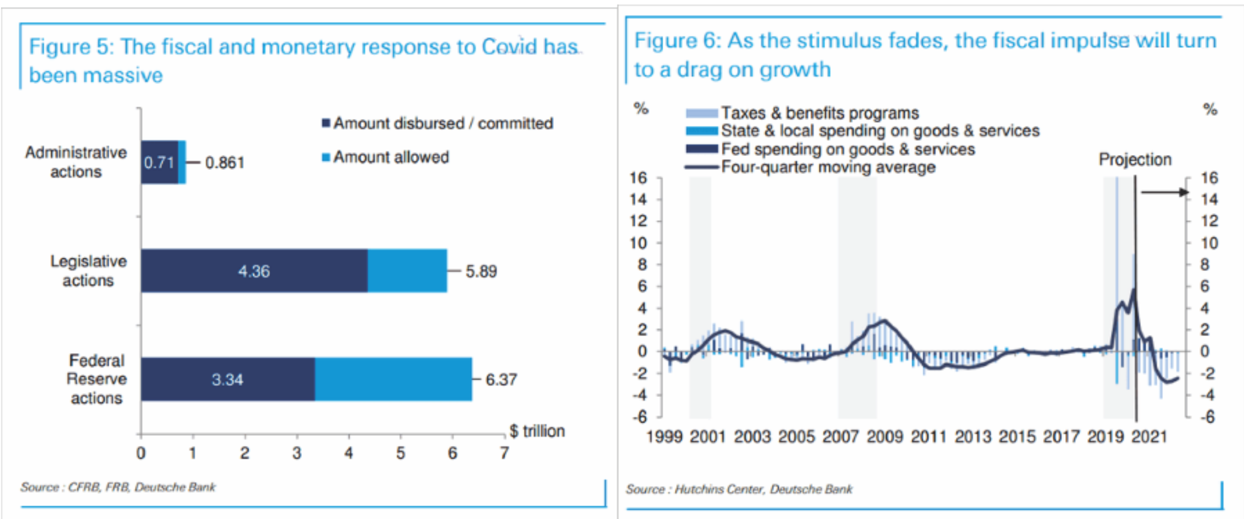
Over the next two quarters and fully into 2022, economic growth rates will decline back to 2% or less.



More importantly, the weaker than expected GDP report pushed the Market Capitalization / GDP ratio (inflation-adjusted) to a record high. But, again, given that revenues are a function of consumption (70% of the GDP calculation), earnings growth will weaken by default.



Lastly, while the economy is indeed larger than pre-pandemic, such is of little consolation. **When you realize it took $8 Trillion in monetary stimulus (40% of the economy) to create $406 billion in growth from Q1-2020, it is a little underwhelming.**



Next year, the fiscal impulse will become a drag.

Such will make it much harder to justify current valuations in a much slower economic growth environment.

Portfolio Update (Party On Garth)

For now, as noted above, the markets remain bullishly biased, and there seems little to derail that mentality currently. The weaker than expected economic growth rate gave the markets reassurance the Fed won't *"taper"* anytime soon.

In the meantime, we continue to maintain nearly full equity exposure in our portfolio models. **However, the one change we have been quietly making over the last two months is increasing the duration of our bond portfolios. Such is because the** recent peak in interest rates is more telling about the economy's outlook and markets than many would like to admit. (***See Why Bonds Aren't Overvalued.***)

While the markets are indeed in *"Party On Garth"* mode, the current extended, overbought, and bullish conditions provide the necessary backdrop for a short-term correction.

As discussed over the last couple of weeks, August and September tend to be weaker performance months. Therefore, with the bulk of earnings soon behind us, the focus will turn back to the economy and the Fed.

In the near term, the most significant risk for the market comes from the Federal Reserve at the Jackson Hole Summit this summer. If there is a change in their outlook to a more *"hawkish"* stance or more detailed *"taper"* discussions, the markets may react negatively.

Another immediate risk could be a failure to pass additional stimulus in Congress or a movement to *"lockdowns"* due to the virus.

In conclusion, it is simple enough to say *"I have no idea"* what could derail the markets. Such is why we analyze the risk each week and try to make prudent and informed decisions about portfolio exposures and risk management.

It's the best we can do for you and our clients.

Have a great weekend.

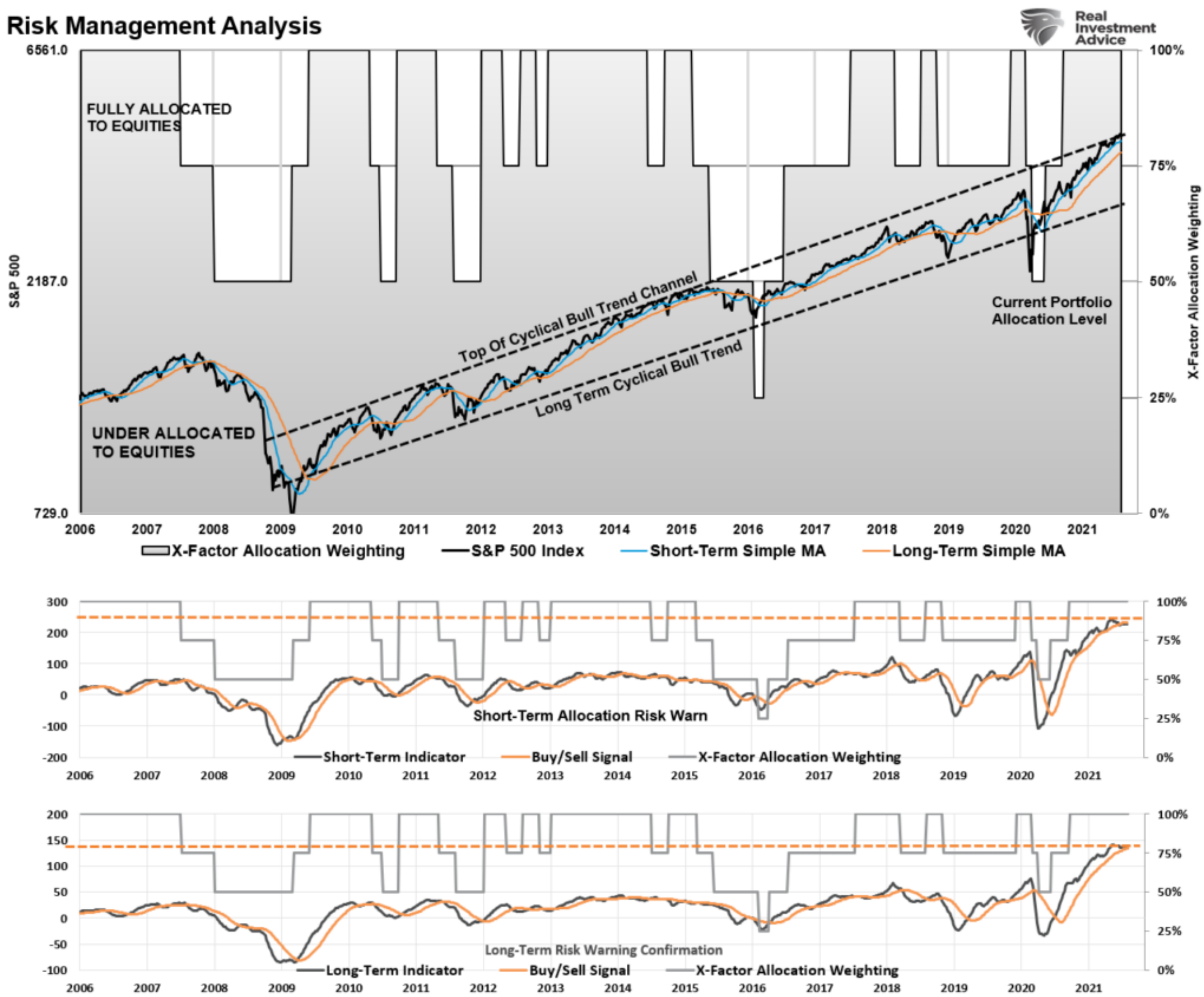
By Lance Roberts, CIO

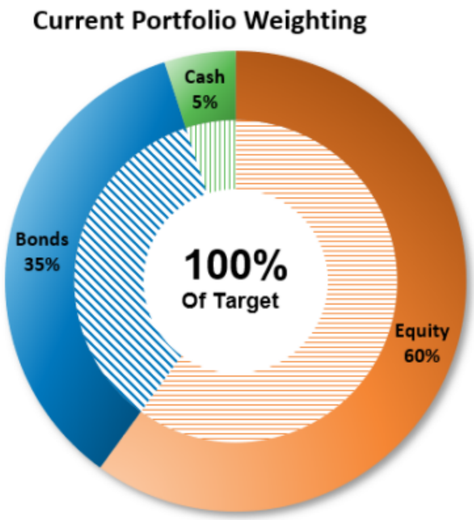
Market & Sector Analysis

Analysis & Stock Screens Exclusively For RIAPro Members

THE REAL 401k PLAN MANAGER

A Conservative Strategy For Long-Term Investors





Current 401k Allocation Model

5.00% **Cash + All Future Contributions**

Primary concern is the protection of investment capital

Examples: Stable Value, Money Market, Retirement Reserves

35.00% **Fixed Income (Bonds)**

Bond Funds reflect the direction of interest rates

Examples: Short Duration, Total Return and Real Return Funds

60.00% **Equity (Stocks)**

The vast majority of funds track an index.
Therefore, select on ONE fund from each category.
Keep it Simple.

20% Equity Income, Balanced or Conservative Allocation
30% Large Cap Growth (S&P 500 Index)
5% International
5% Mid-Cap

Portfolio Instructions:

Allocation Level To Equities	Recommendation	When To Take Action
Less Than Target Allocation	Hold Current Exposure	Hold Exposure
Equal To Target Allocation	Hold Current Exposure	Hold Exposure
Over Target Allocation	Hold Current Exposure	Hold Exposure

Commentary

After a brief tumble and retest of the 50-dma, the market surged to new highs. However, that was about it as over the past week markets made little progress before selling off on Friday. Importantly, the technical underpinnings remain weak as we move into the two weakest months of the year.

The GDP report came in much weaker than expected which is likely to start bringing down forward earnings estimates for companies. This is going to keep valuations very elevated, and make it more difficult to eak out further gains this year.

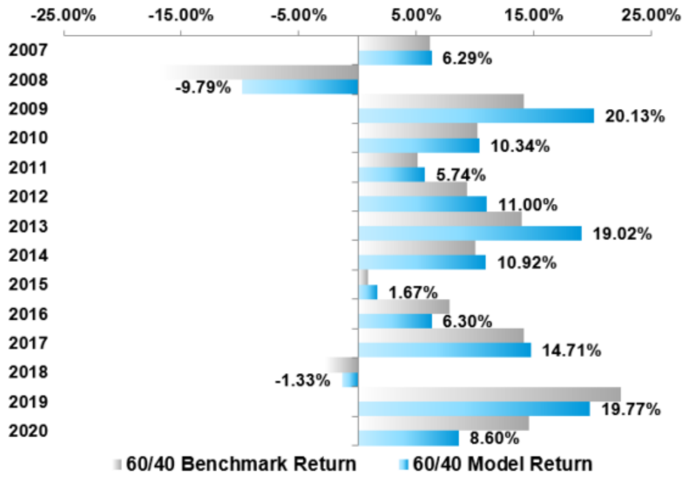
However, with that said, this is also not a time to be overly conservative with allocations. For now, keep exposures at full weights, but hold new contributions in cash for now. There likely is not a lot of upside here to warrant chasing markets, but if we continue to consolidate over the next month or so, we will have a better opportunity to deploy cash for a stronger year-end performance.

If you need help after reading the alert, do not hesitate to **contact me**.

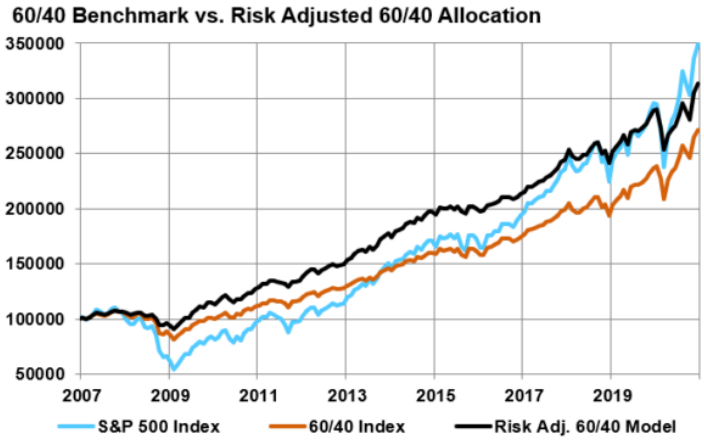
401k Model Performance Analysis

Model performance is a two-asset model of stocks and bonds relative to the weighting changes made each week in the newsletter. Such is strictly for informational and educational purposes only, and one should not rely on it for any reason. Past performance is not a guarantee of future results. Use at your own risk and peril.

Year	60/40 Benchmark Return	60/40 Model Return
2007	6.16%	6.29%
2008	-16.73%	-9.79%
2009	14.14%	20.13%
2010	10.19%	10.34%
2011	5.11%	5.74%
2012	9.33%	11.00%
2013	13.94%	19.02%
2014	10.04%	10.92%
2015	0.88%	1.67%
2016	7.77%	6.30%
2017	14.12%	14.71%
2018	-2.71%	-1.33%
2019	22.41%	19.77%
2020	14.58%	8.60%



Portfolio vs Benchmark Statistics	
Number of Up Years	12
Number of Down Years	2
Best One Year Return Of Benchmark	22.41%
Best One Year Return Of Model	20.13%
Worst One Year Return Of Benchmark	-16.73%
Worst One Year Return Of Model	-9.79%
Benchmark Return 2007-Present	171.16%
Model Return 2007-Present	213.32%
Total Alpha Generated	42.17%
Mean Annual Return Of Benchmark	7.80%
Mean Annual Return Of Model	8.81%
Beta Of Model vs Benchmark	0.87
Jensens Alpha	1.91%
Sharpe Ratio	0.29



Have a great week!