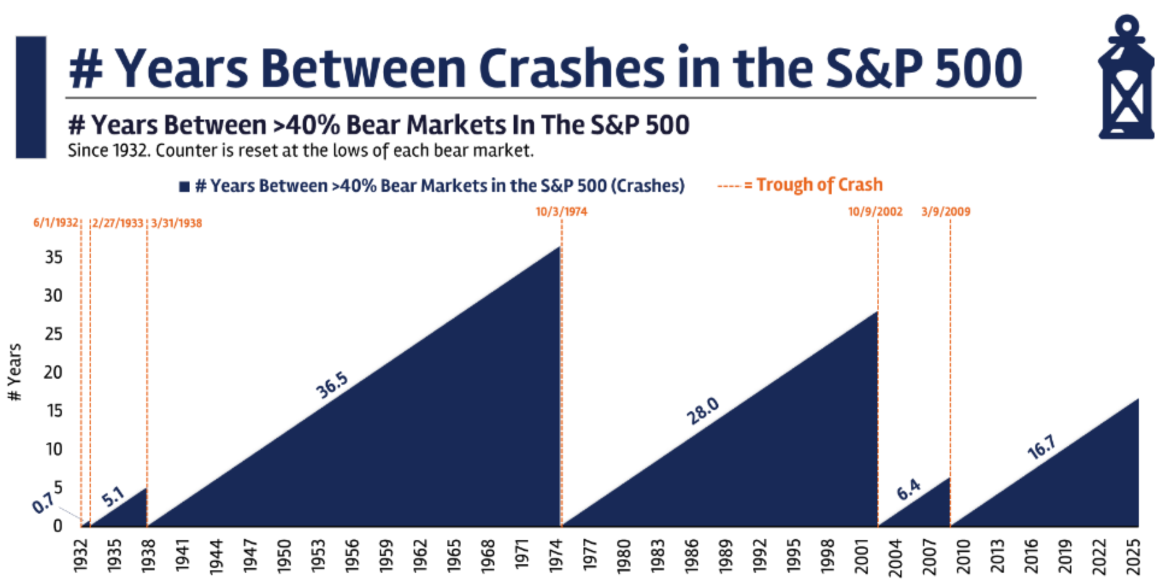
Volatility persisted last week. Nvidia posted stellar results and guidance Wednesday afternoon only to see the stock finish in the red the following day. The market followed suit – after opening strong the rally quickly faded. Last Thursday, the S&P 500 posted a 3.5% reversal between the highs and lows of the day. The apparent catalyst – Fed Governor Lisa Cook, whose experience has been confined to academic and public sector roles versus managing money in the private sector. During a speech on Thursday, she suggested that there is "an increased likelihood of outsized asset price declines" given current valuation levels.

I believe last Thursday's market reaction, driven by nothing more than a Fed Governor's questionable market view, highlights how fragile sentiment has become. And that's good news for the bulls. The underlying fundamentals continue to strengthen – corporate earnings are growing at roughly two times the historical average, forward estimates are being revised higher, and capital investment keeps accelerating. Meanwhile, the bears have temporarily assumed control of the narrative, which has collapsed sentiment indicators. This sudden shift towards investor pessimism has shaved some froth out of the market, which I believe sets us up nicely going forward.

Market pullbacks are never ideal, but sentiment-driven declines against a strengthening fundamental backdrop are often healthy short-term resets. I believe the recent choppiness is simply a brief pause on the march towards new highs as earnings growth fuels the next leg of this secular bull market. While it might seem like an eternity since the last market crash, which occurred during the 2008 Financial Crisis, long-term bull markets tend to last multiple decades. During these periods, such as the post-WWII boom or the 1980s/1990s, economic growth compounds along with robust profit expansion for businesses and increased productivity. All of these elements are firmly in place during the current expansionary cycle.



Source: S&P Global, Ritholtz Wealth Management, YCharts, A Wealth of Common Sense

Market tops generally coincide with peak optimism when the underlying fundamentals begin to deteriorate beneath the surface. That was the case during the mid-1970s against soaring valuations for the "Nifty Fifty" stocks and at the very end of the 1990s just before the dot-com bubble burst. The opposite is true today – sentiment has soured while underlying growth metrics are accelerating. I believe this recent dip is little more than a blip on the radar driven by a rapid shift in sentiment. As long as capital investment continues to grow along with earnings, it's my view that this pause represents an attractive buying opportunity across quality stocks that are suddenly on sale.

Andrew P, Kerai, CFA®, Chairman & Managing Partner

Capital Ideas, Inc.
