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Sound Investments Inc.

DJIA - 25812   S&P 500 - 3100   NASDAQ 10058

Summary

The market appears to be overvalued, for instance, the largest 5 growth stocks of the S&P 500 make up 23% of the index and trades at a rich 35.4 times earnings. The remaining 495 stocks trade at just 19.5 times earnings. Year to date, the index is down approx. 2% but if you exclude the 5 largest growth stocks, the remaining 495 stocks are down 7.3% year to date. This is known as a narrow breathe -- with so much of the gains coming from a handful of big stocks -- it often indicates a top.

Twice a year, Barron's, a well known financial magazine, hosts a round table of knowledgeable portfolio managers. As a group they think the economy has improved and expect things to get better in 2021 but that the good news is already priced into the market and there is no margin for error. <u>Overall they think the market is expensive and somewhat uncertain.</u>

This investment letter is mailed quarterly to our clients and friends.

<u>The Times They Are A-Changin</u>

I often read Peggy Noonan articles in the Wall Street Journal. Like all good writers, no doubt, she was looking for a way to capture or communicate the times we live in and and last month she quoted Bob Dylan's folk song <u>The Times They Are A-Changin.</u> Scripted in 1964 Dylan's song predicted the social upheaval we had in the late 1960's and 1970's. His book, "Chronicles," won the Nobel Prize for literature. One of the things he talks about is how we must face change. Today, we face different challenges as the plague marches on. In this letter we want to explore how we can protect our savings and investments and better still, make <u>some money </u>from it.

<u>Mid-Year Uncertainty</u>

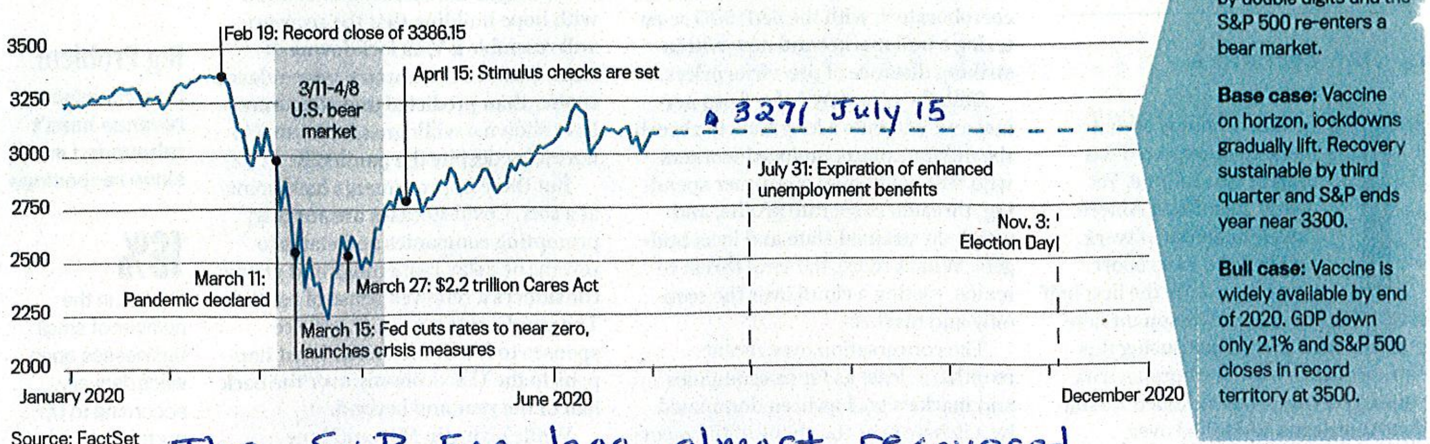
It has been an event-full first half of the year to say the least. For the first time since 1932, a 20% market decline in one quarter was followed by a 20% gain in the next.

It was a tough first half-year for Wall Street. To recap, the year started out strongly, with multiple all-time highs being set by the major indexes. The Dow Jones Industrial Average, which would reach the doorstep of 30,000, a record high. Then, COVID-19 struck, spreading across Asia and Europe before hitting our shores. This deadly pandemic would lead to business closures, mandated social distancing, and a plunge in equity prices, with the Dow falling to 18,200 in a matter of weeks. Stocks then would rebound, (Dow Jones now 26,415 @ July 17) regaining much of the lost ground on hopes for a successful reopening of the economy, rising profits, and progress on the disease front. However, the S&P 500 is still down 3% from the year to date high.

In hindsight, the stock market overreacted to the covid-19 pandemic in March. Some sectors have recovered while others parts of the economy, such as travel and entertainment, are still reeling. Despite improvements, we are in the midst of a recession with investors understandably wary about the 2nd half of 2020. Our feeling is that the pandemic is not a long term issue and may clear itself in the next 6/12 months or so. However, it had a severe affect on the economy, which already had a lot on its plate to consider as outlined on the next page.

Portrait of a Pandemic

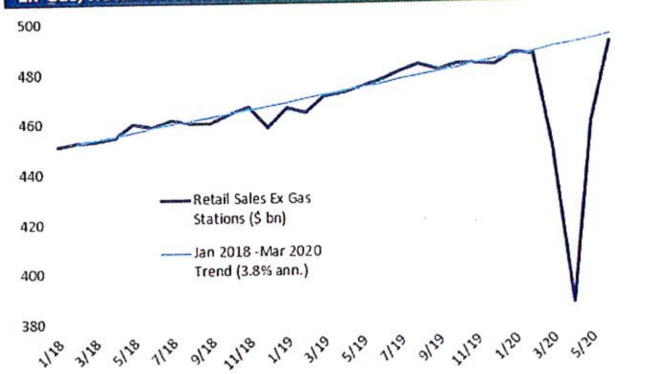
The coronavirus crisis in the U.S. has driven the S&P 500 from all-time peaks to the depths of a bear market, and back, all in the first half of the year. The second half holds many wild cards that are certain to leave investors on edge.



The S&P 500 has almost recovered but we are now facing high unemployment, an election and lower earnings. Our sense is the gains are already priced into the market.

the way back to pre-pandemic trendline growth.

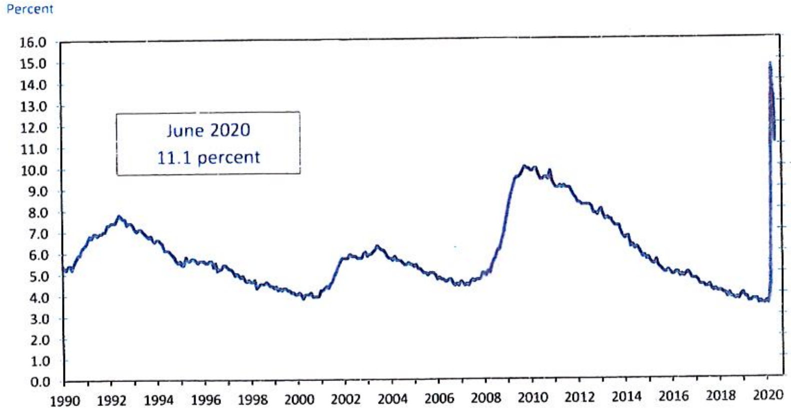
Ex-Gas, Retail Sales Are Back to Record Highs & Only Just Below Trend



Retail Sales appear to have recovered but it could be due to consumers restocking their pantries and spending stimulus checks.

Chart 10. Civilian unemployment rate

Seasonally adjusted, 1990–2020



Note. Shaded areas represent recessions as determined by the National Bureau of Economic Research (NBER). An endpoint for the recession that began in February 2020 has not yet been determined. Data online at https://data.bls.gov/timeseries/LNS14000000.

Unemployment is currently at 11% which is higher than it was during the great recession of 2009. Eventually, this will reduce Consumers demand.

The Market Has A Lot to Ponder

The market has often been compared to a weighting machine ... where it takes each bit of news and incorporates it all into the closing price each day. News on the covid-19 front has heavily influenced the direction of the market these past 4 months, but there is also a host of other factors listed below it has to contend with as well.

- Credit card usage was down 21% in May from the same time last year.
- Up coming presidential and congressional elections. At stake are the differing approaches to taxation, regulation, tariff and trade policies, infrastructure spending, and international relations, all of which have an impact on financial markets.
- Trade fiction with China.
- Foreign trade forecasted to fall by1/3 due to a reduction in global supply chains.
- Mike Pompeo advised this should prompt a reassessment of U.S. reliance on China not just for pharmaceuticals but rare-earth and a host of other things central to America's security.
- Federal Governments increased debts and spending to support the economy.
- In a post-pandemic world, more economic activity will be designated essential to national interest which will most likely increase costs.
- Unemployment remains at over 10% ... levels not seen since the Great Depression.
- Cultural upheaval and protest from George Floyd's death.

If the above isn't enough, the market appears to be overvalued, for instance, the largest 5 growth stocks of the S&P 500 make up 23% of the index and trades at a rich 35.4 times earnings. The remaining 495 stocks trade at just 19.5 times earnings. Year to date, the index is down approx. 2% but if you exclude the 5 largest growth stocks, the remaining 495 stocks are down 7.3% year to date. This is known as a narrow breathe -- with so much of the gains coming from a handful of big stocks -- it often indicates a top.

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Conclusion

We started this essay off with a quote from Bob Dylan on how thinks change. We think the markets have a lot to digest and it may be time to change our investment posture. We plan on discussing the above with each of you on the possibility of lightening up a bit.

<u>Once a year, I am required by the Security Exchange Commission to offer to send out a copy of my ADV Part 2 which outlines my companies policies and procedures. I am happy to send it or even better come in to my office so I can explain it to you. Our privacy statement is also enclosed.</u>

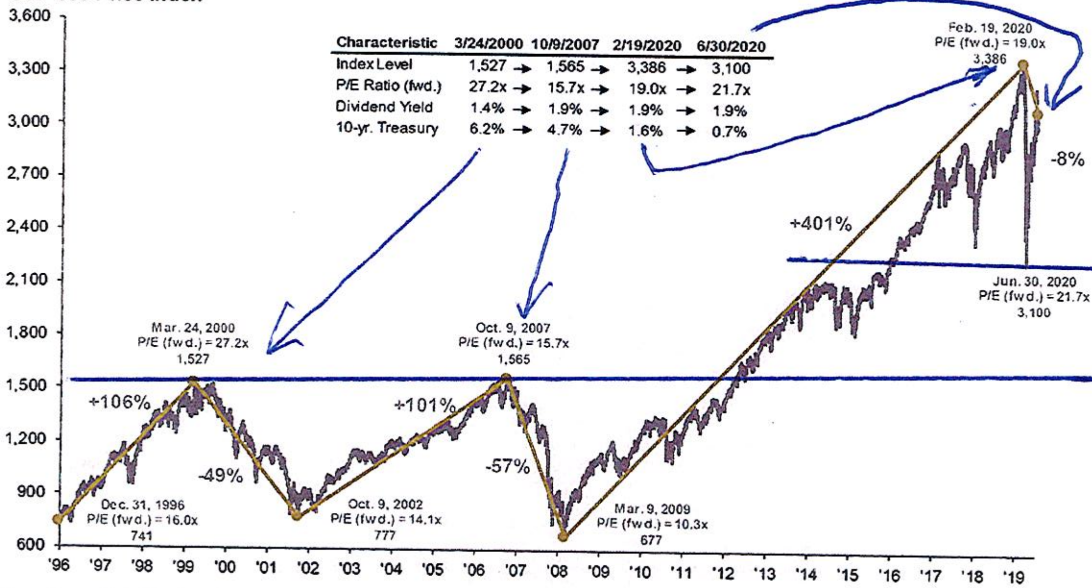
Sound Investments Inc. Kenneth Gilpin CFP 913 908 4366

Equities

S&P 500 Index at inflection points

S&P 500 Price Index

Characteristic	3/24/2000	10/9/2007	2/19/2020	6/30/2020
Index Level	1,527 →	1,565 →	3,386 →	3,100
P/E Ratio (fwd.)	27.2x →	15.7x →	19.0x →	21.7x
Dividend Yield	1.4% →	1.9% →	1.9% →	1.9%
10-yr. Treasury	6.2% →	4.7% →	1.6% →	0.7%



Source: Compustat, FactSet, Federal Reserve, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price to earnings ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of June 30, 2020.

J.P.Morgan
Asset Management

As per the chart, the all-time high on the S&P 500 is 3386 on Feb. 9th. On July 15, it went back to 3271. We feel the market has already priced in most of the recovery.

New Support Level

Old Support and Resistance