The Hudson River Group at Morgan Stanley

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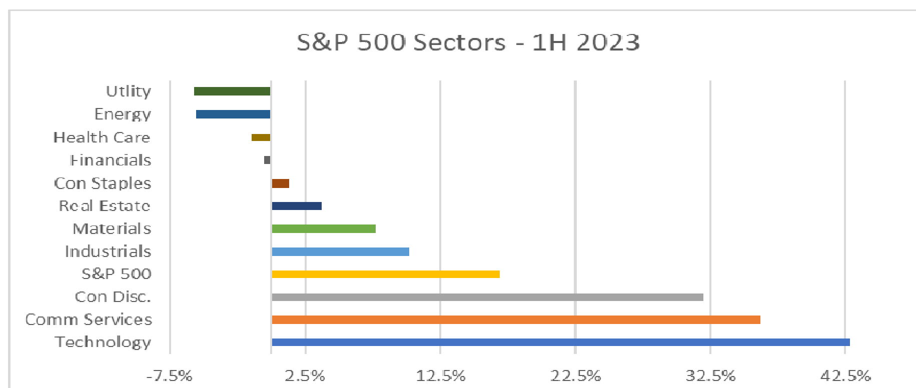
"There's something happening here. But what it is ain't exactly clear"

\- Buffalo Springfield

We entered the year wearing a cautious hat feeling a tad uncomfortable since everyone else seemed to be wearing the same hat. We wrote "The one setup into the new year that gives us hesitancy in our current cautious stance is the fact that to be cautious seems to be the consensus call." To rehash a quote, one we have used before and utter often from the retired Wall Street vet Walter Deemer; "The stock market will do whatever it has to do to embarrass the greatest number of people to the greatest extent possible." The major index surely did that posting a 16.9% total return for the first half[1]. But as always there is more than meets the eye.

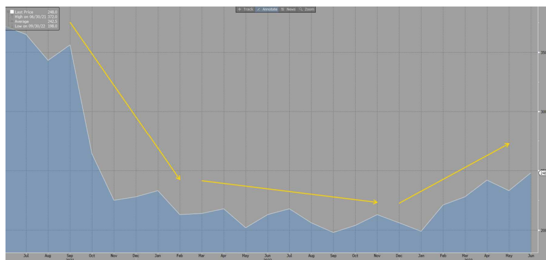
It was late 1966 when Buffalo Springfield recorded and released "For What It's Worth"; the opening lyrics don the top of this letter. Around the same time the Nifty Fifty started to become the darlings of Wall Street. This group of companies were deemed to be "one-decision" stocks so appealing that their shares should be bought and never sold – no matter the valuation. While there is no exact list of these companies an old article out of Forbes states "One old-timer believes that Kidder Peabody's monthly list of 50 Big Board stocks with the highest [P/E] multiples probably came closest"[2]. In the early 1970's some of these companies where trading north of 50x earnings and inevitably got taken to the woodshed in the bear market that soon followed. Today Wall Street has their own set of darlings which are known as the "Magnificent Seven." We are prohibited from mentioning individual stocks however many of you know a vast majority of the member of this small elite group (if not feel free to contact us or a quick internet search will give you the answer). For the first half of 2023 the "Magnificent Seven" was the market.

Per the work of Howard Silverblatt, S&P Dow Jones Indices Senior Index Analyst[3], the "seven" were responsible for about 75% of the year-to-date return of the S&P 500 and the sectors where they are members of were responsible for roughly 97% of the gains. Every sector without a "Magnificent" member lagged the index:



This so called “bad breadth” has been a top bullet point for bears and rationalized by bulls. We are fully congizent in the power of momenetum and money flows especially in the age of computer trading/algorithms and ETF’s (exchange traded funds) so in the short term we would not be surprised if the “mangificent” continue to be just that. Our preference, as it always is, is to find companies/sectors/areas that we see as of value rather than chase momentum. Our homework in equity land will be on the “not so great 493” the small and mid cap space as well as outside of the US. Whether the markets girggles some mouthwash or not may depend on the path of the economy and rates.

The bevy of economic data that we have noted in prior missives has not altered much which is why we still belive a recession could still be in the cards down the road; we just are not sure how long the road is. The Conference Board US Leading Index continues to be negative for a staggering 11 months in a row with only a 0.01% rebound from its lows[4]. The yield curve has been inverted for now a full calender year while manufacutring data (Dall Fed, Philly Fed) sit in the red[5]. Employement and the consumer have held up much better than we would have guessed however for both the future may sour a bit. Jobless claims are slowly rising; (left chart) while temp jobs have been declining since March (right chart). Morgan Stanley’s chief economist see’s the possibliy of a negative payroll print later this year[6]; though she is still in the soft-landing camp.



Source: Bloomberg

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As for the US consumer according to research published recently by the Federal Reserve Board accumulated savings during Covid has been unwound[7] while post the FOMC’s historic tightening any debt now utilized is that much more expensive: credit cards, mortgage, home equity loans, etc.

While our cautious stance to start the year has indeed been incorrect, we do not see it as prudent to chase what has already worked out especially when there are many un-loved pockets of the markets that in our opinion exhibit an attractive risk/reward especially if we are incorrect and the economy is entering an expansion. As for those whose goals is not just soley capital appreciation (which is many of you) most of the US treasury curve is now over 4% - something we have not seen since before the Great Financial Crisis of 2008-2009.

As we enter the back half of the year we are watching to see the path of financial conditions. Post the regional bank crisis conditioned eased (chart on the following page) which has been positive for risk assets. It will be interestersing to watch this path over the next six to twelve months.

Enjoy the remaining few months of summer. Thank you for allowing us to be of service.

The Hudson River Group

S&P 500 Index (black) & Chicago Fed National Financial Conditions Index (yellow -inverted)

Source: Bloomberg

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[1] Source: Bloomberg

[2] The Nifty-Fifty Re-Revisited (pomona.edu)

[3] Howard Silverblatt (@hsilverb) / Twitter

[4] Source: Bloomberg

[5] Source: Bloomberg

[6] Morgan Stanley: Friday Finish – US economics. Risks Beyond July

[7] The Fed - Accumulated Savings During the Pandemic: An International Comparison with Historical Perspective (federalreserve.gov)

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