

Delta Investment Management is a registered investment advisory firm. Delta welcomes discussions with individuals seeking investment advice and advisors seeking a new turnkey asset management solution.

Delta manages portfolios at TD Ameritrade and Schwab.

Please contact Delta at info@deltaim.com or 415-249-6337 to learn more.

May 20, 2022

Inflation Profit Pressure

Walmart and Target reported better than expected sales. But earnings disappointed primarily because inflation pressures are shrinking margins. Both companies said they expect price pressures to persist for several quarters.

The problem investors face is the rising possibility that inflation remains higher for longer. This will have a negative impact on profits and may cause consumers to pull back from currently high levels of consumption. Additionally, the Federal Reserve will have to remain hawkish on interest rates for longer which increases the probability of recession.

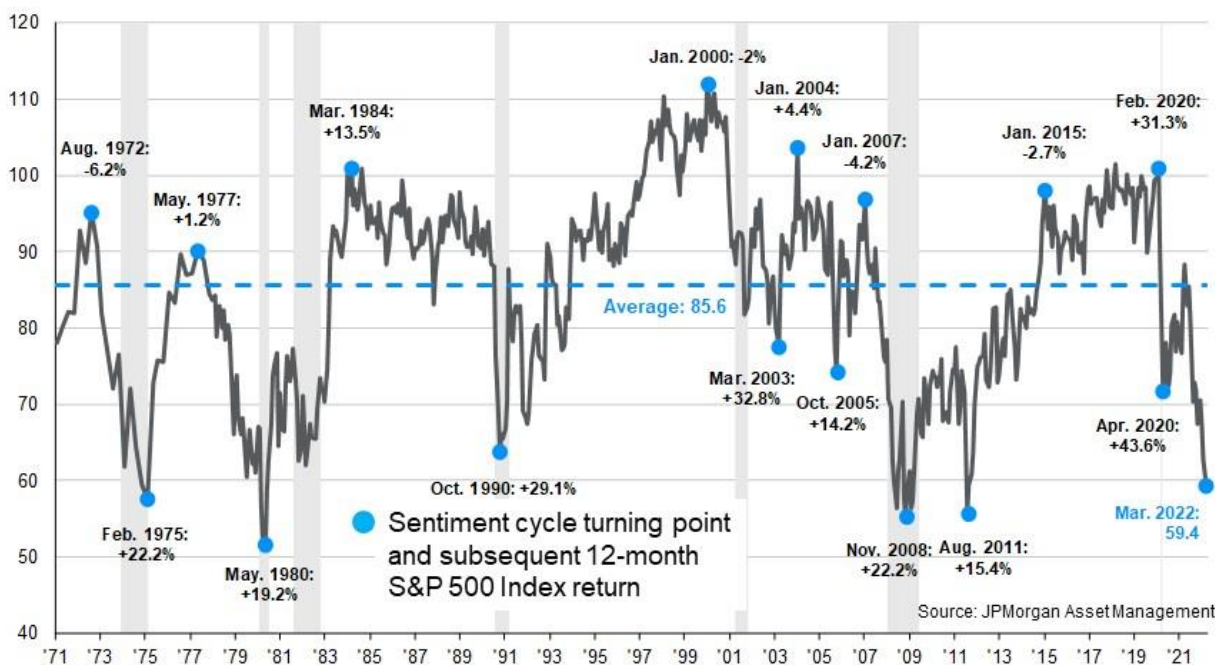
When two of the largest retailers in the US say they have an inflationary cost problem which will persist for several quarters, profit expectations and stock valuations for the S&P 500 decline.

Uncertainties arising from the inflation/profit/interest rate/supply-chain/war outlook are elevated. The bond and equity markets are not in agreement on what happens next. As of May 12th, the US and Euro area equity markets were pricing in a 70% probability of a recession this year. The corresponding pricing of a recession by investment-grade credit markets was around 50%. The high-yield credit market was pricing in close to a 30% chance of a recession. Spreads between various rate types were pricing in a 10-20% probability of recession. Historically, the bond markets have been correct more often than the equity market in their predictions of recessions.

In the short-term, high investor uncertainty creates high volatility. This is not an easy market for the faint of heart. Warren Buffett, in his letter to shareholders this year, made clear that successful investors stay within their comfort zone. According to Buffett: 'People who are comfortable with their investments will, on average, achieve better results than those who are motivated by ever-changing headlines, chatter and promises.'

For long-term investors, depressed valuations and sentiment may offer opportunity. The University of Michigan Consumer Sentiment Index is depressed. Below is the chart of sentiment dating back to 1971 showing peak/trough cycle turning points and subsequent 12-month returns of the S&P 500.

Peak/Trough Sentiment; Next 12-month Return



If you bought the S&P 500 at peak sentiment since 1971, your subsequent 12-month return was 4.1% on average. If you bought at sentiment lows, your average return was 24.9% over the next 12 months. The chart above makes clear we are near or at a consumer sentiment low.

The Leading Economic Index (LEI) decreased by 0.3% in April. The LEI trend is decelerating but the six-month moving average of the indicator (Delta's recession threshold) remains positive. The Conference Board still projects 2.3% GDP growth in 2022.

There is broad agreement that there are downside risks stemming from inflation, rising rates and supply chain disruptions. Where there is little agreement and cause for stock valuations to be volatile is how much of a slowdown will the economy experience and where will stocks eventually find bottom. If Consumer Sentiment is our guide, the indication is most of the damage to stock values has already taken place.

Let Us Help You Position Your Portfolio – Give Us a Call Today

We have unique and sophisticated investment methods that seek to capture the stock market's gains while minimizing drawdowns in bear markets. If you would like to learn more about how we manage money, we invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com.



"I had no idea our marriage was so interest-rate sensitive."

Delta Stock Market Dashboard

MARKET SENTIMENT IS

BEARISH

THIS WEEK'S NUMBER IS

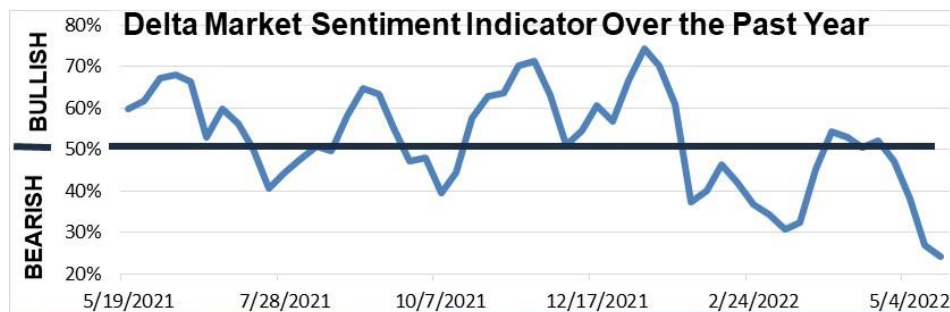
24.2

Our technical indicator decreased from 26.8 to 24.2 this week

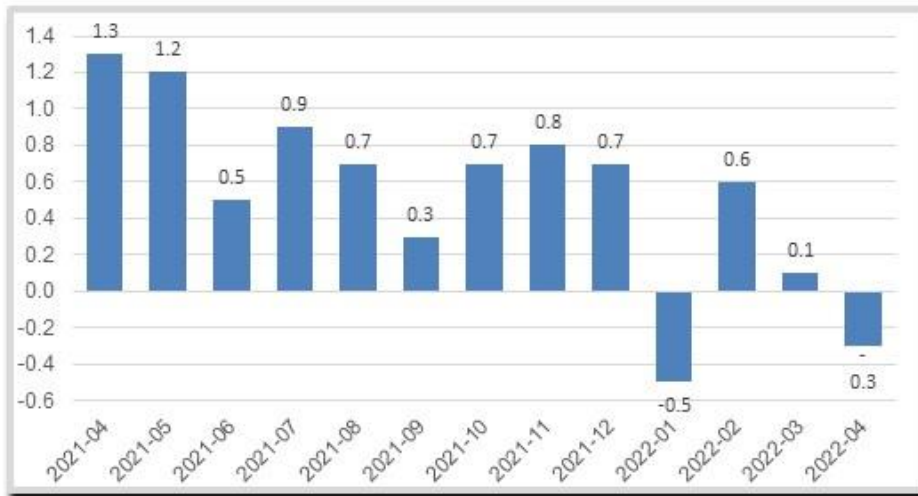
INDICATOR STATISTICS

Consecutive Bearish Weeks:	3
Cycle Inception Date:	5/4/2022
Range:	24.2 - 38.0
Mean:	29.7
Bullish Weeks YTD:	8
Bearish Weeks YTD:	12
*S&P 500	-8.3%
*DJIA	-7.4%
*NASDAQ	-9.5%

* Percentage change during current cycle



Leading Economic Index % Change Monthly April 2021 – April 2022



Source: The Conference Board – last update 5/19/2022

Pursuant to the provisions of Rule 206(4)-1 of the Investment Advisors Act of 1940, we advise all readers to recognize that they should not assume that recommendations made in the future will be profitable or will equal the performance of past recommendations. This publication is not a solicitation to buy or offer to sell any of the securities listed or reviewed herein. The contents of this letter have been compiled from original and published sources believed to be reliable, but are not guaranteed as to accuracy or completeness. Nicholas Atkeson and Andrew Houghton are also principals of Delta Investment Management, a registered investment advisor. Clients of Delta Investment Management and individuals associated with Delta Wealth Adviser may have positions in and may from time to time make purchases or sales of securities mentioned herein.

THIS NEWSLETTER IS PROTECTED BY COPYRIGHT LAW. UNAUTHORIZED DISTRIBUTION AND/OR REPRODUCTION BY PHOTOCOPY OR ANY OTHER MEANS IS STRICTLY PROHIBITED AND PUNISHABLE BY A FINE OF UP TO \$25,000.