

PENDER MARKET INSIGHTS

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Like a giant black hole from a summer blockbuster movie that pulls in everything around it, equity markets continue to drag cash off the sidelines. Global risk assets moved higher for the month of July as reasons to be bearish were overlooked and laughed off. But like all good things, they do come to an end, and that time appears to be nearing.

The rally has been impressive. From the April lows, the S&P500 has increased by over 30% and once again sits at all-time highs. A year many expected to yield muted returns, is now higher by double digits.

This is making many investors feel empowered to add risk. After all, with markets at record levels, every dip has been a buying opportunity. There aren't many better indicators of exuberance than the MEME stocks, and they joined the party near the end of July, setting off a short squeeze that saw several fly over 25% in a day on no news.

These are 'Red Flags' and it's worth thinking back to previous similar times of excess and noting that this is not a time for complacency. Added to that unease, the calendar is now flipping over to the seasonally worst period for markets and being a little more defensive makes some sense.

Markets have had to deal with many concerns this year. Tariffs have added a degree of uncertainty to what was already a challenging earnings environment. After several strong years of performance in which valuations have increased to elevated levels, we believe that earnings growth is now needed for markets to move higher.

Early results from second quarter earnings reports have been mixed. The spending around AI by the hyperscalers continues to power related businesses higher, and it has been encouraging to see the big banks report strong numbers, albeit led by capital market's activity. While concern continues in the consumer segment, economic uncertainty is beginning to take effect, and pockets of weakness are appearing.

The bond market continues to signal caution. Japanese bond yields have moved to multi-year highs, pulling rates higher in other nations, while Switzerland has returned to the world of negative yields as the safety trade reappears. Back in the US, Fed chair Powell continues to come under political pressure to cut rates, while inflation remains elevated and uncertainty high.

In the background remains the tariff issue. Ahead of President Trump's self-imposed deadline, several countries and regions were able to reach deals with the Americans, but the damage has been done. Long established trading partnerships have been shredded, and even when deals are reached, who would be shocked to hear that they have to be renegotiated? Not a great environment for long-term planning.

With these concerns, and markets hitting records, we believe this isn't a time to be a hero. Markets are stretched and may be due for a reset. Warning signals are appearing and, in our view, should not be ignored. While there are always going to be single name opportunities, the broader market is now looking risky and needs to be regarded with caution.

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