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There is still lots of talk about stock market bubbles and pending bear market declines, but all this fear mongering is not backed up by the data. Another better-than-expected inflation report for producers helped to alleviate concerns about Federal Reserve rate increases, and Treasury yields eased again across the curve. Earnings season has started at a blistering pace with all of the big banks handily outperforming expectations. According to the Fed's Beige Book survey, economic activity strengthened modestly in recent weeks, as the economic expansion continues.

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It is hard to find a clearer picture of the rotation going on within the technology sector, as well as into other sectors, than yesterday's heat map of S&P 500 performance below. Profit taking continues in memory, chip, and hardware manufacturers that fueled the bull market off the April low. They became extremely extended and more than fairly valued after a near doubling of the Philadelphia Semiconductor Index. They are now reverting to fair value, but I see no breakdown in the fundamental story yet. Meanwhile, investors are shopping for value within the Magnificent Seven companies that have been fueling the spending on this AI infrastructure buildout.

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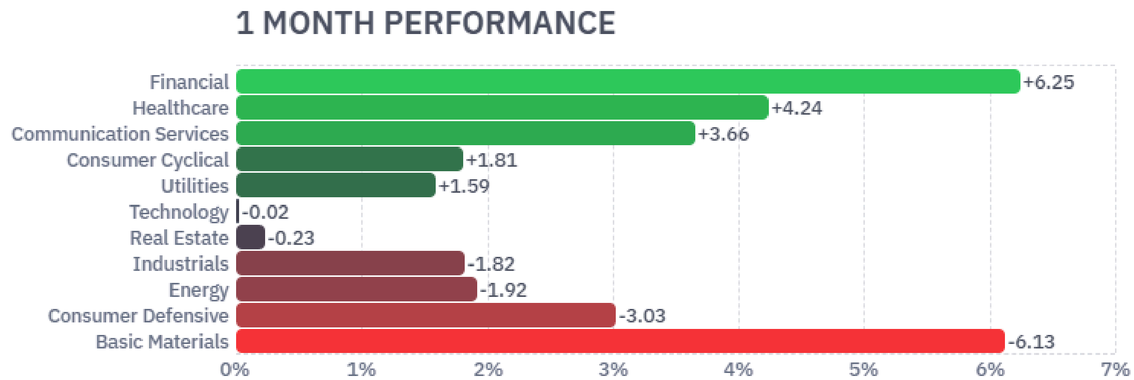
Microsoft (MSFT) is trading at its lowest forward multiple (20x) in more than five years, which is well below its average of approximately 30 times. It now trades at a discount to the S&P 500's forward multiple. I am seeing similar discounts for Meta Platforms (META) and Amazon (AMZN). This rotation within the tech sector should continue in fits and starts during the second half of the year rather than seeing an overall decline in the sector that drags the S&P 500 index significantly lower.

At the same time, investors are rotating out of technology into other sectors with better value propositions. Corporate earnings in the financial sector have been fantastic, as banks capitalized on the volatility in markets to juice their trading revenue. This explains their outperformance over the past month. Healthcare's outperformance can be explained by its defensive nature and extremely discounted valuations. My bottom line is that this broadening in performance is a healthy development and a positive sign for the bull market.



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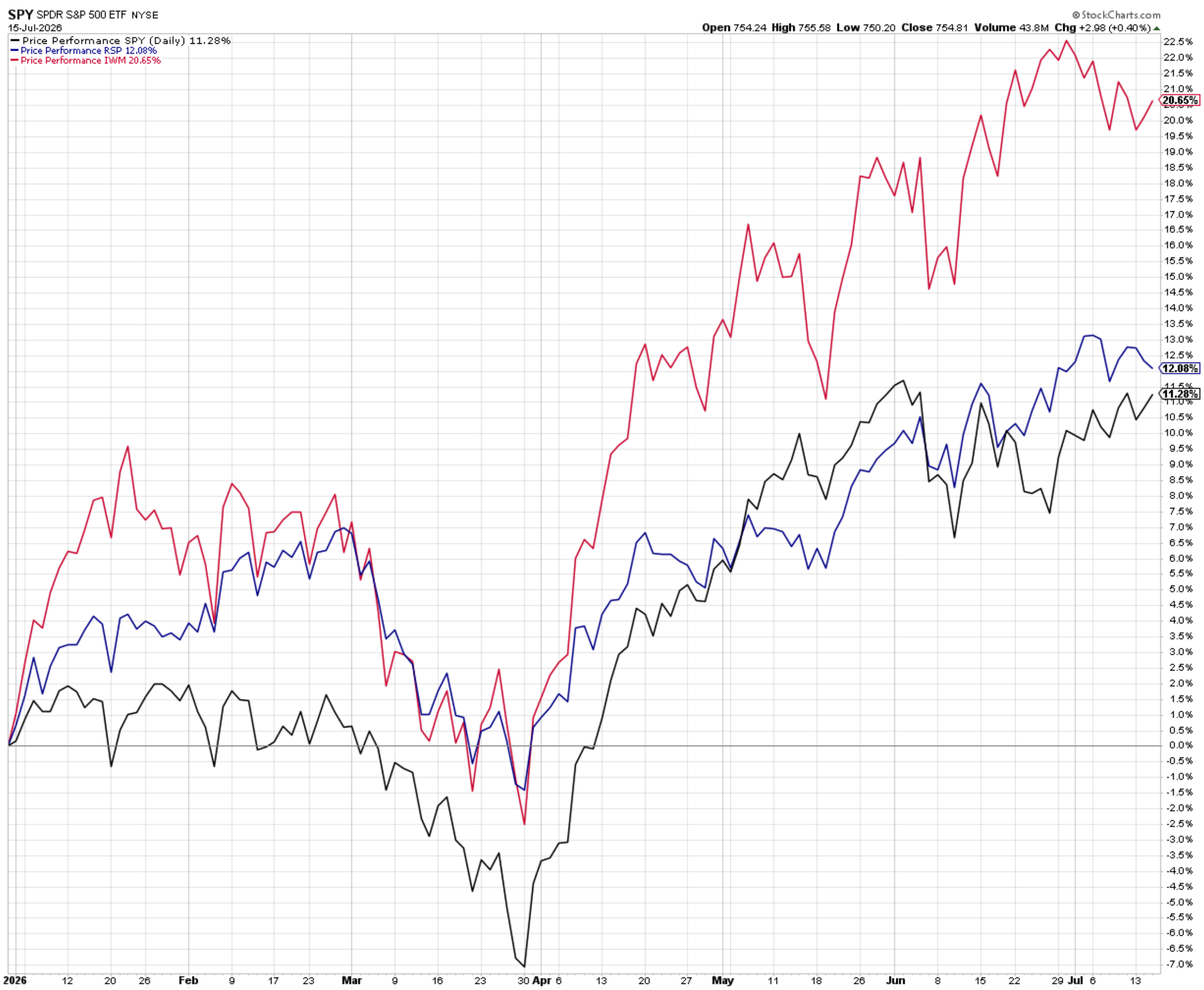
This ongoing rotation is exemplified by the average stock, as measured by the equally weighted S&P 500, outperforming the S&P 500 index this year, while the Russell 2000 small-cap index has produced nearly double the return.



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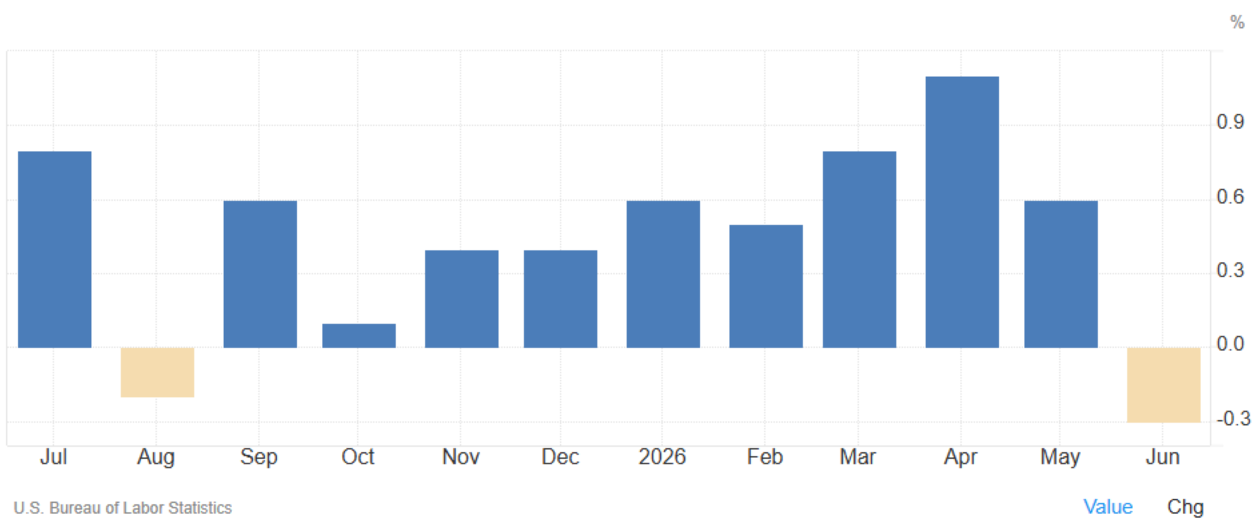
The S&P 500 has risen more than 10% this year, and that is due entirely to earnings growth. There has been no increase in valuation. That said, some sectors have seen valuation compression, led by tech, while others have seen valuation expansion. Again, this is normal for a bull market. Earnings are likely to continue driving performance in the second half, as investors are clearly reluctant to pay more than 20 times for the S&P 500 index. In my view, finding companies that sell at a discount to the market and are realizing improving rates of change in revenue and earnings growth is the key to producing market-beating returns.

The two things that could halt this bull in its tracks are a meaningful increase in interest rates that is a prelude to Federal Reserve tightening, but it looks like we have skirted that risk after this week's inflation reports. Tuesday's Consumer Price Index report was a sigh of relief, and it was backed up by yesterday's Producer Price Index (PPI). Producer prices fell 0.3% in June compared to expectations for no change. The cost of goods declined 1.4%, which was due to a 12% slide in gasoline, and the annualized rate fell from 6% to 5.5%. The core rate, which excludes food and energy, declined to an annualized 4.7%. The cooling in producer prices was broad-based, and it should allow the Fed to sit tight as war-induced price increases abate.



Trading Economics

Futures markets are still pricing in one rate hike this year, but after this week's reports, the timing has been pushed out to December. As more data on the economy is reported this summer, we should see expectations for a rate hike diminish and then disappear. The consensus of investors will shift back to a focus on when the next rate cut is expected. This should help pave the way to more bull market gains.

More on my IG service