MARKET REVIEW & OUTLOOK

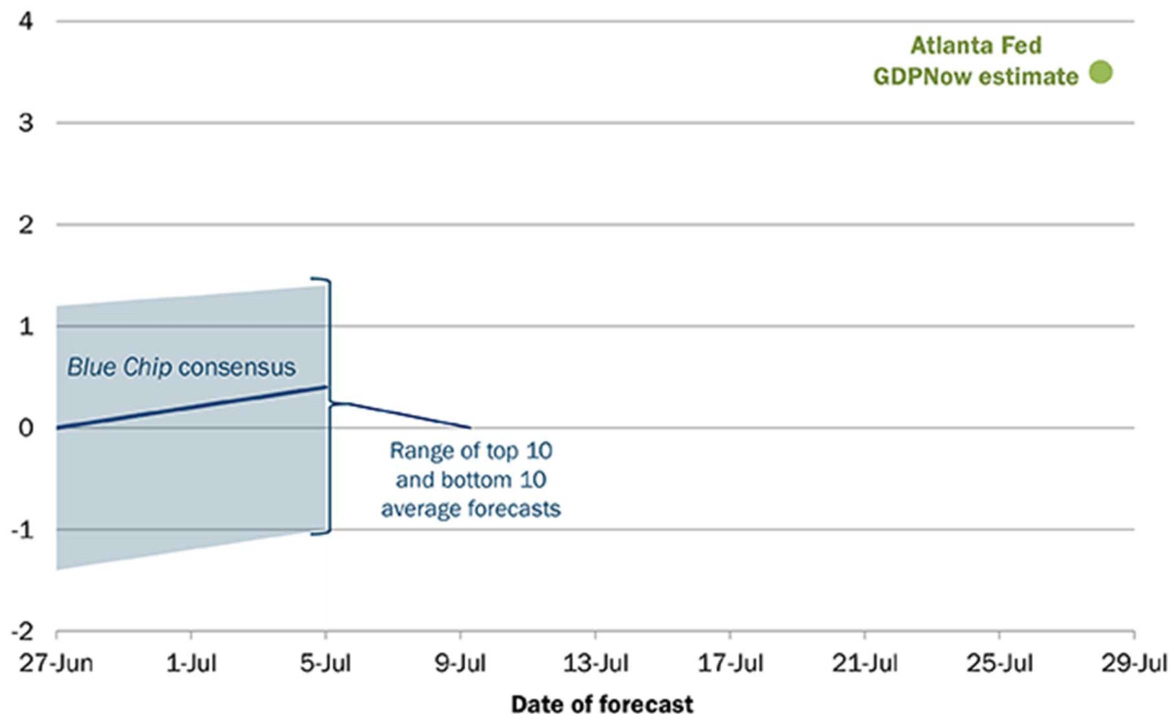
JULY 2023

KEY TAKEAWAYS

- The equity markets continued strong gains during the summer "doldrums".
- The 10-year Treasury market is once again knocking on the door of 4% on persistent economic strength and inklings of inflation stabilizing at a level higher than 2%.
- Crude oil continues to trade in its' multi month range but moved to the top end of the range.

The U.S. Economy

GDP for the 2nd quarter came in at 2.4%, substantially stronger than expectations of 1.8%. Additionally, core PCE, the imbedded inflation measure, decreased to 3.8%, down meaningfully from last quarter's 4.9% and expectations of 4.0%. The initial 3rd quarter GDP estimate from GDPNow is near 3.5% with the Blue-Chip consensus is just over 0%, as shown in the chart below. The economy continues to report better than expected GDP and now the PCE deflator is also signaling that inflation is becoming better controlled. The economy continues to rebuff the Fed's interest rate hikes, though the reported data is showing signs of inflation calming down.



Source : https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

Interest rates traded in a higher range of 3.75% - 3.95%, with a couple of excursions north of 4%, but buyers kept stepping in and pushed yields back under 4%. The strength of the economic data, and creeping concerns that the Fed wants to continue raising interest rates and that inflation may be gaining a second wind were supporting yields. The distortions of the last decade plus continue to show through with economic strength. Corporations issued so much low yielding debt the past 10 years, combined with large cash stockpiles, is creating a tailwind for a lot of companies. I.e., their interest expense has been stable even in the face of rising interest rates, but the large spike in Treasury yields is supplying them with a large influx of interest income. So, we continue to see distortions coming out of the woodwork that derail the traditional "rate hike" playbook. The modest increase in yields created a mild headwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF eased -0.07% for the month. The U.S. 10-year Treasury bond yield ended the month at 3.96%, up from June's close of 3.82%.

The Dow Jones Industrial Average rallied +3.35%, the S&P 500 climbed +3.11%, and the small cap Russell 2000 jumped +6.06%. The international markets traded in line with the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index increased +2.92%, and the MSCI Emerging Markets iShares Core ETF Index popped +6.11%.

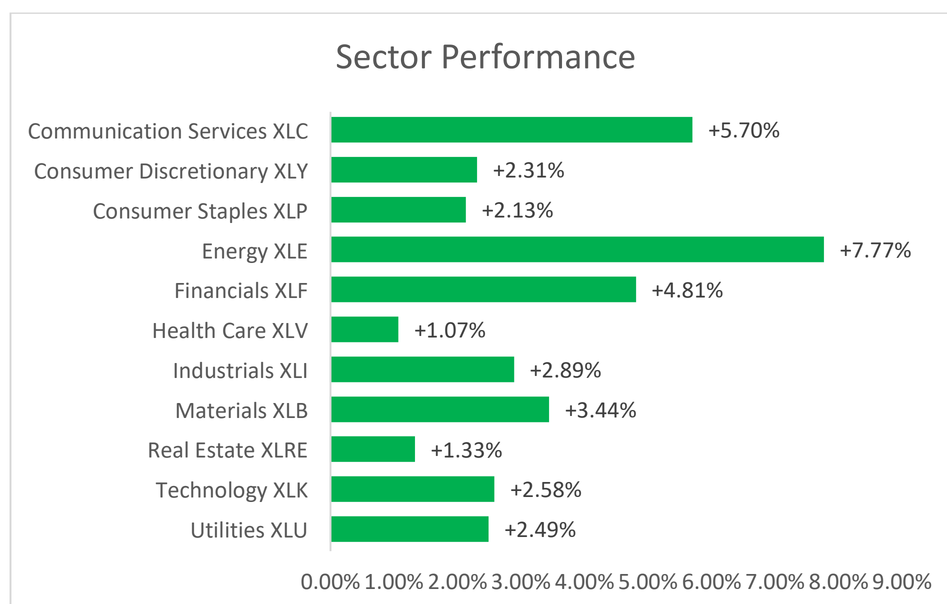
July's performance was again to own early economic cycle winners and equity in general.

The best performers were…

- Energy: +7.77%
- Communication Services: +5.70
- Financials: +4.81%

The "worst" performers were…

- Healthcare: +1.07%
- Real Estate: +1.33%
- Consumer Staples: +2.13%



Source: https://www.morningstar.com

Oil Report

The oil market traded in an orderly fashion from the $70 mark to $80+ and once again testing the highs of the past 8 months. This rally is looking more sustainable versus the quick pop we saw in April off the Saudi oil cuts spike. China's growth continues to disappoint, but the talk of imminent stimulus out of China and the continued speculation of large oil deficits between demand and supply later in the year is providing a solid boost to oil prices. The current NYMEX WTI Crude Oil futures settled at $81.80 posting a gain of over 16% from the prior month's close of $70.45 a barrel. The increase in crude oil helped RBOB gasoline along with some unexpected refining maintenance, as RBOB gasoline finished with a gain of over 14% vs June's close. The current 8-month range bound trading remains intact, but this past month is showing signs of wanting to break higher. Ukraine is escalating direct attacks on Russia and now there is geopolitical upheaval in Niger with the prospects of France bombing Niger to add fuel to the geopolitical winds. And of course, we are moving into the heart of hurricane season. All told, the one definite, gas prices have moved up steadily with the strength of the underlying commodities. Stay tuned.

The Rest of the Data

The June ISM Manufacturing Index decreased to 46.0 from May's reading of 46.9. However, the ISM Services Index increased to 53.9 in June, from May's print of 51.5. The prices paid component for Services again decreased well into "normal" levels and Manufacturing prices dropped again moving to deflating levels. Any reading below 50 generally indicates deteriorating conditions and any reading above 50 generally indicates improving conditions. Consumer confidence jumped again to 117.0 in July, which compares to an upwardly revised figure of 110.2 in June. The unemployment rate eased to 3.6%, while the economy added 209,000 jobs in June, which missed expectations of 230,000 jobs and was the first miss to consensus in 14 months. The Consumer Price Index for All Urban Consumers (CPI-U) increased +0.2% in June, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index rate again dropped further to +3.0% on a non-seasonally adjusted basis. The CPI ex Food and Energy, eased further to 4.8% over the last year. The economic data is good, the employment data is good with a minor blemish in this month's slight employment miss, the stock market is great, and inflation is still relatively high. The Fed has continued to talk about more rate hikes and no rate cuts until late 2024 at the earliest. So far economic activity doesn't suggest a need to deviate from that course. We will continue to monitor economic activity along with inflation reports and how that may impact Fed policy.

Summary

The broad markets continued the rally that was originally ignited by the mega cap US Tech names. Economic activity continues to be good with enough immediate signs of moderating inflation to fuel the animal spirits. The Fed raised rates once again and continues to talk about higher for longer and fearing a revival of inflation, not wanting to declare victory over inflation prematurely. The equity markets have clearly been looking at the glass as half full and betting that the Fed has slayed inflation and will be cutting rates much sooner than late 2024. The bond market seems to be simply looking at a glass that contains 50% water, not making a positive or negative judgement. Interest rates have been creeping higher, likely more driven by the surprising economic strength tempered by the Fed's stated resilience

rather than imminent fears of inflation roaring back to life. Commodities, especially oil and gas, are showing signs of either weak supplies, strong demand, or a combination of the two. Either way, if prices move up from the current range, that will boost the narrative that inflation is reviving.

As always, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. growing debt and deficits, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. The continued equity rally has most segments exposure in equities, the one exception is Real Estate, which remains in floating rate Treasuries.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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