Week in Review

Equity Markets:
The S&P snapped its four-week winning streak; ending down 1.2%. After starting the week in strong form; the market struggled following the release of the FOMC meeting minutes and weakening economic data. There has been a ~16% rally from the mid-June lows. The strength of the rally lessened last week and it appeared investors did not accept the "better than expected" at face value. The current numbers are coming in better after near-term sentiment fell to historical lows. Investors appear to be looking for an improving environment, not just less bad.

Q2 earnings season is entering the final stages; nearly 95% of S&P 500 companies have reported and 76% have beat earnings expectations, according to Bloomberg data. This is in line with the 5-yr average. Earnings growth has been much better than expected. Current earnings growth stands at just over 8%, which is nearly double the expected earnings growth rate entering the quarter. FactSet had an expected earnings growth rate of 4.2% at the end of Q2.

Fixed Income Markets:
Fed members' opinions and the FOMC meeting notes release had a large influence on the markets this week. St. Louis Fed President, James Bullard (who is notoriously hawkish), stated he does not see inflation peaking in the data and will likely support a 75-basis point increase at the next Fed meeting.

The meeting minutes from the most recent policy meeting were released on Wednesday and the market initially reacted positively before pivoting quickly. The Fed is going to stay committed to fighting inflation and the probability of slowing economic growth while doing so is increasing in their eyes. Treasury yields increased as we saw selloffs in the fixed income markets. The 10-yr treasury ended the week a touch below 3% while the yield curve stays heavily inverted. The 2-yr/10-yr treasury spread ended the week at 0.28%.

Economic:
The housing market has continued its softening trend. For the sixth straight month, existing home sales have decreased. In part, due to pricing pressures with higher interest rates and inventory shortages. The consumer has stayed resilient despite inflationary pressures. Retail sales, month-over-month, increased 0.7%. A mixed regional manufacturing report surprised many. A New York manufacturing survey saw a surprise decline into contraction territory and a Philadelphia survey saw surprise improvement back into expansion territory.

Looking Ahead

Equity Markets:
In our view, mixed data from multiple sectors of the economy should warrant target equity allocations. Excessive risk-taking is not recommended as the Fed continues to embark on tighter policy whose effects may not be fully appreciated by the market.

Earnings have historically been the long-term driver of expected market returns. As the Q2 earnings season comes to a close, market participants will have a sharp focus on Q3 as softening economic conditions have not shown a major impact on corporate earnings thus far. It's conceivable that the impact of sharp rate increases, along with a more significant Quantitative Tightening program, have greater negative impact going forward.

A disciplined investment approach, that an investor can commit to for the long-term, is very important in the current environment. Volatility is likely to stay elevated for the near term and an appropriate, diversified, asset allocation should help investors build conviction in their long-term strategy.

Fixed Income Markets:
With no Fed meeting this month; the headline event for the month is the Annual Jackson Hole, Wyoming Symposium. Fed Chairman, Jerome Powell, will likely have the most impact on the markets this week.

Recent reports have shown indications that inflation could be slowing. We could be seeing year-over-year inflation growth slowing, but the absolute level of inflation still remains elevated. This is likely the reason for concern by the markets on Fed action going forward. Policymakers have stated their commitment to lowering inflation, and the high single-digit inflation is conducive to long-term economic growth. For this reason, we still believe the 10-yr treasury will moderate above the 3% level and we have a target range of 3.25-3.5% in the current rate cycle. There will be times the 10-yr falls outside of this range, but market forces should move the yield near our target over the short to intermediate term until the next easing cycle begins.

Economic:
More housing data will be released this week. New home sales and pending home sales are expected to continue the negative news seen lately. August manufacturing data and a services PMI from S&P Global will continue to build the full economic picture. The final University of Michigan Consumer Sentiment Index will be released, along with a timely personal income and spending report. The first revision for Q2 GDP will also garner heavy attention.

See important disclosures below

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