Week in Review

Equity Markets:

The market had a strong rally last week despite more weakening data, with the S&P ending the week up over 4%. Last week was a perfect example of better or worse – it was neither good nor bad, with respect to data. Earnings season has been less than stellar when looking at the past decade and the second quarter of negative GDP. There has been a pessimistic aura over the market this year. This week's earnings were better than expected, and parts of the economy were not as bad as expected. This is a recipe for positive market movement.

56% of S&P companies have reported so far and 73% have beat earnings expectations, according to FactSet. This is only slightly below the 5-year average and an increase from the 68% mark from last week. Also, the blended growth rate according to FactSet is 6%. The blended growth rate includes companies having already reported and the expected earnings from companies yet to report. This is certainly better than the 4% expected growth rate at the end of the second quarter.

Fixed Income Markets:

The highlight for the fixed income markets was the FOMC meeting where they raised the fed funds rate by 0.75%. This brings the Fed's target rate to 2.25-2.5%. The bond markets reacted by driving yields down on the back of Fed Chairman Jerome Powell's comments on the potential for slowing hikes in the future.

The 10-year treasury ended the week at 2.66%, down from its June high of nearly 3.5%. The bond market, along with equities, is viewing that the end of this rate hike cycle might be in sight.

Economic:

The second quarter GDP report dominated the majority of the headlines. The report showed that the US economy contracted by 0.9% in the quarter. Residential investment was the largest downside contributor to the negative reading, and the consumer softened relative to the previous quarter. This is the second consecutive quarter of negative GDP growth, and by many, this is a strong indicator of a recession. The National Bureau of Economic Research (NBER) is the one responsible for determining a recession. Negative GDP is not the only factor, and the NBER looks for broad economic weakness. The Labor market still remains strong and will likely need to weaken before a recession is declared.

Looking Ahead

Equity Markets:

The market is a discounting mechanism of future expectations. When expectations are overly negative, the results don't have to be stellar. If results are better than expected the market tends to react positively. Earnings estimates have seen continued downgrades over the last few weeks and results came in better than expected.

The run-ups like we saw in the market last week are the main reason to stay disciplined as an investor. The market is quick to pivot and rarely foreseeable. Systematic rebalancing allows long-term investors the opportunity to take advantage of oversold assets that can see significant upside in a short amount of time. We are still recommending that investors stay disciplined and not take on excessive risk in light of softening earnings and economic numbers. As we have seen over the past couple of weeks, however, market upside can come out of times when the environment is dominated by pessimism.

Fixed Income Markets:

The FOMC will not meet again until September and the new data-dependent policy will allow them to wait and see when it comes to inflation. Chairman Powell indicated he expects the Fed Funds rate to be in the 3-3.5% range by the end of the year. The bond market has priced in slower hikes for the rest of the year. This should be conducive to the equity markets. If this path were to occur, it would likely mean inflation has started to roll over and the Fed's hope for a soft landing may materialize.

We still believe that the 10-year yield will spend the majority of its time in the 3.00-3.5% range. The current rate structure is still better than what it was 12-18 months ago. With the recent decline in rates, we believe fixed income investors should be patient and take a dollar cost averaging approach if entering the bond market.

Economic:

ISM and S&P Global will report July Manufacturing and Services PMIs. Two labor market reports will likely be the top reports. We will see The JOLTS (Job Openings and Labor Turnover Survey) on Tuesday and ADP will release its national employment report on Wednesday.

See following page for important disclosures

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