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Week in Review

Equity Markets:

The major market indices slipped last week. The NASDAQ outperformed, ending the week down 0.9% while the S&P saw a 1.2% decline. Concerns around a continued tightening in monetary policy contributed to the decline. The drawdown was broad, with 10 of 11 S&P 500 sectors in the red. The lone gainer for the week was Real Estate, up by 0.2%[1].

Second-quarter earnings announcements have just begun. Only 18 S&P 500 companies have reported earnings thus far but they have come in better than expected. 14 have reported earnings above consensus estimates and 12 have beaten revenue estimates[2]. As of Friday, analysts are expecting an earnings decline of 6.4% for the second quarter, well below the -3.9% expected on March 31[2].

Fixed Income Markets:

The fixed-income markets sold off as we saw a steep rise in rates. The 10-yr Treasury yield jumped 20 basis points and ended the week at 4.06%. The 2-yr Treasury Yield peaked at 5.12% intraday last week, the highest level since 2007[3]. The yield curve saw a slight steepening last week after testing the inversion low. The 2's/10's spread ended the week at -.89%.

The labor market reports came in mixed compared to expectations. But the labor market remains resilient and the Fed has reiterated the need for it to cool to ensure inflation is fully under control. Fed Fund's futures have a 92% probability of a 25 basis point increase at the FOMC meeting later this month[4]. The recent economic reports have removed the expectations for a rate cut by the end of the year according to the Fed Fund's futures market.

Economic:

Mixed labor market reports took the majority of the headlines during the holiday-shortened week last week. The ADP payroll report on Thursday showed 497,000 private sector jobs created in June, over double the Dow Jones consensus estimate of 220,000[5]. On Friday the Bureau of Labor Statistics released the Nonfarm Payroll report which came in lighter than expected. According to the BLS, employment increased by 209,000 in June[6]. The unemployment rate slipped slightly lower to 3.6% and average hourly earnings increased by 4.4% vs the expected 4.2%[5].

Looking Ahead

Equity Markets:

Earnings season will start to build significant momentum this week with the start of major financial companies at the end of the week. Second-quarter earnings estimates have continued to be revised lower. At the start of the year, second-quarter earnings were expected to be essentially flat, -0.3%[2], but company revisions and better-than-expected first-quarter results have pushed the downgrades further out on the calendar. Consensus estimates have full-year 2023 earnings at 220 for the S&P 500[7]. The forward P/E for the S&P stands at 18.9x. This is higher than the 5-year average of 18.6x and the 10-year average of 17.4x[8].

We believe investors should be prepared for a rise in volatility coming out of June, which saw the VIX at its lowest level since before the pandemic. Slightly extended large-cap valuations and tighter monetary policy concerns are also likely to contribute to an increase in volatility. Investors should remain committed to a well-diversified portfolio constructed for a full market cycle. The year-to-date rally has been concentrated. Other segments of the market have not been as fortunate. Mid-Cap and Small-Cap companies have not seen rapid multiple expansion and trade at 13.7x and 13.3x forward earnings[9], respectively.

Fixed Income Markets:

Volatility is likely to remain elevated until the end of the month when the FOMC released its policy decision and provides commentary on potential future actions. We see the 10-yr yield hovering near the 4% mark as we believe the market has already priced in the 25 basis point increase at the end of the month.

The recent jump in the rate structure has not changed our long-term outlook for the bond market. We still believe secular deflationary pressures will result in rates moving lower over the next 12-18 months, in the 3% range, and remain suppressed. An aging population and disruptive technology (artificial intelligence as the newest disruption) are two major factors we believe will put long-term downward pressure on the rates.

Economic:

This week will be a busy one for economic reports, headlined by the CPI report on Wednesday and the PPI report on Thursday. Reports regarding the health of the consumer will also garner heavy attention. The Federal Reserve will release its consumer credit report to start the week and July's Preliminary University of Michigan Consumer Sentiment Index will be released on Friday.

**** *See Important Disclosures on following page*

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Sources:

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5) CNBC
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