Week in Review

Equity Markets:

Choppiness returned to the markets amidst a busy week of earnings data, economic reports, and the important Federal Open Market Committee (FOMC) policy decision. Despite the mid-week volatility, markets finished higher. The S&P 500 finished the week up 1% bringing its year-to-date return to 20.5%. Last week saw the DJIA snap its multiple-week winning streak. The streak ended at 13 days, marking the longest streak since 1987[1].

Q2 earnings season gained steam as 30% of S&P 500 companies reported last week. So far, 51% of companies have reported, and the results have come in better than expected. 79% of S&P 500 companies have exceeded earnings estimates and 62.5% have beaten revenue estimates[2].

Fixed Income Markets:

The FOMC increased the federal fund's rate by 25 basis points, bringing the target rate to 5.25-5.50%, the highest level since 2007[3]. The hike marked the 11th increase in the previous 12 meetings. The commentary post-decision was expected to be just as important as the actual policy decision based on the market anticipating the move. Chairman Powell softened his tone slightly but reiterated that policymakers remain committed to the fight against inflation and did not rule out more hikes in the future.

Treasury yields sold off following the conclusion of the FOMC meeting but backed off to close the week. The 10-yr treasury yield jumped above 4% briefly before closing the week at 3.97%, 12 basis points above the previous week's close.

Economic:

Last week was a busy one for economic reports. The highlight report for the week was the Personal Consumption Expenditures Index which closed out the week. The PCE is the preferred inflation gauge for the Fed and has a heavy influence on future rate policy decisions. The headline reading rose 3% year-over-year. This is the lowest reading since March 2021[4]. Core PCE, which excludes food and energy due to its volatile price behavior, rose 4.1%. Economists' estimates were for the index to rise 4.2%, and Core PCE saw its lowest year-over-year increase since September 2021[5]. Significant progress has been made in the Fed's fight against inflation, but it still remains above its target of 2%. Fears of economic slowdown eased as the first estimate for second-quarter GDP came in. GDP grew 2.4% in the second quarter, handily beating economists' estimates of 1.8%[6]. Business investment growth offset a cooling in consumption in the previous quarter. The University of Michigan Consumer Sentiment Index rose to 71.6 in July. The index reached its highest level since October 2021 and now sits halfway between the historic low of 50 from June 2022 and the February 2020 pre-pandemic reading of 101[7].

Looking Ahead

Equity Markets:

Market fundamentals remain the main focus for us as we look to the next cycle. We are likely to be in a higher rate environment than the previous cycle. Inflationary pressures are still present and we believe the Fed will follow through with its "higher for longer" tone. Even if the Fed were to pause rate hikes at the current level, the equity markets will need to adjust. Higher rates are likely to put pressure on margins and should slow earnings growth. Margins were historically high going into the rate hikes but have backed off slightly. The current profit margin for the S&P 500 is 11.3%, down from 12.2% a year ago[8]. We anticipate downward pressure as the monetary policy actions continue to make their way through the economy.

As long-term investors, we believe well-diversified portfolios that reflect an investor's risk tolerance are positioned to perform over full market cycles. As the market continues its march higher as uncertainties remain, from a macroeconomic and policy perspective, the fear of missing an upward move is equal to the fear of missing a drawdown. An investor's appropriate target allocations should be the focus. Remaining disciplined during market rallies can be just as difficult as market turmoil.

Fixed Income Markets:

The commentary following the latest rate hike indicated a potential for softer policy going forward. The Fed remains "data dependent" and they will have the opportunity to see two months' worth of data before their next meeting in September. The rate hike last week very well could be the last hike for the cycle, but we believe that any further hikes are going to be incremental and will have little impact on the overall rate market. The time period around the decision still has the potential to create short-term volatility, but we believe will rates will settle quickly afterward.

Our view remains positive on the fixed-income market and believe that peak yields on the 10-Yr Treasury are behind us. The Fed has navigated the inflationary environment well and they now have the ability for small adjustments to achieve their target inflation of 2%. Over the next 12-18 months we believe the 10-yr will settle in the 3-3.25% range. The days of near-zero rates are likely a thing of the past but secular deflationary impacts will likely keep a cap on the rates for many years to come.

Economic:

Following an important week for economic reports, this week also holds important readings. The focus this week will be in the labor market, which Chairman Powell referenced many times in post-meeting remarks. On Tuesday, JOLTS will be reported followed by the ADP employment report on Wednesday. On Friday, the jobs and unemployment report will be released by the Bureau of Labor Statistics. Other important reports include the ISM Manufacturing and Services PMI along with the productivity and labor cost report to be released Thursday.

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

Sources:

1)Jonh Hancock Investments
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4)CNBC
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