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WEEKLY MARKET RECAP | August 7, 2023

Week in Review

Equity Markets:

The markets sold off this week as the U.S. debt downgrade frightened the markets. The S&P 500 ended down 2.3% despite large earnings beats by some of the index's largest members. Large Cap Growth continues its dominance for the year, up 29.4%. Large-Cap Value lags by a large margin year-to-date, up by 6.8%[1].

84% of S&P 500 companies have reported earnings. Thus far, 79% have beaten earnings estimates which exceeds the long-term average of 66% and the prior four quarter average of 73%[2]. Second-quarter earnings are expected to decline by 4.2%, an improvement from the -5.7% expected to start the quarter. For the second consecutive quarter, corporate profits have been better-than-feared.

Fixed Income Markets:

The 10-yr Treasury pushed higher midweek, nearly testing the October highs of 4.25%. Following the brief sell-off yields settled lower to close the week at 4.05%. Fitch, a credit rating agency, downgraded the U.S. credit rating to AA+ from AAA. Fitch put the U.S. on a "watch" during the debt ceiling negotiations. The reasoning for the downgrade cited more frequent debt ceiling stand-offs and the rising federal debt could lead to an erosion of governance. The downgrade was not the only factor that contributed to the jump in yields. Economic data continues to show resiliency which could lead to tighter fed policy for longer.

The yield curve continued its steepening trend. The 2's/10's spread ended that week at -.71%. This spread narrowed by 0.2% throughout the week as longer-dated bonds sold off.

Economic:

187,000 jobs were created in July. The number was a slight miss when compared to economists' estimates from Dow Jones[3]. The JOLTS report showed that the labor market remains on steady footing but has started to soften with 9.58 current openings. Layoffs came in at 1.53 million, slightly lower than 1.55 million in May. These slowing numbers point to a labor market that may finally begin to cool. The ISM Manufacturing PMI remained in contraction with a reading of 46.4. The ISM Services PMI fell to 52.7 in July, slightly lower than the forecast of 3.

Looking Ahead

Equity Markets:

Analysts have overestimated the impacts of inflation and monetary policy on corporate profits for the second quarter in a row. The strength of corporate balance sheets and the consumer were often cited as the reasoning for a less-severe economic slowdown, but the stability of corporations has surprised many. The net profit margin for the S&P 500 stands at 11.5%[4]. Margins have compressed mildly from a year ago when they were 12.2%, but cost-cutting and the ability to pass on portions of price increases to consumers have shown to be effective.

The forward four-quarter P/E for the S&P 500 is 19.5x. This valuation is elevated but not at extreme levels. The year-to-date rally has been on multiple expansion and we believe that earnings will need to improve to continue justifying the elevated multiple. Earnings declines continue to be pushed further out on the calendar by analysts, despite the earnings surprises that have occurred so far this year. As uncertainty remains, investors should not stray from their target allocations. Broad diversification is ever important as there has been large divergence across the market as much of the rally has been dominated by a small number of companies.

Fixed Income Markets:

Volatility should be expected to remain high in the fixed-income markets until the next policy meeting. Macroeconomic factors have the potential to put short-term pressure on rates as we saw last week. We still believe that the high the 10-yr from October will be the cyclical high and even in moments where we approach the 4.2% level, it should be short-lived and rates will retreat rather quickly.

We still have a positive outlook on the fixed-income market, specifically the quality sector, as investors have the opportunity for attractive yields, and greater potential for negative correlation if we were to see a steep equity market sell-off.

Economic:

The Consumer Price Index will be the headline report released this week. This will mark the first of two readings before the next policy meeting by the Fed next month. The preliminary University of Michigan Consumer Sentiment Index will also be released. Other noteworthy reports will Consumer Credit, Trade Balance, and the Treasury Budget report.

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

Sources:

1)JP Morgan
https://am.jpmorgan.com/content/dam/jpm-am-aem/americas/us/en/insights/market-insights/wmr/weekly_market_recap.pdf

2)I/B/E/S Refinitiv
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3)JH Investments
https://www.jhinvestments.com/weekly-market-recap#market-moving-news

4)FactSet
https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_080423.pdf