Week in Review

Equity Markets:

The S&P 500 and NASDAQ sold off for the second consecutive week. The S&P 500 ended down 0.3% and the NASDAQ declined 1.9%. Value was the lone winner for the week, with the Dow ending up 0.7% and the Russell 1000 Value finished up 0.33%. The outperformance closed the value-growth spread, but large-cap growth still has a wide margin year-to-date compared to its value counterparty, up 28.07% vs large-cap value up 7.13% year-to-date[1].

Just over 90% of S&P 500 companies have reported earnings. 78.7% of companies have reported earnings above analysts' estimates[2]. Companies are reporting earnings 7.7% above estimates, which significantly exceeds the long-term average of 4.1%[2]. Analysts entered the quarter anticipating an earnings decline of 5.7%, but as of the close on Friday, the earnings decline is expected to be 3.8%.

Fixed Income Markets:

The 10-yr Treasury yield was pushed higher last week. Finishing at 4.16%, after a short-lived rally following the CPI report. The CPI report came in near expectations and the bond market reacted initially reacted positively with bond yields falling as prices increased. Yields reversed course following the PPI, which showed the economy is not in the clear in regards to inflation as wholesale prices increased more than expected.

Moody's, the credit rating agency, downgraded 10 small and midsize U.S. banks while putting other large banks on their "watchlist". The downgrade cited "profitability pressures following second-quarter earnings results"[3]. Commercial real estate concerns have become top of mind for many and Moody's also considered the impacts of declines in the quality of smaller bank's loan portfolios, due to their higher exposure to the commercial real estate sector. If the banking industry's asset base declines, this could put pressure on rates as the consumer credit market becomes more restrictive.

Economic:

The fight to tame inflation has made significant progress over the past year. Headline CPI came in at 3.2% year-over-year, nearly 6% below the high of 9.1% in June 2022. Core CPI remains sticky at 4.7%. Both readings rose by 0.2%, in line with Dow Jones estimates[4]. The PPI (Producer Price Index), which measures the prices paid by wholesalers, increased 0.3% for the month and was slightly above the 0.2% estimate. The PPI is traditionally looked at as a leading indicator for the direction of CPI. Consumer sentiment fell slightly in the preliminary August University of Michigan Consumer Sentiment Index to 71.2, down from 71.6 in July.

Looking Ahead

Equity Markets:

Analysts have begun to stabilize their earnings estimates following a better-than-expected second-quarter earnings season. Week-over-week, analysts made very few adjustments to future quarter's earnings estimates. Previously, analysts were pushing the earnings decline out further on the calendar, but for the first time in months, estimates have stabilized[2]. Third-quarter earnings are expected to grow at an annual pace of 1.3%, the same as the start of the quarter. Full-year 2023 earnings ticked up slightly to 1.6% from the 1.3% growth at the start of the quarter.

Last week's inflation reports have shown significant improvement, but the stickiness of inflation still remains. The core numbers still remain well above the Federal Reserve's 2% target. If the Fed struggles in the late innings, which is where we believe we are, to get inflation back to target it will likely lead to hawkish policy for an extended period of time. Higher rates for longer will put pressure on earnings and the risks of an economic slowdown will also increase. At current valuations, further weakness in earnings will be difficult to justify. Investors should not lose sight of strategic allocations in favor of strategies that have recently outperformed. There is significant dispersion in valuations across the equity market, with large-caps trading at 19x forward earnings while their small counterparts are trading at 13.9x forward earnings[5]; prudent diversification can position investors to benefit when valuations normalize.

Fixed Income Markets:

The Federal Reserve will not have a monetary policy meeting this month, so that means there will be another month of inflation data before they make their decision. As we move further away from the peak in inflation last June, we expect to see inflation numbers have volatility due to the base effects of the readings. The 10-year treasury yield has moved well above 4% and briefly appeared ready to test the October highs, but quickly retreated. The Fed may need to remain restrictive, but we believe the inflationary environment is still trending in the right direction, thus leading to downward pressure on yields over the next 6-12 months.

Economic:

This week's economic reports will get started on Tuesday with the retail sales report. The health of the consumer will be in focus for the market as the use of credit has accelerated recently. The Conference Board's Leading Economic Index will be released on Thursday. The index has declined for 15 consecutive months, the longest downward streak since 2007-2008[6]. Housing starts, industrial production, and the weekly unemployment report are also on the calendar this week.

**** *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
https://lipperalpha.refinitiv.com/wp-content/uploads/2023/08/TRPR_82221_710.pdf

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4)CNBC
https://www.cnbc.com/2023/08/10/cpi-inflation-july-2023-.html

5)Yardeni Research Inc.
https://www.yardeni.com/pub/stockmktperatio.pdf

6)The Conference Board
https://www.conference-board.org/topics/us-leading-indicators