Markets Contented by Soft Landing Prospects, AI Enthusiasm

Have the steady hand of the Federal Reserve (Fed) and the resilience of the U.S. economy created the much-hoped-for “soft landing” at the bottom of the inflation crisis? Time will tell – even as it declines, inflation remains above target levels – but the market seems willing to give the benefit of the doubt.

In July, equity markets built on a strong first half of the year and continued to push upward. The S&P 500 marked a 3% climb for the month and the Dow Jones Industrial Average reported 13 consecutive days of gains, falling one day shy of a record run that dates back to 1897. It’s the ninth straight year July has closed with positive market performance. The clarity of the Fed’s forward messaging has likely helped, allowing it to raise interest rates as part of its inflation-fighting program by another quarter of a percentage point in July without causing much of a blip. The target federal funds rate, now set between 5.25% and 5.5%, is the highest in 22 years.

“July was a microcosm of what has propelled the equity market most of this year – bearish sentiment fading on the back of a resilient economy, decelerating inflation, and better-than-expected earnings,” said Raymond James Chief Investment Officer Larry Adam. “And with the Fed near the end of its tightening cycle, a glimmer of hope for the elusive soft-landing led to a broadening of performance beyond just tech.”

It's worth reiterating that soft landings for the economy infrequently occur, and a confluence of data still suggests a mild – and brief – recession on the horizon.

Before we dive into the economic data and other topics of interest, let’s look at our year thus far.

	12/30/22 Close	7/31/23 Close*	Change Year to Date	% Gain/Loss Year to Date
DJIA	33,147.25	35,559.53	+2412.28	+7.28%
NASDAQ	10,466.48	14,346.02	+3,879.54	+37.07%
S&P 500	3,839.50	4,588.96	+749.46	+19.52%
MSCI EAFE	1,943.93	2,192.76	+248.83	+12.80%
Russell 2000	1,761.25	2,003.17	+241.92	+13.74%
Bloomberg Aggregate Bond	2,048.73	2,087.52	+38.79	+1.89%

*Performance reflects index values as of market close on July 31, 2023. MSCI EAFE and Bloomberg Aggregate Bond numbers reflect July 28 closing values.

Economy grows while consumer spending slows

The U.S. economy grew at a better-than-expected annualized rate of 2.4% during the second quarter of the year, bolstered by non-residential investment growth, while growth in consumer consumption slowed considerably.

Additionally:

- Private employment creation, at 149,000 in June, was the lowest reading for payroll jobs since December 2020. However, payroll employment increased by 209,000 in June, supported by 60,000 new state and local government jobs.
- Home prices continued to increase in May after falling in late 2022 and stabilizing earlier this year.
- Data suggests the service economy expanded in June while the manufacturing side of the economy remained in contraction territory in June.
- Surveys showed that consumer sentiment improved in June.

Inflation falling and the Fed's forward message

U.S. consumer price inflation slowed to 3.0%, year-over-year, in June, the lowest calculation since March 2021. While good news, Fed Chair Jerome Powell took the opportunity after announcing July's interest rate hike to reiterate the Fed's determination to fight inflation, suggesting rates may remain elevated – or could go higher – until the 2.0% target rate of inflation is achieved.

The bond narrative continues

The story of fixed income persisted in July: Spreads moved very little, remaining at levels not seen in around 15 years, and the yield curve is still in its longest-ever inversion – historically a strong indicator of a coming recession. Regional banking fears have receded after spring volatility and successful stress tests, which helped to calm the bond market.

Relief in the developed world

Financial markets have responded positively as inflationary pressures have subsided across the developed economies of the U.K. and euro zone. The main focus over the month has been the debate regarding to what extent and for how long key interest rates will be raised. U.K. rates remain elevated compared to the U.S. – a historical trend – but some of the current difference can be explained by the former's high energy prices. More central to the U.K.'s inflation, however, may be its persistently tight labor supply, which is partially the consequence of a health service under stress.

U.S.-China de-escalation continues

Treasury Secretary Yellen's visit to China in July was an overall positive development in the ongoing U.S.-China effort to reduce tensions and reestablish regular contacts in the bilateral relationship. During her visit, Yellen focused on reestablishing contacts with key members of Beijing's economic apparatus and reopening dialogues around key issues. In official statements following those meetings, Yellen struck an optimistic tone about the path forward.

The bottom line

The soft-landing narrative and the surge of enthusiasm for AI technology have contributed to the market's good mood, but there are plenty of concerns to consider which could upset those cheerful feelings in the coming months: inflation, the lagging effects of higher interest rates, or price adjustments as the reality of even a soft landing emerges.

As that information presents itself, we may see a fair bit of market choppiness. This is why, even though the market's monthly moves are fascinating and informative, they are far from instructive for a long-term investor.

As we discover tomorrow together, I remain grateful for your continuing support and trust. If you wish to speak about any topic here or would like to discuss any aspect of your financials, please reach out at your earliest convenience.