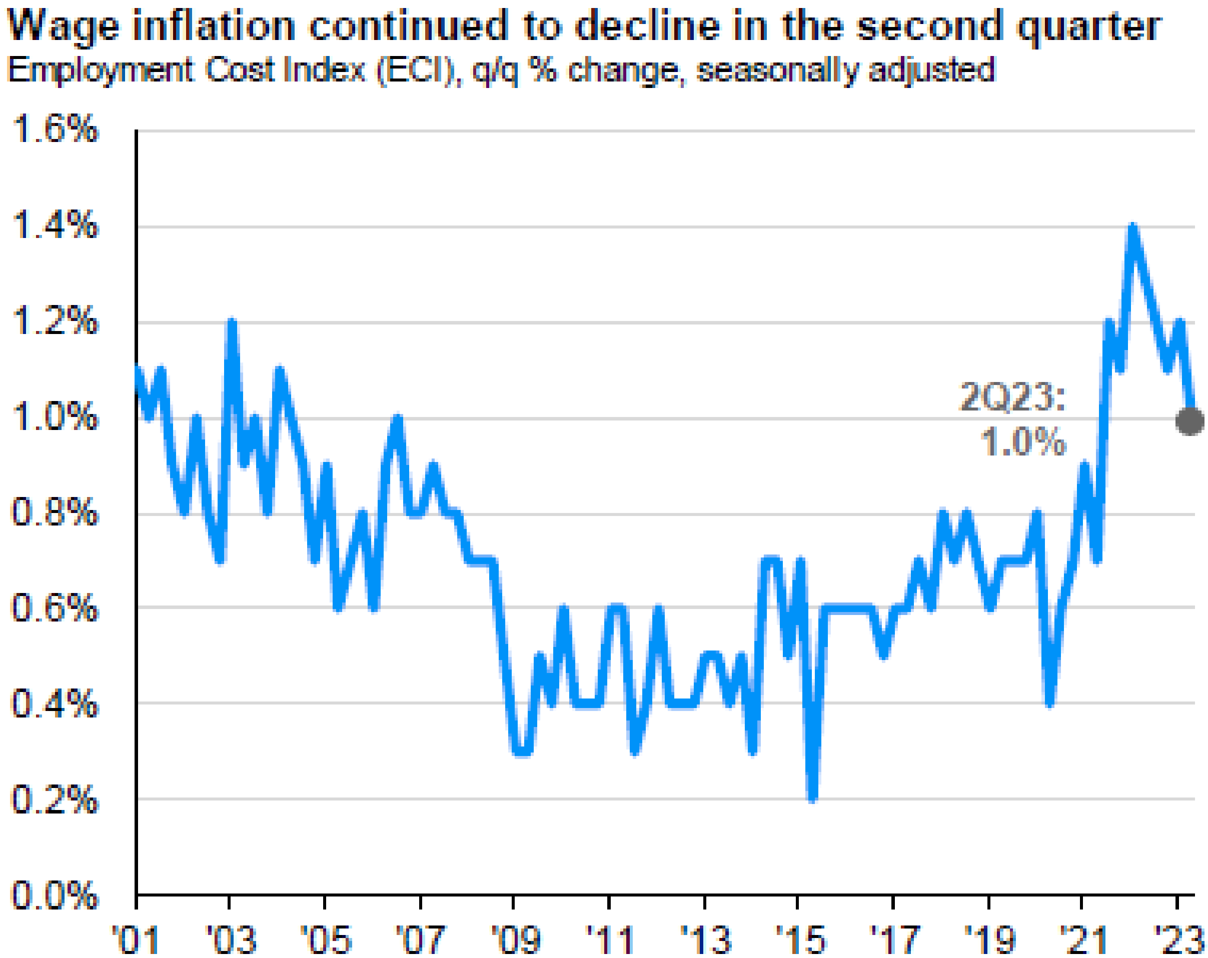
Monday July 31, 2023

SUMMARY-

I. *Markets unfazed by Fed rate hike.*
II. *Solid earnings results keep market's winning streak alive.*
III. *Broadening out of rally continues without hurting prior leaders.*
IV. *Key macro trends bode well for coming quarters as markets enter historically challenging months.*

Good afternoon:

As expected, the Fed raised interest rates by 0.25% at its July FOMC meeting last week, bringing the Fed Funds rate to 5.25% to 5.50%. Notably, Fed Chair Jerome Powell was careful not to declare an official end to this long and steep tightening cycle. He emphasized that no decision had been made on future rate hikes or on the September meeting. While consciously trying to remain tough in their fight against inflation, Powell did acknowledge that headline CPI is well off its peak of 9.1% in June 2022, down to 3% today. With a stated 2% target and core inflation still elevated at 4.8%, strong consumer demand for services, and wage growth only modestly easing, the Fed is likely to continue its hawkish rhetoric, keeping the idea of an additional rate hike alive until core inflation cools further.

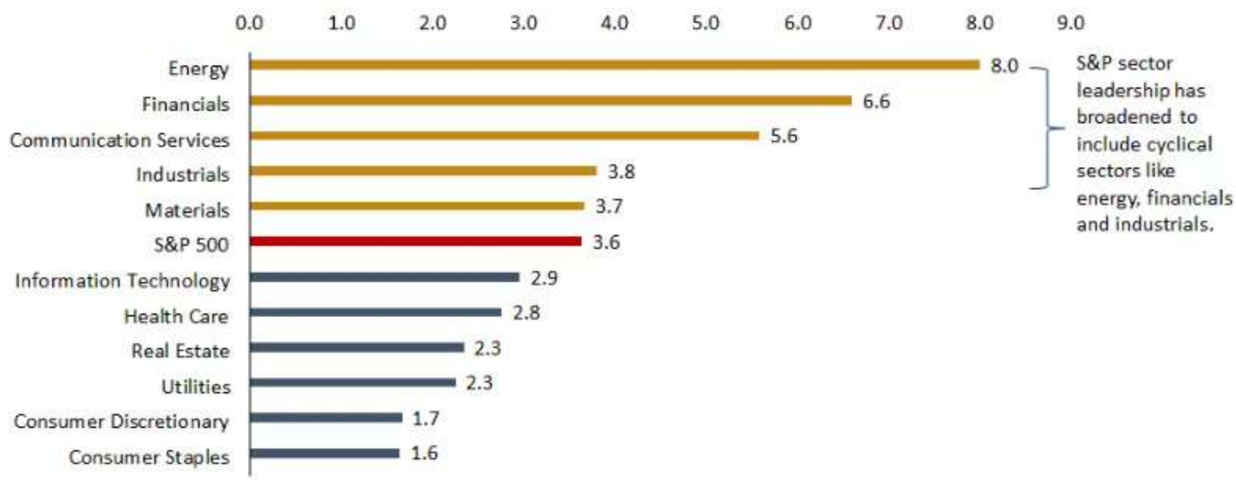


Source: J.P. Morgan Asset Management

Before the next FOMC meeting in September, the Fed will have two additional sets of monthly inflation and jobs reports which will undoubtedly help determine their decision on interest rates at that time. Markets continue to celebrate the belief that whether rates are bumped up another time or two from here, we are seemingly near the end of this process. However, if the economy stays resilient, we do not see the Fed initiating any rate *cuts* for at least a few quarters. So long as inflation's trajectory remains on a glidepath to the 2% level, the Fed may be content to pause subsequent hikes for an extended period over the next 12-18 months.

Equity investors also celebrated several critical earnings reports last week from some of the nation's largest companies. Large gains among Communications Services sector stocks helped the NASDAQ lead all major averages with a weekly gain of 2.03%. Participation across the market continued to broaden with additional strong gains posted within the Materials and Energy sectors. Fortunately, it does not appear to be a "zero-sum game" as previously unloved areas of the market play catch-up without seeing a concurrent drawdown in the handful of mega-cap tech stocks that have been the big winners since the market bottomed last fall. Additional key earnings reports coming this week will potentially add further evidence to the bulls' argument that our economy remains strong and resilient despite all the rate hikes.

S&P 500 sector leadership has broadened over the past month



Source: FactSet, 6/27/23 to 7/27/23.

As investors regain confidence in equities, especially those who may have missed this year's rally opting for an increasing money market yield instead, we believe the trend of broadening sector leadership could continue. Many companies in these previously unloved sectors trade at much lower valuations and may offer attractive dividend yields as well. If it becomes clear that the economy will avoid a severe downturn or recession, small-cap stocks may also begin to outperform in an even bigger way.

While enthusiasm earlier this year in several of the big tech companies focused on the possibilities surrounding artificial intelligence (A.I.) as many waited for the rest of the economy to roll over, investor sentiment among institutional traders and market strategists seems to have improved based on three themes: The Fed and other global central banks may be nearing an end to rate hikes, inflation continues to decline, and economic growth and consumer activity remain resilient.

As we close out July with stocks on pace for the fifth consecutive winning month, it is important to still anticipate normal market volatility as the rest of the year unfolds. With August and September historically the worst two months for equities, we could see some periods of mild correction in the coming weeks which may be good buying opportunities in high quality areas of the market.

Source: Bloomberg

Have a great week and we hope everyone is having an enjoyable summer!

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