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INVESTMENT MANAGERS

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Stocks continued to climb in July. Large cap stocks in the S&P 500 index gained 3.2% for the month resulting in a year-to-date gain of 20.7%. Small cap stocks in the Russell 2000 jumped 6.1% in the month bringing their year-to-date gain to 14.7%. International stocks in the MSCI EAFE index were up 3.2% in July and 15.3% for the year. Meanwhile, emerging market stocks gained 6.2% for the month and 11.4% for the year. Yields on the Barclays US Aggregate Bond Index rose slightly so the index lost -0.1% in the month but is still up 2.0% year-to-date. The yield on the 10-year Treasury bond is currently 4.0%.

According to Zacks, second quarter is expected to be the third consecutive quarter of negative earnings with a projected contraction of -9.2%. Even so, earnings reports are encouraging; more than 81% of the companies in the S&P 500 that had reported as of July 26th exceeded their earnings expectations. Guidance by management has been positive as well. Although third quarter is also expected to be negative, Zacks anticipates that positive growth will resume in fourth quarter.

With earnings down so far this year, the robust returns of the stock market have been largely a result of multiple expansion. Price earnings ratios are again stretched above their long-term averages. Stocks seem to be priced for a scenario where the Fed will be successful in fighting inflation and where higher interest rates do not result in a recession.

Economic growth in the first quarter increased at an annual rate of 2.0% and the advance estimate for second quarter growth is 2.4%. Analysts seem to be pushing their recession calls into next year. However, as of now, the Fed's projection for the full year is for 1.1% GDP growth which would indicate near 0% or negative growth for the remaining two quarters of 2023. Brian Wesbury of First Trust also has not changed his view that inflation will persist and higher interest rates will hurt the economy.

Unemployment is still low which some analysts are citing to support their opinion that a recession is not imminent. Brian Wesbury notes that recessions normally start, though, when employment is near highs. Regardless, the anticipated recession is expected to be mild, so even in recession, the unemployment rate may stay low.

Wages are rising at a slower rate than prices which has concerned analysts because purchasing power is eroded. However, the higher interest rates on savings is boosting income for some consumers so they can still spend. This higher interest earned on cash balances is also helping corporate earnings.

Inflation has been coming down from highs. The Core PCE Deflator, which is the measure the Fed uses, is now 4.1%. While we like that prices aren't rising as quickly, they also aren't declining. JPMorgan shows that shelter inflation continues to be sticky as housing prices are still rising which may make Brian Wesbury's hypothesis that "inflation will be higher for longer than expected" correct.

The Fed's main tool for fighting inflation has been raising interest rates. After pausing in June, the Fed hiked rates another 25 basis points in July. We may see another increase before year end, but most believe the Fed will begin to lower rates next year either because we enter a recession or because inflation is under control.

The S&P 500 is back within 5% of its all-time highs. With a recession not out of the picture, now is a good time to rebalance back to risk tolerance targets. Brian Wesbury's fair value of the index is 15% lower than current levels so although the market may go higher in the short-term, some caution is still warranted. We continue to encourage investors not to try and time the market by trading in and out and instead invest according to risk tolerance. This is also an attractive time to make gifts of appreciated stock. If you have questions about the strategy for your account, please contact your advisor.

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