JULY 2023
MARKET ROUNDUP

Key Observations & Outlook

- The avoidance of a more significant economic downturn has been enough to propel the equity markets higher
- Labor markets are still tight and remain a bright spot for the economy
- Oil prices have risen 20% over the past 5 weeks, which could potentially trigger a resurgence of inflation in the coming months
- Bank survey data continues to point toward tighter credit conditions across most lending categories at banks
- High yield bonds performed well in July as high yield credit spreads tightened to levels not seen since April of 2022, reflecting investor perception of declining financial markets risk

	MTD	YTD	1 Year	3 Years	5 Years
Equities					
US Large Cap	3.21%	20.65%	13.02%	13.72%	12.19%
US Mid Cap	4.13%	13.33%	10.47%	15.26%	8.28%
US Small Cap	5.51%	11.87%	5.26%	15.70%	5.69%
International Developed	3.24%	15.28%	16.79%	9.25%	4.54%
International Emerging	6.23%	11.42%	8.35%	1.46%	1.71%
Bonds					
US Aggregate	-0.07%	2.02%	-3.37%	-4.46%	0.75%
Short Term Bond	0.39%	1.59%	-0.38%	-1.56%	1.23%
Treasuries	-0.35%	1.23%	-4.01%	-5.27%	0.45%
High Yield	1.38%	6.83%	4.41%	2.04%	3.41%
Specialty					
Real Estate (REITs)	1.95%	5.01%	-10.06%	5.49%	5.11%
Gold	3.05%	8.65%	12.39%	0.10%	10.04%
Bitcoin	-4.06%	75.71%	22.12%	36.96%	30.41%

Market Commentary

The market continued its upward trajectory during July, with the S&P 500 extending it year-to-date gains to 20.65%. Smaller stocks and the broader market have not fared quite as well but have picked up some ground on the large cap index over the last couple of months. The first 7 months of the year have been characterized by falling volatility, a reversal of excessive pessimism, a moderation of

inflation and Fed policy, and avoidance of a recession. This backdrop has enabled the stock market to recover some lost ground from 2022 in the face of a steady dose of news and data that has been mixed at best. Hence, the old adage that the market tends to climb a wall of worry seems very appropriate for 2023.

Best Start for S&P 500 in 27 years

Through July, the S&P 500 has posted its strongest start in the last 27 years, so the obvious question is…what does the rest of the year have in store? There is no doubt that the market's steady increase over the course of the year (except for the banking crisis) caught many investors off-guard. The uptrend is not just US-centric but is also reflected globally in the ACWI global stock market index. The strength of the uptrend is seen in both the trend and breadth indicators, with a growing contingent of stocks participating in the uptrend, as the ACWI Advance/Decline Line reaches new highs for the year.

What remains to be seen is whether the global stock markets will be able to withstand the weaker seasonality immediately ahead of us (August and September tend to be the weakest 2 months for market returns). Even if a small correction does occur, it could relieve some of the excessive optimism and overbought conditions in place as of the end of July. If so, that could set the stage for the resumption of the longer-term uptrend with a rally back to new highs.

Labor Markets Still Tight

One of the keys to avoiding recession has been the tightness of the labor market whereby there has essentially been a shortage of workers. This has placed continued pressure on wage growth, which is great for the economy, but not so much for inflation. In general, recent employment data and trends have been mixed relative to expectations. While job growth has been slowing, fewer workers are being fired. Instead, employers are simply shortening hours, in effect, hoarding labor given that it is in short supply. We will be keeping a watchful eye on the labor markets, monitoring the impact of continued potential rising wages on inflation.

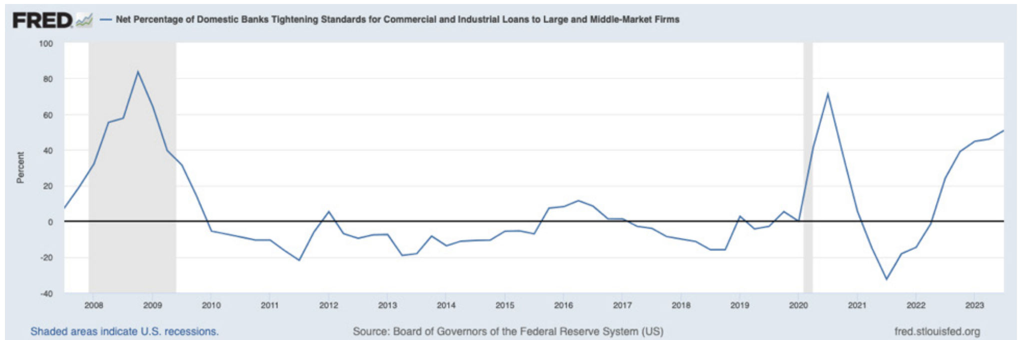
Oil Prices & Other Commodities Rise in July

Over the last year through June, the price of crude oil declined by over 40% during the economic slowdown in the US and globally. However, over the past five to six weeks, we have witnessed a 20% rally in the price of oil. At the same time, we have also seen the CRB Index, reflecting a broad basket of commodities, rise by nearly 8% during the same time frame. Not coincidentally, the yield on 30 year US Treasury bonds has increased from 3.80% to 4.20%, possibly reflecting a resurgence in inflation expectations. This is something to keep a close eye on as it could embolden the Fed's already "hawkish" fed policy position.

Credit Conditions Continue to Tighten

As previewed by Fed Chairman Powell at the most recent Fed meeting, the latest Senior Loan Officer Opinion Survey (SLOOS), a survey that measures the changes in bank lending standards, showed little change in Q2 from the prior report, reflecting tighter credit standards and weaker demand for Commercial and Industrial (C&I) and commercial real estate (CRE) loans.

Looking ahead, the survey noted banks expect further tightening, citing deteriorating collateral values, lower credit qualities, and an uncertain economic outlook.



Given that the supply of credit has tightened, it is completely logical that the cost of capital has risen as well, which impacts borrower's ability to refinance debt on existing projects. Currently, we are approaching similar levels of credit tightness to 2007 and 2020, which could further pressure economic growth.

High Yield Spreads

High yield bond spreads can indicate stress or risk in the public credit markets. The high yield spread represents the extra cost over treasuries that must be priced into non-investment grade bonds (high yield debt) to account for the added risk. While the tightening of credit standards has certainly been reflected in the rates that banks and other private lenders are charging borrowers, we are not seeing the same dynamic in the cost of capital in the non-investment grade public debt markets, reflected by the "high yield index option-adjusted spread". High yield spreads peaked over a year ago during the height of the market sell-off in mid-2022, but have since receded to their lowest level since early 2022. The differential between the public and private credit spreads is interesting and certainly bears watching, but for now, investors seem to be less concerned as the appetite for risk-taking has increased during the year.

The Bottom Line

For 2023, the US and global stock market advance has been encouraging and the strength and breadth of the advance give credence to additional gains, notwithstanding a potential correction during the typical seasonal weakness of August to September. It seems that the avoidance of an economic recession has been enough to propel the equity markets higher for the time being despite signs of economic weakness (ISM Manufacturing Index weaker than expected and Services PMI dropping to its lowest reading in 5 months). Moving forward, the economic narrative for the stock market may shift from relief over no recession in the near term to a balance between a hawkish Fed, the end of disinflation, and tepid manufacturing.

Bank lending standards continue to tighten as collateral (particularly real estate) valuations fall and credit qualities of borrowers deteriorate. Relative to a year ago, lending standards were tighter across all loan categories. Put simply, credit is becoming more difficult to obtain, and the demand for new loans has fallen. The outlook is for this trend to continue to get worse with higher cost of capital and tighter credit standards. Why is this important? There is a direct relationship between credit growth, investment, and the ensuing impact on real economic growth.

There has been no shortage of news and information related to the economy to worry about in 2023. As noted earlier, sometimes the markets do what you least expect and "climb that wall of worry". That has certainly been the case for 2023. This is the very reason why we develop a customized and disciplined long-term investment strategy for each and every client, focused on their specific objectives. That approach has helped navigate changing market environments while still meeting the ultimate financial objectives of our clients.

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Index definitions: "U.S. Large Cap" represented by the S&P 500 Index. "U.S. Small Cap" represented by the S&P 600 Index. "International" represented by the MSCI Europe, Australasia, Far East (EAFE) Net Return Index. "Emerging" represented by the MSCI Emerging Markets Net Return Index. "U.S. Aggregate" represented by the Bloomberg U.S. Aggregate Bond Index. "Treasuries" represented by the Bloomberg U.S. Treasury Bond Index. "Short Term Bond" represented by the Bloomberg 1-5 year gov/credit Index. "U.S. High Yield" represented by the Bloomberg U.S. Corporate High Yield Index. "Real Estate" represented by the Dow Jones REIT Index. "Gold" represented by the LBMA Gold Price Index. "Bitcoin" represented by the Bitcoin Galaxy Index