The Weekly Market Update – 7/10/23: Jobs Gains Point to Higher Interest Rates

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,398.95	-1.16%	-1.16%	14.57%	16.21%	4,796.56	9.0%
Dow Jones Industrial Average	33,734.88	-1.96%	-1.96%	1.77%	9.62%	36,799.65	9.1%
NASDAQ Composite	13,660.72	-0.92%	-0.92%	30.52%	23.86%	16,057.44	17.5%
Russell 2000	1,864.66	-1.27%	-1.27%	5.87%	9.17%	2,442.74	31.0%
MSCI EAFE (USD)	2,087.72	-2.06%	-2.06%	7.40%	13.08%	2,398.71	14.9%
MSCI Emerging Markets (USD)	980.66	-0.89%	-0.89%	2.54%	-2.00%	1,444.93	47.3%
Bloomberg Commodity Index	101.91	0.43%	0.43%	-9.66%	-12.93%	237.95	133.5%
Barclays U.S. Aggregate Bond	88.50	-1.43%	-1.43%	-0.42%	-4.45%	112.07	26.6%

Source: FactSet

U.S. nonfarm payrolls (jobs) increased at a healthy level in June, but also at the slowest pace in more than two years, creating challenges for monetary policy. According to the Bureau of Labor Statistics' (BLS) monthly employment report, the U.S. economy created 209 thousand (K) net new jobs in June, with the largest gains from government and health care and job losses in retail trade and transportation and warehousing. At the same time, the unemployment rate of 3.6% compared to 3.7% in the prior month, and wages (as measured by average hourly earnings) increased 4.4% year-over-year (Y/Y), unchanged from a 4.4% Y/Y increase in May. In our view, the jobs report, as it relates to the future path of monetary policy and interest rates from the Federal Reserve Bank (Fed), was mixed. On one hand, when adding the June jobs report to data released since January, the U.S. economy created a monthly average of 278K net new jobs in the first half of 2023, a pace that can support strong consumer spending and positive economic growth. On the other hand, the June jobs growth of 209K was the lowest monthly increase since December 2020 and raises the possibility that jobs gains in future periods could moderate further, pointing to slowing economic growth. Federal Reserve Bank Chair Jerome Powell made comments on 6/28/23 reiterating the Fed's position that additional restrictive monetary policy might be necessary to combat elevated inflationary pressures. The BLS' consumer price index (CPI), a widely followed measure of consumer inflation, increased 4.0% Y/Y in May, significantly below the peak monthly Y/Y increase of 9.1% in June 2022. The Fed's primary tool to fight inflation is to set a range for short-term interest rates using its overnight bank lending fed funds target. With the fed funds target currently at a 5.00% to 5.25% range, up substantially from 0.00% to 0.25% in March 2022, Chair Powell admits that policy is "restrictive" (can be a brake on economic growth and inflation) but perhaps not restrictive enough. Despite the progress discussed above, inflation remains well above the Fed's 2.0% target (core CPI, which excludes volatile food and energy prices, was 5.3% in May). If the Fed raises rates at its upcoming meeting on 7/26/23, it runs the risk of slowing the economy more than expected (previous interest rate hikes have a lagged and variable effect on economic growth). To us, a more restrictive Fed is likely to keep interest rates higher for longer, which could eventually weigh on equity market valuations.

S&P 500 second quarter 2023 (2Q23) earnings are expected (FactSet consensus estimate) to decrease 6.2% Y/Y, marking the third consecutive down earnings quarter. In our view, a 2023 surprise is higher equity prices (the widely followed, large-company S&P 500 equity index gained 15.9% in 2023 through 6/30/23) despite a Y/Y earnings decline. Driving investor optimism, however, was better-than-expected 1Q23 earnings results (down -1.3% vs. down -6.6% expected) and a view that 2Q23 will be the low point for S&P 500 earnings with growth resuming in 3Q23. While 2Q results could again exceed expectations (but still decline Y/Y), company outlooks for the second half of the year will be very important. Earnings reports from large banks will begin later this week, with the bulk of S&P 500 earnings scheduled in late July and early August.

The June CPI report is due this week, with further inflation moderation expected. The BLS' June CPI (due 7/12/23) is expected to show inflation at 3.1% Y/Y, and core CPI up 5.0%, both below May numbers. On a sequential basis from May, both inflation numbers are expected to increase 0.3%. June inflation was likely helped by lower Y/Y gasoline prices, while prices for shelter (including rent) and services (travel, medical etc.) were expected to remain elevated.

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