The Weekly Market Update – 7/17/23: Inflation Improves But The Job's Not Finished

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,505.42	2.42%	1.24%	17.34%	19.02%	4,796.56	6.5%
Dow Jones Industrial Average	34,509.03	2.29%	0.29%	4.11%	12.13%	36,799.65	6.6%
NASDAQ Composite	14,113.70	3.32%	2.36%	34.85%	27.97%	16,057.44	13.8%
Russell 2000	1,931.09	3.56%	2.24%	9.64%	13.06%	2,442.74	26.5%
MSCI EAFE (USD)	2,188.99	4.85%	2.69%	12.61%	18.56%	2,398.71	9.6%
MSCI Emerging Markets (USD)	1,028.49	4.88%	3.94%	7.54%	2.78%	1,444.93	40.5%
Bloomberg Commodity Index	104.60	2.63%	3.07%	-7.28%	-10.64%	237.95	127.5%
Barclays U.S. Aggregate Bond	89.85	1.53%	0.07%	1.09%	-3.00%	112.07	24.7%

Source: FactSet

June inflation was lower than expected, confirming moderating price trends, but more progress is needed. The June consumer price index, or CPI (widely followed measure of consumer inflation reported by the U.S. Bureau of Labor Statistics, BLS) increased 3.0% in June 2023 year-over-year (Y/Y), which was lower than the 3.1% FactSet consensus (from Wall Street economists) estimate. Since peaking at 9.1% Y/Y in June 2022, the CPI data has increased at a lower rate for 12 consecutive months. With the U.S. economy producing a monthly average of 278 thousand nonfarm payrolls (jobs) over the first six months of 2023, the progress on inflation is notable, and thus far validates the Federal Reserve Bank's (Fed) policy strategy to aggressively increase its short-term bank lending fed funds interest rate target to address inflation pressures. Since March 2022, the Fed raised the fed funds target to 5.00% to 5.25% from 0% to 0.25%. After raising the target rate at ten consecutive policy meetings, the Fed made no change at its 6/14/23 meeting. That "pause" could be temporary, as we expect another 0.25% hike on 7/26/23. Fed Chairman Jerome Powell has said that the trend of higher interest rates was necessary to slow economic activity (including jobs) to limit upward pricing pressure, indicating a willingness to see weak economic growth if inflation improves. The progress so far of lower inflation and solid economic growth is a positive surprise, in our view. However, core CPI, which excludes more volatile food and energy prices, increased 4.8% in June. While core CPI has also improved (peaking at 6.6% Y/Y in September 2022), it remains significantly above the Fed's 2.0% target, and is the reason we believe another rate hike this month is likely. Over the past three months (Y/Y monthly average), CPI for consumer goods increased 1.8%, consumer services rose 6.5%, food prices were up 6.7%, and energy prices dropped 11.2%. While the inflation for food and consumer services has moderated this year, we believe the Fed wants to see even more progress before declaring that inflation is under control.

Equity markets have rallied to start July, as the path of least resistance appears higher. The widely followed, large-company S&P 500 equity index closed at new 52-week highs on both Wednesday and Thursday last week, and despite a dip on Friday, closed the week ended 6/14/23 up 2.4%. This erased a pullback over the first week of the month and the index's July price return (does not include dividends) is +1.2%. From a sector perspective (using Global Industry Classification Standards), July gains (admittedly just two weeks) were led by Communication Services and Consumer Discretionary, with Real Estate, Utilities and Technology each up at least 1.3% to begin the month. While we continue to see strong investor interest and performance contribution from a select group of highly valued, technology-centric growth stocks, market gains have broadened to include participation from more stocks, continuing a trend that began in June. We attribute gains to macro expectations for the U.S. economy that consider the possibility of a "soft landing," which would avoid economic growth turning negative.

Second quarter (2Q23) earnings season is underway with about 12% of the S&P 500 scheduled to report financial results this week. According to FactSet, 2Q23 S&P 500 earnings are estimated to decline 7.1% Y/Y, marking the third consecutive quarterly Y/Y decrease. Recent equity market gains suggest that investors expect earnings to mostly exceed expectations, feeding into estimates that reflect Y/Y earnings growth resuming in the second half of the year. Sales are estimated (FactSet) to be flat (zero growth) in 2Q23, indicating some pressure on margins driving the earnings decline.

James D. Ragan, CFA
Director of WM Research
(206) 389-4070
jragan@dadco.com

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