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July 17, 2023 – Investment Commentary

Equities

US equities returned +2.4% as a “soft-landing” narrative continues to gather steam and analysts continue to revise upward S&P 500 earnings. Consumer inflation came in lower than expected and increased at its slowest pace since 2021, while producer price inflation increased at its slowest pace since 2020. Growth outperformed value across market caps. All S&P 500 sectors had positive performance with communication services and (+3.4%) and consumer discretionary (+3.3%) stocks leading. EAFE markets returned 4.9% led by Australia (+6.2%) and Europe (+5.7%). EM markets rose +4.9% led by Korea (+7.7%) and China (+6.2%).

From a valuation perspective, most markets are within ±1 standard deviation based on historical forward P/E ratios though the NASDAQ is now up to +1.5. The S&P 500 (US Large Cap) and NASDAQ trade above their 20-year averages based on forward P/E ratios as does MSCI EM (Emerging Market Equities), while the Russell Midcap (US Midcap) and Russell 2000 (US Small Cap) trade below, as does the MSCI EAFE (Non-US Developed Market Equities).

Fixed Income

Investment grade fixed income sectors had positive returns as rates fell across the curve. Municipals returned +0.4%, while US AGG returned +1.5% and US IG returned +1.6%. HY bonds returned +1.6% though bank loans returned +0.6%. EM debt returned +2.5% the US dollar fell 2.3% and spreads compressed slightly.

Rates

Rates fell across the curve as inflation came in slower than expected. The recession-watch 3M-10Y spread widened 25bps and closed the week at -158, still signaling recession in coming months. The 2Y-10Y spread widened 5bps and is now -94. Rates were lower in other developed markets though rose slightly in Japan. The BTP-Bund spread fell 6bps to 1.66%. 5-year and 10-year breakeven inflation expectations were slightly lower and now sit at 2.16% and 2.24% respectively; the 10Y real yield fell 21bps to 1.60%. The markets expect rates to end the year at current levels with a July rate hike being reversed by year end. The peak rate for this cycle is expected to be 5.5%, 25 bps above the target rate by year end.

Currencies/Commodities

The dollar fell 2.3% responding to cooler inflation while the commodities complex rose 2.4%. Brent rose 1.8% to $80/bbl. US natural gas fell 1.7% while European gas fell 20.4%.

Market monitors

Volatility fell for equities and bonds (VIX = 13, MOVE = 112). Market sentiment fell to 15 indicating that investors are maintaining cautious optimism in the current environment. The FRA-OIS spread was flat at 26, off its March peak at 60.

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Disclosures