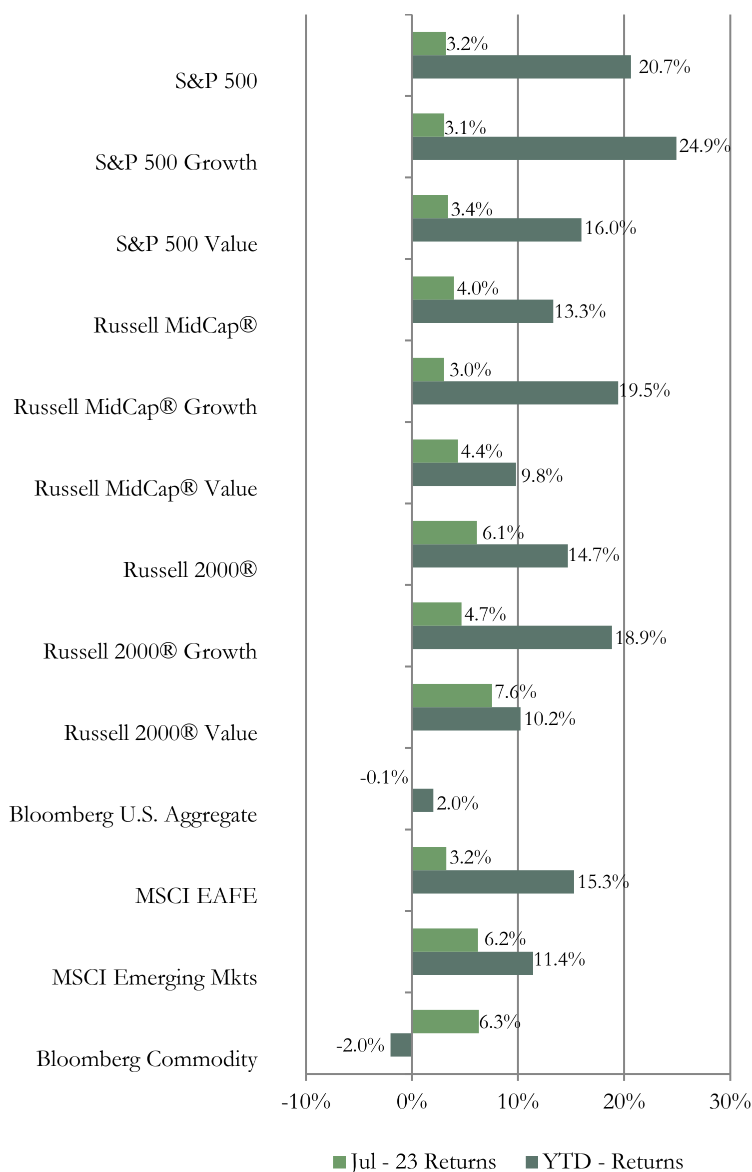
Monthly Market Summary – July 2023

Encouraging economic data, slowing rates of inflation in key markets, and better than expected earnings reports pushed consumer sentiment up in July. Investor sentiment also improved. Market participants seemed to be increasingly confident that the Federal Reserve (Fed) will be able to accomplish a "soft landing" of taming inflation without a significant economic slowdown. These factors drove most financial markets higher. However, certain bond sectors did post negative returns since interest rates moved higher with the Fed and other central banks raising key policy interest rates again. The U.S. dollar fell to a 15-month low on disinflationary data but recovered some of the decline after the better than expected gross domestic product report.

Market Indices – July 2023



Inflation data continues to be a primary focus of central banks and investors. The trend of slowing rates of inflation around the world continued with the reports in July. In the U.S., the consumer price index (CPI) report showed a 3% year-over year increase with the core CPI at 4.8%, which was a 28-month low but still well above the Fed's 2% target. The CPI for the eurozone declined to 5.5% and the UK CPI declined to 7.9%. Japan was one exception with the CPI moving up to 3.3%. The Fed and the European Central Bank each raised their policy interest rate by a quarter of a percentage point in July and emphasized that future rate decisions will be data dependent.

The manufacturing sector around much of the world continues to be weak with many purchasing manager index reports remaining under 50, which indicates contraction. In the U.S., the ISM Purchasing Managers' Index of Manufacturing activity came in at 46. That index has been in contraction territory for eight consecutive months, which is the longest streak since the global financial crisis in 2009. Service sector indices continue to be in expansion in many countries. Labor markets continue to be strong which is boosting the service sector. In the U.S., the latest unemployment rate was 3.6% with wages growing at 4.4% over the prior year. Economic data continued to weaken in China which spurred the government to extend support measures to the property sector and signal additional measures to support consumer spending.

The rally in the U.S. equity market continued throughout July with the major indices posting solid positive returns. In addition, the rally continued to broaden since both the Russell Midcap index and Russell 2000 index of smaller companies outperformed the S&P 500 index of larger capitalization (cap) stocks. Value outperformed growth in each of the three market cap indices. The energy sector had the highest return among the 11 sectors in the S&P 500 and Russell Midcap indices and the second highest return in the Russell 2000 index reflecting the surge in crude oil prices during the month on tightening supply amid increasing demand. Financials was the top performing sector in the small-cap index boosted by encouraging earnings reports by regional banks. Healthcare was the weakest performing sector in the S&P 500 index and the communications sector was the laggard in the mid and small-cap indices.

The MSCI EAFE index of developed international equities had a return in line with the S&P 500 index for July. However, the MSCI Emerging Markets index (EM) outperformed both by a sizeable margin due to strong gains in Asia, Latin America, and Emerging Europe. Currency movements provided a boost to returns from foreign investments since the U.S. dollar moved lower during the month. Value stocks outperformed growth stocks in both the EAFE and EM. The more cyclical sectors had the best returns in foreign markets with energy, materials, financials, and consumer discretionary posting the top returns while utilities and information technology had the lowest returns. On a geographical basis, the Pacific ex Japan region was the best performing region among developed markets boosted by a strong return for the Singapore index. Particularly newsworthy in emerging markets is the 11% gain for the China index reflecting optimism after the government announced its intention to support the flagging economy and government fines on large internet and technology companies appeared to signal the end of the regulatory crackdown on those industries. Poland was also a strong performer for the second consecutive month on declining inflation and improving business sentiment.

U.S. bond market sector returns were mixed for July resulting in a small negative return for the Bloomberg U.S. Aggregate Bond index. Yields moved up during the period (and prices went lower) reflecting stronger than expected economic data, another rate hike by the Fed, and indications from the Fed that additional interest rate hikes are possible if the inflation rate stays above the target level. However, that stronger than expected economic data provided a boost to the corporate high yield sector, which was the best performing sector with a return of over 1%. Corporate bond, municipal bond, and short-term Treasury bond indices had a positive return while long-term bond indices and the mortgage-backed bond index posted negative returns. The yield curve continues to be very steeply inverted. The 3-month Treasury bill yield was 5.6% at month-end compared to the 2-year Treasury bond yield of 4.9% and the 10-year Treasury bond yield of 4.0%.

The Bloomberg Commodity index had a robust positive return for the month and outperformed most equity market indices. Each of the commodity sub-indices we track had a positive return with the petroleum and industrial metals sub-indices topping the performance chart. The petroleum sub-index was up nearly 20% due to both supply and demand impacts. Supply tightened due to OPEC+ production cuts. Demand was at record levels from economic growth in India and the U.S as well as the U.S. government starting to refill the Strategic Petroleum Reserve. Industrial metals prices, such as nickel and copper, rose in July on expectations for higher demand after the Chinese government pledged to support the construction industry and consumer spending such as automobile purchases.

Vogel Consulting, LLC (Vogel) Tactical Recommendations

The economy has been resilient with gross domestic product and corporate profit reports coming in better than expected, the labor market remaining tight, and inflation cooling. Therefore, consumer and investor sentiment has improved, which is a positive for equity markets. However, even though inflation rates are well off the year ago peaks, inflationary pressures persist as shown by the latest release of the Fed's preferred measure of inflation, the core personal consumption expenditures price index, which increased to 4.8% in the latest report and is well above the Fed's 2% target. Therefore, even though consensus is building that the Fed and other central banks are near the end of rate hikes, the possibility of further rate hikes remains. In addition, bank lending standards have been tightening for a few months

with the latest report showing more tightening. The resumption of student loan payments later this year adds some uncertainty about the outlook for consumer spending. These factors could be a drag on economic and profit growth. With valuations up from the start of the year, periods of market volatility are likely in reaction to new reports while there is heightened uncertainty about the impact of tighter monetary conditions on corporate profits. We continue to recommend an overweight to cash reserves to avoid having to sell assets in a down market period to cover spending needs. Our neutral view on growth relative to value remains in place as we prefer to have exposure to sectors benefiting from longer-term secular growth trends along with some exposure to cyclicality.

We retain our neutral weight position recommendation for developed market and emerging market equities. Since bond yields are more attractive than they have been in many years, we encourage investors to revisit fixed income allocations. Our fixed income recommendation is for an equal weight position relative to long-term targets. We favor shorter maturity bonds due to the steeply inverted yield curve. We recommend an underweight allocation to hedge funds. Within the hedge fund sector our view is that the opportunity set for distressed investing strategies may be improving as interest rates are at multi-year highs and credit conditions are tightening.

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