

July was a strong month for equity markets while fixed income markets were essentially unchanged. The S&P 500 added 3.2% led by Energy (7.4%), Communications (6.9%) and Financials (4.9%). The small cap Russell 2000 index gained 6.1% and Value (3.5%) and Growth (3.4%) ran roughly even. Yields on U.S. Treasuries nudged higher as the 10-Year Treasury rate rose to 3.97% from 3.81% and the 5-Year U.S. Treasury rate ended at 4.2% up from 4.1%. Bond indices were virtually unchanged with the Bloomberg Aggregate Bond Index declining 0.07%, Corporate bonds adding 0.34% and Muni bonds adding 0.40%.

The Federal Reserve raised the Federal Funds rate by 25 basis points bringing its target rate to 5.25% - 5.50%, its highest level since 2001. It was the Fed's 11th hike since March 2022 and Chair Powell indicated that rates are finally in 'restrictive territory'. The Fed Funds rate now exceeds inflation as measured by a variety of methods, including CPI Headline (3.0%), CPI Core excluding food and energy (4.8%), PCE Headline (3.8%) and PCE Core (4.1%). Historically, on average, real rates above 50 to 75 basis points have been considered restrictive.

The key question now is how long the Fed maintains its restrictive stance. The Fed's own forecasts call for one further rate hike this year and Powell did indicate a roughly even chance of another rate hike in September. However, market forecasts, as measured by the CME Fed Futures, indicate a low probability of further rate hikes. Though the expectation is that the Fed will not cut rates any time soon and will remain at this level into Q1 next year. The Fed will need to see clear evidence of core inflation heading back towards its target of 2% which equates to consistent monthly readings near 0.2% to 0.3%. June's reading, at 0.2%, was the first in the past seven months to reach the target level.

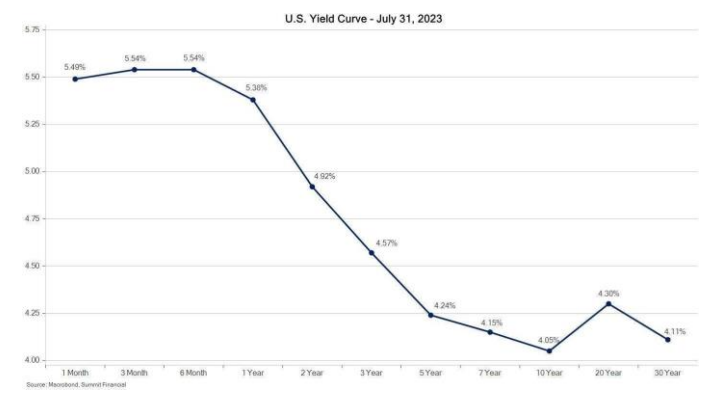
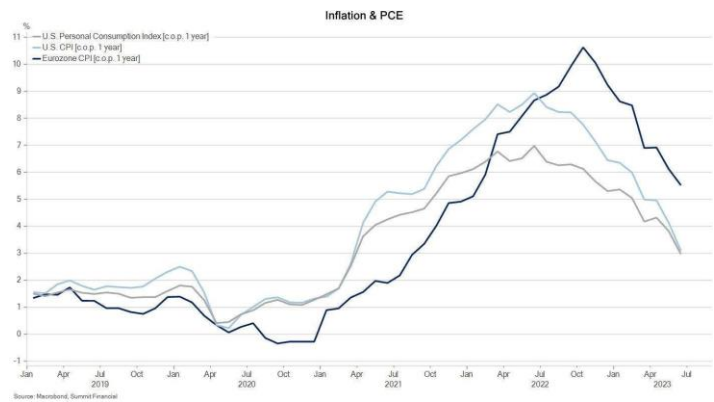
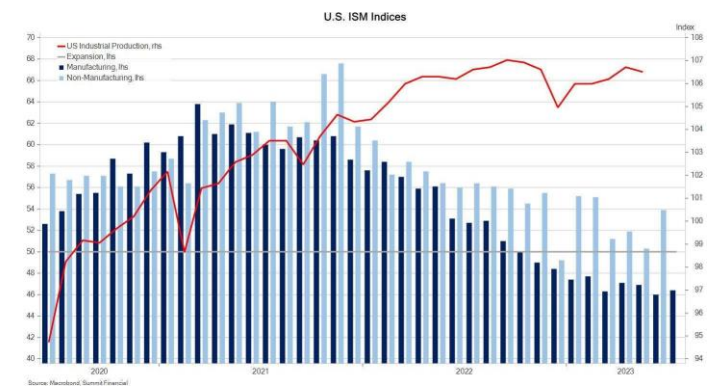
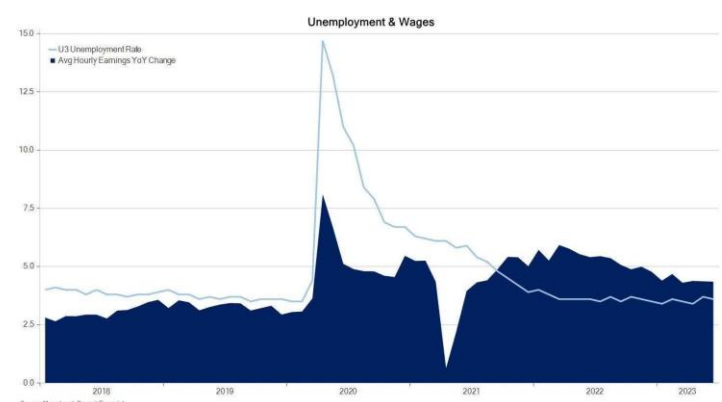
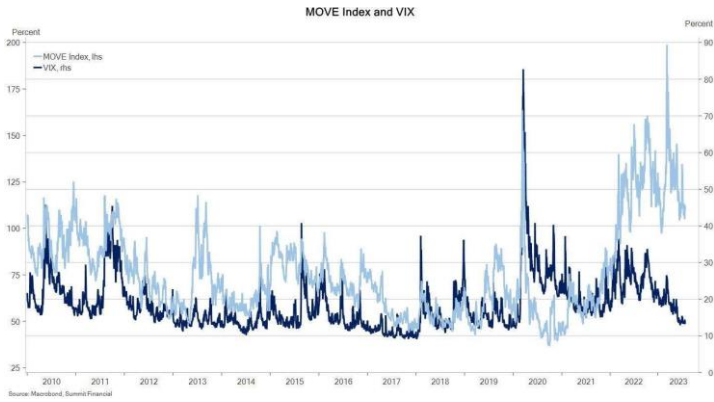
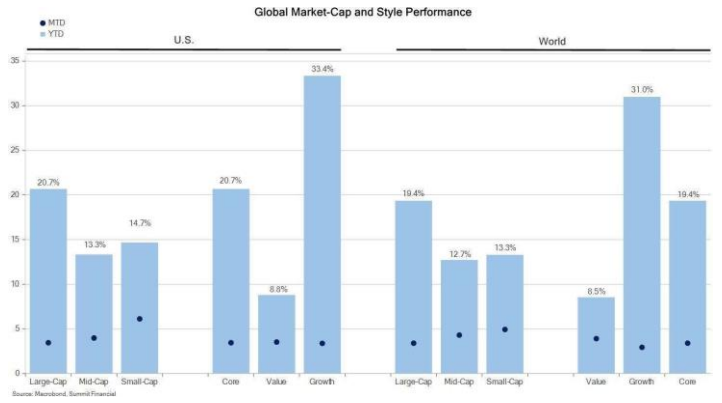
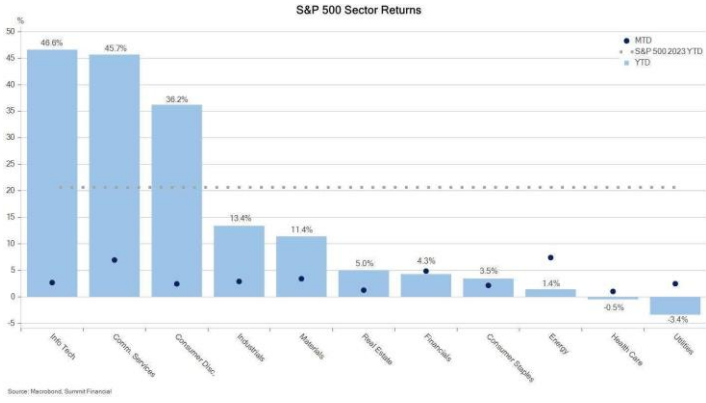
Looking forward, Powell confirmed that "reducing inflation is likely to require a period of below trend growth and some softening of labor market conditions". Unfortunately for Fed policymakers, U.S. economic growth was not below trend in Q2. The GDP reading, released in late July, showed the U.S. economy grew at 2.4%. Increases in consumer spending, federal and state spending, nonresidential fixed investment, and private investment all contributed to the broad-based growth. Only residential investment and exports were offsetting. For policymakers, the news was somewhat better on the employment side, as the Conference Board's Employment Trends Index showed a decrease of 3% year-on-year in June indicating that pressures in the labor market are easing. Further beneficial news on inflation came via the second quarter Employment Cost Index report which showed costs decelerating across wages, salaries and benefits versus the prior quarter and the prior year. The Fed likely pauses here as it awaits the lagged effects from credit tightening to (actually) slow the economy and further reduce inflation.

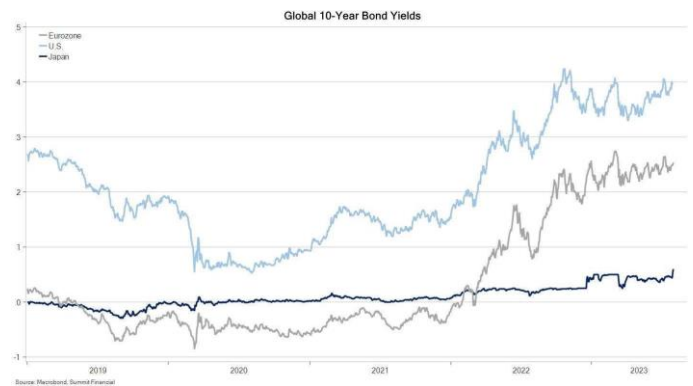
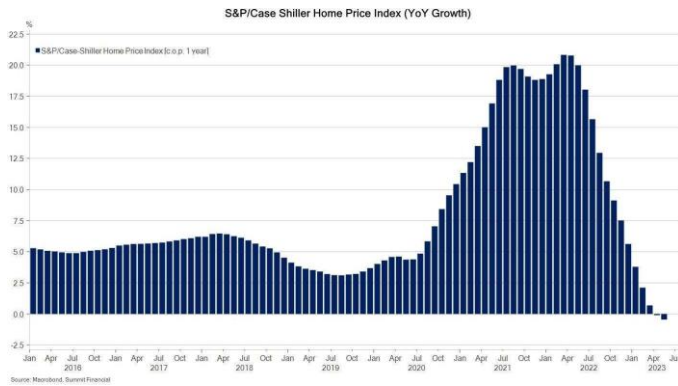
Globally, official Chinese growth estimates remain at 5% for this year. GDP growth for the second quarter was 6.3% year over year, though it came in below forecasts of 7%. With inflation near 0%, concerns about deflation and slow growth continue to pressure officials to either increase government spending or cut rates. Europe reported economic growth of 0.3% in the second quarter, led by Ireland, France, and Spain. The growth, while meek, was above first quarter's 0% and fourth quarter's slight decline. European growth forecasts remain muted and overall credit demand is declining significantly. The Bank of Japan, in order to combat rising inflation, began exiting its yield curve control policy allowing rates on long dated Japanese Government Bonds to rise. This may be significant for U.S. rates as Japan is the largest foreign holder of U.S. treasury bonds and given the high cost of hedging, Japanese investors may reallocate towards their own sovereign bonds.

Within fixed income markets, yields are up across the board. Long-run expectations for inflation, as measured by five-year breakeven rates, are modestly above the Fed's target at 2.4%. This is a key indicator for the Fed and one that will likely trigger concern if it rises much higher. Nonetheless, with the Fed most likely at the end of its rate hiking cycle, extending duration especially for investment grade bonds and Treasury Inflation Protected Securities (TIPS), provides a reasonable risk reward trade-off.

Halfway through Q2 earnings season, S&P 500 firms are reporting a -7% growth rate year over year. Positive growth from Communications and Consumer Discretionary has been more than offset by flat growth in Technology and deeply negative growth from Energy, Materials and Healthcare. Per Factset, Q3 growth is forecast at 0.2%, and Q4 growth at 7.5%. Analysts are forecasting 12.6% earnings growth for CY 2024. With the S&P 500 P/E near 20x and given the high cash and bond yield backdrop, it will be difficult for the multiple to expand further from here. Future equity returns will likely be closely tied to rate of earnings growth with a high sensitivity to any downward revisions or negative surprises.







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It is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership; The Russell 1000 Index measures the performance of the large-cap segment of the US equity universe. It is a subset of the Russell 3000 Index representing approximately 90% of the total market capitalization of that index. It includes approximately 1,000 of the largest securities based on a combination of their market-cap and current index membership; The Russell Midcap Index measures the performance of the mid-cap segment of the US equity universe. The Russell Midcap Index is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The Russell Midcap Index represents approximately 31% of the total market capitalization of the Russell 1000 companies; the S&P 500 Index is a market capitalization-weighted Index of 500 widely held stocks often used as a proxy for the stock market. It measures the movement of the largest issues. Standard and Poor’s chooses the member companies for the 500 based on market size, liquidity and industry group representation. Included are the stocks of eleven different sectors; the MSCI EAFE Index (Europe, Australasia, Far East) captures large- and mid-cap representation across developed markets countries around the world excluding the US and Canada. The index covers approximately 85% of the free float-adjusted market capitalization in each country; the MSCI Emerging Markets Index captures large- and mid-cap representation across emerging markets countries across the world. The index covers approximately 85% of the free float-adjusted market capitalization in each country; The MSCI World Index captures large- and mid-cap representation across developed markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country; the Bloomberg Commodity Index reflects commodity futures price movements and is calculated on an excess return basis. The index rebalances annually weighted 2/3 by trading volume and 1/3 by world production, and weight-caps are applied at the commodity, sector, and group level for diversification. Roll period typically occurs from the 6th-10th business day based on the roll schedule; the Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, US dollar-denominated, fixed-rate taxable bond market. The index includes treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency); the Bloomberg Barclays Global Aggregate Ex US Index is a measure of investment-grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers. Bonds issued in US dollars are excluded; the Bloomberg Barclays Municipal Bond Index covers the US dollar-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds; the Dow Jones US Real Estate Index measures the performance of real estate investment trusts (REITs) and other companies that invest directly or indirectly in US real estate through development, management, or ownership, including property agencies; The Bloomberg Barclays US Corporate High-Yield Index measures the US dollar-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody’s, Fitch, and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded; The HFRX Global Hedge Fund Index is comprised of funds representing the overall hedge fund universe. Constituent funds include but are not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, even driven, macro, merger arbitrage, and relative value arbitrage. The underlying strategies are asset weighted based on the distribution of assets in the hedge fund industry; The S&P Case-Shiller Home Price Index measures the value of single-family housing within the US The index is a composite of single-family home price indices for the nine US Census divisions. Leading economic indicators (LEI) are statistics that precede economic events. They predict the next phase of the business cycle. The OECD Composite leading indicators (CLIs), designed to anticipate turning points in economic activity relative to trend, continue to strengthen in most major economies. The MOVE Index measures US interest rate volatility. The index tracks the movement in US treasury yield volatility implied by current prices of 1-month OTC options. The Cboe Volatility Index (VIX) is a real-time index that represents the market’s expectations for the relative strength of near-term price changes of the S&P 500 Index. The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The Consumer Confidence Index is a measure based on a survey administered by The Conference Board that reflects prevailing business conditions and likely developments for the months ahead. This monthly report details consumer attitude, buying intentions, vacation plans and consumer expectations for inflation, stock prices and interest rates. A treasury Bill (T-Bill) is a short-term US government debt obligation backed by the treasury Department with a maturity of one year or less. The ISM manufacturing index, also known as the purchasing managers’ index (PMI), is a monthly indicator of US economic activity based on a survey of executives covering all North American Industry Classification System’s businesses in the manufacturing sector. The ISM Non-Manufacturing Index is a monthly indicator of US economic activity based on a survey of executives covering all North American Industry Classification System’s businesses in the services (or non-manufacturing) sector. Data in this newsletter is obtained from sources which we, and our suppliers believe to be reliable, but we do not warrant or guarantee the timeliness or accuracy of this information. Consult your financial professional before making any investment decision. Past performance is no guarantee of future results. Diversification/asset allocation does not ensure a profit or guarantee against a loss. 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