OBSERVATIONS: *Markets rally on better-than-expected inflation, confidence improves, weak China data.*

- Markets got a big boost last week from softer than expected inflation data. The S&P 500 reached a fresh 52-week high after closing the week up +2.4%, while small cap stocks (Russell 2000) jumped +3.6%. Treasury bonds also rallied and the 10-Yr fell from 4.07% at the start of the week to finish Friday at +3.83%.[1]
- Producer prices increased by +0.1% on a year-over-year (YoY) basis in June, while core-PPI—excluding food, energy, and trade services—increased by +2.6% YoY. These subdued producer price inflation numbers were below expectations and underscore the relative weakness in the manufacturing sector.[1]
- Small business sentiment (NFIB US Small Business Optimism Index) climbed to 91.0, better than expectations. Sentiment is now at the highest level since November 2021 but remains below the 49-year average of 98.0. Of note, the net percentage of firms anticipating higher selling prices fell to 29%, which is the lowest since March 2021.[2]
- University of Michigan consumer confidence came in at 72.6 for July, higher than June and better than estimates. July's reading is the highest reading since September 2021 and was led by improving expectations in long-term and short-term business conditions—thanks to falling inflation and stable labor markets.[3]
- In contrast to most western economies, China teeters with outright deflation as the country's consumer price index registered 0.0% in June on a YoY basis—the slowest pace since February 2021. Producer prices in China fell to -5.4% YoY, the ninth consecutive month of YoY declines and is the weakest PPI reading since December 2015.[4]
- Chinese exports declined sharply in June in both YoY and month-over-month (MoM) terms, falling -17.5% YoY and -10.6% MoM, respectively. The slowdown in Chinese exports is reflective of the slowdown in overall global growth in 2023 and weakness in global trade—similar disappointing trade data was registered in June in the economies of South Korea and Taiwan.[1]

EXPECTATIONS: *Inflation continues to move in the right direction, Q2 earnings season gets started.*

- Headline inflation (CPI) came in at 3.0% YoY basis, expectations were for 3.1%. The more relevant core CPI (CPI ex. food and energy) was 4.8% YoY, also below expectations (5.0%) and is the lowest since October 2021. This marks the fourth consecutive month of YoY declines for core CPI. With this particular measure remaining above the Fed's 2% target, markets continue to price in a 90% probability for a +25bps rate hike at the Fed's meeting in late July.[1]
- Big banks kicked off earnings last Friday with JP Morgan, Wells Fargo, and Citigroup each beating estimates. Q2 Earnings seasons will pick up in the coming days, current expectations are for earnings growth of -7.2% (YoY) on revenue growth of -0.3% (YoY). This week will see 60 S&P 500 companies report Q2 earnings.[5]

ONE MORE THOUGHT: *Looking ahead – tailwinds and headwinds.*[1]

The US economy and US equity markets are caught amid some crosscurrents some of which are likely to drive economic growth and stocks higher, while others are undermining their strength. On the positive side, while the US housing market has slowed materially from 2022, overall housing activity looks to have bottomed out in the first half of the year and the fundamentals—starts, permits, and sales—are set to gradually improve. Meanwhile the US labor market remains strong, and the US economy is by a variety of measures at—or at least very near to—full

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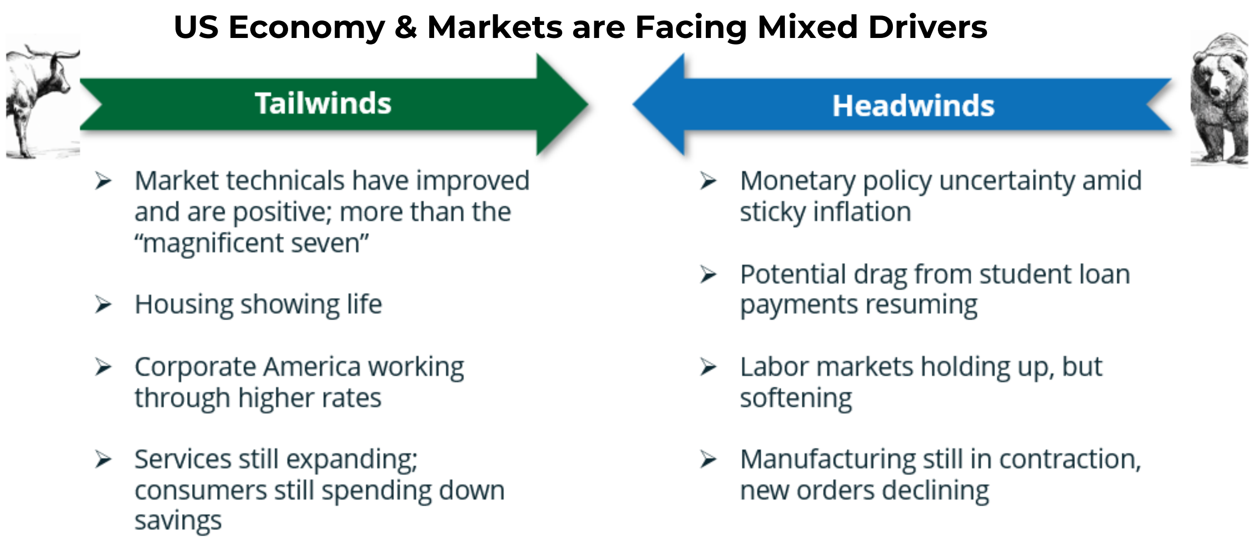
[1] *Bloomberg LP*
[2] *https://www.nfib.com/content/press-release/economy/small-businesses-raising-prices-falls-to-lowest-level-since-march-2021/*
[3] *http://www.sca.isr.umich.edu/*
[4] *Bloomberg LP, WSJ, Reuters*
[5] *Factset Earnings Insight, July 14, 2023*

employment. The strong jobs market has kept the US consumer spending, which has helped corporate America navigate a world of higher rates and pressures on its margins. Lastly, in terms of market technicals, the S&P 500 broke above the 4,500 level and the Q2 earnings season may be set up to beat the relatively low expectations that consensus estimates have established. On the negative side, there is still uncertainty if the Fed is going to be done hiking rates this year—currently the market only expects one additional rate hike and then for the Fed to signal a pause. The manufacturing sector has been weak this entire year and new regulations in the US banking sector are likely to constrain many small and regional banks from further lending. Additionally, many US consumers will soon have to contend with resuming student loan payments, which will eat into their ability to spend in other areas. Currently, in a battle between the positive factors and the negative ones, the market has focused on the positive factors as being more dominant—at least as evidenced by the past several weeks of gains in the S&P 500. However, much depends on the continued strength of the US labor market, and should we see a rapid increase in unemployment in the back-half of 2023, then it is likely there will be an equally sharp pull-back in US consumer spending. So far, the tailwinds buttressing the US economy have led to the idea that the US will have a soft-landing—slow, but positive growth—or even a no-landing—gradual improving growth rates—in 2024, but we are mindful of the risks to this narrative and will be vigilantly watching for the signals that could portend a less rosy scenario for the US economy and ultimately for our clients.

CHART OF THE WEEK



Source: Clearstead 6/30/2023

Aneet Deshpande, CFA
Chief Strategist
Clearstead

Dan Meges
Senior Managing Director of Equity
Clearstead