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OUTLOOKS

August 2023

ECONOMIC OUTLOOK

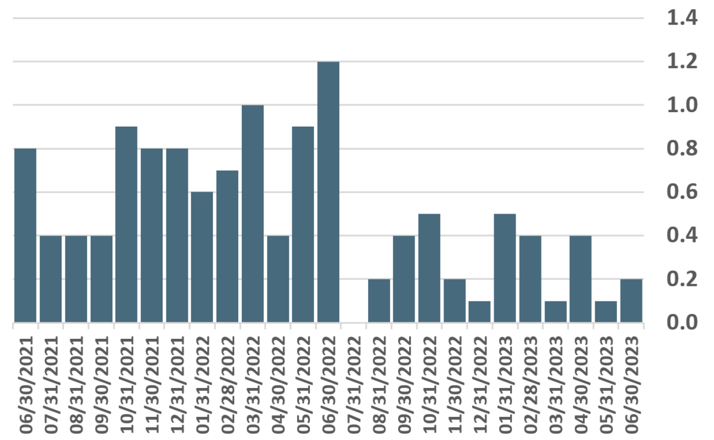
Summary

During the past year, headline Consumer Price Index (CPI) has fallen roughly six percentage points – from above 9% in June 2022 to just under 3% through June 2023. This sharp decline in inflation should not come as a surprise since it has been the Federal Reserve's singular focus for more than a year. They've even implemented the fastest start to a rate-hiking cycle in history to expedite its decline. However, with inflation falling so rapidly, it's fair to wonder if the Fed's 2% target is now within sight.

To understand this, we need to take a quick look at the math. When referencing certain data points in year-over-year terms, each monthly value from the prior 12 months is included in the equation. When a new value is released, the oldest value is removed. With that in mind, the chart below provides a visual of monthly CPI values since June 2021 and shows how much larger they typically were compared to 2023. It makes sense then, as those larger values have been removed and replaced with smaller values, why we've seen a significant decline in CPI.

However, now that the June 2022 CPI data has rolled out of the equation, you can see how the task of reducing inflation further becomes more difficult. For example, with a zero value rolling off from July 2022, unless we experienced deflation in July 2023 (set to be released on Aug. 8, 2023), we will see the first uptick in inflation during the past year. Additionally, with annualized inflation through the first half of 2023 tracking at 3.4%, it's possible that getting inflation down from 9% may have been the easy task for the Fed. Getting it from 3% to 2% could prove significantly more difficult.

Thankfully, despite all of the rate hikes, the economy is stronger than most would have envisioned. First-half GDP substantially outpaced the Fed's projections and the job market remains strong with the unemployment rate only slightly off the cycle low. If inflation does struggle to reach 2%, it's possible the overnight rate may remain restrictive for longer than anticipated. That may catch up with the economy eventually, but for now, a soft landing is still possible.



Positives

CPI and Producer Price Index (PPI) for June both came in lower than expectations (0.2% and 0.1% respectively)

After declining in Q1, productivity increased by 3.7% in Q2

The unemployment rate unexpectedly decreased to 3.5%

Negatives

Retail sales disappointed in June, trailing estimates by 0.3% (0.2% vs. 0.5% est.)

ISM manufacturing and services both missed expectations (46.4 and 52.7 respectively)

Revisions to nonfarm payrolls decreased the prior two months job totals by 49,000

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OUTLOOKS

August 2023

EQUITY OUTLOOK

Summary

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Higher valuations for stocks does set up the possibility of higher volatility as we move through the next few months. Some possible catalysts for a move lower include a shift higher in the projected path of inflation, poor earnings results or guidance, or a negative geopolitical even. There are countless possibilities that could surprise.

Still, the backdrop for equity markets seems to be setting up quite nicely for the intermediate and longer-term periods. Corporate fundamentals are generally strong and a soft landing looks increasingly possible. Conditions look entirely more opportunistic than most thought they would 12 or even six months ago.

Positives

- Soft landing increasingly likely
- Resilient corporate earnings
- Market breadth continues to widen

Negatives

- China recovery has fallen flat
- Core inflation more stubborn
- Near term equity valuations stretched

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OUTLOOKS

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FIXED INCOME OUTLOOK

Summary

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economies on much firmer footing compared to the 2011 U.S. downgrade by S&P Global Ratings, we believe the downgrade by Fitch Ratings is unlikely to put substantial pressure on Treasury yields or credit spreads. On the other hand, significant levels
of new debt issuance announced by the Treasury to fund the ballooning deficit will likely continue to pressure the market and could push yields slightly higher. Combined with a modestly higher issuance of corporate bonds, buyers will need to be enticed to buy longer-maturity notes and move away from very short-term yields.

Positives

The Fed rate-hiking cycle is likely complete.

U.S. investment-grade corporate bonds yield almost 5.5% in aggregate

Negatives

Significant issuance to fund ongoing deficits and rebuild government cash

At the margin, the U.S. government downgrade could reduce international demand

Unknowns

Impact of tighter lending standards on the economy

Russia/Ukraine war impact of commodity prices and inflation

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