JULY 2023 MARKET REVIEW

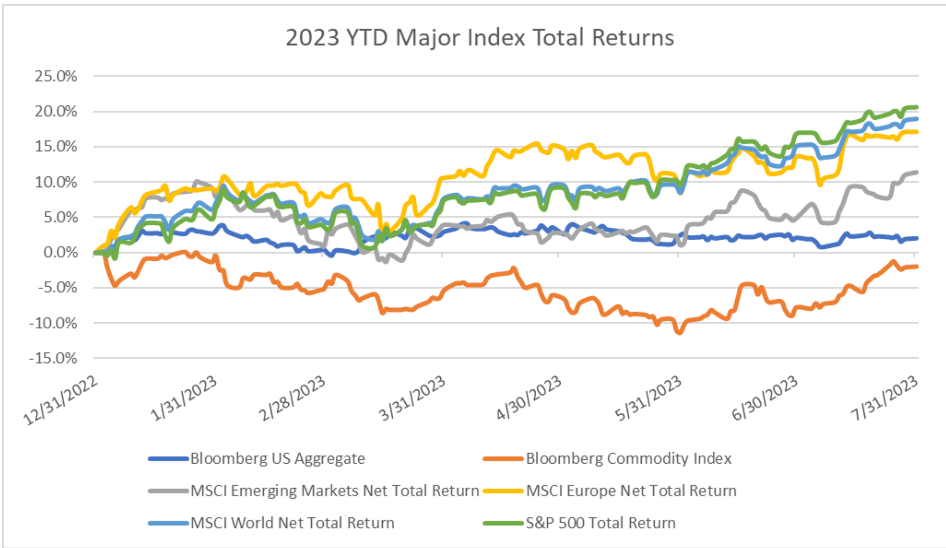
Market Recap: The past month has seen widely telegraphed events in markets surrounding the earnings season and Fed policy; that is, until last week when Fitch (one of the three major credit rating agencies) downgraded the US government's credit rating, which caught the majority of investors by surprise. Before diving into the rationale for the downgrade and what it could mean moving forward, we do want to update our readers on what we feel are more important drivers of the economy: first, how companies are performing in a difficult environment, and second, the ongoing changes in central banking policy.

July turned out to be quite a strong month in equity markets as global equities returned 3.4%, while commodity markets advanced, and bond markets remained largely unchanged. Global equities were led higher by emerging markets while both US and European indices advanced over 3%. The earnings season in the US has been a mixed bag thus far; a higher number of companies are meeting or beating expectations on bottom-line earnings, however, the overall level of earnings in the S&P 500 has fallen for the third straight quarter. Top line revenue figures have held up better than earnings have; a sign that corporate profit margins are contracting as companies struggle to contain their costs. Earnings growth is expected to bottom in the current reporting season, and the aggregate level of earnings should increase in late 2023 and 2024, barring a recession.

On the central banking front, the Fed increased their policy rate by an additional 25 basis points and has signaled a preference to hold rates steady while remaining data dependent. The Fed continues to deploy their tools to reduce inflation in the US with some success; the US Consumer Price Index peaked in mid-2022 just above 9% and has now fallen to approximately 3%.

As we mentioned in our opening, the major news over the past week has been Fitch's downgrade of the US government credit rating. Fitch argues that the political divide in Washington has led to governance issues as evidenced by the recent near debacle surrounding the debt ceiling. Fitch also bases their decision on the level of government debt, which has increased at a faster pace than GDP. It is hard to argue with Fitch on either of these points, although the rating agencies have a poor track record of forecasting economic difficulties and they themselves have governance issues that may hinder their ability to provide independent ratings.

How does this impact our perspective? Our view is that the bases for Fitch's downgrade are widely known to investors, therefore it should not cause market panic. There should not be forced liquidations of US treasuries by institutional investors, and it is likely that the US dollar will maintain its status as the global reserve currency for the foreseeable future. We believe that after a brief period of higher-than-expected volatility driven by Fitch's decision, markets will return to a place where they are driven by fundamentals. In a research piece titled "Fitch is more obviously irrelevant than wrong", we feel that 22 V (one of our research partners) sums up the downgrade perfectly: "*They have no inside information about the US government, or especially any unique expertise, which means that their perspective is about as valid as yours or mine. In fact, the perspective they share is probably less valuable than yours or mine because they have a commercial interest affecting their communication strategy. So, let's not fall for the notion that something happened to the United States yesterday. The country was not downgraded, which is a bizarre grammatical form. It is more analogous with me giving an opinion on the January 2024 fed funds future, whose status is invariant to that.*"



Data Source: Y Charts

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