Weekly **Market Commentary**

THE WEEK IN REVIEW: July 4 – July 10

Markets post a strong week on hopes Fed will ease

The markets were going strong last week, buoyed by hopes that concerns over a slowing economy would be the catalyst for the Federal Reserve to back off raising rates. In case you haven't noticed, equity markets really hate higher interest rates, especially the tech stocks. Higher rates are a direct competitor to equities; they make doing business more expensive and result in lower profits for companies that borrow – and tech companies borrow a lot.

When rates were at zero, there seemed to be no other choice but to invest in stocks, since you were likely getting solid returns and dividends with little volatility. Now rates are on the rise and what seemed unthinkable a few years ago is reality. Locking in 3% and avoiding a tumultuous market now seems like a good idea to some investors.

Which brings us to last week's markets. The adage is "Don't fight the Fed," or you might say, "Don't fight the Fed when it's raising rates." That's what the stock market was doing last week. The assumption was that bad news was good news (more in the next section), in the sense that the Fed will change its posture on rates and blink because the economy is weakening and all the recession warning signs are flashing. Sure, the Fed might blink, but other things can happen, too – and the markets were in no mood to consider that last week.

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We continue to see yield curve inversions. Not every inversion results in a recession, but an inversion preceded every recession. The Fed minutes from its most recent meeting were released last week and reiterated that the Fed is poised to aggressively raise rates to combat inflation. With low unemployment and inflation at 40-year highs, it's hard to understand why the markets would consider a deceleration in the economy an appropriate reason for the Fed to slow its rate increases. The Fed clearly wants to slow the economy and will not stop until inflation comes down. We may start to see that happen this week when Consumer Price Index (CPI) and Producer Price Index (PPI) numbers for June are released, but it needs to be a trend. So it may take several months to see overall improvement on that front. By then the Fed could have moved another 150 basis points (75 in July and 50-75 in September), so markets could be unpleasantly surprised by then.

In the meantime, we're in a short-term bear market rally, because markets were tired of losing and decided enough is enough. Lower volumes and higher volatility are standard in the summer months, especially when most experienced Wall Street traders are taking vacations. The most recent rally could be another head fake from the markets, as there are a multitude of headwinds that could send us scurrying for cover before we can expect any change in the Fed's rate-raising stance.

Alternative Realities?

The Biden administration keeps citing strong job growth as a measure of economic health and saying the economy is strong. But here's where we are: First-quarter Gross Domestic Product (GDP) was finalized at -1.6%. The Atlanta Fed initially forecast +0.09% GDP growth for the second quarter, then revised the estimate to 0.00% and is now forecasting -1.2%. We should see the initial print of second-quarter GDP on July 28, and my guess is it won't be pretty. If that guess bears out, it will mark two consecutive quarters of GDP contraction and we'll officially be in a recession.

It's really no surprise: Inflation is at 40-year highs. Gas prices dropped slightly but are still painfully high. Consumer sentiment is at rock bottom, and wage growth continues to trail inflation, which means people aren't keeping up with price increases. Mortgage applications have dropped. Does that sound like a strong economy? The jobs being "created" are barely back to pre-pandemic employment levels, and that's not counting the job creation we could have had without the pandemic. These are jobs that were lost during the shutdown and are being filled because people have run out of savings and now have to go back to work.

We still have twice as many openings (11.3 million) as we have people to fill them, so there's a built-in bias to claim jobs are being created. The totality of the situation needs to be considered, not just one data point. Sure, you can claim jobs are being created, but what about all the other concerns afflicting the economy? If the administration doesn't take the economic conditions seriously and acknowledge the issue – while counting on the Fed to do this alone – it could put us on a course to experience a worse recession than we otherwise might have had.

Coming This Week

- June inflation readings are on tap this week. We'll see CPI on Wednesday, which was 8.6% in May and will likely remain at those levels because we were still hitting record gas prices well past mid-June. PPI numbers will be released on Thursday. Any meaningful declines in either number will be welcomed by markets and stoke more hopes that the Fed will ease on raising rates.
- The Atlanta Fed will release its Business Inflation Expectations right after the CPI release. If CPI is bad and the follow-up from the Atlanta Fed is bad as well, it could accelerate negativity.
- Other data this week includes mortgage applications on Wednesday plus consumer sentiment and retail sales on Friday.
- Fed members will be speaking all week. Any slip of the lip could worry markets.

Equities:	1 WK	YTD	1 YR	3 YRS	5 YRS
S&P 500	1.94%	-18.19%	-9.75%	9.43%	9.96%
NASDAQ	5.37%	-25.72%	-20.75%	12.50%	13.56%
DJIA	1.98%	-13.63%	-9.51%	5.25%	7.94%

Interest Rates:	7/8/2022	7/1/2022
UST 10 YR Government Bond Yield	3.08%	2.89%
Germany 10 YR	1.347%	1.336%
Japan 10 YR	0.254%	0.220%
30 YR Mortgage	5.67%	5.61%
Oil	$104.88/ppb	$110.27/ppb
Regular Gas	$4.88/ppg	$4.98/ppg

All data as of July 8, 2022

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