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Commerce Trust Market Brief with Scott Colbert
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Scott Colbert: Good morning. It's July 31st, the month is ending, and of course, the stock markets have been trending very, very positive, with risk on assets doing exceptionally well. What's driving the market up? We would say it's probably three "E's": 1) would be that earnings for the second quarter are coming in better than expectations; 2) economic growth remains reasonable if not surpassing expectations; 3) employment continues to grow.

How strong are these equity results? The S&P 500 (Index) is up over 20%. Small-cap stocks, as measured by the Russell 2000 (Index), are up over 13% and international stocks have been helped along too. Larger-cap international stocks are up over 15% and even emerging market stocks are up 11%.

The bond market hasn't hurt you either. It's up on a year-to-date basis despite the fact that short-term interest rates have risen. The Federal Reserve (Fed) now has bumped up the cash rate by 75 basis points (bps) as the year progressed in three 25 bps increases. The two-year Treasury is up about 40 bps, and the 10-year Treasury's up just a few bps. The Bloomberg aggregate, which measures the broad measure of all the fixed income investment-grade securities, is up nearly 2% and municipal bonds are up closer to 3% now on a year-to-date basis.

In terms of earnings, the expectations were already lowered by quite a bit. Expectations were that S&P 500 earnings would come in down 9% on a year-over-year basis. Fortunately, they're doing better than that. They're only down 7%, and you might suggest, well, they're still down. Why would the stock market react positively? Well, over half of the reporting companies so far have beat their earnings estimates, and of course, anytime you're surpassing earnings estimates, the market has the potential to recover. In addition, most investors were positioned in a defensive manner. In fact, money has been flowing out of the U.S. stock market. Basically, the earnings beat, even though it was still down, was an important catalyst to continue this marvelous return that we've had so far in the S&P 500.

In terms of the economy, we just got the report on second-quarter growth. It came in at 2.4% on an annualized basis, and of course, that's about 60-65 bps of positive growth just for the quarter. This was also ahead of expectations where economic growth was only projected to grow at 1.8%. Driving this was very solid personal consumption, the big driver of GDP (gross domestic product), which was up 1.6%. But the real outstanding part of this GDP report was business investment in fixed-type assets. Businesses are investing in their plant, they're investing in their capital equipment, they're investing in software. Driving this is probably that CHIPS (and Science) Act, which, of course, has started building out different semiconductor plants across the United States, and the Inflation Reduction Act which is spurred investment in basically infrastructure.

In addition, nominal growth on a year-over-year basis came in at 6.3%, down from 7.2%. Okay, growth is cooling, but inflation is falling even faster. The GDP deflator the prior quarter was 5.6% for the full year, and now it's down to 3.6%. If inflation falls quicker than growth, we continue to have this positive economic expansion, and we all know we continue to create jobs.

Last month, we created 209,000 jobs. Now that happened to be the lowest amount of jobs created in this entire recovery, but at 209,000 jobs in a month, that is still higher than the average of the entire recovery post the subprime crisis into the pandemic (2009-2020.) In addition, on a year-to-date basis, we've created 275,000 jobs per month, and even more important, some of those cracks that had been showing up in employment seemed to have disappeared.

Every week, those people that lose their jobs show up for unemployment. Initial unemployment claims though have been falling from their high of about a four-week moving average of 255,000 down to something closer to 233,000. You might say, "Well, that doesn't sound like much difference," but a drop of newly unemployed in terms of 20,000 in a week. 20,000 in a week times four is 80,000. That means we have to create 80,000 less, fewer jobs just to keep everybody employed. It's a strong indicator that the economy continues to move in a very positive forward direction.

Finally, let's quickly talk about the last Fed meeting. Everybody knows by now that they bump(ed) rates up another 25 bps, the third time (in 2023) they pushed rates up. Short-term cash rates now are in the range of 5.25 –5.50%. The biggest takeaway from that meeting, though, is probably two things. Number one, they certainly haven't taken the option of adding an additional rate hike this year off the table. The markets don't think the Fed will do that, but I will tell you if growth continues on the same pace that it is, inflation continues to cool, they're likely to take advantage of this and still raise rates one more time. Secondly, the internal folks at the Federal Reserve now have taken a recession off the table for the year.

That's big news because internally at the Federal Reserve, they had been predicting a recession. Why is it being pushed back? Probably three reasons: 1) all the stimulus was provided to push us forward; 2) the demographics that afford us the ability to keep low unemployment with modest job growth, and probably the third thing that we don't hear a lot about is that during the ultra-low interest rate environment that we've had over the last decade or so, people termed out their fixed rates. Almost all mortgages out there are exceptionally low fixed rate.

Corporations weren't silly. They extended their average maturity to the longest the average corporate bonds have ever been. It's now 12 years. Even our own Federal Reserve pushed the treasury debt stack out. In other words, these fixed-rate, lower coupon financings that are out there are taking a long time to react to the higher interest rate environment that we have today.

As always, there's a lot of economic news to digest and we'll be back in a couple of weeks to see how the financial markets are adjusting to it.

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