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July 2023 Recap

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PRELUDE

What does a "soft landing" mean for the U.S. economy? If you follow the excitement around the upside surprise in U.S. economic data, it may seem like we will never see another recession again. And yes, it certainly feels like we are achieving that elusive soft landing while raising rates to levels not seen in 22 years. Yet, I cannot help but to ask, "then what?" The unbridled enthusiasm seems to suggest that we are barely going to touch the runway and then take off immediately to new economic heights. But the truth is that the full impact of all the rate hikes have not yet been felt on Main Street, and the Fed acknowledged this fact when they raised rates by 25 basis points on July 26th[1]. It may feel good right now, but what follows may not be painless. In a highly levered economic system such as ours, we cannot be lulled into complacency when the very cost of leverage has soared. The story may have another chapter. So, all those headlines that mention a "soft landing" or a "goldilocks" scenario for the economy may be communicating a premature conclusion at this time.

GLOBAL EQUITY

On the heels of June's gains, equity markets continued to advance in July. The U.S. markets saw a general broadening of the bullish sentiment, responding positively to the excitement of the soft-

TABLE 1: **Global Equity**	JUL	QTD	YTD	1 YR
Dow Jones Industrial Average	3.44	3.44	8.55	10.62
S&P 500 Index	3.21	3.21	20.65	13.02
Russell 2000	6.11	6.11	14.67	7.87
Russell 1000 Growth	3.37	3.37	33.36	17.31
Russell 1000 Value	3.52	3.52	8.82	8.28
MSCI ACWI USD	3.66	3.66	18.10	12.91
MSCI EAFE USD	3.24	3.24	15.28	16.79
MSCI EM USD	6.22	6.22	11.42	8.35
MSCI ACWI ex US USD	4.06	4.06	13.92	13.41

Source: Bloomberg, as of 7/31/2023. Past performance does not guarantee future returns.

1 FOMC Statement, July 26, 2023
2 FactSet Earnings Insight July 28, 2023

landing narrative. The Russell 2000 Index, representing small cap stocks gained 6.1% for the month, outperforming the S&P 500 Index by nearly 300 basis points. Cyclical areas of the market, such as the Energy, Financials, and Industrials sectors also rose at the prospect of a more favorable economic backdrop. The equity market rally, however, was a pure multiple expansion play as the underlying earnings environment remained recessionary. With 51% of companies in the S&P 500 Index reporting as of July 28th, the blended earnings growth on a year-over-year basis is -7.3%[2]. If the earnings profile finishes the second quarter reporting season with a year-over-year decline, that would mark three consecutive quarters of negative earnings. A momentum-driven rally with a weak earnings backdrop renders the equity markets vulnerable to future shocks and volatility.

International markets fared well for the quarter, with the MSCI EAFE Index rising in line with domestic large cap equity and the MSCI EM Index benefiting from pledges of stimulus from the Chinese government. The weakness in China's economy has been a source of worry for investors. The reopening from China's zero-COVID policy has been a disappointment, and the heavily indebted nation may be walking into what many are calling a balance sheet recession where assets are directed to de-levering rather than real consumption and investment. In July alone, we saw China miss its GDP growth expectations as well as flash deflationary signals. In order to support its struggling economy, Beijing may implement targeted stimuli, focusing on personal consumption and the real estate sector. While equity markets have rallied on the potential boost, the real impact on China's growth potential remains to be seen. And in a globalized economy, the fate of the second largest economy has an effect on the countries that rely on China's strength, many of which are on the European continent as well as in other emerging markets.

FIXED INCOME

U.S. Treasury yields moved little, resulting in small variance around zero return for most fixed income indices. The Bloomberg U.S. Aggregate Bond Index fell on the red side of the ledger with a 7-bp loss, while credit-oriented indices benefited from narrowing spreads. Once again, Bloomberg High Yield Corporate Bond Index came out at the top with a 6.8% return year to date, aided by the 1.4% gain in July. After a brutal year in 2022, it is nice to see positive returns for fixed income, but the general headwind for the asset class has continued halfway into 2023. The "higher for longer" monetary policy from the Federal Reserve and the persistent inflationary pressures in core areas of the economy have continued to put pressure on bond prices this year.

TABLE 2: **Fixed Income**	JUL	QTD	YTD	1 YR
Bloomberg US Aggregate	-0.07	-0.07	2.02	-3.37
Bloomberg 1-3 Yr Gov/Credit	0.42	0.42	1.56	0.42
Bloomberg Treasury 5-7 Yr	-0.10	-0.10	1.21	-4.17
Bloomberg Investment Grade Corp	0.34	0.34	3.56	-1.30
Bloomberg High Yield Corp	1.38	1.38	6.83	4.41
JPMorgan EMBI Global Diversified	1.91	1.91	6.08	6.37

Source: Bloomberg, as of 7/31/2023. Past performance does not guarantee future returns.

The message from the FOMC statement in July was just as hawkish as the June statement. In summary, the Fed believes that the economic growth is "moderate" and inflationary pressures remain a concern. While raising the fed funds rate by 25 bps, the Fed emphasized the need to be "data dependent," leaving the door wide open for flexibility. Looking back, I wonder why the Fed paused in June when nothing of substance could change in a month's time. Perhaps the Fed is slowing itself down as it reaches peak rate policy and the end of this hiking cycle. From that perspective, waiting to see the full impact of the policy changes would be a good idea. After all, average mortgage rates have jumped from 2.8% to 7.4%[3], and high yield corporate borrowing cost has gone from 3.5% to 8.3%[4] in about a two-year's time. We are an economy that runs on leverage, so a dramatic rise in borrowing cost is expected to have a sizeable impact on the economy in due time. So "wait and see" may be the best monetary policy at this point in time.

POSTLUDE

Perhaps it is the summer heat that has created a mirage of a perfect economic scenario where we can have our cake and eat it, too. We can raise rates *and* achieve growth simultaneously! But here is the thing – the story may not be over. Where I live, August brings a hint of cool air back into my surroundings, and I know that the chapter on my summer is coming to an end. The cooler air of the fall months may restore sobriety back into the markets and bring to focus the gulf that has emerged between earnings and market performance. And only time can reveal the true impact of the rate hikes that began in early 2022. In uncertain times when markets diverge from fundamentals, keeping the portfolio diversified in terms of asset class exposure remains crucial. Operationally, re-balancing the portfolio and good cash management for near-future liabilities are prudent tactical moves. No one knows what the fall months will bring with the cooler temperatures, but for portfolio management, the list of best practices remains tried and true.

3 Bankrate 30-year fixed mortgage rate, low on 2/9/2021, high on 7/7/2023
4 Bloomberg U.S. Corporate High Yield Index Yield to Worst, low on 7/6/2021, latest 7/31/2023

Anna Rathbun serves as the Chief Investment Officer for CBIZ Investment Advisory Services. Her tenure with the firm has spanned economic and market research, portfolio construction, and creating insights in investment themes to share with the investment community. Anna began her career in investments at Wellington Management, and subsequently, Harvard. She has served as a Managing Director for a registered investment advisory firm where she specialized in alternative investments. She is a graduate of Harvard University with a B.A. in Economics. Her early passion for the arts led her to classical music, for which she obtained a Master of Music and Doctor of Musical Arts from the Cleveland Institute of Music. Anna's career in music spanned a wide spectrum of performances to a faculty position at her alma mater. With a unique background that embraces both finance and the arts, Anna is dedicated to the issue of financial sustainability for organizations serving a mission.