OBSERVATIONS

- Big rally across most asset classes. The S&P 500 gained +9.4% and small cap stocks (Russell 2000) rose +10.5%, the best month for both indexes since November 2020.[1]
- Meanwhile, the aggregate bond market (Bloomberg Aggregate) rose +2.4% in July, the index's best month for 2022. High yield bonds rose +5.9% in July — the best month since late-2011.[1]
- Since peaking near 3.5% in mid-June, the 10-year U.S. Treasury yield has declined by over 80bps to 2.65% as markets continue to digest the Federal Reserve's growth and inflation policy conundrum.[1]
- Sales of new homes — which account for about 10% of the housing market — declined by -8.1% month-over-month in June to an annualized rate of 566k homes. Meanwhile, inventories of new homes for sale climbed to 457k, the most since 2008.[1]
- There are currently zero countries with inflation below 2%, while in the pre pandemic period that figure stood at 80% of the world's countries having inflation rates below 2%. While much of the blame has rested with the fiscal and monetary policy response, supply chains and energy has been the more material culprit on a global basis.[2]
- Core Personal Consumption Expenditures (PCE, the Fed's preferred measure of inflation) rose 0.6% month-over-month and now stands +4.8% on a year-over-year basis. Core PCE peaked (at least as of today) in February at 5.3%.[1]
- Michigan's consumer sentiment Index increased to 51.5 from June's historic low of 50.0, but the one-year economic outlook index fell in July to the lowest levels since 2009.[3]

EXPECTATIONS

- The International Monetary Fund (IMF) reduced expectations for world GDP growth by -0.4%. The IMF now expects global GDP growth of 3.2% in 2022 while inflation expectations are expected to be 6.6% and 9.5% for advanced economies and emerging economies, respectively.[4]
- The Federal Reserve, as expected, raised its main policy benchmark interest rate by 75bps to 2.5%. The central bank maintained its data dependent reaction function, with Chair Powell noting that "while another unusually large increase could be appropriate at our next meeting, that is a decision that will depend on the data." Fed Funds futures markets continue to price in a year end fed funds rate of 3.25%. The Fed does not meet in August, with the next policy meeting coming in late September.[5]
- Earnings season continues onward, 56% of S&P companies have reported earnings with 73% beating earnings expectations and 66% beating revenue expectations, both figures are below the five-year 'beat rates' of 77% and 69%, respectively.[6]

ONE MORE THOUGHT: *As expected GDP contracts during Q2*

Last week the Bureau of Economic Analysis (BEA) reported that the U.S. economy (as measured by GDP in real terms – inflation adjusted) declined by -0.9% in Q2, this follows a -1.6% decline in Q1. This has many suggesting that the U.S. economy is in a recession given the popularized technical definition of recession being measured by two

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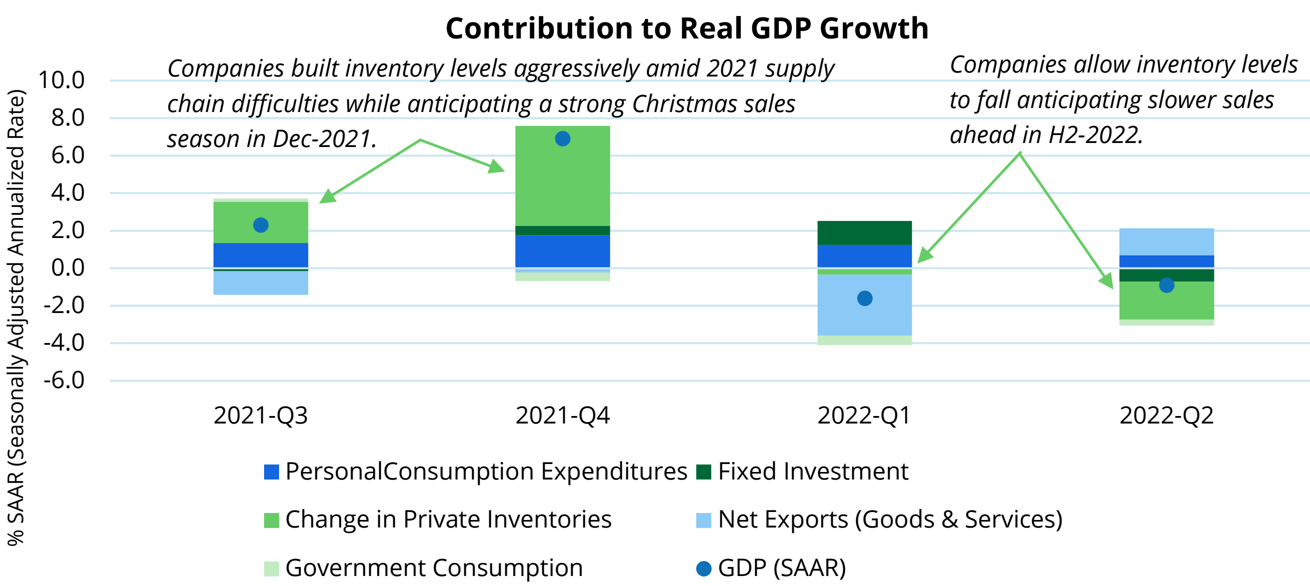
[1] *Bloomberg LP 29-Jul-2022*
[2] *Apollo Global Management (h/t Torsten Slock)*
[3] *http://www.sca.isr.umich.edu/*
[4] *https://www.imf.org/en/Publications/WEO/Issues/2022/07/26/world-economic-outlook-update-july-2022*
[5] *Bloomberg LP, Federalreserve.gov*
[6] *FactSet Earnings Insight 29-Jul-2022*

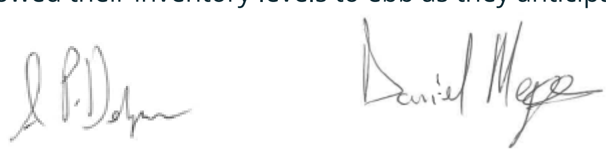
sequential negative quarters of GDP growth. What differs this time around is the significant nominal growth the economy continues to experience. In nominal terms, GDP expanded by 6.6% and 8.2% for Q1 and Q2, respectively — not insignificant figures by any stretch. Once adjusted for inflation however, we arrive at the negative real growth rates in GDP. This nuance is important for a few reasons. First, the likelihood that the National Bureau for Economic Research (NBER, official business cycle dating committee) calls this current period a recession is low. Employment, wages, and consumption remain strong and other manufacturing and services related data continue to point towards economic expansion, albeit at a slower pace. Second, strong nominal growth means strong reported corporate profits which in turn means higher corporate tax receipts. Lastly, the risks to the economy become heightened as nominal growth slows and inflation remains high, so the risk of recession mount as those factors, while oversimplified, evolve. We are still in the camp that the probability remains low for a recession this year, with those odds rising into next year. Importantly, for investors, markets as leading indicators will have done their job well in advance of any confirmation from economists of an actual recession.

CHART OF THE WEEK



Source: Clearstead, BEA 28-Jul-2022

The building of inventories (light green) played a key driver in the strong growth in the economy in H2-2021, but in 2022 companies' have allowed their inventory levels to ebb as they anticipate slower growth in H2-2022.



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