<u>OBSERVATIONS</u>: *Markets maintain positive momentum, consumers still spending.*

- Markets continued their positive momentum with the S&P 500 tacking on +0.7% for the week—the S&P has gone 40 straight days without a -1% or worse decline, a stretch last seen in late 2021. Small cap (Russell 2000 Index) gained +1.5%, while regional banks (KBW Regional Bank Index) jumped +7.3%.[1]
- China Q2 GDP registered +0.8% growth on a quarter-over-quarter basis, bringing year-over-year (YoY) growth at +6.3% which was below expectations of +7.1%. Notably, China's youth unemployment rate (ages 16-24) increased to 21.3% in June from May's reading of 20.8%.[2]
- Retail sales (ex. auto and gas) rose +0.3% on a month-over-month (MoM) basis in June, in line with expectations. More relevant, the retail sales control group—the figure that feeds into GDP—was up +0.6% in June MoM, which was better than estimates of +0.3% MoM and twice the growth rate of May.[1]
- Industrial production declined in June across all three categories—manufacturing, mining, and utilities—on a MoM basis from May. Capacity utilization also fell in June to 78.9% down from May's 79.4% reading.[1]
- Housing starts fell to a 1.434 million annualized rate which is down -8.0% from May's surprisingly strong reading of 1.559 million units. Similarly, new housing permits also declined in June to 1.44 million permits (annualized rate), down -3.7% below May's figure.[1]
- Existing home sales also disappointed last week, registering 4.16 million home sales (annualized rate) which was below expectations and represented a -3.3% decline MoM from existing home sales rate in May.[1]
- The Conference Board's Leading Indicators Index declined slightly more than the consensus expectations falling -0.7% MoM in June and May's initial estimate was revised down to show the same monthly decline (-0.7% MoM) from April's level—this is the 15th consecutive month of MoM declines for this index.[1]

<u>EXPECTATIONS:</u> *Special rebalance for the Nasdaq index, Fed meets this week*.

- The Nasdaq 100 (an index of the largest 100 Nasdaq listed non-financial companies) announced a special rebalance of the index and will go into effect today (7/24). The "magnificent seven" accounts for 55% of this index and the concentration has breached its index methodology rules. A special rebalance has only occurred twice before, 1998 and 2011. Post rebalance, the "magnificent seven" will see their weights in the index decline led by Nvidia and Microsoft, which will see their respective weights drop by nearly 3% each.[3]
- The Fed will meet Tuesday and Wednesday and markets have priced in a 96% chance that the Fed raises its benchmark policy rate by +25 basis points. Markets will be looking for clues from Chairman Powell's subsequent press conference as to whether or not the Fed is likely to hike any further this year—currently markets only forecast a 1-in-3 chance that the Fed hikes further in 2023 after this week's anticipated hike.[1]
- About 90 companies have reported earnings thus far and 75% have reported positive earnings surprises—which is above the 10-year average of 73%, and as of now, full Q2 earnings growth is forecast to be -9.0% YoY.[4] This week another 166 companies will report their Q2 earnings.

<u>ONE MORE THOUGHT</u>: *Back to the basics. 2023 has been all about valuation expansion: A mirror image of 2022.*[5]

The market's strength this year has been confusing for most investors considering the uncertain, though resilient, economic backdrop. This year has been mostly about changes in valuations, resembling 2022—though in the

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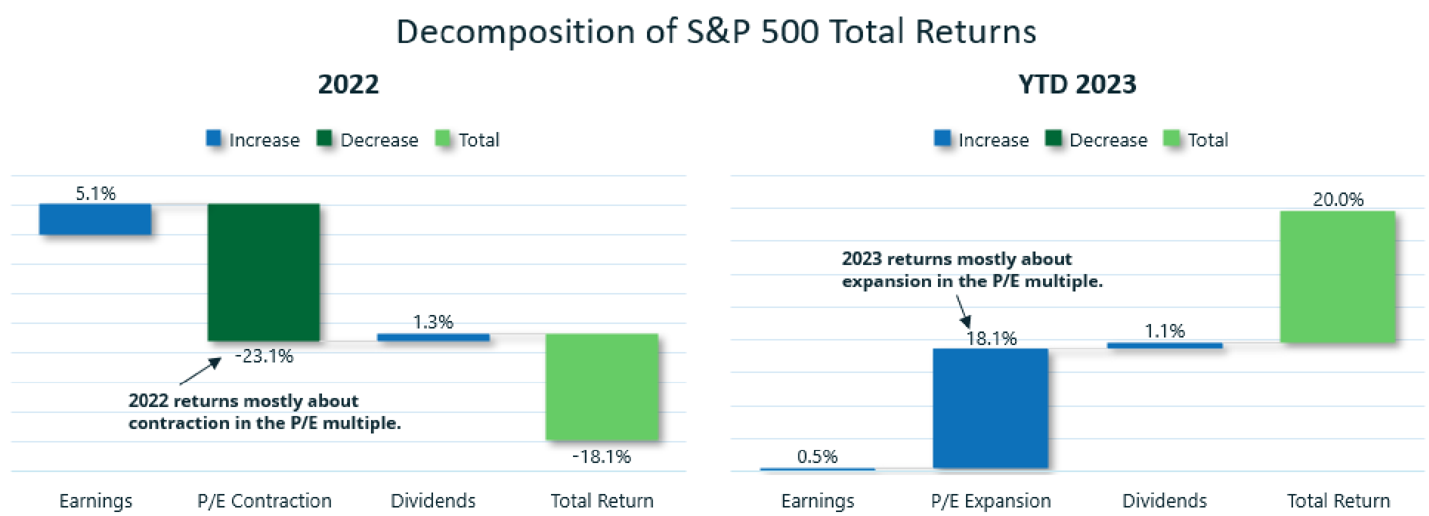
[1] *Bloomberg LP*
[2] *https://www.wsj.com/articles/chinas-economy-barely-grows-as-recovery-fades-5652a92a?mod=hp_lead_pos1*
[3] *https://www.morningstar.co.uk/uk/news/237279/index-investors-beware-the-nasdaq-is-rebalancing-next-week.aspx, https://www.ft.com/content/35dae6f7-9554-442d-abfa-608adcbc72aa*
[4] *Factset Earning Insight 7/21/2023*
[5] *Clearstead, Bloomberg LP, return data as of 7/19/2023*

opposite direction (more on this in a moment). Year-over-year changes in stocks can be very volatile and heavily influenced by changes in valuations, and over the long term we expect the primary return drivers to be oriented towards fundamentals (i.e., earnings growth and dividends). To be sure, valuation changes over short periods of time make it tough to figure out if investors are just experiencing volatility rather than experiencing durable long-term returns. Rising interest rates and rising inflation hurt valuations (Price-to-Earnings multiples or P/E) in 2022, while falling inflation and stable interest rates have been generally supportive of P/E multiple expansion thus far in 2023 (Chart of the Week). A byproduct of the general volatility in P/E multiples has led to big differences between growth and value stocks with growth having a tough year and value generally outperforming in 2022 and the opposite happening in 2023 to date. In 2022 the Russell 1000 Growth index (-29.1%) lagged the Russell 1000 Value index (-7.6%) by -21.6%, while in 2023 YTD the Russell 1000 Growth index (+33.8%) has outpaced Russell 1000 Value (+7.3%) by +26.5%. Join the two periods together and cumulatively since January 2022, growth stocks (Russell 1000 Growth -5.2%) are losing to value stocks (Russell 1000 Value -0.8%) by -4.4%, thanks to the effects of compounding. Back to the broader market, given that so much of what we have seen in markets has been a result of valuation changes, the path forward for markets likely hinges more on earnings than on continued P/E expansion.

CHART OF THE WEEK



Source: Clearstead, Bloomberg LP, Multiplicative decomposition of S&P 500 Total Return from earning growth (2023 earnings growth based on current consensus estimates for CY 2023), dividends (2023 YTD dividend accruals), and change in P/E multiple, as of 7/19/2023, Past performance is not an indicator of future results.

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