August Market Update

We hope this email finds you well! Stock market bulls were on parade again in July in the U.S. financial markets. With so much activity, let's review with a brief market recap.

Major U.S. Stock Indexes

The recent market rally showed signs of broadening throughout July, with underappreciated sectors like industrials and transports filling the shopping lists of eager bulls.

Buyers were consistent throughout the month, with the S&P 500 notching three straight weeks of gains during July and the Dow Jones Industrial Average booking thirteen consecutive positive trading sessions.

For July, the mega-cap tech-heavy Nasdaq 100 increased by 3.81%, the S&P 500 was higher by 3.11%, and the Dow Jones Industrial Average increased by 3.35%.

Valuation Considerations

With such a sharp rally recently in the major U.S. stock indexes, many prospective investors are wondering: “What may be a good investment at these levels?”

There is no doubt that the recent market rally has been fueled by a combination of cooling inflation, a potentially nearly-complete Fed hike campaign (more on that in a minute), and AI/tech stocks.

The Magnificent 7

FAANG stocks are so 2020.

Now, the new buzz term is “The Magnificent 7”, referring to Alphabet, Amazon.com, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla.

Consulting valuations, we can see that the price/earnings (P/E) ratio for the “Magnificent 7” group of stocks is around 112 as of July 19th, indicating that investors are paying around $112 for each dollar of corporate earnings.

While there are no exact rules, generally, a lower P/E ratio is considered a better investment, with the average resting around 20 to 25.

Some contend that AI advancement justifies these price-to-earning multiples. However, others are seeking additional opportunities aside from the Magnificent 7, and perhaps we have been seeing signs of that with the market rally broadening out recently.

July Rate Hike

Meeting market expectations, the Federal Reserve raised the U.S. benchmark lending rate by 0.25% at its July meeting. The most recent interest rate hike comes after a pause in the June meeting and brings the Fed’s target interest rate range to 5.25% - 5.50%.

Jerome Powell, the chair of the Federal Reserve, emphasized the Fed needs to see evidence that inflation is "durably down" and stated that the central bank would be assessing interest rates on a “meeting-by-meeting” basis.

While there is no crystal ball, markets are pricing in a better-than-even probability that there will not be any more rate hikes this year. However, it is too early to tell.

The July Fed rate hike brings the U.S. benchmark interest rate to its highest level in 22 years.

Jobs Growth

Nonfarm payrolls for June (released on July 7th) missed analyst expectations, showing 209,000 jobs created versus 240,000 expected.

The weaker-than-expected employment data could help the Fed achieve a soft-landing for the U.S. economy.

More Inflation Moderation

CPI: Are you noticing any changes in the pricing of items you have purchased lately?

According to the latest June Consumer Price Index (CPI) data, inflation has been cooling for twelve consecutive months. Notably, we observed a softening in inflation in areas such as food, used vehicles, and airline prices at the last reading.

- CPI increased only 0.2% month-over-month versus the 0.3% expected.
- CPI increased 3% from one year ago versus the 3.1% expected, the lowest level since March 2021.
- Core CPI (excludes food and energy) rose 4.8% from one year ago.
- Food prices are still higher by 6.7% from a year ago.

So, the year-over-year CPI metric decreased from 4% in May to 3% in June, fueling investor optimism.

Core PCE: The Fed's favorite inflation gauge dropped to its lowest annual level in nearly two years last month, rising by 4.1% from one year ago versus estimates for 4.2%.

Markets reacted positively to the PCE data indicating that inflation has cooled further.

The Takeaway

July featured the overall stock market rally spilling over to other sectors and industries outside of AI and tech.

The Fed will remain data-dependent on a meeting-by-meeting basis, per the commentary from the last meeting. With labor market data missing expectations last month and cooling inflation metrics, one could deduce that the Fed's plan has been working. Investors will continue to look for clues of the Fed completing its rate hiking cycle, but it is too early to know with any certainty.

With that said, remember – long-term investing works. We don't have to worry about chasing current market themes or stories; success lies in discipline, a balanced portfolio, and having a long-term strategy. Together, we have that.

However, if there is anything on your mind that you would like to discuss, please don't hesitate to reach out to your advisor.