CERITY PARTNERS®

# Economic & Market Update

AUGUST 2023 OUTLOOK

- The U.S. economy is showing surprising strength despite aggressive central bank monetary tightening, pushing recession forecasts further out.
- Despite slowdowns in some sectors, consumer strength continues to drive positive GDP growth.
- Challenges persist in Europe and China, while the U.S., Japan, and emerging economies are maintaining economic growth.
- In terms of fixed-income securities, we remain cautious in this environment.

**ceritypartners.com**

## GLOBAL ECONOMY

- The surprising strength of the U.S. economy in the face of aggressive central bank monetary tightening has pushed most recession forecasts out until early next year. It is possible that the economy will avoid a broader recession in gross domestic product (GDP), as it is likely already experiencing “rolling recessions” among various sectors. Housing fell into recession last year due to the sharp spike higher in mortgage rates, but the sector has bottomed and may be starting to turn up this year as the secular demand of first-time homebuyers remains strong. Capital spending in the manufacturing sector may be falling into recession around now according to the purchasing managers’ surveys, but the reshoring trend has already led to a surge in the building of manufacturing structures, which should make any downturn relatively short and shallow.
- The strength of the consumer and its impact on the services sector of the economy has prevented recession so far this year and will continue to drive positive GDP growth in the second half of 2023. This consumer strength may impede progress on services inflation although goods price inflation has declined to virtually zero with some goods in outright deflation. Recent increases in certain commodity prices in the energy, agricultural and industrial metals categories may also cause some stalling in the progress of bringing inflation down to the Federal Reserve’s 2.0% target.
- European growth has slowed to a trickle as Germany, the largest economy in the bloc, has fallen into recession. Inflation is at risk of becoming entrenched due to the relative strength of labor unions in the United Kingdom and on the continent, with recession being perhaps the only option remaining in bringing inflation down to target levels.
- A weak Japanese yen and continued global economic growth led by the United States has supported the Japanese economy year to date with no recession, but continued slow growth is expected for the remainder of the year.
- The Chinese economy did not receive the jolt many had expected when the government removed the draconian COVID-19 mobility policies as consumers remained wary.  Continued trade frictions with the United States and turmoil in the property market were additional factors. While the economy continues to grow at rates that would be the envy of most developed market economies, it will take a combination of more aggressive monetary and fiscal policies to bring the economy back to its long-term potential growth rate.

## MONETARY POLICY

- After having paused its rate hikes at the June Federal Open Market Committee meeting, the Federal Reserve (Fed) increased rates another 25 basis points (bps) at the July meeting, taking the federal funds rate to a range of 5.25%–5.50%. With no meeting in August and continued improvement expected in the July and August inflation statistics, the Fed is likely to again skip a meeting—with no rate increase announced in September. November will remain in play for another potential rate increase, but there will be much inflation data between now and then to confirm continued progress toward the 2% inflation target.
- Inflation is declining in Europe but remains at a much higher level than seen in the United States, which presents both the European Central Bank and Bank of England with the dilemma of having to continue to tighten into notably slowing economies. With each central bank having only a single mandate of achieving price stability, monetary policy may have to continue to contract despite the recessionary implications.
- The Bank of Japan at the end of July announced a slight tweak in its yield curve control policy. It will continue to target a 0% interest rate for the 10-year government bond, but the strict band of plus or minus 0.5% around that target will be relaxed and serve as more of a reference point. This appears to be merely the first step in the

rate normalization process that is expected to occur under the new governor Kazuo Ueda.

» In a relatively low-inflation environment, the People's Bank of China will continue to be pressured to support the economy with slight policy rate decreases, although it will keep a close eye on the impact of policy on currency and capital flows.

## BOND MARKETS

» Stronger-than-expected economic growth statistics have pushed interest rates higher across the yield curve with the 10-year U.S. Treasury recently moving above the 4.0% level. With no recession in the near-term forecast, some upward pressure on intermediate to longer maturity rates should persist over the coming months.

» Having passed the one-year anniversary of the initial inversion of the Treasury yield curve, this unusual occurrence is usually rectified by the Fed having to aggressively decrease interest rates to combat a recession that its tight monetary policies had a role in causing. While continued tightening into an economy that is already expected to slow remains arguably the biggest risk to financial markets, a more likely path to resolution of the inverted curve is the Fed being able to bring the federal funds rate—and subsequently shorter maturity rates—down, as inflation returns to target levels with intermediate and longer rates continuing to move higher to a more normalized level in a positive economic growth environment.

» Tighter monetary policy and the resulting slowdown in economic growth should lead to some increase in default rates in the high-yield debt markets as stretched corporate borrowers are forced to refinance at much higher rates. With yield spreads to Treasuries historically narrow, the risk/return dynamic in the space is relatively unattractive.

## EQUITY MARKETS

» With the equity markets in the United States moving closer to the highs established prior to the 2022 bear market, it is encouraging to see the recent broadening of participation in the advance beyond the top seven stocks in the technology, communication services and consumer discretionary sectors. A continued pickup in the relative performance of the more cyclical sectors of the market will increase conviction that this advance has moved beyond a bear market rally to a new bull market.

» The specter of continued monetary tightening regardless of the recessionary implications may be more of a relative headwind to European equities, although many of the companies in these markets are more leveraged to global economic conditions.

» Japanese equities have closely matched the year-to-date advance in the United States as Japanese yen weakness will help the earnings of the country's large multinational corporations. Any monetary-policy-induced end to the weakness may be a headwind to future performance.

» Disappointing growth and pressures in the property and banking sectors have been impediments to the performance of Chinese equities. Monetary and fiscal policy relief should be helpful moving forward. Latin American equities should be supported by the recent strength in commodity prices.

## COMMODITIES & CURRENCIES

» Increased demand in a still-growing global economy combined with supply cuts that appear this time to be truly taking hold exerted upward pressure on oil prices in July. Watch for U.S. shale producers to increase supply should crude oil break firmly above the $80 level. Better policy-induced growth rates out of China should help industrial metals continue to advance.

- The anticipated end of Fed tightening has helped drive the year-to-date advance in gold prices, but with rates expected to remain at high levels and other central banks maintaining tightening stances, it may be difficult for gold to sustain its strength at current price levels.
- The U.S. dollar is expected to continue to trade in the tight trading range it has been in all year. The relative economic growth advantage of the United States, which should benefit the U.S. dollar, should be effectively offset by incrementally tighter monetary policies by most other developed and emerging market central banks.

## WHAT THIS MEANS FOR INVESTORS

- Equity markets have benefited from this apparent Goldilocks environment of an economy that is strong enough to avoid recession but not so strong as to impede the natural process of bringing down inflation. Recession and a revival of concerns around deflation has probably become a larger risk to the markets than inflation so any confirmation that corporate earnings may be bottoming and beginning to advance will be key to the continuation of this bull market equity rally. We remain cautious around fixed-income securities in this environment and prefer the relatively high yields offered by cash and shorter-duration maturities.

Cerity Partners LLC (“Cerity Partners”) is an SEC-registered investment adviser with office locations throughout the United States. Registration of an Investment Advisor does not imply any level of skill or training. The foregoing is limited to general information about Cerity Partners’ financial market outlook. You should not construe the information contained herein as personalized investment, tax, or legal advice. There is no guarantee that the views and opinions expressed in this commentary will come to pass. The information presented is subject to change without notice and should not be considered as an offer to sell or a solicitation of an offer to buy any security. Material economic conditions and/or events may affect future results. All information is deemed reliable as of the date of this commentary but is not guaranteed. Before making any decision or taking any action that may affect your finances or your company’s finances, you should consult a qualified professional adviser. For information pertaining to the registration status of Cerity Partners, please contact us or refer to the Investment Adviser Public Disclosure website (www.adviserinfo.sec.gov). For additional information about Cerity Partners, including fees, conflicts of interest, and services, send for our disclosure statement as set forth on Form CRS and ADV Part 2 using the contact information herein. Please read the disclosure statement carefully before you invest or send money.

Indices or other financial benchmarks are provided for illustration purposes only. Indices are unmanaged, statistical composites and an individual cannot directly invest in an index. Any returns portrayed do not reflect the deduction of underlying investment expenses and third-party fees to purchase the securities they represent. Past performance is no guarantee of future results. Data from indices (i.e., the S&P 500) are supplied by third party suppliers. Cerity Partners does not attest to the accuracy or reliability of these numbers nor the methods of calculation from which they are derived. Investing in the financial markets involves risk, including the loss of the principal amount invested; and may not be appropriate for everyone.

Certain information contained herein concerning economic trends and market performance trends are based on or derived from information provided by independent third-party sources that, in certain cases, may not have been updated through the date of this information. While such information is believed to be reliable for the purposes used herein, Cerity Partners has not independently verified the assumptions on which such information is based nor assumes any responsibility for the accuracy or completeness of such information.

**ceritypartners.com/contact**

©2023 Cerity Partners LLC, an SEC-registered investment adviser. All Rights Reserved. (08/23)