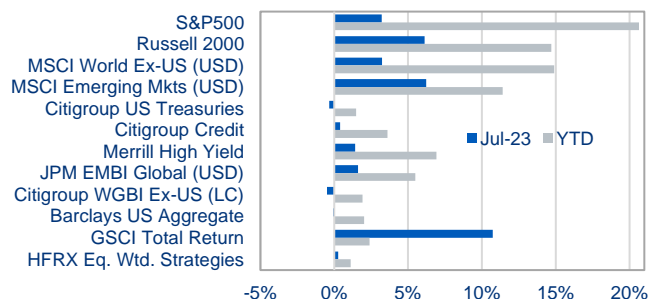


Global Market Review

Declining inflation and continued economic resilience kindled hopes of a soft landing in the U.S. and an eventual easing of monetary policy. Buoyed by these hopes, the U.S. equity market floated higher in July, raising the year-to-date gains on the S&P 500 to over 20%. Advanced and emerging equity markets also rallied, with the latter propelled by a sharp rebound in the Chinese market following an extended period of underperformance. Both the Fed and the ECB raised their policy rates again in July amid speculation, discounted by both institutions, that July's hikes might be the last of the cycle. Sovereign bond markets across advanced and emerging economies were mixed but overall little changed in July. U.S. high yield bonds rose modestly. Oil prices jumped 15.8% higher in July but are up only slightly in the year to date. Declining inventories, higher-than-expected demand, and continued supply cutbacks by Saudi Arabia and other producers contributed to July's oil price spike.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



Falling inflation and resilient growth send equities higher.

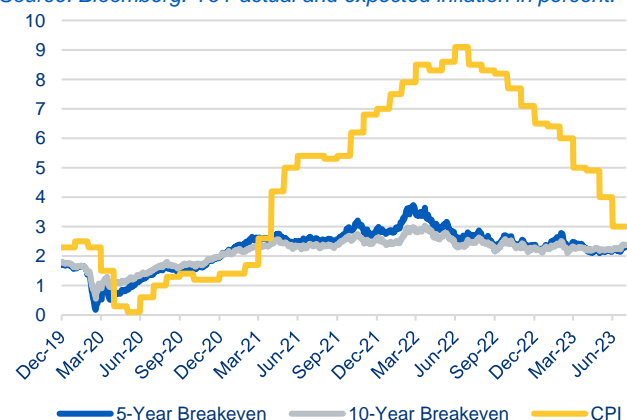
U.S. Equity Market Extends Strong Rally

The foundation for this year's U.S. equity market rally appears shaky. Equity prices continue to be driven by multiple expansion. Second quarter earnings, although mainly higher than expected, appear likely to decline significantly. With 51% of S&P 500 companies reporting, a blend of actual and expected earnings estimated by Factset points to a 7.3% decline in the second quarter. Moreover, the gains in the U.S. market are based on a small number of high-tech firms thought likely to profit from applications of artificial intelligence (AI). The FANG+ index of mega-cap tech stocks, including potential AI beneficiaries, is up over 80% so far in 2023.

The macro backdrop is mixed, and economic activity unbalanced. Leading economic indicators and the inverted U.S. Treasury yield curve point to a coming recession. Moreover, manufacturing output has contracted for eight straight months, and data on new orders point to continued sluggish demand. In contrast, an ongoing post-pandemic spending spree focused on services remains the wellspring of economic resilience. The purchasing power driving this spree has been boosted by declining inflation, which is rapidly converging toward the Fed's policy target and long-run, break-even inflation expectations priced in by the U.S. Treasury market (Exhibit 1). The easing in price pressures is raising hopes of Fed easing, providing a boost to asset prices.

Exhibit 1. CPI Converges toward Target and Expectations

Source: Bloomberg. YoY actual and expected inflation in percent.



Against this decidedly mixed backdrop for corporate earnings and the economy, the S&P 500 rose 3.2% in July, bringing its gain so far this year to 20.6%. Reflecting the lopsided nature of this year's rally, growth stocks are up 32.4% so far in 2023, compared with an 8.9% gain for value. Across sectors, tech and telecom stocks are up about 44%. Energy, utilities, and healthcare stocks, in contrast, have declined.

China's Strong Rebound Boosts Emerging Equities

The MSCI World ex-U.S. index of advanced equity markets rose 3.2% in July, bringing its total gain this year to 14.9%. As in the U.S., the macro backdrop across advanced economies is mixed. European manufacturing output is contracting, sentiment is sour, and overall economic growth has been barely positive. Inflation in the euro area, although declining, remains well above the ECB's policy target, prompting a further hike in July to a record 3.75%. The ECB is signaling that the latest increase will not be its last. Despite this mixed picture, European equities climbed further in July to bring gains so far this year to 17.1%. As in the U.S., optimism that declining inflation will bring an end to the monetary tightening cycle is a catalyst for these gains, notwithstanding continued high inflation and the ECB's warning that more hikes are likely.

Japanese equities are also up solidly this year (16.4%), but against a much different macroeconomic backdrop. The surge in global inflation has brought a welcome reprieve from deflation for Japan, raising speculation that the Bank of Japan will end its longstanding policy of yield curve control that has been a major source of liquidity to the Japanese and global markets for many years.

Emerging market equities surged 6.2% higher in July, led by the Chinese market's 10.8% gain (Exhibit 2). A faltering Chinese economy had been weighing on the broader emerging equity market index, which, after July's jump, is up 11.4% for the year. Signs that the Chinese authorities are prepared to support the economy provided the catalyst for the Chinese market's rebound. The challenges facing the Chinese economy are daunting. In the near term, these include high levels of youth unemployment, an overheated property market, weak export demand, cautious consumers, borderline deflation, and a fragile financial sector. High debt levels and an aging population pose impediments to growth over the medium term.

Exhibit 2. Chinese Equities Rebound in July

Source: Bloomberg. Index January 1, 2023 = 100.

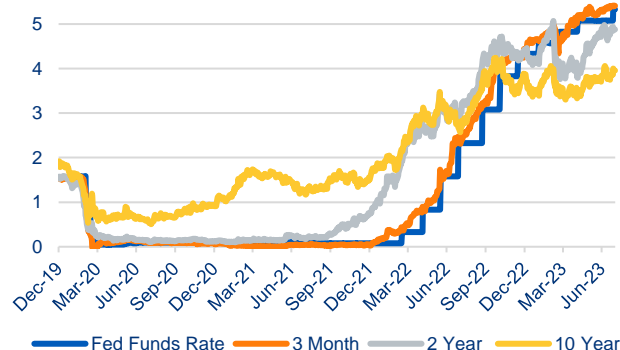


Policy Rates, Yields, and Expectations

Starting in May 2022, the Fed has raised rates 11 times this tightening cycle from effectively zero to a target range of 5¼ - 5½% (Exhibit 3). The yield on 3-month and 2-year U.S. Treasuries have followed a similar upward trajectory, while 10-year yields have been rangebound this year. The increase in yields mainly reflects higher real yields.

Exhibit 3. Fed Funds Rate and U.S. Treasury Yields

Source: Bloomberg. Fed Funds rate and U.S. Treasury yields in %.



As illustrated earlier by Exhibit 1, inflation expectations derived from the spread between real and nominal U.S. Treasury yields have remained relatively well-anchored. Bond markets have seen price pressures as being transitory and remained confident in the Fed's ability to bring inflation back to target. This relatively sanguine view on inflation has been coupled with pessimism over the Fed's ability to achieve a soft landing, as evidenced by the steeply inverted yield curve. Reflecting these yield trends, the U.S. Treasury market has managed a small gain of 1.5% so far in 2023. Both real and nominal U.S. Treasury yields are at about fair value.

U.S. investment grade bonds are up 2.1% this year, while the high yield sector has gained 7%. Credit spreads on investment grade and high yield bonds are near fair value, but the outlook for the U.S. credit markets is mixed in light of higher financing costs and the possibility of reduced credit availability. Outside of the U.S., the WGBI ex-U.S. index of advanced sovereign bonds is up 2.4% so far this year, largely reflecting the 5.6% gain in European bond markets. The EMBI index of emerging market sovereign bonds is up 5.5% year to date.

Performance of Major Market Indices through 7-31-2023

Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	3.2%	3.2%	20.6%	13.0%	13.7%	12.2%
Russell 2000	6.1%	6.1%	14.7%	7.9%	12.0%	5.1%
MSCI World Ex-US (USD)	3.2%	3.2%	14.9%	15.5%	9.5%	4.7%
MSCI Emerging Mkts (USD)	6.2%	6.2%	11.4%	8.3%	1.5%	1.7%
Citigroup US Treasuries	-0.3%	-0.3%	1.5%	-3.9%	-5.2%	0.5%
Citigroup Credit	0.4%	0.4%	3.6%	-1.1%	-4.3%	1.6%
Merrill High Yield	1.4%	1.4%	6.9%	4.2%	2.1%	3.2%
JPM EMBI Global (USD)	1.6%	1.6%	5.5%	5.2%	-3.3%	0.7%
Citigroup WGBI Ex-US (LC)	-0.5%	-0.5%	1.9%	-6.4%	-5.2%	-1.4%
Barclays US Aggregate	-0.1%	-0.1%	2.0%	-3.4%	-4.5%	0.7%
GSCI Total Return	10.7%	10.7%	2.4%	-5.0%	27.8%	5.6%
HFRX Eq. Wtd. Strategies	0.3%	0.3%	1.1%	1.7%	1.9%	1.3%