Market Commentary

Michael Hyde
michaeljhyde12@gmail.com

Marcos Cuartas Jaramillo
marcos.golf1@hotmail.com

This is our second newsletter, and we want to thank you for bearing with us as we work through the growing pains. And indeed, another week has passed, full of significant announcements and noise for the market. Again, Trump continues to make headlines while the market tries to interpret what the Fed is doing, how the overall economy is behaving, and the future path for asset prices.

This past week

Rates Unchanged, following the fed's decision to keep rates steady on Wednesday. This was not a shocker to most, but afterwards Trump still had choice words for the fed chair Jerome Powell.

Jobs Report Shocked on Thursday when previous numbers were revised downwards by 258,000 and the month of July only saw an increase of 78,000. This is significantly below previous months and likely is a reaction to the uncertainty produced from tariffs. However, this poor jobs report has raised alarm bells for economists and has caused Treasury yields to drop on the expectations of the Fed cutting interest rates going forward, including the next meeting in mid September.

Trump Vehemently Disagreed with the jobs numbers and even fired the statistician in charge of producing the figures, citing a Biden bias and a previous 818,000 downward revision after trump won the presidential election in November.

Trump Attacks Swiss Neutrality with shocking 39% on Swiss imports to the United States despite that the US has a trading surplus with the Alpine nation.

The Dollar shed some of its previous gains after the weak jobs report; yet, July was the best month so far for the US dollar, recovering 2 percent of its value.

The US is calling for the Chinese to stop buying Russian and Iranian Oil, something they seem very much opposed to. This issue was brought up during trade talks however due to the Chinese's reliance on cheap oil it seems like an issue they are unlikely to concede on.

Market Reaction

Name	Price ($)	1 Week % Change	1 Year % Change
S&P 500	6238.01	-2.43%	16.86%
Dow Jones Industrial Average	43588.58	-2.87%	11.21%
Nasdaq Composite	20650.13	-2.56%	21.55%
Global X DAX Germany ETF	43.16	-2.50%	28.59%
FTSE 100 Index	9068.58	-0.14%	11.69%
Nikkei 225	40799.6	-0.49%	22.90%
BSE SENSEX	80599.91	-0.36%	2.28%
SPDR Gold Trust	309.11	1.20%	28.03%
Fidelity Advantage Bitcoin ETF	51.49	-3.71%	49.50%

Broader equities markets took a sizable hit last week on the back of a poor jobs report. Questions about the soundness of the US economy remain, however stocks are still near all time highs.

In individual stock news: Novo Nordisk [NVO] is down over 30% this week due to flagging growth from their GLP-1 line. There are two reasons for this: knock off GLP-1s are hitting their sales as well as a general sentiment that Eli Lilly's GLP-1 is superior and has less side effects.

European bank stocks hit all time highs as a sharp increase in long term interest rates drove earnings (FT Article).

Treasury yields fell broadly on expectations of more Fed cuts, with the 10 year down to 4.24%.

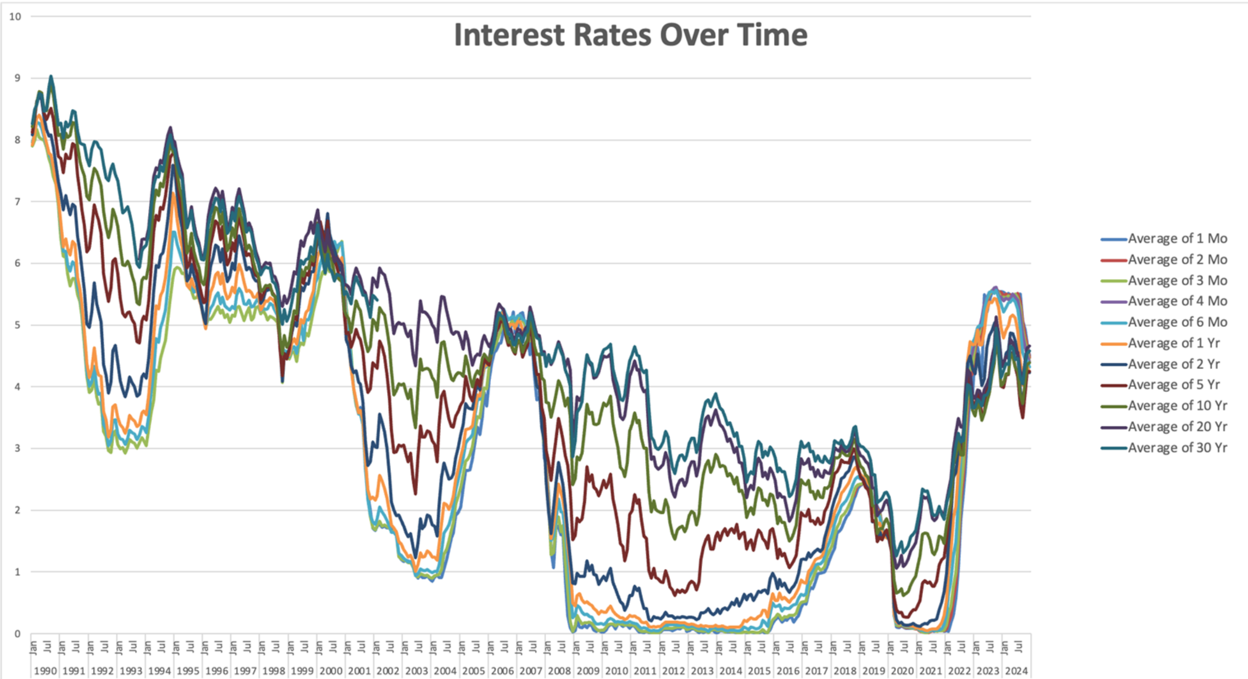
Market Outlook

Last week we called for caution and that sentiment remains. The VIX is at 20 and there is still significant uncertainty for Tariffs, most notably the lack of a Chinese trade deal. Something suggests a Chinese deal won't be as one sided as the others have been so far; China also has leverage over the US on rare earths, which are critical for today's tech economy.

Q2's earning season is underway and while markets have certainly been a little overexcited, results can quickly temper that euphoria.

Regarding fixed income, due to the uncertainty on interest rates because of inflation and increasing fiscal pressures, we recommend staying short on duration.

The End of the Great Moderation?



The last thirty-five years, or even more, since Volcker's tenure at the Fed, macroeconomic conditions have been relatively good, output variation has fallen, inflation has been under control, and in general, it has been a period of strong economic growth. However, since the Great Financial Crisis, economic conditions have started deteriorating. Recently, due to the COVID pandemic and the monetary and fiscal response because of it, inflation has made a comeback. The graph above, titled "Interest Rates Over Time," shows a downward trend in interest rates, beginning in 1990 and ending in 2022, with the COVID pandemic. The period of falling interest rates, and thus raising bond prices (the US's greatest bond rally ever) has been called the Great Moderation because it was characterized by low inflation and moderate economic growth.

The recent increase in interest rates, as shown in the picture, denotes a possible regime change; many economists and financial analysts are preparing for "higher rates for longer." Others, meanwhile, believe that interest rates would return to lower levels, following a period of monetary tightening, and hopefully, aided by lower fiscal deficits. The two of us – Michael and Marcos – have opposite views regarding the future path of interest rates. I – Marcos - am quite more optimistic that interest rates have already reached maximums and that interest rates will settle along a higher r*; however, that does not imply a higher real interest rate. Furthermore, worsening economic conditions, especially a weakening job market, could force the Fed to lower the fed funds rate, allowing a drop in interest rates across the broad economy. However, I - Michael - am not so sure, I believe that unless we see a significant and prolonged bout of inflation, the Fed will be forced to keep rates elevated. The direction of interest rates will certainly have a big impact on both the strength of the dollar and the economy. So hoping for lower long term rates is certainly in the interest of all parties.

Are you too late to invest in Emerging Markets?

by Marcos Cuartas Jaramillo

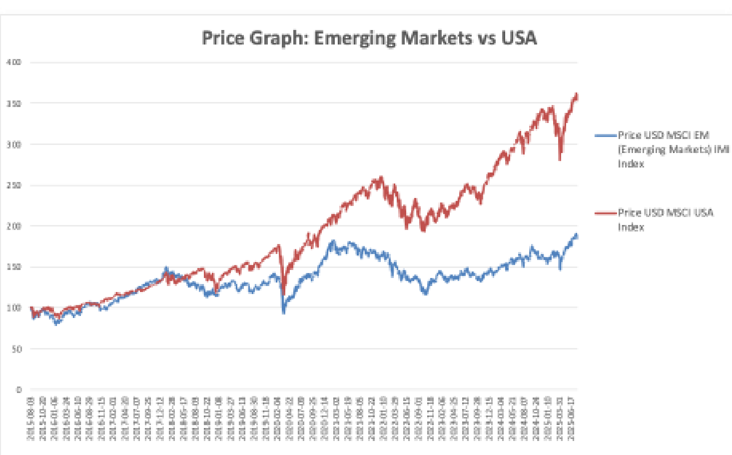
If you have been following the financial news for the last couple of years, you would have encountered a changing view regarding capital markets; one year ago, news headlines emphasized American exceptionalism and the significant outperformance of the US economy and stock market compared to the rest of the world. *The Economist*, right before the US presidential election, printed headlines with "American exceptionalism" and the immunity of America's economy to the world's economic problems. Indeed, the American economy had been growing faster, and its stock market, propelled by the magnificent seven, was the world's envy.

One year later, and six months into Trump's second presidential term, having experienced a liberation day and the subsequent TACO trades, a lot has changed.

The American stock market, for instance, despite recovering its post-liberation day losses, has been trailing, for example, European and some Latin American indexes. The dollar has even lost close to 10 percent of its value against a basket of developed currencies. The policy uncertainty coming from the Trump administration, particularly regarding tariffs, has already inflicted painful damage to the US economy, reducing potential GDP growth and weakening job creation and private investment. Still, foremost, and despite the stock market recovery, it is undoubtedly evident the significant concentration of the US equity market in a couple of names. Close to ninety percent of market returns have come from a group of big market cap companies in the technological sector, raising questions about the expensiveness of the US market and the feasibility of prolonging the US market rally. It is pertinent to remind the audience that most US companies have not experienced significant equity returns in the last three years, nor have they shown increasing profitability, showing a market totally dependent on a couple of companies.

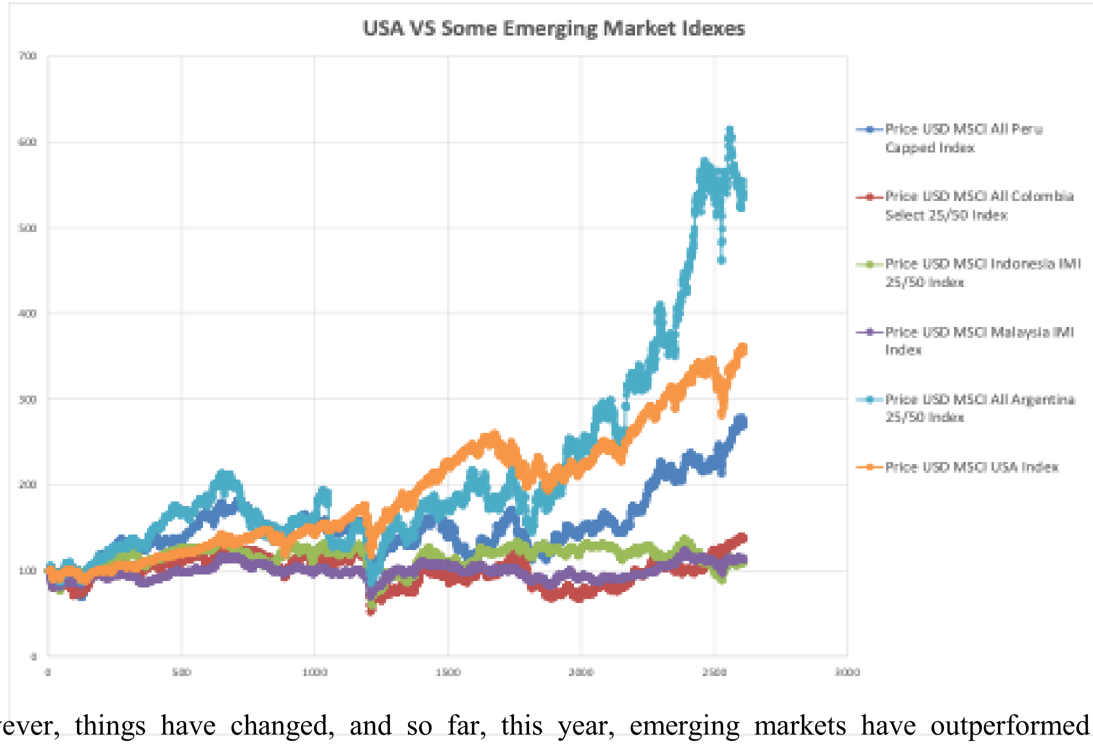
In the midst of such circumstances regarding the US economy and equity market, emerging markets have enjoyed one of their strongest first halves of the year in a long time, aided by a weakening dollar, stable commodity prices, low valuation multiples, and better-than-expected economic growth.

The question then is: Are you too late to invest in Emerging Markets?

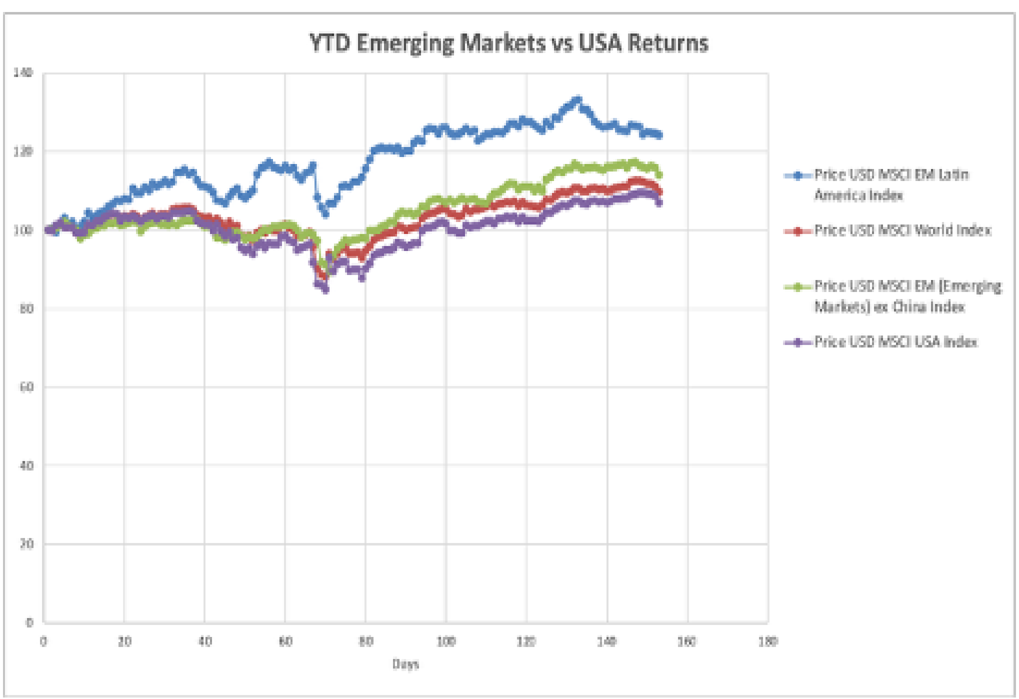


The first thing that has to be said is that it has not paid out in the last ten years to be diversified into emerging markets equities; US equities have outperformed any other stock market, and global equities as an asset class, propelled mainly by US equities given, that 70 percent of the world's market capitalization derives from US equities, has enjoyed the best performance among any asset class in the last ten years.

For any investor, therefore, being heavily concentrated in US equities, even with a traditional 60-40 portfolio, has been extremely profitable. In the graph “USA VS Some Emerging Market Indexes” it is easy to see that US equities have performed better in the last ten years than Colombia’s, Peru’s, Indonesia’s, and Malaysia’s market index but Argentina’s.

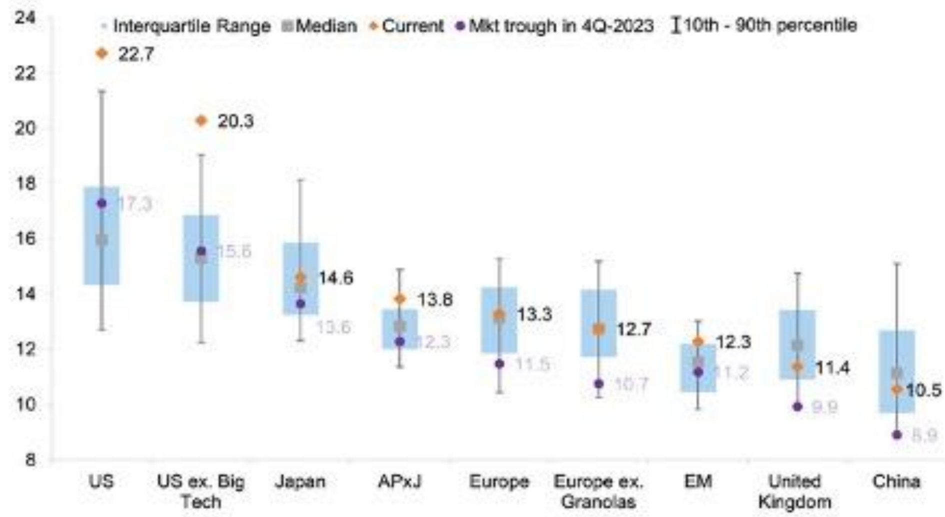


However, things have changed, and so far, this year, emerging markets have outperformed US equities. The graph “YTD Emerging Markets vs USA Returns” shows US equities underperforming emerging markets, with the MSCI Latin American index clearly outpacing the USA index. Market indexes from countries, like Colombia, Peru, Argentina, and Brazil have enjoyed significant returns this year.



The question of whether this emerging markets equity rally is going to continue remains a puzzle, especially because many variables have been contributing to the good momentum of emerging markets. First, a decline in the dollar and better global economic growth have dissipated investors' fears of a global recession, and thus, increasing market appetite for riskier assets in developing countries. Similarly, the Trump administration's policy uncertainty has encouraged investors to diversify away from the United States, and given emerging markets attractive valuations, emerging market equities have received continuous flows from abroad

Exhibit 3: All regions have experienced a rise in valuations through 2024
12m fwd P/E, MSCI regions; data since 2003



Source: FactSet, Goldman Sachs Global Investment Research

The reality, though, is that emerging markets remain "cheap" compared to the US - see fwd P/E graph. Furthermore, emerging markets are not heavily concentrated as the US equity market, dismissing any concern that we are facing anything like an asset bubble, which is something far from certain in the US where equity returns continue to be concentrated among a few names. To the investor looking to diversify, and who thinks that the best has already passed, and he missed the train, I would say that it is never a bad option to expand your portfolio's exposure. I would recommend strongly decreasing allocation to US equities and starting to think about increasing portfolio exposure toward something safer, like US core fixed income. Then the investor who has a greater risk appetite can think about buying emerging market dollar-denominated debt - which has been rallying - and then look into particular products that offer significant exposure to emerging markets equities - ex China. So, definitely, it is never not too late to have some allocation toward emerging market assets and rebalance your portfolio into more diversified holdings, beginning with different asset classes, and then, broadening your portfolio's geographical exposure.

I particularly like emerging markets dollar denominated debt, you can look at sovereign and even corporate, and all across the spectrum those coupon payments look very attractive. Yet, the best is that buying dollar denominated debt saves you from currency risk so it is definitely an interesting option to buy emerging market dollar denominated bonds right now, which also, gives you some exposure to emerging markets.

The Jobs Revisions Are Not a Big Deal

by Michael Hyde

Top of everyone's mind this week – especially Powell – are the recent job revisions. Just after he sweated through Trump's visit to his $2.5B renovation project and then once again rebuked his calls for a rate cut, the jobs report was revised. Unfortunately for Powell's wait and see stance, we saw a revision downward of 258,000 (nonfarm) combined for the months of May and June, this means that over those two months we only added 33,000 jobs (14,000 in June and 19,000 in May). And with July seeing a lackluster 73,000 new jobs, economists are worried, and the market now expects Powell to cut rates in September. Many are saying that Trump was right, and he should have been cutting for a long time now, however I think we are all viewing at these figures in the wrong way.

First, given all the data we had seen up to the Fed meeting, I think it was the correct decision to hold rates steady. Jobs were seemingly strong and the GDP expanding nicely, there didn't seem to be a good case for cutting rates, not to mention uncertain inflation implications from the newly added Tariffs. Also, from a Fed independence perspective, ignoring Trump does give investors confidence, which I believe is certainly on Powell's mind. Now that these revisions have come in, it does seem like they should have cut, but since time travel is impossible, a September cut will suffice. One last comment about rates: since rate setters are at the mercy of market expectations, I don't believe a different Fed chair would have had a dramatically different outcome than Powell, on the contrary, it is his hawkish personality that is doing such a good job tempering inflation expectations.

But more important than the rate decision, the strength of the economy is being questioned due to these new numbers. Many see such poor nonfarm job numbers as a big indication that Trump's tariffs have stunted economic growth, however, I think we need to take a step back and look at the bigger picture and examine why so few jobs were created over the past three months.

The primary cause of the job growth decline is Tariff uncertainty. Businesses have waited to hire until they know to what extent these tariffs will affect their customers and suppliers. It wasn't until Trump announced deals with the UK, Vietnam, Japan, and the EU that we started to see the clearer picture as to what the baseline tariff might look like and what countries would be willing to give up for access to the US market. Now that many of our most important trading partners have largely conceded to Trump's demands, we are seeing businesses hire again, as shown in the July job numbers.

In the perspective of business owners, this certainty should be a huge relief. Not only do you have a pretty good sense of what the tariff landscape will look like, but you have also likely seen your suppliers' willingness to take on tariff cost. On top of that, consumer confidence has rebounded from the lows in April and inflation has yet to spike.

Essentially: business sentiment is strong (at least more than it was). These positives, combined with the aforementioned tariff certainty and surprising effectiveness of Trump's deals leave the economy in a far better position than the Jobs report headline might lead you to believe.

That being said, equities market are still overvalued in my opinion. 22 P/E ratio? Come on. This overvaluation of the stock market is one of my chief concerns. Whether it be market rally or market crash, either could cause significant problems for the economy because of the wealth effect. The market's growth over the past 3 months is a major reason why both consumers and the economy have remained resilient. If this trend were to reverse, I predict a significantly weakening economy. Inversely, if markets rally past 7000, and consumer spending remains strong the Fed would be forced to keep interest rates higher than expected. All I am hoping for is more moderation.

Next Week

US Factory Orders numbers will be released on Monday, where we will be looking to see the state of US manufacturing following months of output declines and losses in manufacturing employment.

Jobless Claims will be available next Wednesday following last weeks jobs report; we expect further weakening of the US labor market.

Corporate Earnings are back; are we are particularly interested in Palantir and Eli Lilly.

Chinese Inflation Data will become available at the end of the week; we expect further price decreases, signaling the complicated deflationary spiral the Chinese economy is currently facing.

The Bank of England will be meeting on Thursday (7th), it is expected that they will cut rates 25 basis points down to 4%.

Many Tariffs will go into effect on August 7, these countries include India, Vietnam, Taiwan, and Switzerland. Trump would probably call it a day of "too much winning."

About the Authors

My name is Marcos Cuartas Jaramillo; I graduated from the University of Miami with degrees in economics, finance, and history, and a minor in mathematics. For the next year, I will be pursuing a master's in economics at Tufts University, and apart from writing this newsletter with Michael Hyde, I have my own Substack. You can find me writing and reading about economics, finance, and current events; feel free to contact me at marcos.golf1@hotmail.com.

I am Michael Hyde, a recent graduate from the University of Miami Herbert Business school. I studied finance and next year I will be pursuing a Masters in Finance at Imperial College London. I'm interested in economics, politics as well as equities. Please write to me at michaeljhyde12@gmail.com.