TRADITION
INVESTMENT MANAGEMENT

Economic and Market Review July 2023

July 31, 2023

Equity Indices	YTD Return
Dow Jones	6.54%
S&P500	17.19%
NASDAQ	32.66%
MSCI - Europe	12.97%
MSCI–Emerging	7.65%
Bonds	**Yield**
2yr Treasury	4.76%
10yr Treasury	4.09%
10yr Municipal	2.71%
U.S. Corporate	4.66%
Commodities	**Price**
Gold	$1925/oz
Silver	$22.72/oz
Crude Oil	$82.75/barrel
Currencies	**Rate**
CAD/USD	$0.74
GBP/USD	$1.27
USD/JPY	¥143.29
EUR/USD	$1.10

Overview

The rating on U.S. government debt was cut from AAA to AA+ by Fitch, one of the three major credit rating agencies. Standard & Poor's, another primary rating agency, cut its rating on U.S. government debt to AA+ in 2011, which was the first ever downgrade below AAA. Fitch's reasoning for the downgrade includes a growing federal debt burden, fiscal deterioration, political gridlock, and eroding governance.

Lower credit ratings make it more costly for the U.S. government to borrow money and issue debt, indirectly raising bond yields on U.S. Treasuries. The recent rise in rates has increased the amount of interest that the government pays, increasing from roughly $520 billion quarterly in 2020 to over $900 billion quarterly in 2023.

U.S. banks are also coming under closer scrutiny by rating agencies as their exposure to commercial real estate loans continues to evolve as a concern. Rising rates on commercial real estate loans along with weaker demand for office and industrial space have intensified the risk of defaults and liquidity constraints.

Inflation and the U.S. dollar trended lower in July as evolving economic conditions altered the dynamics of consumer prices and sentiment. Inflation stood at 3 percent in July, the lowest in two years.

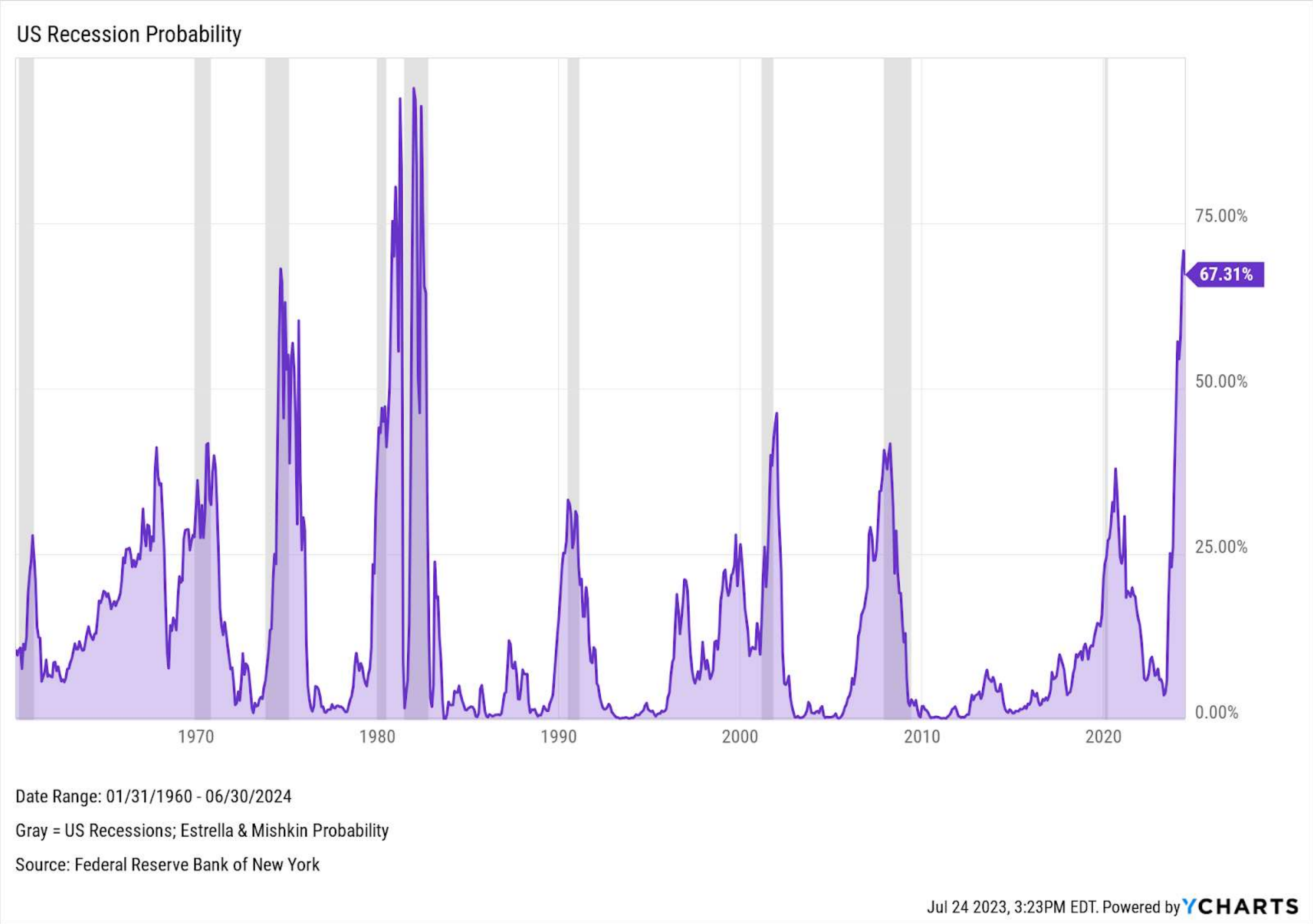
Small businesses have seen an increase in bankruptcy filings in 2023, an indicator to analysts of probable slowing economic conditions. According to the Small Business Administration, there are 33.2 million small businesses in America, which account for approximately 99% of all U.S. firms.

Atlanta Federal Reserve Bank President Raphael Bostic said that there is a risk of over-tightening of rates by the Fed. Financial markets are concerned that the Fed may have continued to raise rates to the point that it may have become counterproductive.

A weakening U.S. dollar is becoming an inflationary concern for consumers and the Fed. A weak dollar is inflationary because a weaker dollar makes imported goods more expensive for consumers, lowering their purchasing power. This is because the U.S. heavily relies on imported goods, such as clothing, autos, phones, computers, and televisions.

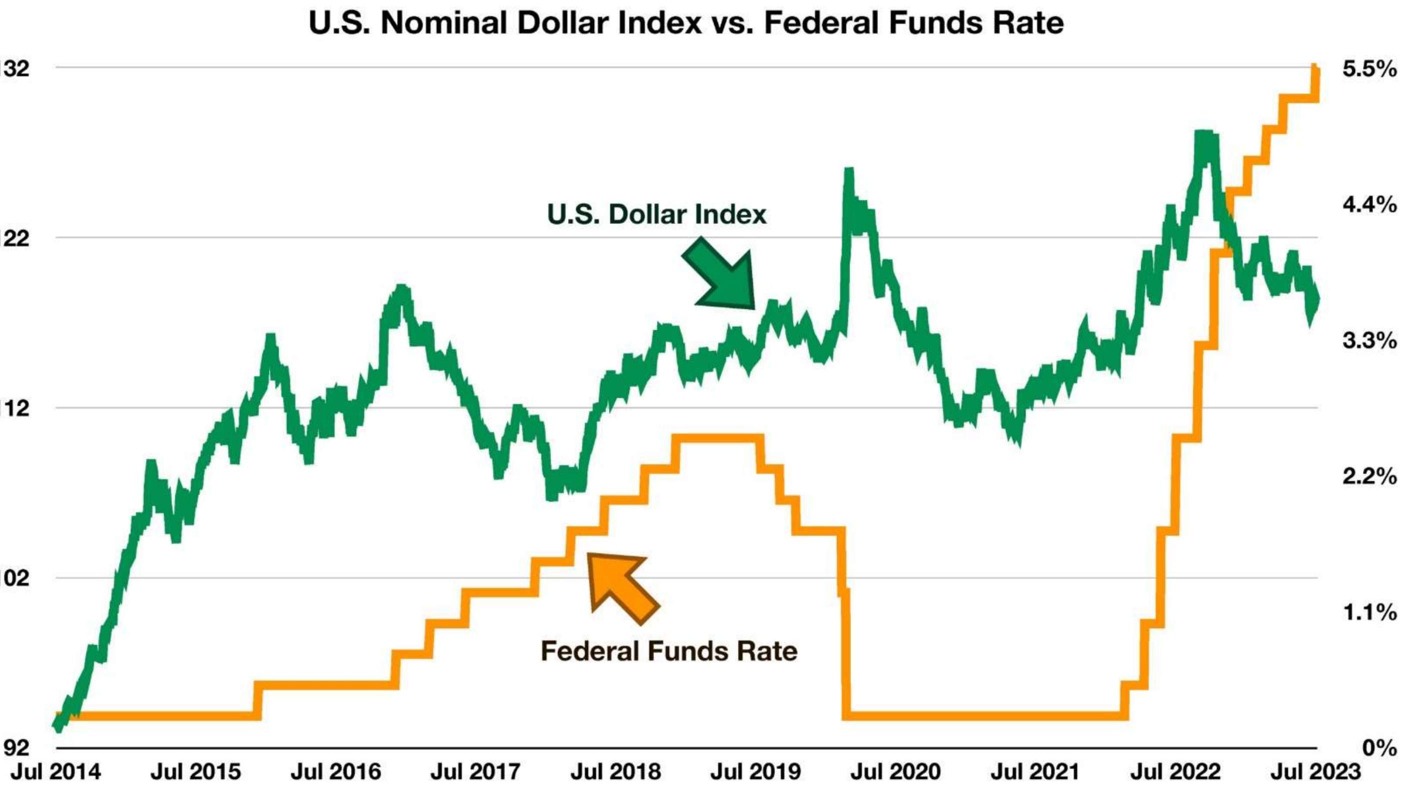
Recession Probability Still on the Rise

Estrella & Mishkin recession probability model is at 67%. It has never been at these levels without a recession. Moreover, it has only once in the late 1960s been over 30% without a recession occurring.



USD Slides as Rates Increase

When the Fed began increasing its Fed Funds Rate in 2022, the U.S. dollar became stronger as higher rates attracted foreign funds. Other currencies, such as the euro, simultaneously lost value due to global turmoil stemming from the Ukraine war. Thus, in much of 2022, exchange rates were very favorable for Americans and holders of U.S. dollars. Since then, the dollar has seen a decline in value over the past year.



In July, the dollar's nominal value index fell to a 14-month low, down over 8% from its peak in October 2022. The Fed Funds Rate, which is the Fed's primary tool for altering interest rates, continues to rise as it reaches upwards of 5.25%. For reference, the Fed Funds Rate was just 0.25% in early 2022 before the Fed's aggressive fight against inflation.

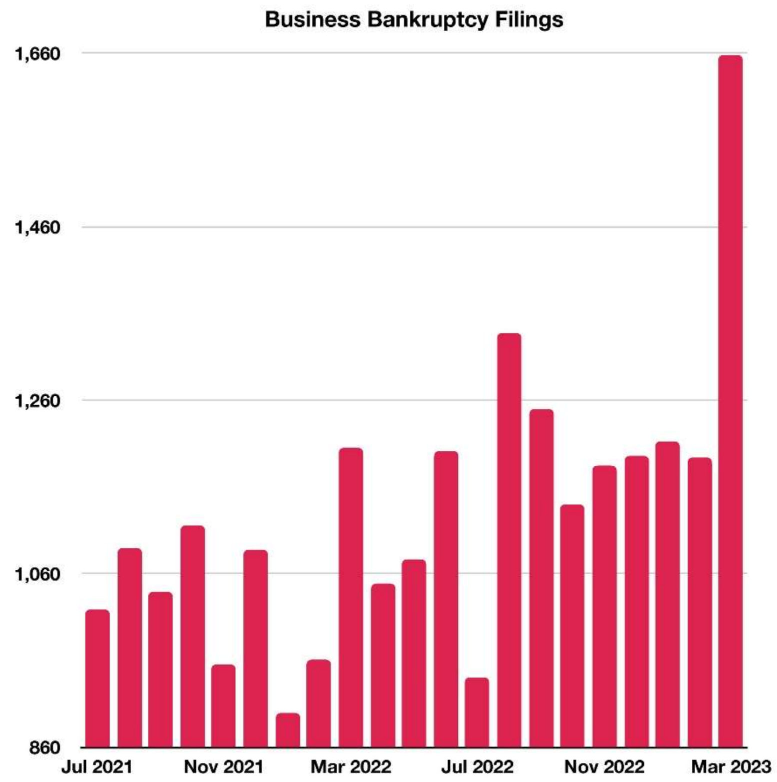
With the dollar being the primary reserve currency of the world, a weak dollar could have a wide range of consequences for both Americans and the global economy. A weaker dollar would reduce import prices for developing nations, easing the inflationary pressures on emerging markets. It could also bolster currencies currently at lower values in comparison to the dollar. A weaker dollar would boost American firms' exports, yet would make imported goods more expensive for U.S. consumers. Since the U.S. has a sizable trade deficit, this could likely make goods more expensive for American consumers and increase domestic inflationary pressures.

Business Bankruptcy Filings Increasing

An indication of where the economy might be headed is business bankruptcy filings. Small and large businesses tend to react to economic changes via their business activity and financial conditions. Despite both 2021 and 2022 having far fewer bankruptcies than pre-pandemic years, 2023 is seeing an uptick in filings. Thus far, more businesses are declaring bankruptcies in 2023, reaching a 28-month high in filings not seen since late 2020.

Government aid programs throughout the pandemic alleviated the concerns of bankruptcies for many small businesses and individuals, providing stimulus packages to support consumers. Bankruptcy numbers appear to have slowly returned to pre-pandemic levels with these programs ending, yet are still not as high as in the late 2010s.

The financial well-being of small businesses is an indication of the direction of the overall economy and where it might be headed. Hiring, wholesale purchases, rent, capital expenditures, and tax payments are just part of how small businesses contribute to the economic health of the nation.

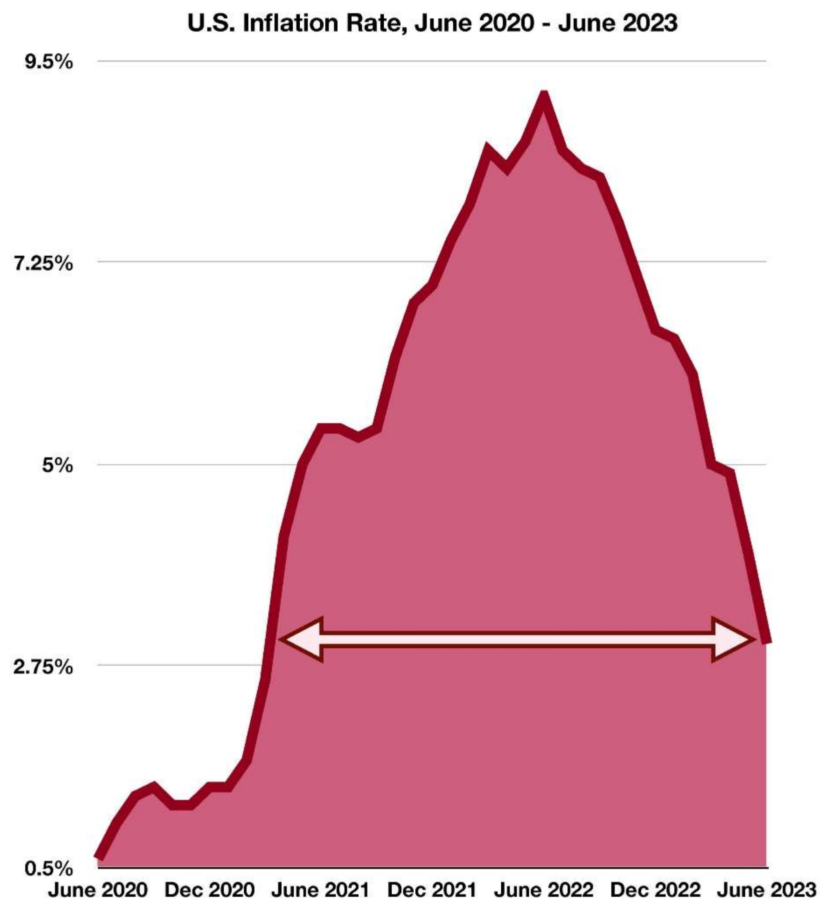


Inflation Sinks to Two-Year Low.

Inflation measured at 3% in June, a two-year low not seen since March 2021. Inflation peaked at a four-decade high of 9.1% in June 2022, more than three times the latest inflation figure. Other factors indirectly affecting inflation include a weakening U.S. dollar and the recent debt rate cut on U.S. government debt.

Reasons behind the causes of inflation vary, such as June 2022's inflation was abnormally high due to Russia's invasion of Ukraine. Headline inflation is more volatile to events of this sort because it considers the volatile factors of food and energy. However, the Fed prioritizes core inflation, which even though it has dropped from previous months is still at 4.8%. This remains much higher than the Fed's 2% target rate, and many Fed officials are focused on ensuring that inflation does not return to higher levels.

A significant concern for the Fed is the strong labor market, where jobs are being added at a robust pace despite employers finding difficulties in recruiting qualified employees. June's inflation data saw airline fares and used car prices decline. However, increases in housing costs composed 70% of June's monthly rise in consumer prices.


U.S. Inflation Rate, June 2020 - June 2023
9.5%
7.25%
5%
2.75%
0.5%
June 2020
Dec 2020
June 2021
Dec 2021
June 2022
Dec 2022
June 2023

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