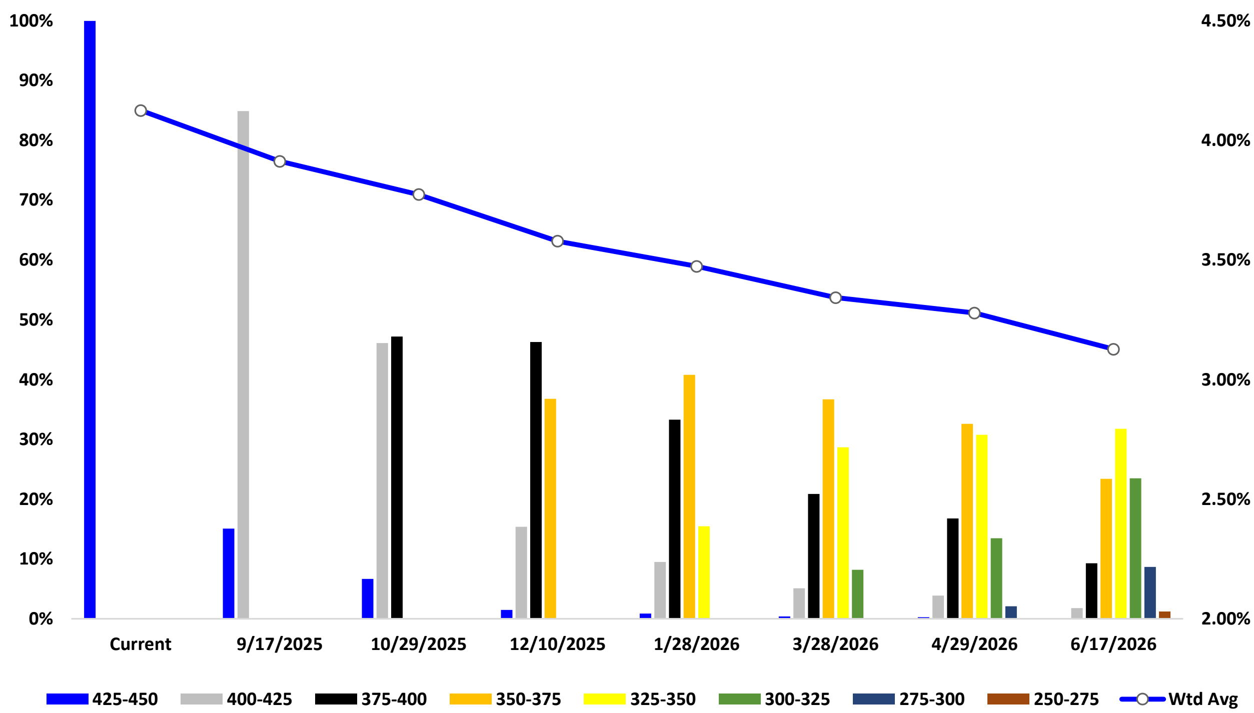
Stocks again displayed impressive resilience this week. Despite the core PPI (producer price index) reading for July increasing 0.9% month over month, well above the 0.2% economists expected, markets barely moved following the data release on Thursday morning. Stocks closed the session roughly flat (the S&P 500 was up 0.03% at the close) while the Treasury futures market continues to price in a quarter point rate cut by the Fed next month.

Target Fed Funds Rate Range Probability (Left Axis) and Weighted Average (Right Axis) By Meeting



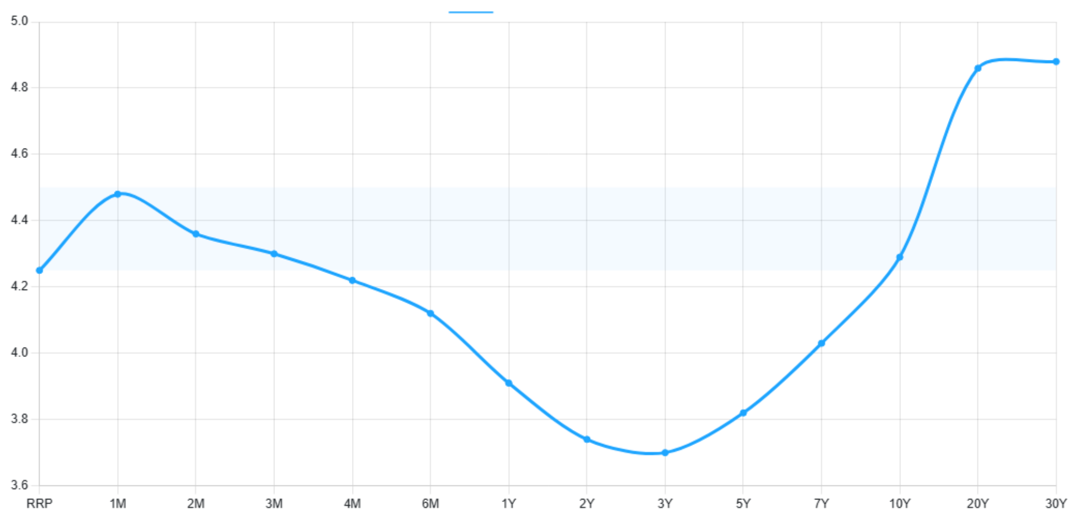
Note: Probabilities implied by current pricing across the Treasury futures market

Source: CME Group

We believe the market's continued strength is driven by two main factors – the outlook for corporate earnings remains robust, while the likelihood for a near-term recession is low. Regarding the latter point, the retail sales print released on Friday morning reflected a 0.5% monthly increase in July, which followed a 0.9% uptick during the prior month. The Atlanta Fed's GDPNow forecast model is predicting 2.5% annualized GDP growth during the third quarter, highlighted by respective increases of 2.2% and 6.6% across consumer and business spending.

While recent labor market weakness remains concerning, the underlying data suggests that consumers continue to spend at a healthy clip while companies further ramp up capital expenditures. As written previously, we believe corporate spending levels will remain strong for the foreseeable future given the magnitude of capital commitments earmarked for AI-related initiatives over the next several years. It's also my view that the Fed will likely resume its rate cutting cycle next month, eventually lowering the Fed Funds rate towards the neutral level (around 3%) through the end of 2026. Pricing across short-term Treasury futures and the front-end yield curve inversion (first three years) currently supports this thesis. In essence, the bond market is urging the Fed to cut rates, and we believe the central bank will accommodate its guidance.

U.S. Treasury Yield Curve



Source: U.S. Treasury

Should the broader economy continue to grow at a reasonable clip (i.e. ~2%+), I believe we may be in the midst of a corporate earnings "goldilocks" scenario. If this occurs, macroeconomic resilience would likely support profit expansion broadening across sectors. Furthermore, higher capital spending is likely to have a multiplier effect across corporate earnings, especially for the largest technology companies leading the charge. This is a potent combination that should drive a bullish landscape for corporate profits over the near to medium term. Furthermore, labor market weakness may give the Fed enough reason to loosen monetary policy, which would stimulate consumer spending while supporting specific areas such as housing.

While the economic data remains mixed, the financial picture for companies is much more encouraging. Fed rate cuts would be a nice cherry on the sundae if they come to fruition. Nevertheless, the bigger picture suggests that the largest companies continue to ramp up capital investment and the consumer is still spending at a healthy pace. Those two legs of the stool should be enough to power this market forward assuming they remain firmly in place.

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