Week in review and ahead (vol.29-26)

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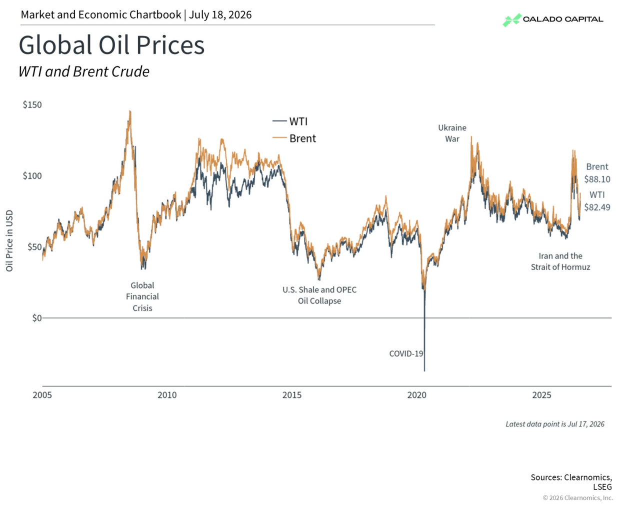
Week in review

Markets declined this week as elevated overseas volatility, particularly in South Korea, continued to reverberate across global markets. As previously discussed in these publications (https://caladocapital.com/week-in-review-and-ahead-vol-26-26/), weakness in memory and semiconductor-related companies weighed heavily on investor sentiment. The Philadelphia Semiconductor Index (SOX) officially entered a technical bear market after falling more than 20% from its June 22 peak.

Beyond the semiconductor selloff, renewed geopolitical tensions contributed to market uncertainty. Concerns emerged that recent improvements in inflation may prove temporary amid escalating hostilities involving Iran and growing tensions surrounding the Strait of Hormuz. Iran's renewed assertions regarding control of the strategically important waterway raised fears of potential disruptions to global energy supplies. As a result, crude oil prices rebounded sharply, with Brent crude gaining more than 15% during the week and settling above $88 per barrel in after-hours trading on Friday.

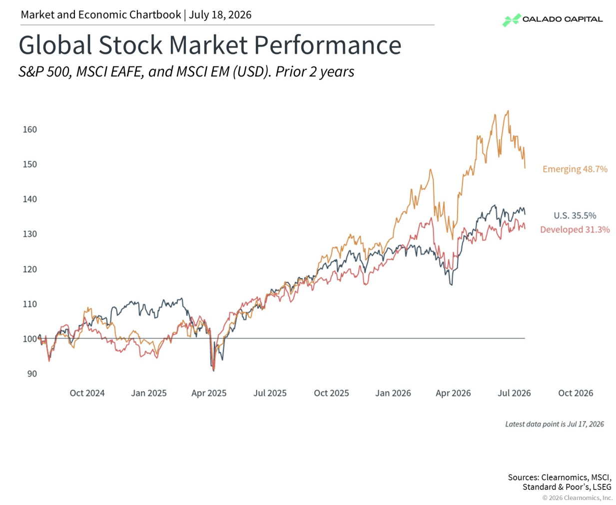


U.S. equity markets finished the week lower. The Nasdaq Composite and S&P 500 declined 2.9% and 1.6%, respectively, while the Dow Jones Industrial Average and Russell 2000 posted more modest losses of 0.9% and 0.5%. Selling pressure in the semiconductor sector appeared to moderate on Friday, and major indices remained within approximately 3.5% of their respective all-time highs. This suggests that investors were largely rotating between sectors rather than broadly reducing equity exposure. With earnings season set to unfold over the coming weeks and expectations for another solid quarter of corporate results, investor participation remained relatively resilient despite portfolio repositioning. Thus far, market reactions to earnings releases have been relatively restrained when companies exceed expectations and raise forward guidance, while reports that merely meet or fall short of expectations continue to be met with disproportionately negative price responses.

International markets were broadly weaker as investors reassessed geopolitical risks following the resurgence of Middle East hostilities. Hong Kong was a notable exception, extending the prior week's rally in Chinese technology shares, with the Hang Seng Index advancing 1.6% for the week. In contrast, mainland Chinese equities continued to struggle, with the CSI 300 declining 5.8% after second-quarter GDP growth of 4.3% came in below both expectations and the previous quarter's 5.0% reading, suggesting a moderation in economic activity.

Volatility remained elevated in South Korea, where the Kospi Index declined nearly 10% for the week, extending its one-month loss to approximately 25%. In response to heightened market instability (see https://caladocapital.com/week-in-review-and-ahead-vol-26-26/), South Korean regulators implemented measures aimed at limiting speculative activity in ultra-leveraged products linked to the country's largest index constituents, including Samsung Electronics and SK Hynix.

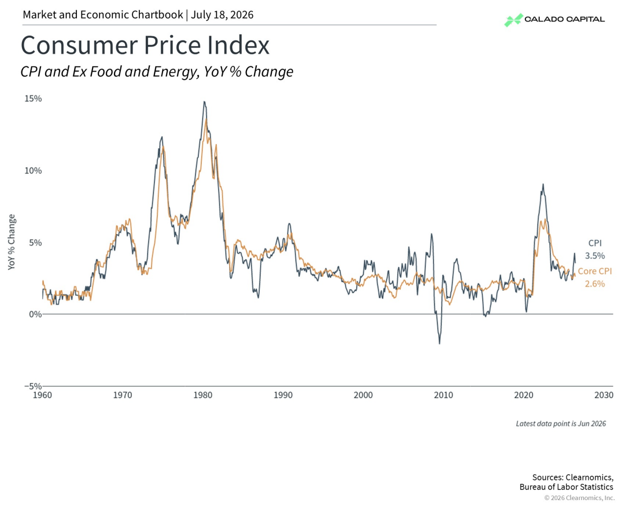
European markets proved comparatively resilient despite mounting geopolitical concerns. Germany's DAX declined 0.9% during the week, while France's CAC 40 finished essentially unchanged. Economic data remained mixed, with Eurozone industrial production falling 0.2% month-over-month, below consensus expectations. In the United Kingdom, the FTSE 100 advanced 1.0%, supported by political developments as Andy Burnham was nominated to lead the Labour Party, replacing Keir Starmer following his earlier resignation.



Week in review – US macroeconomics

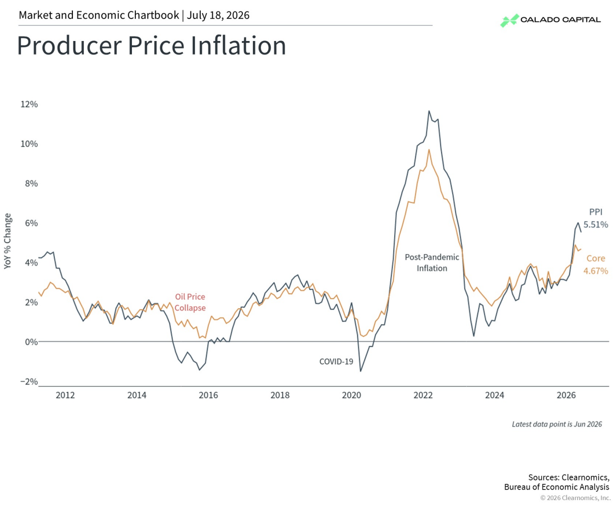
This past week's US macroeconomic calendar was centered squarely on inflation, headlined by the June CPI and PPI reports, June retail sales, and Fed Chair Warsh's semiannual monetary policy testimony before Congress. A full slate of housing data, weekly jobless claims, import and export prices, and the preliminary University of Michigan consumer sentiment reading for July rounded out the week.

The June Consumer Price Index ("CPI") came in cooler across the board. Headline prices fell -0.4% month-over-month ("MoM"), a sharper decline than the -0.1% expected and a marked reversal from May's +0.5% increase. On an annual basis, headline CPI eased to 3.5%, better than the 3.8% consensus and down meaningfully from the prior +4.2%. Core inflation, which excludes food and energy, was equally encouraging, printing flat at 0% MoM against expectations of +0.2% and the prior +0.2%, while the annual core rate slowed to 2.6% from 2.9%, also below the 2.9% consensus.



Wholesale prices told a similar story. The June Producer Price Index ("PPI") declined -0.3% MoM, better than the unchanged reading expected and a sharp slowing from the prior +1.1%. On an annual basis, headline PPI eased to 5.5%, below the 6.2% consensus and down from a downwardly revised 6.0% in May (initially reported at 6.5%). Core PPI rose +0.2% MoM, below the expected +0.4% though up from the prior +0.1%, while the annual core rate of 4.7% came in well below the 5.2% consensus, albeit up from a downwardly revised 4.6% in May (initially 4.9%). As with CPI, the better-than-expected PPI, even accounting for the meaningful downward revisions to May's figures, lends support for the Fed's FOMC to hold its current path, notwithstanding the geopolitical risks that could yet reignite pricing pressures at both the wholesale and retail levels.

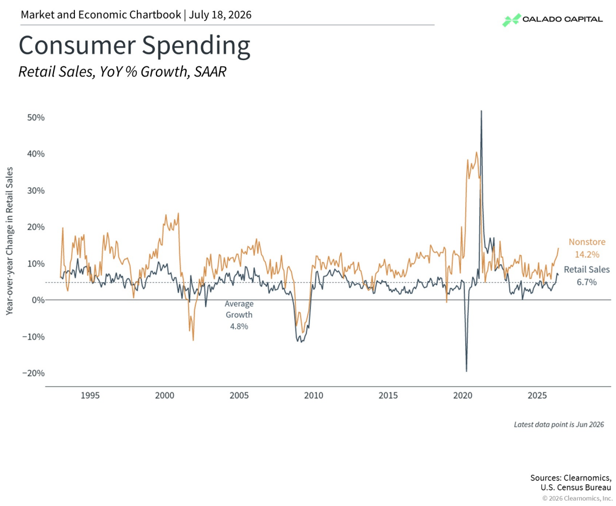
Against the better than expected inflation data, Fed Chair Warsh delivered his first semiannual monetary policy testimony before the House and Senate, and the tone remained decidedly hawkish. Warsh acknowledged that high inflation has been an "undue burden" on American households and businesses and, with annual CPI still at 3.5% and well above the Fed's 2% target. Beyond the near-term policy stance, however, much of his message centered on reforming how the Fed conducts monetary policy. Warsh outlined a series of task forces to take a "fresh look" at the central bank's practices, spanning its communications, the balance-sheet and ample-reserves framework, data and methodology, the productivity effects of the AI investment boom, and the inflation framework itself, effectively signaling a regime change in how policy is set and conveyed. Consistent with his stated intent to communicate less about the Fed's future intentions, and as already evident in the abbreviated June minutes, the shift toward reduced forward guidance is a meaningful one, and markets are likely to struggle with less transparency from the central bank as they are left to infer the policy path with less of a roadmap than they have grown accustomed to.



On the state of the consumer, June retail sales rose +0.2%, in line with expectations but down sequentially from May. The all-important control group, which feeds directly into GDP, advanced a stronger-than-expected +0.5%, though it too slowed from the prior month, suggesting that consumer spending, while still positive, appears to be losing some momentum. The labor market, by contrast, remains firm, as initial jobless claims continue to run below historical averages and were fairly steady at 208K, below both the 217K expected and the prior week's 216K.

The housing market, however, remains a clear soft spot in the US. Pending home sales declined nationwide, falling -5.4% MoM and -0.3% on an annual basis, while homebuilder sentiment for single-family homes held below 40 for the 15th consecutive month, a disappointing reading reflective of the sector's broader malaise. The construction data was more mixed. June housing starts of 1.43 million topped both the 1.3 million expected and the prior 1.2 million, though the beat was driven almost entirely by a sharp 76.3% MoM rebound in multifamily units, even as single-family starts continued to retreat. Building permits, a forward-looking gauge, fell -3.0% MoM to 1.37 million from 1.41 million, as stretched affordability and elevated mortgage rates continue to keep US housing activity depressed.

The week's remaining data offered a few crosscurrents. Import prices declined sequentially to +0.3%, though this was firmer than the -0.7% expected, and on an annual basis import prices exceeded 7%, up 0.4 percentage points sequentially and well above the 6.1% consensus, a reading somewhat at odds with the softer CPI and PPI prints earlier in the week. Export prices were closer to expectations, declining -0.6% MoM against the -0.5% expected and well off the prior +1.2%, with the annual rate up 10.2%, in line with estimates and down from 11.3% previously. Capping the week, the preliminary University of Michigan consumer sentiment reading for July surprised to the upside at 54.4, comfortably above the 51 expected and improving sequentially for a second consecutive month to its highest level since February, as easing gasoline prices supported a broad-based improvement. Notably, however, the survey was conducted before the US resumed its strikes against Iran, which have since pushed oil prices higher once again and may temper that optimism in the final reading.



Corporate earnings

The second quarter reporting season is off to a strong start. Per FactSet, with 10% of the S&P 500 having reported, 88% have topped EPS estimates, well above the 5-year average of 78%, and by a wider-than-usual margin. As a result, the blended earnings growth rate has climbed to 24.7%, up from 22.5% a week ago and 23.2% at quarter-end (June 30), which would mark the second straight quarter of growth above 20% and the seventh consecutive quarter of double-digit growth, led by the Financials sector. Revenue growth of 12.8% would be the highest since Q2'22. Expectations for the season are running high. This week two of the "Magnificent Seven," Alphabet and Tesla, are scheduled to report, with markets keenly focused on Alphabet's capital spending to gauge whether the AI infrastructure buildout is set to continue, an outcome with wide ramifications for the broader equity markets.

Week ahead

The week ahead will be light on the macroeconomic front, allowing markets to turn their focus to corporate earnings and to the risks emanating from the widening conflict with Iran. The main data point of note will be S&P Global's preliminary, or "flash," PMIs for July, which will offer an early glimpse into the pace of US economic activity at the start of the third quarter.

Number of the week: 180 days

The length of time investors could go between financial disclosures under a rule change the SEC is looking to advance, roughly double the current gap of about 90 days. Proposed in May under Chair Paul Atkins, the amendment would let US public companies report on a semiannual basis, filing a single new Form 10-S alongside the annual 10-K, in lieu of the long-standing requirement to report earnings quarterly. Framed by the agency as offering "regulatory flexibility" to let companies and their investors settle on the cadence that best suits them, in practice it would cut the frequency of mandatory financial reporting in half, stretching to six months the window in which the market operates without an updated look at corporate performance and management’s commentary thereto.

The proposal has met with significant objection. It has drawn tens of thousands of comment letters, among the largest responses in the agency's history, with independent tracking suggesting roughly 99% opposed the change, while a CFA Institute survey found 62% of investment professionals against a shift to semiannual reporting and 70% opposed it even to making it optional. Among many, core concerns are that longer gaps risk unequal access to information, greater volatility, and a higher cost of capital. Major industry bodies, including SIFMA and the Investment Company Institute, have argued to simply streamline the existing 10-Q rather than abandoning it, and the path from here is uncertain, as the SEC must first work through the record volume of comments before deciding whether to revise, advance, or shelve the rule. Coming alongside the Fed's own move toward communicating less, the proposal appears to mark a broader trend toward reduced transparency, one that would likely disadvantage retail investors most and, over time, weigh on valuations, as markets tend to confront less disclosure with lower equity premiums.

If you have questions about how this may impact your investments, or how you should be positioned, please do not hesitate to contact us at claudio@caladocapital.com.

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