Commerce Trust Market Brief with Scott Colbert

Interest Rates Continue to Rise as Inflation Persists

Recorded August 3, 2026

Scott Colbert: Good morning. It's Monday, August 3rd, and the markets are open. Returns this past week were largely positive, making up for about two down weeks prior to that as we return to some fighting back in the gulf war. But the S&P 500 (Index) returns are largely similar to what they were when we talked to you about three weeks ago. Returns to the overall market as measured by the S&P 500, are up 10.12% so far year-to-date.

The average stock continues to do a bit better, closer to 13% for the average stock (as measured by the S&P 500 Equal Weight Index). And of course, as you move down on capitalization this year, we've seen higher returns. The Russell 2000 (Index) now almost up about 19% on a year-to-date basis.

International returns have followed a similar pattern, where the larger-cap (capitalization) stocks are up about 11% to 12% in the developed markets (as measured by the MSEI EAFE Index). But the real action has been in the emerging markets driven by South Korea and Taiwan. Total returns there year-to-date about 20% (as measured by the MSCI Emerging Market Index).

What has changed since we've last talked is that interest rates have continued to rise. This has pushed the total return of the Bloomberg Aggregate (Index), the broadest measure of the investment grade bond market, into negative territory. Driven up by what? Stubborn, sticky inflation plus nominal GDP (gross domestic product) that continues to rise, and perhaps a Federal Reserve that people are expecting to tap on the brake but didn't over the past several weeks.

And of course, the markets are still bounced around day to day with what's going on over in the Persian Gulf. So far this year, the price of a barrel of oil in this country has averaged about 25% or 26% more than it averaged last year. And we know this is likely to subtract from GDP perhaps as much as 0.3% if oil prices stay elevated for the entire year. That's still, though, just a modest impact to overall GDP and doesn't push us anywhere near recessionary territory.

And while there's been a modest amount of good news coming out of the (Persian) Gulf, and perhaps a second negotiation for some type of peace agreement with Iran, you can see that the forward markets do expect energy prices to slowly decline. But still, even two years forward, the markets have the price of a barrel of oil here in this country at $68 a barrel, where it only averaged $65 a barrel last year. So the market suggests that it could still take as much as two years to get energy prices back to where they were prior to the gulf war.

And of course, these higher energy prices have pushed inflation up. In fact, inflation on an average basis was running in excess of 4%. But with the recent hostilities cooling down over in the Gulf, we've seen a modest drop in inflation.

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Still, year-over-year inflation, as measured by the average of both the CPI (Consumer Price Index) and the Personal Consumption Expenditure[s] Index (PCE), is still clocking in at 3.6% on a year-over-year basis. And even when you X out those energy prices and the food prices, which we all know have risen, core inflation is still running a solid 3%.

And of course, with core inflation up to 3% on a year-over-year basis, the bond market has reacted and pushed interest rates up as well. We now see interest rates today that are averaging about 0.5% higher than they were at the end of last year. These higher interest rates ultimately will also bite to slow growth as we move forward, particularly over the second half of the year.

In addition to those higher interest rates, the market now expects the Federal Reserve to begin to push back against these inflationary pressures. While they paused again at the last meeting, somewhat of a surprise, because about one out of three market participants thought the Fed (Federal Reserve) might hike rates at the last meeting that we just had in July.

The forward markets are expecting at least one rate cut by the end of the year, and perhaps as many as two by March of next year. We would tend to agree that the Federal Reserve, in order to basically effectively prove that it wants to be an inflationary hawk and push back on inflationary pressures, will likely have to raise interest rates, certainly by the end of the year.

One important economic statistic that came out since we last talked was the second quarter GDP. For that quarter, real growth was only 1.5%, down from this first quarter's growth rate of 2.1%, but we did see an increase in nominal growth. Basically, the GDP was depressed because of higher inflationary statistics. When we look back on an entire year's worth of growth, though, the economy is growing just about as it always does, 2.1% on a real basis, which happens to be exactly the average 12-month growth rate that we've had since the turn of the century.

Nominal growth, however, is elevated, about 6.5% year-over-year, as the inflationary pressures have raised nominal prices but have not improved any real returns to the economy. Holding some of this real growth back has been what? An adjustment in inventories, where inventories have come down. That's the good news because as we rebuild inventories, that should be a positive contributor to GDP. And it's also been held back because of imports.

Now you might say, "With tariffs, why aren't we importing less?" But recall that almost all of the materials that go into a data center are imported. Those NVIDIA (NVIDIA Corporation) chips are made either in Taiwan or South Korea. And we continue to import those technological pieces of equipment that go into this huge data center buildout, which actually pulls back on GDP.

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We do expect to see GDP accelerate slightly over the second half of the year, particularly if energy prices remain modest. For the first half of the year, GDP averaged 1.8%. We think we can do better over the back half of the year and get back to closer to that 2% annualized growth rate that we currently have today.

Finally, we're about to get July's employment report. The employment report typically is the most important report and moves the market the most, because if we're creating jobs, this economy makes forward progress. To the extent that we've been to lose jobs, the market begins to worry about a recession.

We would note several things. Number one, as you're all well aware, job growth in 2025 was very anemic, averaging only about 10,000 jobs per month, largely because of a confluence of three events that weren't likely to occur this year. Number one was the total shutdown of non-documented immigration. Number two was the government shutdown plus the loss of 300,000 large government jobs. And then number three was the implementation of the tariffs, which basically froze middle market businesses and their hiring prospects.

This year, fortunately, we've seen a solid bounce back in job growth. And more importantly, we've even seen an acceleration in job growth from the first quarter to the second. Our best guess is that we probably created somewhere around 80,000 to 90,000 jobs in the month of July, but we'll find out this Friday.

The most important statistic, though, to probably look at within that report will be the diffusion index. In other words, how many sectors are participating? Last year we had a very narrow job market where, if it wasn't for healthcare and basically hospitality services, we would have had no job growth at all. This year, over 50% of the employment sectors are showing gains in employment. Last year's was a narrow market driven by hospitality and healthcare. This year it's broadened out to business services, financial services, and even manufacturing.

Of course, that's a lot of business and financial market news to digest, and we'll be back in about three weeks to talk to you how all the new economic news is impacting the financial markets.

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