Post Oak Private Wealth Advisors

Advisory, Consulting & Investment Management

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Monthly Market Commentary

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In July, the stock market looked calm on the surface, but was anything but calm underneath. We had volatile days where the market indexes went into full reactive mode, but also longer periods of sustained rotation into underperforming sectors. The S&P 500 declined narrowly by 0.1% for the month, while the Nasdaq Composite Index fell 1.8% as investors began to question the narratives driving tech and chip stocks.

In this month's letter, I'd like to unpack this gap: where the calm is real and where it's masking something worth your attention. We'll start with a dive into semiconductors, where momentum has swung wildly between reward and risk. Then, we turn to the energy markets and a story that hasn't gotten the attention it deserves: two critical shipping chokepoints now under threat at the same time. From there, we'll review the Federal Reserve's recent meeting and assess where second-quarter earnings season stands so far. Our goal, as always, is that you are not just informed but equipped to make sense of what happening now and what comes next.

Chips pull back, but no need to panic

Chip stocks have had a rough few weeks as of late. The Philadelphia Semiconductor Index is down roughly 20% from its late-June high and its peak year-to-date gain of 60%. Several factors are behind the pullback. First, investors are still questioning whether all the AI infrastructure spending (money that's already spent and money committed but not yet spent) will translate into real returns. To be sure, investors aren't questioning the premise of AI—enthusiasm and belief among market participants is still high—but they are wondering if the current pace of AI capital expenditures by the big tech firms is justified. Rising borrowing costs are also on investors' radar as long-term interest rates climb and hawkish tones from the Federal Reserve hit growth-oriented firms like the chipmakers.

Among the chipmakers themselves, some have sent signals about changing business dynamics. Korean firm SK Hynix, for example, reported blockbuster earnings and strong demand for its high-bandwidth chips but still below market expectations. Its stock price plunged nearly 20% after the announcement but pared its daily loss to just 9.6%. The news affected other semiconductor stocks too, including US-based Micron Technology, which dropped 13% in a single day, and the chip-heavy KOSPI Index for the South Korean stock market, which at one point was down 30% last month. Rising competition from Chinese chipmakers is also fueling investor concern, following the strong debut of CXMT on the Shanghai stock market. Additionally, the Chinese government is backing development of its domestic chipmaking equipment industry, including the deep ultraviolet lithography machines that are key for the manufacture of high-end memory chips.

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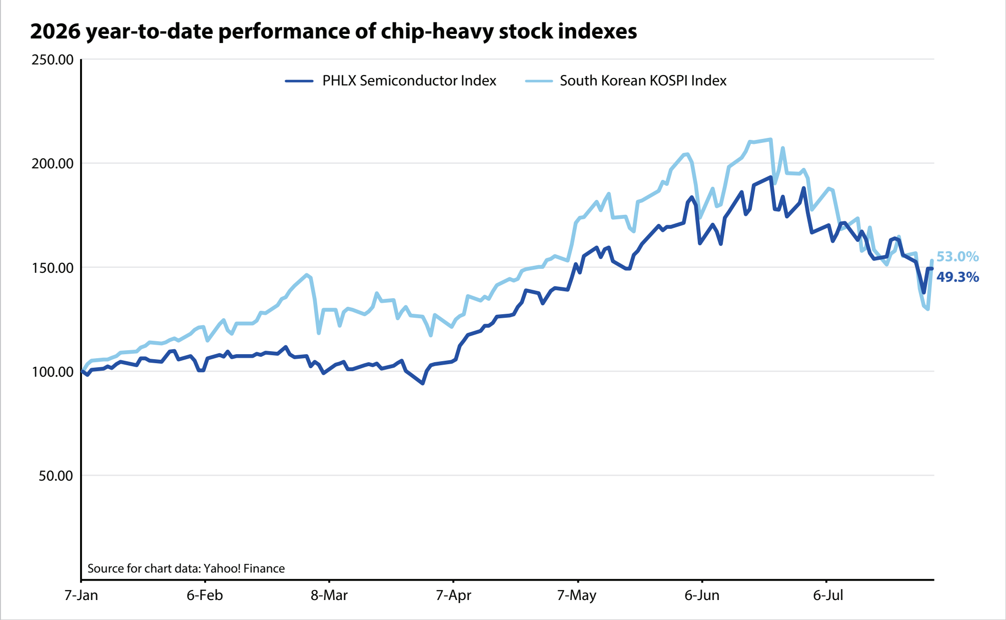

For all of the company news and stock price volatility, we are staying measured in our view on the semiconductor industry. To us, last month's market movement looks more like a reset of valuations and sentiment while the growth story remains intact. We don't see a demand problem with the supply of high-bandwidth memory chips sold out through most of 2027.

Moreover, Q2 earnings reports offered some clarity. As an industry, Q2 semiconductors earnings are expected to grow 131% year-over-year, once all firms have reported. Earnings reports from the chipmakers' primary customers, the AI hyperscalers who are making the massive investments in infrastructure, showed a divergence in success stories. Amazon and Microsoft reported surging revenues for their cloud-based AI services and stock investors applauded these results. But Alphabet and Meta Platforms found themselves on a different path where excessive spending has led to more questions than clarity for investors, and their stock prices subsequently took a beating. Robust earnings growth and price volatility has compressed price/earnings metrics for Nvidia, whose valuation has fallen to 22-times forward earnings as of June month-end, much lower than its five-year average of 72-times forward earnings.

Energy returns to the spotlight

The second quarter may have belonged to technology, but July was much different. Even though the S&P 500 declined slightly last month, beneath the surface momentum among sectors rotated sharply. The best example of that rotation is energy, which climbed over 12% in July and usurped technology as the year-to-date performance leader. It was a sharp reversal of fortune for energy stocks, which had fallen 5% in June and over 13% for the second quarter.

Other value-oriented sectors like financials, health care and consumer staples were positive in July while technology fell and dragged the S&P 500 down for the month. Other sectors that had been benefiting from AI hyperscaler spending, such as industrials and utilities, also retraced their recent gains last month. (See the sector performance chart on the following page.)

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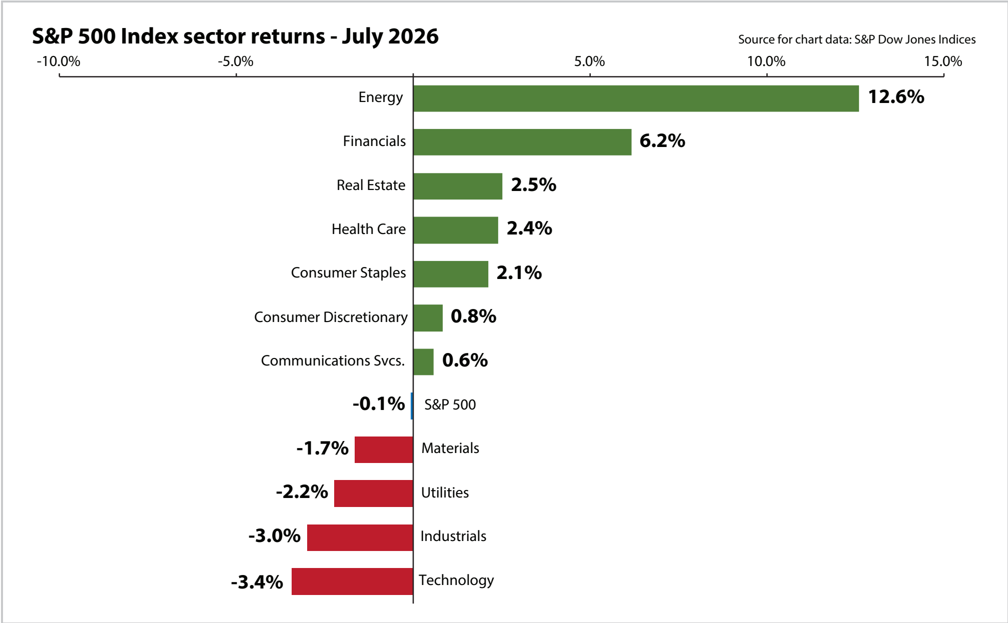

The catalyst for energy's latest market surge was the same one driving most of last month's major storylines: rising oil prices tied to conflict in the Middle East. Since our Q2 commentary, hostilities in the Persian Gulf have reflared and the Strait of Hormuz, which carries roughly a fifth of the world's seaborne oil, remaining unreliable for shipping. Additionally, the alternate route of Saudi Arabian oil is now under direct threat as well. For months, Saudi Arabia has rerouted a significant share of its oil exports away from the Strait of Hormuz and through a pipeline to its Red Sea terminal at Yanbu. That workaround depended on a different chokepoint staying open: the Bab el-Mandeb Strait, which connects the Red Sea to the Gulf of Aden.

But this past month, Iran-backed Houthi militants in Yemen resumed strikes, breaking a pause in Red Sea shipping attacks since 2024, and declared a maritime embargo specifically targeting Saudi oil shipments through the Bab el-Mandeb route. Several tankers carrying Saudi oil have already turned back rather than risk the crossing. Iran-aligned officials have also described a coordinated strategy explicitly aimed at pressuring both chokepoints—Hormuz and Bab el-Mandeb—at the same time. In previous Red Sea shipping disruptions (2023-24), there was always a workaround. This time, the workaround itself is being targeted.

Markets have noticed: Brent crude, the global benchmark, jumped from around $90 per barrel over $100 within days, the highest level in two months, before easing modestly by the end of July. Oil prices have been volatile and headline-driven since the outbreak of the Iran conflict, but investors shouldn't fixate so much on the price than on the mechanism because it directly impacts inflation and the possible direction of Federal Reserve monetary policy. Economists estimate that every 10% rise in oil prices adds roughly 0.2 percentage points to headline inflation, mostly through transportation costs with a smaller but real effect on food prices tied to higher fertilizer costs. Separately, shipping costs are rising as insurers have raised war-risk premiums to four or five times their prior levels. Shipping lines continue to route vessels around the southern tip of Africa rather than risk the Red Sea, adding weeks to transit times and cost to the goods that eventually reach store shelves.

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None of this makes a repeat of 2022-style inflation inevitable. But the recent escalation of oil prices may reverse the trend of easing inflation from the past few months and comes at an inconvenient time for a new Fed chair who has already said the quiet part out loud: prices are still too high.

The Fed won't tip its hand

Following Kevin Warsh's second meeting as Fed Chair on July 29, the rate-setting committee chose to stand pat on interest rate changes, although the number of dissenting voices favoring a rate hike increased to three. The bigger news coming out of the Fed's decision was Warsh's remarks to the press afterwards, where he essentially swatted away requests to address the Fed's plan to fight inflation and stated his preference for letting the markets respond to rising price pressures.

What the market responded to was a growing loss of confidence in the Fed's ability to keep inflation under control. Stocks sold off massively in the hour following Warsh's comments and yields on the longest Treasury bonds hit levels last seen 19 years ago. The shift away from Fed transparency comes at a time when central bank officials are increasingly divided over how to read the disparate signals on the economy and respond to rising inflation pressures, especially given the pervasive uncertainty surrounding events in the Persian Gulf and the impact on oil prices.

The minutes from the June FOMC meeting, released in early July, showed a committee that remains roughly split between officials who see room to hold or eventually cut rates and those who believe a hike before year-end is warranted. I would encourage clients to look past the Fed's rate decision and pay attention to the effect of near-term oil price spikes on the next monthly inflation numbers and how different Fed officials voice their concerns. A Fed that sounds unbothered by $95-plus oil is a very different signal than one that sounds newly concerned.

Managing risk remains paramount

Given everything that has transpired over the past month, we think the throughline is the same one we've emphasized all year: risk management matters more than ever when so much of the market's recent success is already priced in. In the coming weeks, we'll learn more about the health of the economy and the resilience of the market as Q2 earnings season reaches its peak. Already, the early numbers show strong year-over-year growth and continued beats of analyst expectations. But we must remember how much the bar has been raised by stellar results in previous quarters and what a small earnings miss can mean for the stock price of well-managed quality companies.

As always, we welcome the opportunity to talk through these events in context with your wealth management plan and investment portfolio. Please contact our office to schedule a time if you would like to discuss your concerns with us. In the meantime, we hope you and your families enjoy the rest of the summer.