Markets Get Mixed Signals in August

The Federal Reserve's (Fed's) resolve, the end of a rally, trouble overseas and a strong jobs growth report were some of the ingredients of August's strange brew of market news and events.

We entered August in the midst of an upswing for stocks that had provided consistent, broad gains since mid-June, likely bolstered in part on the belief that the Fed would cease its interest rate raising plan. The momentum faded mid-August. Then Fed Chairman Jerome Powell deflated the optimistic speculation.

Despite positive movement on inflation, Powell said households and businesses should expect "some pain" as the Fed holds fast to its price stabilization plan. His blunter-than-usual statement may have added to volatility we saw at the end of the month.

To mix the signals further, the July jobs report indicated a surprising 528,000 non-farm hires – a number counter to expectations as the Fed tightens the money supply. We also saw second quarter gross domestic product estimates revised – still showing the economy shrank, but to a lesser degree than earlier reports.

"The contradictory tale of the economy is summed up in the second estimate, which, while negative, improved from the first estimate on the strength of consumer demand. Economic data reinforces our view that the U.S. economy, while slowing, should not fall into a recession this year," said Raymond James Chief Investment Officer Larry Adam.

Despite the drama at home, the larger global economic news is happening elsewhere, where the outlook is less mixed than in the U.S. Before that, let's look at where the mainline indices stand for the year.

	12/31/21 Close	8/31/22 Close*	Change Year to Date	% Gain/Loss Year to Date
DJIA	36,338.30	31,510.43	-4,827.87	-13.29
NASDAQ	15,644.97	11,816.20	-3,828.77	-24.47
S&P 500	4,766.18	3,955.00	-811.18	-17.02
MSCI EAFE	2,336.07	1,847.99	-488.08	-20.89
Russell 2000	2,245.31	1,844.12	-401.19	-17.87

Bloomberg Aggregate Bond	2,355.14	2,109.95	-245.19	-10.41

*Performance reflects index values as of market close on August 31, 2022. MSCI EAFE and Bloomberg Aggregate Bond reflect August 30, 2022, end-of-day values.

Where the grass isn't greener

Despite the drama in the U.S., much of the world's most challenging events are occurring overseas. In brief:

- The Bank of England and European Central Bank, to battle inflation, are continuing their aggressive rates-raising strategies as their economies teeter on the brink of recession.
- Europe and the U.K. are experiencing surging natural gas prices, with drought also contributing to record electricity prices. The good news is that despite a near-total cutoff of Russian gas supply in recent weeks, European Union gas storage is already 80% full.
- China is facing its own energy crisis even as the impacts of its "zero COVID" policies continue to hamper growth.
- Emerging economies face even stronger headwinds, being more adversely affected by high inflation and a rate-hiking cycle, which typically began earlier than in developed economies.

Less water, less energy

This exceptionally hot summer was especially intense in Europe, and among the effects of the drought is a worsening of the energy crisis that originated with Russia's war in Ukraine. First, drought reduced the productivity of hydropower plants: less water means less electric output. Second, water scarcity can force nuclear power plants to go offline as a safety measure, because water is essential for cooling the reactors. Third, with major rivers such as the Rhine at their lowest water levels on record, barges hauling coal sometimes could not physically move, curtailing the ability of coal-fired power plants to get the necessary fuel.

Competing ideas jockey on fixed-income markets

The biggest noise for fixed income investing in August was the back and forth between inflationary pressures and recession fears. The biggest impact from those competing concerns was that Treasury rates ended higher across the maturity spectrum. Three- and six-month bills were up 48 basis points and 33 basis points, respectively, while the five-year and 10-year weakened, pushing rates up 48 basis points and 38 basis points respectively.

The late-summer policy sprint

The passage of major Democratic legislative priorities, and surprise results around ballot initiatives and special elections, may shift the conversation around the likely outcomes of the midterm elections. The House of Representatives remains primed to flip to Republican control, but the Senate may prove much tougher to take. Control of the Senate will be closely watched for the impact on regulatory policy and confirmations during the second half of the Biden administration's first term.

The bottom line

We live in interesting times and volatility remains a constant companion. On the other hand, all the bad news may be already priced into the market, providing a reasonable belief that valuation throughout the stock market represents a stable floor. The underlying strength and participation in the recent rally bode well for this assessment.

But while the worst of this bear market may be behind us, don't expect unbridled enthusiasm to follow. Expect setbacks and normal back-and-forth trading ahead as investors gain more clarity on the path of inflation within the Fed's tightening program.

We remain thankful for your continuing trust as we help you navigate this era of uncertainty. If you have any questions about this letter, your accounts or anything at all, please reach out at your earliest convenience.