Market Still in an Uptrend Despite Cool August Performance

A steady stream of news drained enthusiasm from the equities markets through most of August, snapping a five-month growth streak at a time of the year known for cool market performance despite the swelter of its dog days.

Among that news: A tick in the wrong direction of a key measurement ignited fears of a second wave of inflation. Oil prices rose, as did bond yields. Federal Reserve (Fed) Chairman Jerome Powell reiterated the Fed's commitment to lowering inflation with higher interest rates. Fitch Ratings downgraded the U.S.'s sovereign credit rating one notch from AAA to AA+. And cracks in China's economy highlighted structural challenges in the world's second largest economy.

"Rising bond yields contributed to the weakness in stocks this month. A surge in Treasury issuance and the market coming to grips with the Fed's decision to keep interest rates higher for longer policy also weighed on sentiment," said Raymond James Chief Investment Officer Larry Adam. "Historically, the S&P 500 has experienced three to four 5% pullbacks a year – and this year, we've only had one. We continue to believe the market is in an uptrend."

Despite the gloom of most of the month, the last week of trading saw a strong rally for equities in the wake of positive economic and inflation data. This narrowed the month's loss but fell short of closing it.

Looking out, the arrival of a long-expected (yet delayed) recession may be further back than some analysts estimated at the start of the year. Now, the first quarter of 2024 seems a more likely landing place than the fourth quarter of 2023. Part of that reassessment is on account of the strength of the economy entering the third quarter, particularly in regard to consumer demand, investment in structures and business inventories. The long tail of COVID-era savings may also be serving as a crutch.

Altogether, this came out as relatively untroubling volatility through August.

There's more to explore, but first, let's look at year-to-date results.

	12/31/22 Close	8/31/23 Close*	Change Year to Date	% Gain/Loss Year to Date
DJIA	33,147.25	34,721.91	+1,574.66	+4.75%
NASDAQ	10,466.48	14,034.97	+3,568.49	+34.09%
S&P 500	3,839.50	4,507.66	+668.16	+17.40%
MSCI EAFE	1,943.93	2,117.39	+173.46	+8.92%
Russell 2000	1,761.25	1,899.67	+138.42	+7.86%

Bloomberg Aggregate Bond	2,048.73	2,073.37	+24.64	+1.20%

*Performance reflects index values as of market close on Aug. 31, 2023. Bloomberg Aggregate Bond and MSCI EAFE figures reflect Aug. 30 closing values.

The state of play sinks in, lifting yields

Not more than four months ago, some investors and pundits anticipated the Fed would make as many as four interest rate cuts by the end of the year. This wild-eyed optimism dragged at Treasury rates. August's volatility seemed to help refocus attention on the difference between the economic conditions and the market, leading the 10-year Treasury to shoot up 38 basis points (bps) to 4.34% peak or 15 bps to 4.11% current level in August, a price much more aligned with actual Fed policy and the economic environment.

No easy fix for China's challenges

Country Garden, one of China's largest and most well-regarded real estate companies, struggled to meet its debt obligations in August, spotlighting broader economic challenges and creating volatility for global equities. Issues of demography, slackening rural-to-urban population migration, geopolitical fracturing and subsiding private sector dynamism represent structural economic challenges not easily mended with normal controls like looser monetary policy. As the consequence of top-down political policies, they will demand a political policy solution.

Global water stresses demand combinatory action

Amid the hottest summer in recorded human history, the World Resources Institute released its latest statistics on water scarcity in August. An estimated 25% of the world population faces "extremely high" water stress for at least part of the year. More broadly, half face "high" water stress. The Middle East and North Africa regions, followed by South Asia, experience the most stress. Supply-side solutions like desalination and recycling and demand-side solutions like conservation and metering will require a combination of financial and political will.

A path to a government funding deal

House and Senate leaders spent much of August preparing to negotiate a deal that could provide stopgap funding for the government into fiscal year 2024 after the Congressional recess, though the path towards an interim deal is likely to see some of the volatility that has come to define these moments. Ahead of the September 30 deadline, the House is expected to pass a continuing resolution that would be guided by the House Freedom Caucus's conditions while the Senate is expected to pass a "clean" stopgap bill. The debate will then likely focus on whether the House decides to save the political fight around the Freedom Caucus amendments for the year-end bill, or whether a shutdown is forced.

The bottom line

Investors are apt to get bullish when things are going well, causing them to have less concern about surrounding conditions. The volatility of August seemed to jolt that confidence, giving everyone a reason to reassess. These kinds of corrections may be healthy, allowing the fundamentals of the market to catch up to its aspirations, preventing a harsher correction later on.

And after a first half of the year driven by such high levels of enthusiasm and optimism, we don't expect the prevailing mood to sour.

Thank you for the continuing opportunity to serve your financial goals, and for your trust in our management of your financial well-being. If you would like to discuss the market, this letter or anything pertaining to your financial plan, please feel free to reach out at your earliest convenience. [I'll/We'll] be glad to hear from you.