Monday, August 29, 2022

Good morning:

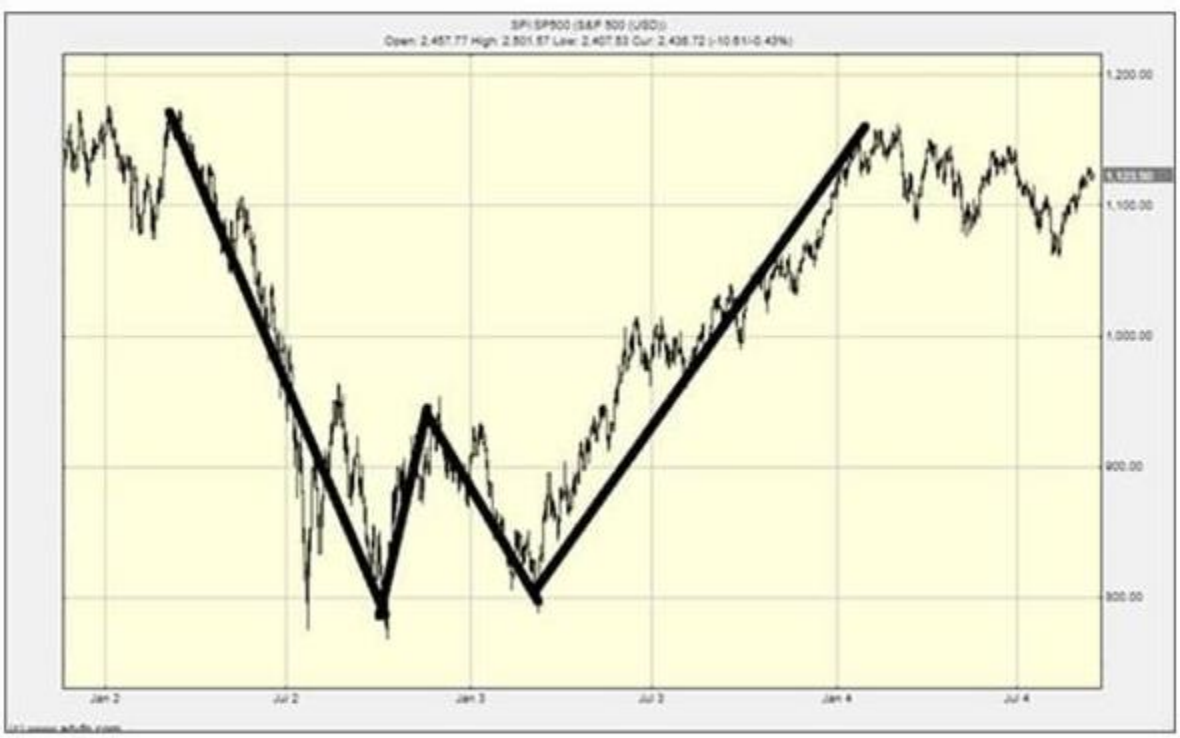
As expected, markets were hyper-focused on the Federal Reserve last week as they held their annual Economic Symposium in Jackson Hole, Wyoming. Some even hoped to hear the Fed reveal a pivot to a less aggressive rate hiking posture, although we felt that was premature and not very likely. Instead, Fed Chairman Powell doubled down on his current tactics commenting, “Restoring price stability will likely require maintaining a restrictive policy stance for some time. The historical record cautions strongly against prematurely loosening policy.”

Equities immediately sold off on these comments, accounting for the bulk of each major stock index’s decline of at least 4% for the week. We now are essentially flat for the month of August after this second week of losses. As we start the week, markets are still well-off June’s low due the strong gains posted in July. However, with a clear loss of upside momentum, some are already positing technical arguments suggesting the market may go back and retest those June lows. While that is certainly possible, we do not believe that will occur since we now see growing evidence that inflation may have peaked.

It does suggest, though, that as the Fed carries out its plan, there will be continuous headwinds to growth. This may eventually reveal itself in diminished earnings estimates for many companies, most now already trading at lower multiples. Despite this contraction in equity valuations, earnings have remained resilient. With over 95% of S&P 500 companies so far reporting their Q2 results, earnings grew an average 8.9% over a year ago, led by strong profit growth amongst energy companies.

As we wrap up a volatile summer in the market, we won’t know whether the Fed’s actions match its words until next month’s policy meeting. A shift from their recent pattern of 0.75% hikes to 0.50% would potentially signal a modest adjustment in their stance, albeit not a full “pivot.” Like last week’s symposium, it will likely garner lots of media and institutional investor attention. The result may be more volatility – in either direction.

While we all enjoyed the immediate snap-back recoveries that stock indices demonstrated nearly every time they endured a pullback or correction over the past several years, these “V-bottoms,” as they became known, may not be what we experience during periods of rising interest rates. In keeping with the letter shape analogy, the market may instead resemble a “W” or a “U” or even “L” until more clarity about our economy, earnings, and inflation is truly known. The chart below illustrates the market’s W-shaped recovery of 20 years ago in 2002.



Source: Forbes.com

Given enough time, we remain confident that our markets and economy will fully recover and be focused on the next phase of growth regardless of what letter emerges in a chart in the coming months!

Have a nice week and a great end to your summer!

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