MARKET REVIEW & OUTLOOK **AUGUST 2023**

Breaking News: The government didn't waste any time releasing August employment data. The jobs data hit and reported a beat at 187,000 jobs added and the unemployment rate increased to 3.8%

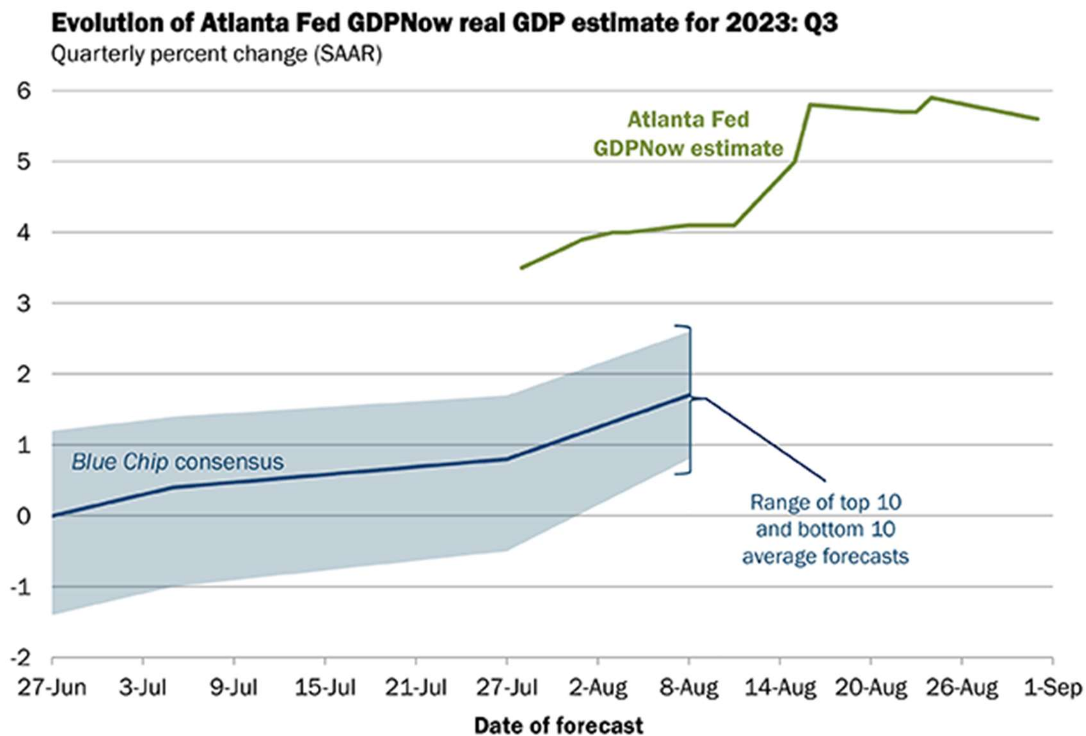
Back to our regularly scheduled programming…

KEY TAKEAWAYS

- The equity markets spent 3 weeks declining and the remainder of the month clawing back.
- The 10-year Treasury Yields saw a strong move higher mid-month then faded into month end.

The U.S. Economy

The final 2nd quarter GDP report came in lower, at 2.1%, vs. the last report of 2.4%. Additionally, core PCE, the imbedded inflation measure, further decreased to 3.7%, down from the last report of 3.8%. The initial 3rd quarter GDP estimate from GDPNow is nearly 6%! The Blue-Chip consensus is now up to almost 2%, as shown in the chart below. The economic activity of expected GDP is a barn burner and the PCE deflator is continuing to signal moderating inflation. This data certainly doesn't suggest it is time to pause or cut rates. On the contrary, more rate hikes would appear the more appropriate course.



Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*
Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

Source : https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

Interest rates traded higher during the month, though the point-to-point yield misses the excursion of much higher yields mid-month that hit levels not seen since 2007 at 4.36% on the 10-year U.S. Treasury. With the continued strength of economic data, the Fed speak of more work to do, and stabilization of commodity prices suggests inflationary pressures may resume. Late month downward revisions, of previously reported, employment data provided comfort that maybe the Fed can pause in September. The increase in yields created a headwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF fell -0.64% for the month. The U.S. 10-year Treasury bond yield ended the month at 4.09%, up from July's close of 3.96%.

The Dow Jones Industrial Average slipped -2.36%, the S&P 500 decreased -1.77%, and the small cap Russell 2000 dropped -5.17%. The international markets traded in line with the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index slumped -3.86%, and the MSCI Emerging Markets iShares Core ETF Index fell -5.93%.

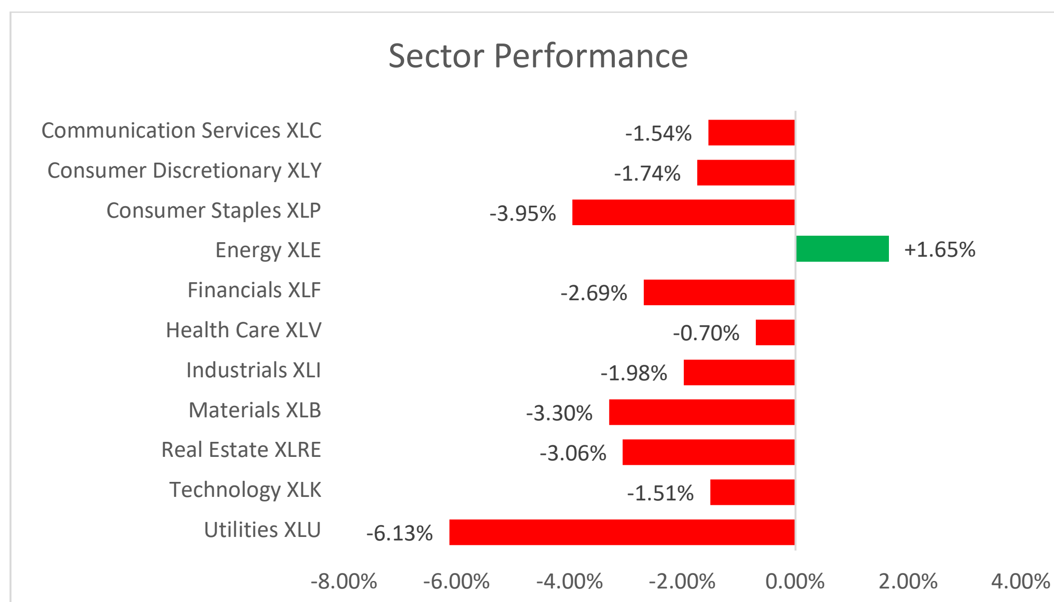
August's performance was decidedly more negative other than Energy in the green.

The best performers were…

- Energy: +1.65%
- Healthcare: -0.70%
- Technology: -1.51%

The "worst" performers were…

- Utilities: -6.13%
- Consumer Staples: -3.95%
- Materials: -3.30%



Source: https://www.morningstar.com

Oil Report

The oil market generally traded in the low $80’s, though continued repeats of easing restrictions on Iranian oil exports gave us a temporary dip below $80. The underpinnings of the rally have been strengthened as the Saudi’s and Russian’s continued to restrain oil supplies, which is pitted against softening oil demand, both from China and the U.S. China has started throwing in a few efforts to stimulate their economy, but so far, their market and economy haven’t responded. The current NYMEX WTI Crude Oil futures settled at $83.63 posting a gain of just over 2% from the prior month’s close of $81.80 a barrel. The increase in crude oil was disconnected from RBOB gasoline, which finished with a loss of over 11% vs July’s close, though it didn’t seem to translate to lower prices at the pump. The 9-month range bound trading is now looking like a big bottoming process with prices starting to hit escape velocity. If prices do sustain a break higher, oil prices look to have a target in the low $100’s, which would likely reignite inflationary pressures and thus more rate hikes. Ukraine continues to escalate direct attacks on Russia and geopolitical upheaval is spreading to more countries in Africa. We have moved into the heart of hurricane season, though the first big storm through the Gulf of Mexico missed most of the energy infrastructure. The “energy” building in the energy complex suggests inflationary pressures are percolating.

The Rest of the Data

The July ISM Manufacturing Index increased to 46.4 from June’s reading of 46.0. However, the ISM Services Index decreased to 52.7 in July, from June’s print of 53.9. The prices paid component for Services increased and Manufacturing prices stabilized at deflating levels. Any reading below 50 generally indicates deteriorating conditions and any reading above 50 generally indicates improving conditions. Consumer confidence dropped to 106.1 in August, which compares to a downwardly revised figure of 114.0 in July. The unemployment rate fell again to 3.5%, while the economy added 187,000 jobs in July, which was a small miss to expectations of 200,000 jobs as well as downward revisions to each of the previous 6 months. The Consumer Price Index for All Urban Consumers (CPI-U) again increased +0.2% in July, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index rate rose to +3.2% on a non-seasonally adjusted basis. The CPI ex Food and Energy, eased modestly to 4.7% over the last year. The story remains the same, economic data is good, employment data is good, and inflation is still relatively high. The only clear sign of weakness is the Manufacturing sector, but the likely source is correcting the pandemic boon, in 2020 and 2021, of goods purchases when everyone was locked down. The Fed reiterated at the Jackson Hole symposium, that more rate hikes may be needed and no rate cuts until late 2024 at the earliest. Economic activity continues to suggest deviating from this course would likely prove premature. We will continue to monitor economic activity along with inflation reports and how that may impact Fed policy.

Summary

The broad markets, both equities and fixed income, remain in a tug of war. Will the economy/Fed thread the needle with a “soft” landing or will we get hit with a recession after a 5% increase in Fed fund rates. We continue seeing this battle of narratives play out, sometimes day to day, sometimes longer. The Fed continues to think/hope they can manufacture a “soft” landing. The “lagging” employment

data is starting to show signs of weakening, which the equity markets love as the Fed can pause or stop raising interest rates. However, it is a fine line between weakening and declining, declining would indicate a recession, which the equity markets are not pricing in at this time. The fly in the ointment is inflation, weak economy or not, strengthening inflation would cause all the current Fed plans serious issues. As mentioned previously, commodities, especially oil, are showing signs of setting up for meaningfully higher prices. If prices continue to move up from the long trading range, the inflation is under control narrative would take a serious hit.

As always, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. growing debt and deficits, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. The continued equity rally has most segments exposure in equities, the one exception is Real Estate, which remains in floating rate Treasuries.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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