Market Perspectives
August 2023

KEY HIGHLIGHTS

- Markets take breather in August
- Seasonality could be a headwind
- Job market showing signs of cooling
- Worries on the consumer
- Inflation off its highs, not low enough

PERFORMANCE

Markets cooled their hot streak in August thanks in large part to a pop higher in 10-year U.S. Treasury Bonds which traded to 4.34% during the month, a level not seen since the Great Financial Crisis. The higher yields pressured the NASDAQ which ended the month in the red. The Magnificent 7, which include high-flying names like Nvidia, Amazon, Alphabet, etc. have driven 75% of the markets Year-to-date performance, but many of the powerhouses failed to deliver in August. Of the group Apple, Meta, Tesla, and Microsoft were negative during the month.

SEPTEMBER'S BAD TRACK RECORD

As readers know we like to have an idea of the historical tendencies of markets on a month-to-month basis. September has not been a friend to markets throughout history and ranks as the worst month historically for the market, averaging a -1.21% loss over the last 100 years. More recent history (50 years) has been better on an absolute basis, averaging a -0.92% loss but still relatively poor. Probably the best thing you can say about the month is that it's followed by the strongest three-month period on the calendar, October through December. Despite September's bumps and bruises, the last three months of the year from a cycle perspective have historically been favorable based on the four-year election and 10-year cycles. Another silver-lining to the dark seasonality clouds is the fact that in five other Septembers like 2023 where the S&P 500 was up over 10% through August and despite August being a negative month, those Septembers averaged a 2.11% gain.

JOBS MARKET HITS PAUSE

The jobs market has been one of the more consistent outperformers this year in terms of economic indicators and one of the main indicators pushing back on the soft or hard landing economic narrative. Based on the last six-month's average the economy has added 197k jobs per month. This month ponied up another better than expected number with 187k job added in August, however revisions to the two prior month's releases took some shine off the data. The unemployment rate ticked up to 3.8% from 3.5% reaching levels last seen in February 2022 while average hourly earnings came in weaker than expected. The data is

Index	MTD	QTD	YTD	1 Year	2022
S&P 500	-1.59	1.57	18.73	15.94	-18.11
Dow Jones Industrial Average	-2.01	1.36	6.37	12.58	-6.86
Russell 2000	-5.00	0.81	8.96	4.65	-20.44
NASDAQ Composite	-2.05	1.94	34.88	19.85	-32.61
Europe, Australia, & Far East (EAFE)	-3.82	-0.70	11.35	18.55	-14.05
MSCI Emerging Markets	-6.16	-0.22	4.86	1.69	-19.78
Bloomberg Barclays U.S. Aggregate Bond	-0.64	-0.71	1.37	-1.19	-13.04

Source: YCharts; As of 8.31.23; Returns in percent

signaling that strength in employment may be fading. This weakening trend has also been noticeable in the Jobs Openings and Labor Turnover report or the JOLTS report for July. This report gives the market a sense of the demand for labor as measured by jobs openings. As of July, there were 8.8mm jobs openings vs. an expectation of 9.5mm. Pre-pandemic jobs openings averaged around 6-7mm and were as high as 12mm in 1Q 2022, so there's a distinct normalization going on in terms of labor demand. While bearish for the economy in a broad sense, the weaker jobs data is actually having a positive impact on stocks and may be music to Chairman Powell's ears as it's lessening the likelihood of higher rates as the economy cools.

YIELD CURVE INVERSION & RECESSIONS

Since 1980, there have been six major US recessions per the Nation Bureau of Economic Research's (NBER) definition. Each of these recessions was preceded by an inverted yield curve so inversions have been an accurate predictor of recessions, however they have been much less helpful at providing the timing of actual recessions. The yield curve (measured by the 10-year versus 3-month Treasury) inverted on 10/27/2022 mainly due to the rapid ascent of short-term rates driven by Fed policy. While the long end of the curve has recently surged, evidenced by the 10-year Treasury yields hitting 4.34% on August 21st, the curve remains inverted. Is a recession imminent? History shows that an inverted yield curve doesn't mean a recession is right around the corner. In fact, recessions take time to show up because monetary policy has a lagged effect. Looking back at the last six recessions can provide context. On average, a recession was declared after 435 days after the initial inversion (10 yr. vs. 3 mo.) but the shortest time was 293 days and the longest 684. As of August 31, 2023, the yield curve has been inverted for 308 days. Interestingly, equity market returns during inversions have generally been good (fully evident in 2023), and recessions typically have not been declared while the curve is inverted, those are usually called after the curve has "un-inverted". This reversal is most often preceded by rate cuts or the imminent possibility of them, leading to short-term rates decreasing. We continue to keep a keen eye on the Fed and economic data to determine proper positioning as the current interest rate regime adjusts.

Date the 10 Year-3 Month Spread First Turned Negative:	Date the Recession Started:	Time from Inversion to Recession:	Number of Days from Inversion to Recession:
August 23rd, 1978	February 1st, 1980	17 months, 10 days	528 Days
September 12th, 1980	July 1st, 1981	9 months, 20 days	293 Days
March 27th, 1989	July 1st, 1990	15 months, 5 days	462 Days
April 7th, 2000	March 1st, 2001	10 months, 23 days	329 Days
January 17th, 2006	December 1st, 2007	22 months, 15 days	684 Days
March 22nd, 2019	February 1st, 2020	10 months, 11 days	317 Days
October 18th, 2022	Recession Not Declared Yet	Recession Not Declared Yet	Recession Not Declared Yet

Source: NDR

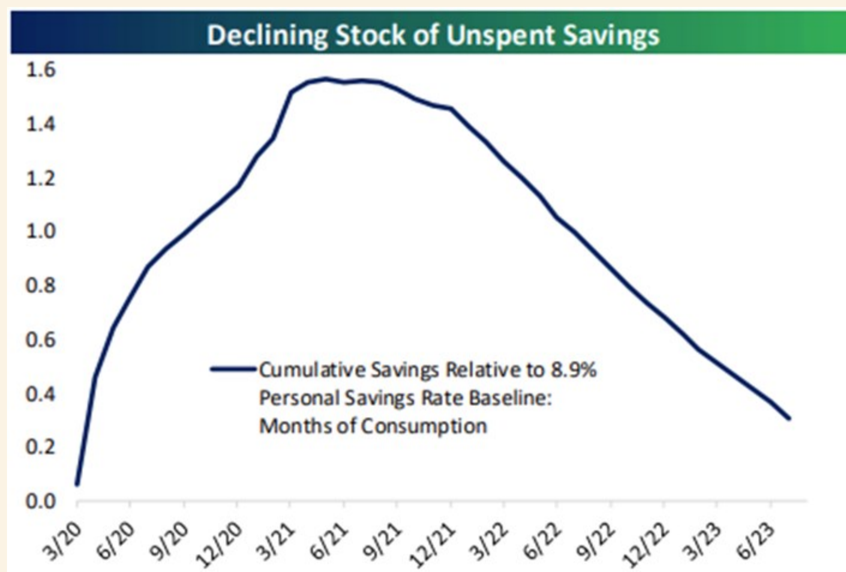
Source: Beskpoke; As of 9/1/23

CONSUMERS FEELING THE PINCH

It wasn't just interest rates that led to heavier prices, bears during the month found much to ponder with additional credit ratings downgrades, tightening lending standards, and softening loan demand. 30-year mortgage rates moved up to 7.25% which is very close to their historical average over time but represent a large increase to would-be borrowers that just last year saw rates that were 2-3% lower. Today the effective rate on outstanding mortgage debt in the U.S. is 3.6%. Consumer credit continues to get negative attention with credit card balances reaching new highs and post pandemic excess savings getting whittled away. At one point reaching a level between $1-2T, consumer excess savings are now down to approximately $200B being reduced by higher prices and unsustainably aggressive spending post pandemic.

EARNINGS

We have reported earnings over the last few months and readers know that in general corporate America has been outperforming in terms of earnings expectations. We've maintained a positive bias in markets due to this fundamental strength. Earnings are always about looking ahead so as we turn the calendar into September analysts are already penciling in expectations for next year's corporate earnings. The consensus expectation currently implies an earnings growth rate for full year 2024 of approximately 11% which would be an above average year. However, some large research outfits are starting to sharpen pencils and cut their expectations by half, to 5% growth based on margin growth concerns. They worry that with employment and input costs leveling off companies' profits will be crimped by higher costs.



Source: Beskpoke; As of 9/1/23

Inflation levels and how quickly pressures abate will be the primary determinant of how this argument unfolds. For now average beat rates for the last three quarters have been improving and more companies are revising their earnings expectations higher for the coming quarters, which historically bodes well for markets.

INFLATION TO MOVE SIDEWAYS

Oil prices recently have ticked back to 12 month highs and that's doing no one any favors, notably consumers, already being stretched by higher interest expense as well as the Fed that wants to see the CPI data continue its march lower. Based on recent energy prices, the Fed's CPI Nowcast is signaling yellow for the upcoming August CPI report. We'll get the official report September 13th but their Nowcast is showing a slight increase year-over-year vs. last month's Core and Headline CPI at 4.46% and 3.82%, respectively. There's an expectation to see housing costs retreat as owners imputed rent adjusts lower but positive base effects will also moderate leading to an increased likelihood of inflation moving sideways at best for the next few months. Important for the market will be to what extent this possible outcome will have on Fed policy. At present Fed Funds futures have rates on hold until March of next year.

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Sources: YCHARTS, Barron's, NDR, Bespoke, CME Group, FRED