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Market Stats & Commentary

Market Vital Signs as of 8/31/2022

Stock Indexes	August	YTD	1 Year
S&P 500	-4.08%	-16.14%	-11.23%
Dow Jones Industrial Average	-3.72%	-12.01%	-9.07%
NASDAQ Composite	-4.64%	-24.47%	-22.56%
Russell Mid Cap Index	-3.14%	-16.53%	-14.82%
Russell 2000 Small Cap Index	-2.05%	-17.16%	-17.88%
MSCI EAFE Developed Int'l Index	-4.75%	-19.57%	-19.80%
MSCI Emerging Markets Index	0.42%	-17.19%	-21.80%
Bond Indexes			
BBgBarc US Aggregate Bond Index	-2.83%	-10.75%	-11.52%
BBgBarc US Corp High Yield Bond Index	-2.31%	-11.22%	-10.58%
Interest Rates	**8/31/22**	**12/31/21**	**8/31/2021**
Fed Funds Target Range	2.50%	0.00%	0.00%
10 Yr U.S. Treasury Rate	3.13%	1.51%	1.29%

Data courtesy of Raymond James

Believe it or not, the first two weeks of August were quite positive. I won't go into all the numbers but on 8/16 the S&P 500 was up 4.2% MTD, which makes the ending number for the month feel all the more miserable. You may be wondering what it was that turned the U.S. stock market (and bond market for that matter) so negative so quick. The answer would be a really strong job creation report on 8/18. Now, you may be wondering why a really strong economic report might be bad news. The answer to that question is that a strong jobs number is counterproductive to the Fed's goal of taming inflation. To achieve that, supply and demand need to come into balance. Getting the supply chain back to normal has been a painfully slow process, so the only other lever to pull is to weaken demand. The jobs number we got on 8/18 was a long way from a weak number and the market took it as a sign that the Fed's work to lower demand is not done yet.

I continue to believe that while the Fed is not done, it will not be nearly as aggressive over the balance of 2022. The Fed Funds Rate is currently at 2.50% and the consensus is that we end the year between 3.50% and 4.00%. My guess is we get two more .50% rate hikes, then another .25% or .50%, depending on how the inflation and economic numbers look.

Interest Rates, Curve Inversions & Lessons from The Past

Interest rates across the board have risen considerably this year, but short term rates have gone up more than long term rates. This is actually a normal thing when rates are going up and when rates are falling the opposite is the norm. But sometimes the norm goes to an extreme and short term rates actually go higher than long term rates, resulting in an "inverted yield curve". I have discussed this in prior commentaries but I think it's a good time for a refresher because the yield curve has inverted over the last couple months. The most common determination for saying the curve is inverted is to compare the 2 year U.S. Treasury yield with the 10 year U.S. Treasury yield. If the 2 year rate is higher than the 10 year rate, the market considers the curve "inverted". This may sound like a technical thing in the bond market that shouldn't matter to the average investor but that's not true and the following chart will explain why.

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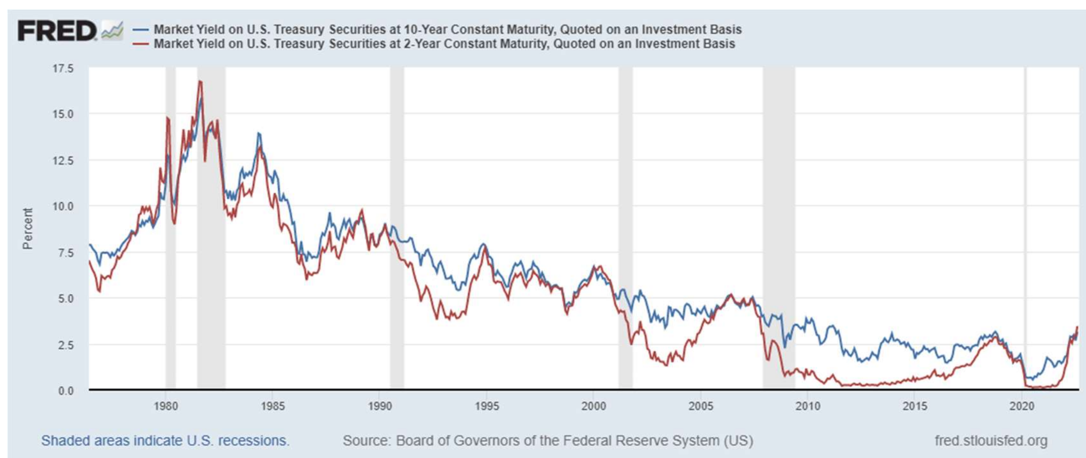
The blue line on the chart represents the spread between the 10 year rate and the 2 year rate. When the line is above zero the yield curve is "normal" and when the line is below zero the yield curve is inverted. Now look for the gray shaded areas. Those are periods of recession in the U.S. economy. You don't need a 160 IQ to see a correlation between an inverted curve and a recession.

I think it is also worth noting here that the yield curve doesn't normally (at least post 1982) stay inverted very long. Out of curiosity, I did some digging to find out how the curve normalized in the past. Did long term rates go up? Did short term rates go down? Turns out, both short and long term rates normally go down but short term rates go down more, which corrects the inversion.



Herein lies a problem with this current environment. **The curve is inverted and the Fed is still raising rates**. This makes the normal corrective pattern of short term rates falling more than long term rates a low probability event, at least for the next 6 to 12 months. So to correct the inversion, the most probable paths are either long term rates moving higher and going through the ceiling put in place in June, or the curve inverts even more to levels not seen since the early 1980's.

Typically, economic comparisons to the late 1970's and early 1980's makes investors (including me) wince and maybe a little nauseated. However, when I looked up the actual total returns (including dividends) on the S&P 500 for those years I found very different numbers than what I expected. Take a look for yourself…

	1978	1979	1980	1981	1982
S&P Total Return	6.51%	18.52%	31.74%	-4.70%	20.42%

https://www.stern.nyu.edu/~adamodar/pc/datasets/histretSP.xls

I'm not saying that time period was filled with economic rainbows and unicorns – it wasn't. But this serves as a stark reminder that markets and economics, while related, are two different animals.

David

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Investing involves risk and you may incur a profit or loss regardless of strategy selected. Past performance does not guarantee future results. Future investment performance cannot be guaranteed, investment yields will fluctuate with market conditions. Prior to making an investment decision, please consult with your financial advisor about your individual situation.

Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary.

Index Descriptions

S&P 500: Representing approximately 80% of the investable U.S. equity market, the S&P 500 measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested.

Dow Jones Industrial Average Total Return: The Dow Jones Industrial Average is a composite of 30 stocks spread among a wide variety of industries, such as financial services, industrials, consumer services, technology, health care, oil & gas, consumer goods, telecommunications, and basic materials. The index represents approximately 23.8% of the U.S. market, and is price weighted (component weightings are affected by changes in the stocks' prices). Maintained by the Averages Committee, components are added and deleted on an as-needed basis.

Russell Midcap: A subset of the Russell 1000 index, the Russell Midcap index measures the performance of the mid-cap segment of the U.S. equity universe. Based on a combination of their market cap and current index membership, includes approximately 800 of the smallest securities which represents approximately 31% of the total market capitalization of the Russell 1000 companies. The index is created to provide a full and unbiased indicator of the mid-cap segment.

Russell 2000: Based on a combination of their market cap and current index membership, this index is comprised of approximately 2,000 of the smaller securities from the Russell 3000. Representing approximately 10% of the Russell 3000, the index is created to provide a full and unbiased indicator of the small cap segment.

MSCI EAFE (Europe, Australasia, Far East) Index: A free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. As of June 2, 2014, the index consists of 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

MSCI Emerging Market Index: A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of June 2, 2014, the index consists of the following 23 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey, and the United Arab Emirates.

Bloomberg Barclays U.S. Aggregate (BCAG): A representation of SEC-registered, taxable, and dollar denominated securities. The index covers the U.S. investment grade fixed rate bond market, with index components for asset-backed securities, government and corporate securities, and mortgage pass-through securities. Must be rated investment grade (Baa3/BBB- or higher) by at least two of the following rating agencies: Moody's, S&P, Fitch; regardless of call features have at least one year to final maturity, and have an outstanding par value amount of at least $250 million.

Bloomberg Barclays U.S. Corporate High Yield: Covers the universe of fixed rate, non-investment grade debt which includes corporate (Industrial, Utility, and Finance both U.S. and non-U.S. corporations) and non-corporate sectors. The index also includes Eurobonds and debt issues from countries designated as emerging markets (sovereign rating of Baa1/BBB+/BBB+ and below using the middle of Moody's, S&P, and Fitch) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included. Must publicly issue, dollar-denominated and non-convertible, fixed rate (may carry a coupon that steps up or changes according to a predetermined schedule), and be rated high-yield (Ba1 or BB+ or lower) by at least two of the following: Moody's, S&P, and Fitch. Also, must have an outstanding par value of at least $150 million and regardless of call features have at least one year to final maturity.