Monday August 21, 2023

SUMMARY-

I. August market correction continues.

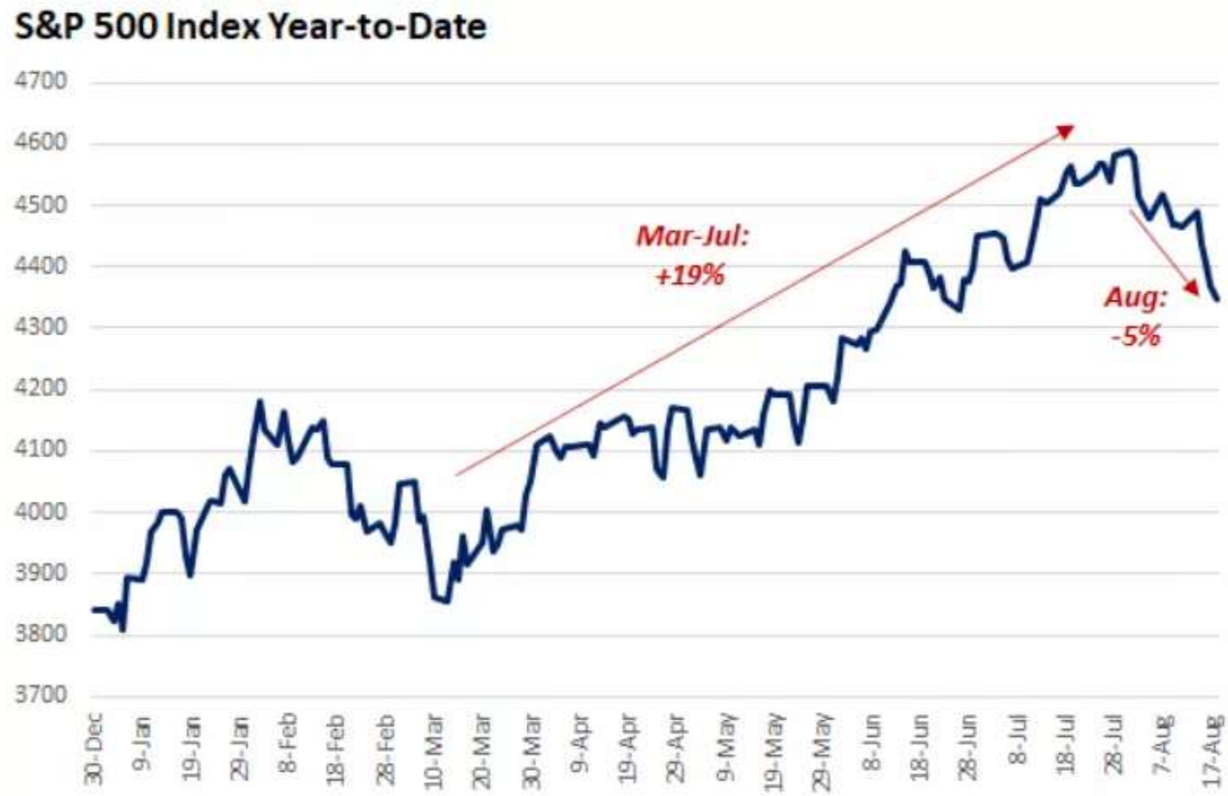
II. Bond yields make new highs for the year.

III. Consumer spending drives retail sales increases, prompting improved Q3 GDP forecast from Fed.

IV. Take advantage of higher rates by increasing duration before yield curve normalizes.

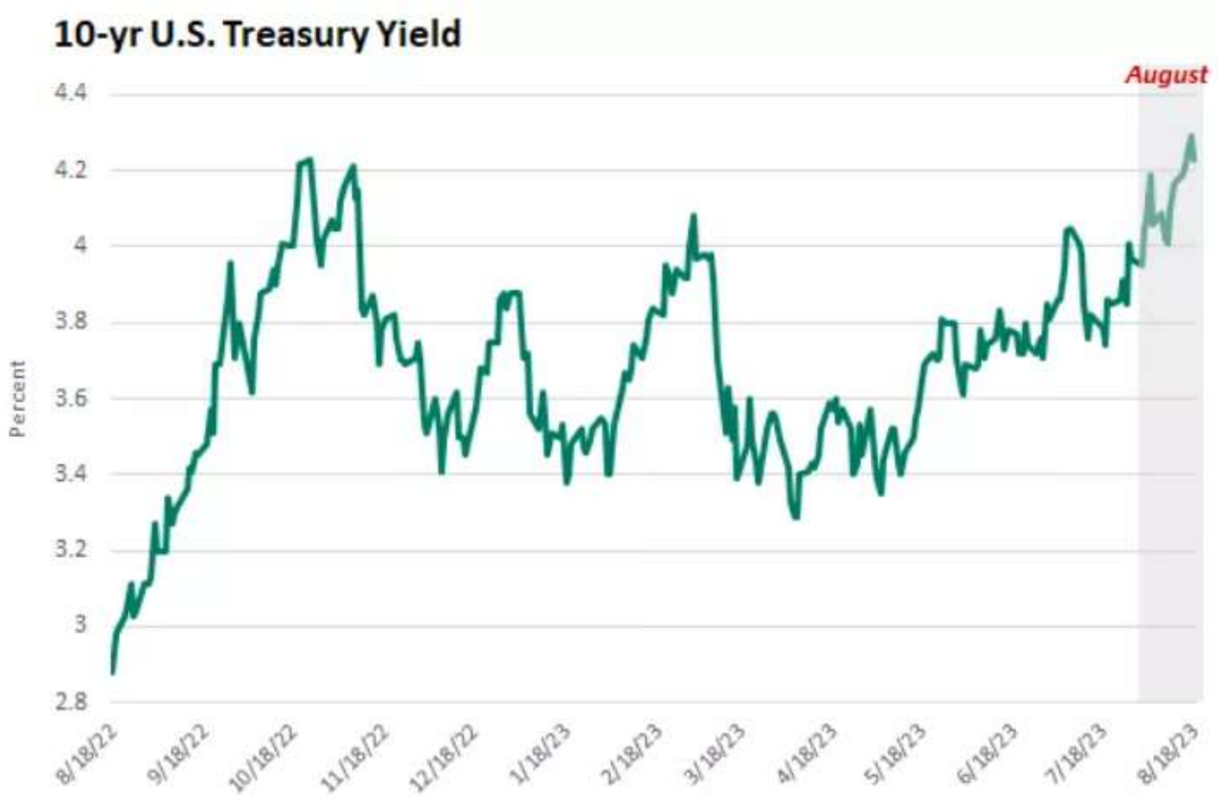
Good morning:

Against the backdrop of several regional bank failures and endless calls for imminent recession, equities staged an impressive rally from March to July, led by the largest mega-cap tech stocks. More recently, on the hopes that the Fed is nearing the end of its long tightening cycle, declining inflation, and resilient economic data, market participation noticeably started to broaden out to include some previously ignored sectors like energy, industrials, and small caps. However, similar to most Europeans going on holiday in August, this month has seen a pause in equities, along with a modest pullback in many of the year's biggest winners. Major large cap averages were all down another 2–2½% last week on lighter volume. Like a good vacation, this modest consolidation may turn out to be the pause that refreshes before equities regain their upward momentum in the near future.



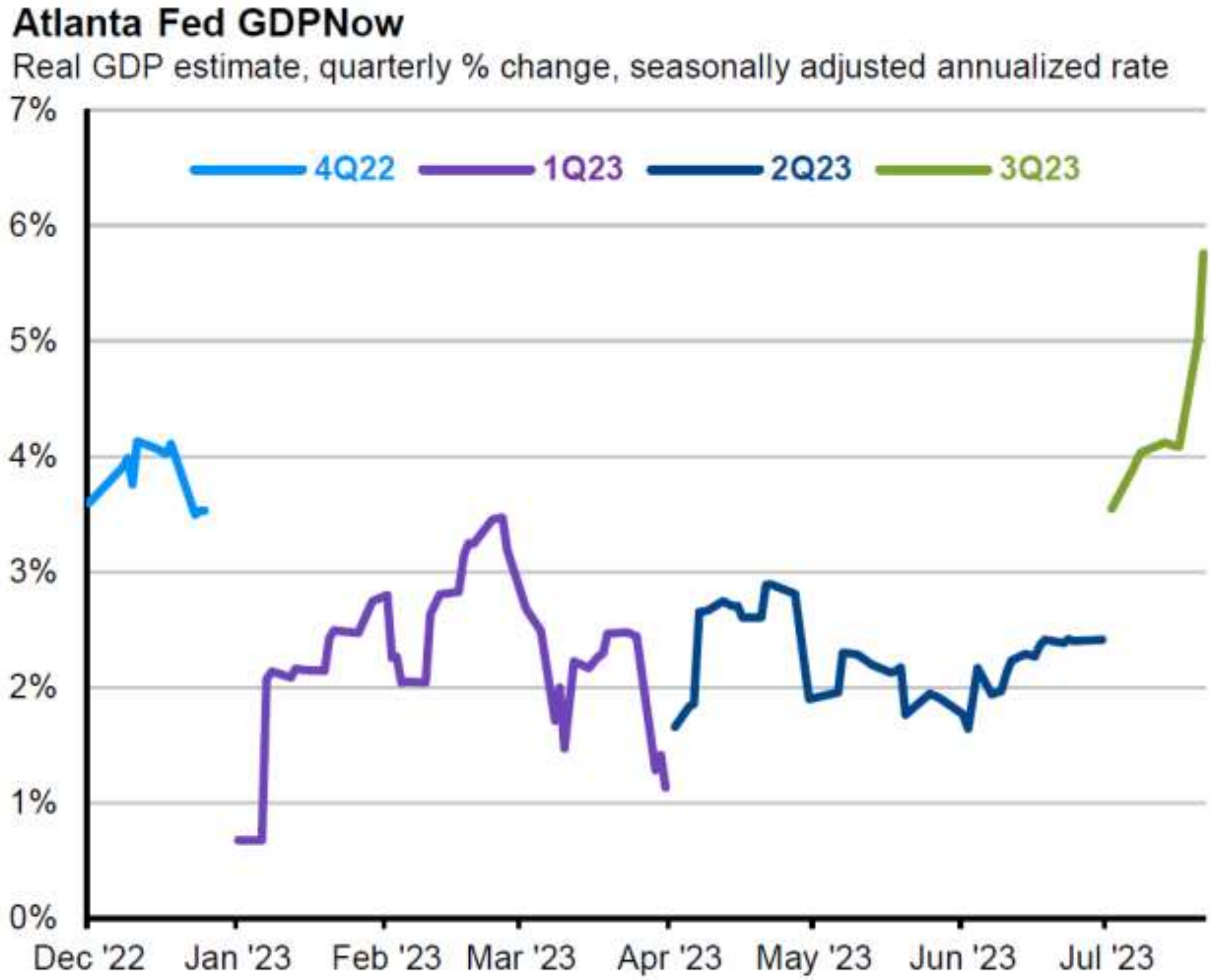
Source: FactSet

Part of this month's correction in equities could be attributed to the recent uptick in treasury bond yields. Although the yield curve is still very inverted with the highest yields in the shortest maturities, longer term rates have climbed materially in recent weeks. Last week saw the 10-year Treasury bond hit a new high for the year of nearly 4.3%. Recent signs of stronger economic growth have begun to shift consensus regarding future Fed actions. Even if the Fed is at or near the end of their hikes, bond yields are now pricing in the possibility of higher rates for longer with a Fed that's reluctant to begin cutting rates out of fears of inadvertently reigniting inflation.



Source: FactSet

As we have often reminded, it is the U.S. consumer that is largely responsible for economic activity, accounting for nearly 2/3 of GDP. For this reason, last week's retail sales data added further evidence that our economy remains resilient. Retail sales handily beat expectations, gaining 0.7% month/month and 1.0% ex-autos. While a 1.9% month/month increase in online sales contributed the most, gains were generally broad-based. Confirming the Fed is closely watching this data, the Atlanta Fed's GDPNow model now estimates that the U.S. economy will grow at a 5.8% seasonally adjusted annualized rate this quarter. If realized, it would mark the fifth consecutive quarter at or above-trend growth. Occurring during a period of aggressive rate hikes makes these results even more impressive and surprising.



Source: J.P. Morgan Asset Management

Despite the recent move up in bond yields, we see the yield curve eventually normalizing. This could bring yields down across all maturities but particularly short rates. Investors with money market balances currently enjoying rates above 5% may want to consider preserving some of the higher fixed rate yields in intermediate and longer-term instruments while they are still available.   Should the recession that so many have predicted materialize next year, the Fed is likely to beginning *cutting* short-term rates in response.

Have a great week!

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Market return and statistical data obtained from: https://am.jpmorgan.com/blob-gim/1383452890099/83456/weekly_market_recap.pdf?segment=AMERICAS_US_ADV&locale=en_US

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