Tuesday September 5, 2023

SUMMARY-

I. Stocks and bonds end August on stronger note.

II. Markets begin Fed watch with hopes of a pause.

III. Labor markets remain strong but shows early signs of weakening.

IV. Fed hikes and short-term yields may be peaking.

Good afternoon:

Equities closed out the modestly corrective month of August last week on a broadly positive note. For the week, the S&P 500 gained 2.55% while the NASDAQ added 3.27% thanks to strong leadership again from the tech sector. Illustrating some market broadening, the energy and materials sectors were also key contributors to the strong weekly gains. Bond yields also eased slightly after 10-year Treasury bonds hit the highest level since 2007 earlier last month.

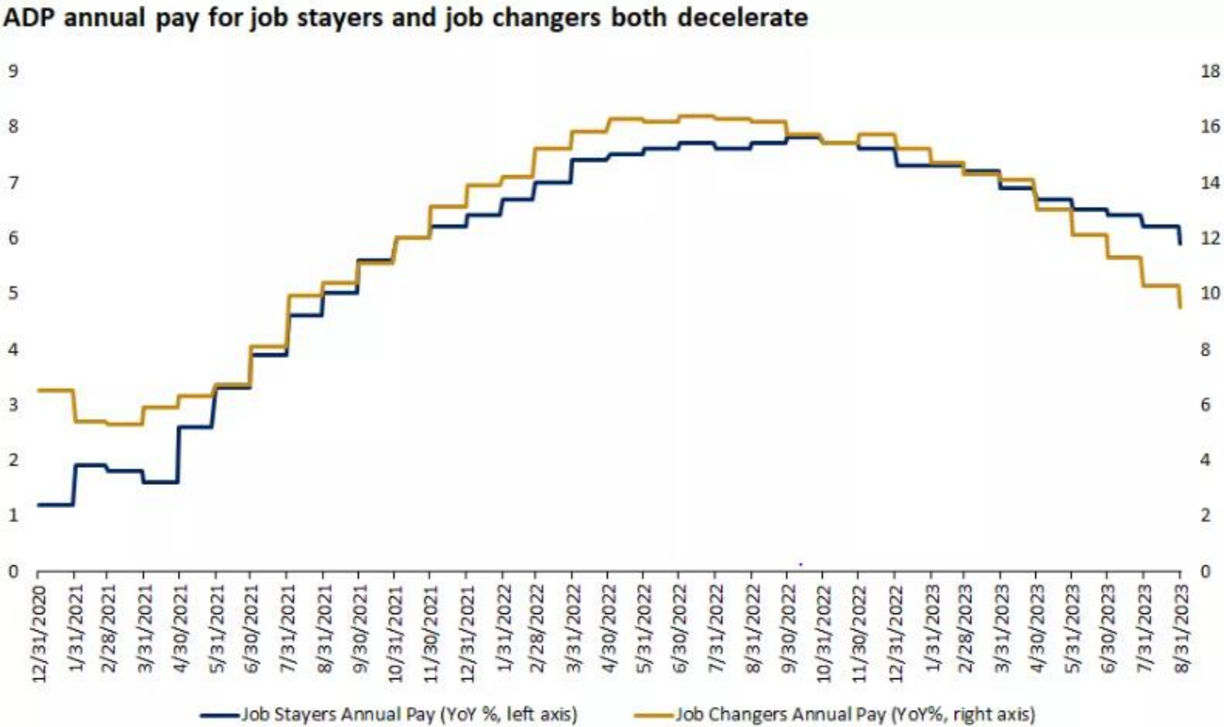
Much of this month's attention will likely be spent on handicapping the Fed's next move ahead of their September FOMC meeting in two weeks. Despite the significant drop achieved this year in the inflation rate, the CPI remains more than a full percentage point above the Fed's 2% target. Clearly the Fed does not want to jeopardize what they have accomplished to date by declaring victory prematurely, only to have inflation resurge higher. For this reason, we expect the Fed to remain diligent and ready to continue hiking as economic data necessitates.

Among their top concerns is the tight and resilient labor market. However, recent signs may be signaling the start of a weakening jobs market. Last week, the JOLTS (Job Openings and Labor Turnover Survey) data for July fell to 8.8 million, well below the 9.5 million that was expected. This was the lowest reading since the heart of the pandemic in March 2021. Fewer job listings and less people quitting their jobs generally imply lower confidence in the labor market. Workers less confident about finding a new job are less likely to quit the one they have.

Source: FactSet

Likewise, the ADP private payroll data for August came in below expectations. Total job gains were 177,000, below the 194,000 that were forecasted, and notably below the 324,000 reported in July. The ADP report also

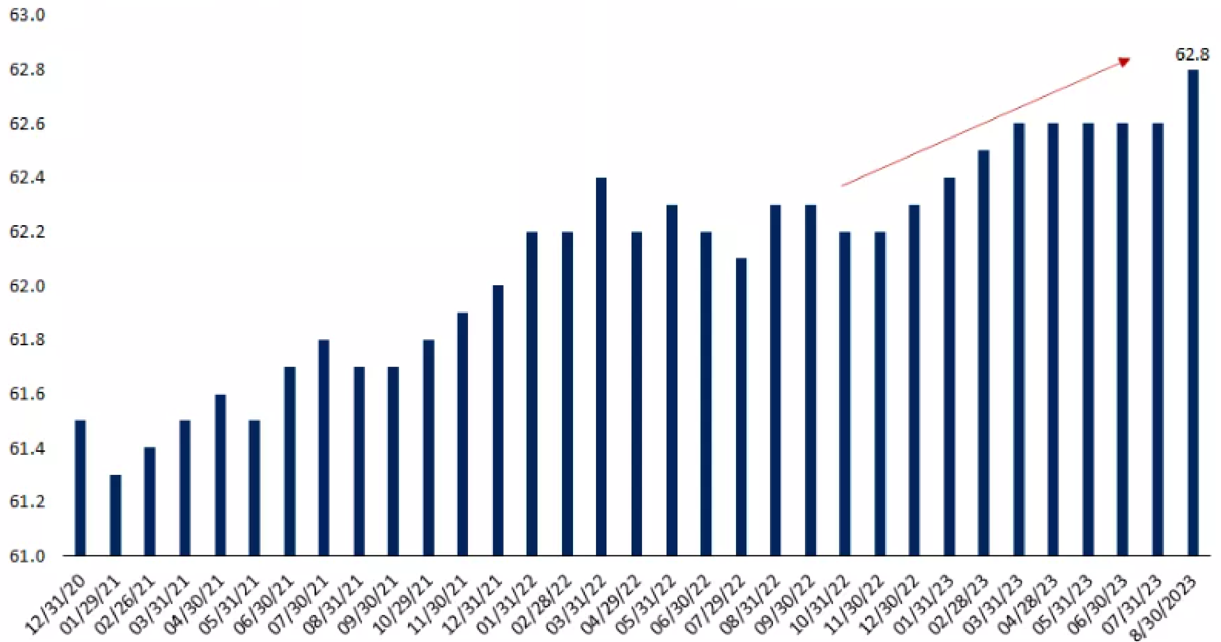
revealed a lower level of wage growth. The 5.9% year-over-year average pay increase was the slowest since July 2021. Wage growth has historically been a key component of overall economic inflation. These early indicators may prove just enough to prompt the Fed to pause once again this month and see how things develop. Considering the well-recognized lag between rate hikes and any measurable impact in economic data, we believe such a pause would be reasonable and potentially applauded by investors.



Source: Bloomberg

Perhaps the most important jobs report last week, and potentially the catalyst to the rally in both stocks and bonds (in hopes it could lead to a Fed pause), was the U.S. nonfarm payrolls report for August. Although payrolls came in slightly above expectations, July's gains were revised lower. Additionally, the

unemployment rate ticked higher from 3.5 to 3.8% as the labor participation rate increased to 62.8%, the highest since before the pandemic.



Source: FactSet

As we start this holiday-shortened trading week, we continue to expect sector participation to continue broadening as we near the end of this Fed tightening cycle. Those with larger than normal money market balances (finally earning more than the rate of inflation for the first time in many years) may want to consider locking in some of today's higher rates for longer periods as a hedge against falling rates in the next year or two. Remember, inverted yield curves like we have today are an anomaly and eventually have normalized. While we do not see money market rates falling immediately, we believe they are close to a peak

in this cycle and therefore have more downside than upside in their yield from here.

Have a great week!

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