Fourth Street Performance Partners
Independent Investment Consultants

August 2022: Market Review

Equity markets were off to a good start in the first half of August as inflation cooled in July (CPI +8.5% year-over-year) before ending the month in negative territory as continued hawkish comments from the Federal Reserve weighed on investor sentiment. Federal Reserve Chairman Jerome Powell made a speech in the last week of August reinforcing the Fed's plan to keep interest rates elevated until inflation is under control, regardless of the impact on households and businesses. The market previously expected the Fed to pivot and lower interest rates sometime in 2023, so this steadfast message from the Fed caused investors to readjust their short-term expectations for economic and earnings growth. The Biden Administration passed a climate change and spending bill, primarily funded by an increase in corporate tax rates, and forgave up to $20,000 of student loan debt per borrower, which investors fear have the potential to increase inflation. The S&P 500 Index fell -4.1% during the month, bringing its year-to-date loss down to -16.1%. The NASDAQ Composite Index dropped-4.5% in August and is down -24.1% year-to-date. The Dow Jones Industrial Average posted a decline of -3.7% this month and -12.0% year-to-date.

In domestic markets, returns were mixed across capitalization sizes and style classifications. The Russell 1000 Value Index (-3.0%) outpaced the Russell 1000 Growth Index (-4.7%). Similarly, the Russell Midcap Value Index fell -3.1% versus a decline of -3.3% for the Russell Midcap Growth Index. In small capitalization stocks, however, the Russell 2000 Growth Index outperformed their value counterparts, falling -0.9% while the Russell 2000 Value Index declined -3.2%. WTI crude oil ended the month at $90, a decline of -8.2% over the month, as concerns of a slowing global economy weighed on expected demand for oil. Conversely, natural gas prices continued to rise throughout the month, reaching $9.13 per metric unit, posting a gain of +10.9% in August and a substantial +69.1% increase over the past two months.

Developed international equities underperformed U.S. equities in August as the increased likelihood of Russia cutting off gas supplies to Europe has caused record-breaking inflation in the region. Consequently, the eurozone purchasing managers index plunged into contraction territory. The MSCI EAFE Index decreased -4.8% while the MSCI ACWI ex-US Index (which includes emerging markets) fell -3.2%. The MSCI Emerging Markets Index (+0.4%) was the sole asset class in positive territory for the month due to gains in Indian (+4.1%) and Chinese (+0.2%) equities despite the ongoing lockdowns in China and a dimming global growth outlook for the remainder of the year.

U.S. fixed income markets also posted declines in August as the hawkish comments from the Federal Reserve raised investors' expectations on where the Fed Funds rate will be at year-end (3.75% vs. 3.25% last month). The yield on the 2-year U.S. Treasury (3.45%) rose more markedly than the yield on the 10-year U.S. Treasury (3.15%), deepening the yield curve inversion to -30 basis points at the end of the month. The Bloomberg U.S. Aggregate Bond Index declined -2.8% in August while the Bloomberg +20 Year Index fell -4.4%. The Bloomberg High Yield Bond Index (-2.3%) outperformed both Treasuries and investment grade bonds during the month.

The comments from the Federal Reserve and the fiscal spending bills passed by the federal government spurred investors to realign their expectations for economic and labor market growth in the coming quarters. However, the labor market has shown resilience as the unemployment rate declined to the pre-pandemic low of 3.5% and the economy added 528,000 jobs in July, fully recovering all job losses caused by the Covid-19 pandemic. The July inflation report came in cooler than expected (+8.5% year-over-year) with energy prices declining. This contributed to a modest rebound in consumer confidence over the past two months. For the remainder of the year, volatility is likely to remain heightened as investors will be paying close attention to remarks from the Federal Reserve, economic data, and corporate earnings.

See disclosures on the following page.

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