August 2023: Market Review

Global equity markets declined in the month of August as Fitch's credit downgrade of the United States put the country's fiscal position into focus for investors. The downgrade, combined with rapidly rising levels of U.S. interest payments, exerted upward pressure on the long end of the yield curve. These higher borrowing costs for consumers and businesses will likely impact corporate profits and investors adjusted their equity marks accordingly in August. In addition, continued slowing of the Chinese economy created a ripple effect globally on investor sentiment and provided the equity market with another headwind. The S&P 500 fell 1.6%. U.S. second quarter real GDP growth was revised downward to +2.1% from +2.4%, while the CPI reading reported a modest increase in headline inflation of +3.2% year-over-year, up 20 basis points from June, driven largely from increased shelter costs. The July unemployment rate was 3.5% as the labor market continues to exhibit strength with initial jobless claims dropping to 320,000. (Although August's employment data released on September 1 did show modest softening of the labor market with the unemployment rate climbing to 3.8%.) Housing data showed mixed results in August with existing home sales declining to its lowest level since January, as the lack of inventory and elevated mortgage rates discouraged home buyers. However, new home sales (+4.4%) recorded the largest monthly increase seen in a year.

Large-cap style equities led smaller-cap stocks during the month, as large-caps were aided by strong corporate earnings from technology stocks. Growth outperformed value in large cap (Russell 1000 Growth Index -0.9% vs. Russell 1000 Value Index -2.7%), adding to the growth-style's sizable outperformance year-to-date. Conversely, within small-cap the Russell 2000 Growth Index (-5.2%) lagged the Russell 2000 Value Index (-4.8%) and small-cap growth was the worst performing domestic equity style in August. From a sector perspective, interest rate sensitive sectors (Utilities and Consumer Staples) declined between 4-6% due to the move higher in longer term rates. All other sectors declined in August, except for Energy (+1.7%). WTI crude oil ended August at $84 per barrel, up modestly from $82 at the end of July.

International and emerging markets lagged domestic equities in August as softening economic trends persist in China while slower than expected growth in Europe weighed on equity returns overseas. The MSCI EAFE Index fell (-3.8%) in the month, followed by the MSCI ACWI ex USA Index (-4.5%). The MSCI Emerging Markets Index declined -6.2%, trailing all major global indices for the period. China declined (-9.6%) as headwinds stemmed from declining exports, high unemployment among youth, and a real estate market riddled with uncertainty. Economic growth has weakened in Europe, yet stickier inflation has left the European Central Bank with a decision on whether to pivot to a hawkish pause in their rate-tightening cycle.

U.S. fixed-income markets were mixed as bond yields surged in the beginning of the month but eased off recent highs in the final week. The 10-year U.S. treasury yield reached a 15-year high of 4.34% before settling back down to 4.09%. The yield on the 10-year U.S. Treasury rose more markedly than the yield on the 2-year U.S. Treasury (4.86%) in August, narrowing the yield curve inversion to -77 basis points at the end of the month. The Bloomberg U.S. Aggregate Bond Index declined -0.6% in August while the Bloomberg U.S. Treasury 20+ Year Index fell -3.2%. The Bloomberg U.S. Corporate High Yield Bond Index (+0.3%) outperformed both treasuries and investment grade bonds during the month.

Economic data remains resilient in the wake of the Fed's aggressive rate hiking campaign over the past 18 months. Investors expect the Fed to pause at their September meeting, yet evidence of persistent elevated prices and strengthening wage growth may warrant one or two more rate hikes in meetings that follow. While it appears the Fed may be in the closing stages of their rate tightening cycle, the stronger economic data implies that rates may be higher for longer and that no rate cuts are necessary in the near term. With this diminished likelihood of multiple rate cuts coming in 2024, upward pressure on the longer end of the yield curve continues as the curve slowly corrects from its inverted positioning.

See footnotes on the following page.

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