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Weekly Market Commentary
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Market Weather Forecast: Volatility Followed By More Volatility

Last Friday, Jerome Powell told investors at Jackson Hole that the Fed is committed to raising rates and fighting inflation until it "gets the job done." This past week, financial markets took that message seriously. We saw equity markets fall and bond yields rise somewhat, even after a resilient jobs report on Friday. Nonetheless, markets are still forecasting a 75 basis-point (0.75%) rate hike at the September FOMC meeting and a terminal fed funds rate of close to 4.0%, with expectations of Fed rate cuts removed from mid-2023 forecasts. While the near-term may be volatile, we see a case for markets to stabilize heading into year-end, driven by two key factors: midterm elections and a potential Fed pause in 2023.

Financial markets prepare for more Fed rate hikes and no pivot in the months ahead

At last week's Jackson Hole economic symposium, Jerome Powell delivered a concise and pointed message for markets: The Fed is committed to raising rates, and keeping them elevated, until inflation comes down in a meaningful way. Chair Powell acknowledged that this process could bring some pain to the labor market and broader economy as well. Notably, the labor report for August still reflected a relatively resilient labor economy, with the unemployment rate ticking just modestly higher to 3.7% -- although this may continue to soften in the months ahead as Fed rate hikes continue. After last week's Jackson Hole economic symposium, market expectations seemed to reset. Not only did this accelerate the sell-off in equity markets and push bond yields higher, but there was also a notable shift in forecasts for the fed funds rate. Prior to Powell's speech, markets had been pricing-in Fed rate cuts starting in mid-2023; however, expectations now call for a Fed pause, but no pivot in 2023.

Markets are now entering the historically volatile months of September and October with a Fed and global central banks poised to move rates higher and implement quantitative tightening balance sheet reduction programs. In this backdrop, we would expect bond yields to also grind higher, putting downward pressure on equities, particularly higher valuation growth sectors of the market.

Inflation should continue to moderate

Investors will now be squarely focused on incoming inflation readings, which will determine the path of the Fed going forward. Perhaps the good news here is that several signs point to peak inflation still being behind us. We continue to see softness in oil and commodity markets (although these are volatile series), last week's ISM manufacturing prices paid index fell to the lowest levels of the year, wage gains are steady, and the housing market is starting to cool, as mortgage rates climb higher. Nonetheless, inflation may take months to move decisively lower, as several components may be sticky, including rent, shelter, and broader services inflation.

Labor market and economy remains resilient – the U.S. started from a position of

strength

This past week also underscored that the U.S. economy remains relatively healthy, as highlighted by the jobs report and ISM manufacturing reading. The August jobs report for example, came in inline to slightly better than market expectations. Nonfarm jobs increased by 315,000, above expectations of 300,000. Keep in mind that in the ten years prior to the pandemic, average job gains were closer to 150,000, so labor market activity continues to remain robust. The unemployment rate did tick higher to 3.7% from 3.5%, but this also remains near record lows.

The strength of the labor market points to a U.S. economy that remains healthy and has some cushion to absorb the ongoing interest rate increases. While you could expect some softening in the economy in the months ahead, the scope for a deep or prolonged downturn in the U.S. For investors is unlikely. This may also mean that markets have priced in much of the downside already in the first half of the year.

Near-term volatility may be followed by longer-term stability

Perhaps the silver lining here is that while markets may have trouble "fighting the Fed" in the near term, we could see calmer waters in the months ahead. There are two key drivers of a potential U-shaped recovery in markets as we head towards year-end:

1. The period after mid-term elections tends to be positive for markets, regardless of which party wins. Midterm elections will be held on Tuesday, November 8th this year, and history seems to be on the side of markets in midterm years. In the twelve months prior to election day, market performance is muted and can be volatile, much like this year. However, in the year after midterms, market returns are positive, on average by about 15%, regardless of which party is in power. Markets in many cases tend to prefer a gridlock outcome (split White House and Congress across parties), as this likely means little to no new legislation or regulations will be passed, giving corporations some more clarity for planning as well. Keep in mind, Past performance does not guarantee future results.
2. The Fed may pause after its December FOMC meeting, particularly if inflation continues to moderate. Perhaps the bigger driver of market performance will be the direction of Fed and monetary policy into year-end. The expectation currently is that the Fed will raise rates three more times (in its September, November, and December meetings), and then pause to assess the impact on the economy and inflation. If inflation continues to moderate through year-end (four CPI inflation readings released from September to December), then the Fed is likely to consider this a trend lower and may pause its rate hikes. While inflation will still likely take 12 or more months further to possibly return to 2.0% levels, a Fed pause will be welcome by markets as a sign of easing financial conditions ahead.

How to consider portfolio positioning

Overall, if we do see ongoing volatility in the months ahead, investors may consider this an opportunity to position portfolios for a potential market rebound in the months following midterm elections. Keep in mind that the average bear market lasts about 13 months, and we are perhaps about nine months into one already. These periods have historically been followed by bull markets, which last nearly four years, and market returns are over 150% on average. We would thus utilize any pullbacks to review portfolios, rebalance if necessary, and ultimately add quality investments at potentially better prices.

In equities, a balanced approach between value/defensive and growth sectors would be something to consider. If the Fed does pause around year-end, yields may peak and potentially move lower as well, which would support growth and longer duration parts of the market. In fixed income, we see better income opportunities broadly in bond markets, particularly in the investment grade space, as yields have reset higher, and price returns may improve as a pause in rate hikes comes into sight. Especially for

those investors who did not participate in the summer rally, markets may offer another opportunity to add to portfolios in the coming weeks – and perhaps to be followed by a more sustained rally ahead.

(Source: oXYGen & Jones)

Markets For The Week

INDEX	CLOSE	WEEK
Dow Jones Industrial Average	31,319	-3.0%
S&P 500 Index	3,924	-3.3%
NASDAQ	11,631	-4.2%
MSCI EAFE	1,790	-4.9%
10-yr Treasury Yield	3.20%	.2%
Gold	$1,712	-1.50%
Bonds	$100.37	-1.2%

Earnings Highlights This Week

Lululemon: Lululemon reported earnings that beat Wall Street's expectations, even as consumers grapple with high inflation. The company reported adjusted earnings per share of $2.20 and revenue of $1.87 billion. Inventories were up 85% compared to the same period last year. But the company said it was "under-inventoried" at the time due to supply chain bottlenecks.

Best Buy: Best Buy's sales dropped by about 13% in the fiscal second quarter, as the retailer felt a pullback from inflation-weary shoppers. The consumer electronics company had already cut its full-year forecast in July. The retailer is seeing a noticeable shift in spending, as people go back to the office, juggle the costs of summer vacations, or skip big-ticket items as they pay more for necessities.

Klarna: Klarna reported a pre-tax loss of nearly 6.2 billion Swedish krona in the first half of 2022, up from 1.8 billion krona in the same period a year ago. The firm, which allows users to spread the cost of purchases over interest-free installments, saw a jump in operating expenses and defaults. The company's ballooning losses highlight the price of its rapid expansion in the wake of the Covid-19 pandemic.

News and Notes:

Do You Have $175 Of Gift Cards Sitting In Your Drawer At Home?

Why is it a bad idea to hold on to gift cards?

- Average unused gift card amount is now $175, up from $116 a year ago. 1 out of 2 Americans have a gift card.
- Inflation is a huge issue. Your $100 gift card becomes worth almost $90.
- You also have the possibility of being charged inactivity fees and what if the

store goes out of business.
- This is like finding a $50 bill in your pocket.

Can you sell gifts cards and get cash in your hands or what if you don't like the gift cards you got?

- The first thing you can do is sell them for cash. Cardcash.com and Giftcash.com get you instant offers on the spot.
- On websites like these and Raise.com you can exchange the gift card for one you want. For example, exchanging an Apple gift card for a Nike gift card.
- You can return the gift cards to the store. Could be for cash or merchandise credit- varies by retailer. Or buy merchandise at the store and then sell it online

Are there any out-of-the-box ideas people can do with their unwanted gift cards?

- You can donate the cards. Charity Choice in a nonprofit that accepts donated cards. Check your local charities. Some states may give you cash for cards less than $10.
- Regifting is an option but remember to check if your name is on the card… holiday time is great for this.
- You can also consider having a gift card exchange with one or two friends or neighbors but remember to be careful….

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