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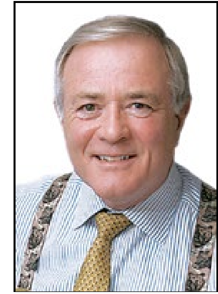
William Rutherford

Fluctuating interest rates and market volatility: bumps in the road | Opinion

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The market began the year on an up note, but reversed course in the summer, leading to a choppy year so far. It has been at the mercy of Federal Reserve Chairman Jerome Powell, who has remained steadfast in his dedication to lower the inflation rate to 2 percent.

As interest rates increased and the threat of more increases prevailed, the market tumbled. Conversely, when rates decreased, the market rallied. The ride has been volatile.

In the meantime, the economy continued to appear strong, yet threats of a recession held on in the background. Chicken Little was everywhere, threatening a recession that did not arrive. At one point the NASDAQ had gained nearly 29 percent, showing a strong economy that was thwarting Powell's effort to break the back of inflation.

As the Fed appeared to be at or near the end of its cycle to tighten interest rates, economists were anticipating no more than one more increase of 25 basis points in short-term rates. The economy remained healthy.

With memories of bank failures fresh in its mind, due in part to the rapid increase in interest rates over the past 18 months, the Fed retained a cautious posture. In the meantime, Moody's and Standard and Poor's rating agencies put a number of regional banks on credit watch, sending a chill through the market. The economy began to cool. Consumer sentiment also cooled. Investors became suspicious about the Fed's strategy to fight inflation. Wall Street thinking changed to believe that the Fed might possibly continue elevating rates to above 6 percent and not cut them. The market reacted negatively.

The bull case for the market right now is that fear of recession is overblown since the fundamentals don't point to a recession. In August, the U.S. reported that jobs in July increased by 187,000. Unemployment dropped from 3.6 percent to 3.5 percent. These numbers are not indicative of a recession. Second-quarter earnings reports have been stronger than expected. Investment and innovation have been strong.

In the bear case, the latest jobs report indicates that government hiring is a large percentage of new hires, suggesting that there is weakness in the employment numbers just below the

surface. Money appears to be flowing into cash from equity markets. New technology, although a ray of hope, may be years or decades from a significant boost to the markets.

August has typically been a “breather month” whenever the market has already been up more than 10 percent for the year. The S&P index is still up more than 16 percent so far this year.

The market reaction to the second-quarter earnings season suggests that buyers are becoming exhausted, Oppenheimer technical analyst Ari Wald says. Based on the average one-day price change, the market reaction to earnings reports has been negative in the current quarter versus positive in the prior quarter, suggesting that buyers are becoming exhausted. Other analysts support this thesis.

August and September are typically not good months for stocks, but investors should not overreact to short-term volatility.

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