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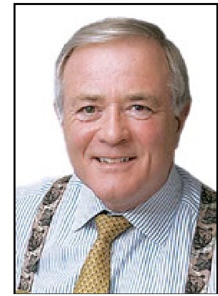
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Defying the dog days: Markets bounce back in August

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August 2024 began with a jolt as financial markets grappled with the sudden unwinding of the now widely known "yen carry trade." This strategy, where investors borrow in low-interest-rate currencies like the Japanese yen to invest in higher-yielding assets elsewhere in the world, had become increasingly prevalent due to Japan's ultra-low interest rates basically providing "free" money. However, as the Bank of Japan raised rates and the gap between U.S. and Japanese government bond yields narrowed, this trade began to unravel spectacularly.

The rush to cover positions led to a surge in the yen and forced selling across various asset classes, contributing to significant market instability in the early days of the month. The Nikkei, Japan's market benchmark, declined 27 percent from its July top.

This event served as a stark reminder of the interconnectedness of global markets and the potential ripple effects of leveraged trading strategies. It underscored the need to understand and manage risk in investment portfolios, particularly when it comes to complex strategies involving currency markets. Moreover, it reminded individual investors of the value in staying calm during such market disruptions, as these events often prove temporary.

Despite the early month turbulence, major U.S. stock indexes managed to close August with noteworthy gains. The S&P 500 finished up 2.3 percent for the month, the Dow Jones Industrial Average rose 1.8 percent and the tech-heavy Nasdaq Composite ticked up 0.6 percent. FactSet reported S&P earnings for the second quarter of 2024 up 10.9 percent, which would be the highest year-over-year increase since Q4 2021. Strong earnings reports and positive guidance from many companies in diverse sectors and recurring signs of a resilient consumer continued to fuel stock prices.

As the dust settled from the yen carry trade upheaval, attention shifted to the labor market. The U.S. Labor Department released a preliminary estimate suggesting that the job market from early 2023 through early 2024 might have been weaker than

initially reported. The data indicated that employers might have added 818,000 fewer jobs in the 12 months through March than previously thought. This revision, if confirmed, would mean the economy added around 178,000 jobs a month over that period, as opposed to the current estimate of 246,000 jobs a month.

This revelation came on the heels of July's unemployment rate rising to 4.3 percent. While still moderate in historical terms, this was its highest level since 2021. The unexpected increase in joblessness, coupled with the potential downward revision in job creation, raised concerns about the overall health of the labor market and its implications for the broader economy. Yet claims for unemployment did not tick up, as might be expected.

Amid market volatility and labor concerns, Fed Chair Jerome Powell's speech at the annual Economic Policy Symposium in Jackson Hole, Wyoming, became August's pivotal moment. Powell signaled imminent interest rate cuts, declaring, "The time has come for policy to adjust," potentially reshaping the financial and economic landscape for the rest of the year.

This pivot toward a more dovish stance reflected the Fed's growing focus on labor market weakness rather than inflation. Powell's comments suggested that the central bank is preparing to transition from its aggressive inflation-fighting campaign to a more supportive stance for the labor market and overall economic growth. The speech sparked a rally in both stock and bond markets, with investors interpreting it as a clear indication that rate cuts are imminent.

As August progressed, additional economic data painted a rosy enough picture of the U.S. economy. July's retail sales rose by a robust 1 percent, blowing past forecasts and indicating continued consumer strength. Meanwhile, the Personal Consumption Expenditures (PCE) price index – which the Fed continues to track closely to monitor inflation – rose 2.5 percent year-over-year in July, meeting expectations. While still above the Fed's 2 percent target, the figure suggests that inflation has gradually cooled, which should further the case for potential rate cuts.

Looking ahead to September and beyond, investors face a landscape filled with both opportunities and challenges. The August jobs report, set for release on Sept. 6, will be pivotal in determining the Fed's next move at its Sept. 17-18 meeting. Market expectations are currently split between a 0.25 and 0.50 percentage point rate cut, with further cuts anticipated in the following months.

As we potentially enter a rate-cutting cycle, investors might want to consider how different stocks could be impacted. Historically, sectors such as financials, real estate and utilities have benefited from falling interest rates. However, in all types of markets,

it is wise to maintain a well-diversified portfolio across investment sectors and individual companies in order to tamp down market volatility.

While September has historically been a challenging month for stocks, the Fed's apparent willingness to support the economy could provide a cushion against significant downturns. The pending presidential election provides additional potential ballast. Historically, the party in power continues to prime the economy with fiscal spending in an effort to sway voters. This anticipated stimulus, plus the labor market and inflation, will drive Fed policy and market sentiment in the coming months.

As we reflect on August's tumultuous journey from volatility to recovery and the return again to volatility on the first trading day of September, it's important to remember that market fluctuations are a normal part of investing. While the road ahead will continue to have noteworthy bumps, a well-thought-out investment strategy aligned with long-term goals and risk tolerance remains the best approach to navigating an uncertain future. The lessons learned from August will serve investors well – the importance of risk management, the impact of global interconnectedness, the power of central bank policy and the wisdom of investors faced with increasingly long retirement horizons to ignore market gyrations and stay the course.

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