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## July's musical chairs: still dancing, but counting seats

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August marched forward with a steady drumbeat of new highs, which was uncharacteristic for the month historically, and therefore a surprise to many investors. The S&P 500 rose 1.9 percent for the month, which included setting fresh records in the final stretch, including the S&P's 20th record close of the year on Aug. 28. The Dow added 3.2 percent in August, and the Nasdaq gained 1.6 percent. The Nasdaq's poorer performance was mostly weighed down by profit-taking in the semiconductor sector, after Nvidia's blowout quarter of AI semiconductor chip sales failed to meet the market's increasingly lofty expectations. Sometimes good news just isn't good enough when stocks are priced for perfection.

Speaking of perfection, gold decided to join the party in earnest. The "barbarous relic," as renowned economist John Maynard Keynes called it, touched \$3,533 per ounce on Sept. 2, making fresh all-time highs as investors sought refuge from an increasingly uncertain world. When the 30-year Treasury bond flirts with 5 percent (as it did in early September) and questions swirl about central bank independence, even traditionalists start eyeing alternatives. Gold's 42 percent year-to-date surge tells you everything you need to know about diminishing confidence in paper currencies, including in the world's reserve currency, the U.S. dollar.

Never mind that gold pays no dividend, costs money to store, and has historically been a lousy investment over long periods. In uncertain times like these, it's sometimes about return of capital rather than return on capital. When investors pay up for ballast during an equity rally, one should pay attention.

Under the surface, market breadth improved. Small caps finally showed some spark, with the Russell 2000 up about 7 percent in August, as investors looked

for alternatives to the increasing price to earnings multiples of large cap growth stocks. That broadening mattered on days when AI hardware leaders slipped; it kept the tape resilient even as high-expectation names took a breather.

Nevertheless, market leadership still hinged on AI infrastructure. Nvidia's \$4 trillion in market value milestone reached in July set the tone coming into August. The market's growth pulse held up enough, even as tech leadership wobbled on the last trading day of August. The backdrop for markets making new highs has been earnings doing the lifting and continued confirmation of massive AI capital spending, not just multiple expansion. Around month-end, however, a mixed read-through from AI-linked earnings began to impact much of the tech sector, resulting in a tech sell-off on the first trading day after the Labor Day weekend. The lesson is as old as the tape: when expectations tower, even good news can be "not good enough."

Rates, meanwhile, reminded everyone they're still a main character in the valuation chapter, since they offer investors an alternative to cash and equities. The U.S. 30-year Treasury bond yield pushed toward 5 percent to start September, amid a heavy calendar of new issues to fund deficits and a global bond selloff related to concerns about U.S. Federal Reserve independence. When the long bond flirts with 5 percent, dependable cash flows matter more to traders and investors, and narratives about company growth prospects, less, often resulting in a rotation out of stocks and into bonds. Such a rotation brings money out of equities, lowering their prices, which then results in bond yields coming down, and a cycling back into equities as their returns again look more attractive. All asset classes continue to be fed by years of expansionary fiscal and monetary policies, fueling an excess supply of global liquidity.

The Federal Reserve's annual late August retreat in Jackson Hole, Wyoming, typically offers global central bankers a chance to pontificate about esoteric monetary policy while enjoying some fly fishing. This year, it turned into political theater. A weaker than previously reported jobs report had led to the unprecedented firing of the head of the Bureau of Labor Statistics. In part due to this revised data, Federal Reserve Chair Jerome Powell signaled that rate cuts might finally be on the horizon, suggesting "the time has come for policy to adjust." The market loved it, with the S&P jumping 1.5 percent that day. But the celebration was soon tempered by relentless political pressure on the Fed.

Which brings us to the latest elephant in the room: the attempt to remove Fed Governor Lisa Cook. President Trump's move to fire Cook over unsubstantiated mortgage fraud allegations represents the first such attempt by a president to manipulate the Board of Governors in the Fed's 111-year history. Cook, for her part, isn't going quietly. She is suing to keep her job, arguing that unproven allegations don't constitute "cause" for removal under the Federal Reserve Act. As this column is being written, the matter is tied up in the courts, where it belongs.

The markets have absorbed plenty of political theater this year, but this takes the cake. The Federal Reserve's independence isn't just some quaint tradition; it's the bedrock of a sound global monetary system. Uncertainty about possible political manipulation of the debt markets, interest rates, the value of the U.S. dollar and liquidity caused global investors to start to look for alternative investments to U.S. Treasuries. And nervous markets are volatile markets.

The whole episode reminds one of another axiom: the market hates uncertainty. And in this situation, markets have uncertainty in spades.

With all this drama, you might think it's time to head for the exits. Not so fast. Yes, we're in uncharted territory with record valuations, political interference in monetary policy, and geopolitical tensions that would make a Cold War diplomat nervous. But that's precisely when discipline matters most. The market has climbed a wall of worry for 16 years now, through pandemics, wars, banking crises, and more political drama than Shakespeare could have imagined. Those who stayed the course have been rewarded. Those who tried to time the market based on headlines have mostly been wrong.

The advice in this column remains boringly consistent: maintain a diversified portfolio of quality companies with strong balance sheets and sustainable competitive advantages. Volatile markets always provide opportunities. And don't let politics drive your investment decisions. Markets do not move in straight lines, but they have rewarded discipline and time invested.

As for gold hitting new highs? Sure, it's nice to see the gold bugs finally having their day. But remember, over the long term, stocks in growing, cash generating companies have trounced gold by a wide margin.

The road ahead will be bumpy. Between Fed independence under assault, valuations stretched, numerous and growing court challenges to White House

edicts and a year of special elections promising more fireworks than the Fourth of July, volatility is virtually guaranteed. But volatility is the price we pay for long-term returns.

Stay invested. Stay diversified. The market will do what it does, regardless of what any of us think about it or politics. Excess global liquidity is still spiking the punch bowl. Our job is to stay the course and take advantage of opportunities when the market serves them up.

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