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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **August 21, 2024**

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Last week's S&P 500 Index: +3.9%

Seasonals and playing the range

Key takeaways

- Data over the past couple of weeks has largely supported our view that, while slowing, the economy has only a low probability of falling into a recession.
- We think the near-to-intermediate term will likely result in a range-bound equity market.

We have had a very nice equity bounce higher from the August 5 lows. In short, investors only briefly lost their nerve in the wake of a July employment report that came in far below consensus expectations. In actuality, the report was not terrible by any stretch of the imagination but did spark fears that economic growth was set to tumble and the Federal Reserve (Fed) was way behind the curve when it came to cutting interest rates. Some financial pundits even called for the Fed to make an "emergency" cut of 75 basis points (100 basis points, or bps, equals 1%) immediately and not even wait for the next policy meeting in September. Our view was that there was no need for an emergency cut and that those fears were overblown.

Data over the past couple of weeks have largely supported our view that, while slowing, the economy has only a low probability of falling into a recession. In addition, consensus earnings estimates for the balance of the year and 2025 have actually crawled slightly higher over the past three months according to Bloomberg data. The overall market mood has brightened as stocks and bonds have both rallied.

But we recommend that investors not get too carried away as the S&P 500 Index (SPX) has now rallied to stand less than 1.5% below the mid-July all-time record high at the time of this writing. True, the index does show noticeable upside to our 6,000 target-range midpoint for year-end 2025, but it is trading above our 5,400 target-range midpoint for the end of this year. In other words, we think the market may be getting ahead of itself, especially if we trade very near the record SPX high (5,667).

Another issue to contend with is the calendar. According to the Stock Trader's Almanac, the month of September shows the worst average performance, -0.7%, for the SPX going back to 1950. (As a side note, April is the best performer over that time frame with an average monthly gain of 1.7%.) While we don't encourage making portfolio decisions exclusively based on seasonal or calendar tendencies, we do keep this history in the backs of our minds.

So the question is what to do about any of this. Our view is that equity markets will likely be choppy and volatile within a wider range in coming months. Should we see the SPX trade up closer to the top end of the range (the record high), we would suggest trimming funds from our lowest-rated asset class, emerging-market equities, along with our least-favored sectors such as Consumer Discretionary, Consumer Staples, Real Estate, and Utilities. We suggest these funds be reallocated to our highest-rated large-cap sectors including Energy, Communication Services, Financials, Materials, and Industrials. We also favor bringing small-cap domestic equities up to a neutral level in portfolios. Pullbacks toward the recent lows should be looked at as further buying opportunities in our favored areas.

In summary, we think the near-to-intermediate term will likely result in a range-bound equity market.

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Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. **Communication Services** companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the Communication Services sector may also be affected by rapid technology changes, pricing competition, large equipment upgrades, substantial capital requirements and government regulation and approval of products and services. In addition, companies within the industry may invest heavily in research and development which is not guaranteed to lead to successful implementation of the proposed product. Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players, reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment. **Consumer Staples** industries can be significantly affected by competitive pricing particularly with respect to the growth of low-cost emerging market production, government regulation, the performance of the overall economy, interest rates, and consumer confidence. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Materials** industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement and manufacturing and cost containment issues. **Real estate** investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions. **Utilities** are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

Definitions

An index is unmanaged and not available for direct investment.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

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