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MARKET MINUTE

AUGUST REVIEW 2023

This month's Market Minute reflects the views of Clearstead's Investment Office and was composed by
Thomas Seay, Senior Managing Director, Research, Clearstead

OVERVIEW

In a month when a lot of investors are relaxing on vacation, the credit rating agencies were busy. Fitch downgraded the U.S. long-term credit rating one notch from AAA to AA+. Fitch cited a worsening expected fiscal outlook and an erosion of governance.[1] As if on que, the U.S. Treasury department reported that the federal deficit had more than doubled over the 10 months through July and the federal debt had ballooned to a record $32 trillion —potentially worrying developments for bondholders.[2] Moody's followed by cutting the credit ratings for 10 small and mid-sized banks. Moody's downgrade reflects increasing risks that many banks are facing — regulatory capital weaknesses, risks associated with commercial real estate, and higher funding costs — as the primary reasons for the downgrades.[3] Neither of these downgrades lead to market turbulence, but these concerns hang like the sword of Damocles over the market.

Lastly, on August 25th, Fed Chair Powell delivered a hawkish message at the Kansas City Fed's Jackson Hole Economic Symposium acknowledging progress has been made with respect to inflation but noting that "it remains too high." And the data supported his concerns as his go to measure of inflation, core services excluding housing ("supercore" services) jumped 0.5% month-over-month (MoM) in July after an upwardly revised 0.3% MoM bump the previous month.[5]

Although none of these items were surprising, when many market participants were on vacation, in a thinly traded market the news challenged already lofty market valuations and financial markets in general sold off for the month.

U.S. EQUITY MARKETS As of August 31, 2023

U.S. EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	-2.0%	1.4%	6.4%	12.6%
S&P 500	-1.6%	1.6%	18.7%	15.9%
Russell 2000	-5.0%	0.8%	8.9%	4.6%
Russell 1000 Growth	-0.9%	2.4%	32.2%	21.9%
Russell 1000 Value	-2.7%	0.7%	5.9%	8.6%

After five straight months of gains for US equities (Russell 3000 Index), equity markets traded lower in August across the board. The S&P 500 Index lost -1.6%, while US Small Cap stocks (Russell 2000 Index) fell by -5.0% and Mid Cap stocks (Russell Mid-Cap Index) fell by -3.5%. Both small cap and mid cap stocks were weighed down by regional banks (KBW Regional Bank Index -8.6%) which sold off after Moody's credit rating actions against several banks in August. There were few places to hide as every sector except Energy (S&P Energy Index +1.8%) traded lower during the month. Both growth (Russell 1000 Growth Index -0.9%) and value stocks (Russell 1000 Value Index -2.7%) traded lower in August, but growth stocks fared slightly better on a relative basis as several AI-oriented big-tech names came in with strong Q2 earnings numbers.

INTERNATIONAL EQUITY As of August 31, 2023

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	-4.5%	-0.6%	8.8%	11.9%
MSCI EAFE	-3.8%	-0.7%	10.9%	17.9%
MSCI Emerging Markets	-6.2%	-0.3%	4.6%	1.3%
MSCI EAFE Small Cap	-3.3%	1.0%	6.5%	9.2%

International equities also slid during August with the MSCI EAFE Index losing -3.8% and the MSCI Emerging Market Index falling -6.2%. EM equities were negatively impacted by the slide in Chinese stocks (MSCI China Index -9.0%) during the month which was caused by stress building in their property sector that is weighing on consumer and business sentiment. Non-US equity returns were also hampered by the US dollar, which gained steadily throughout the month, particularly against the Euro and the Yen. This was due, in part, to concerns that economic growth in Europe and Japan would suffer as the Chinese economy slowed.

FIXED INCOME As of August 31, 2023

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	-0.6%	-0.7%	1.4%	-1.2%
BarCap Global Aggregate	-1.4%	-0.7%	0.7%	-0.1%
BarCap US High Yield	0.3%	1.7%	7.1%	7.2%
JPM Emerging Market Bond	-1.4%	0.2%	4.0%	5.0%
BarCap Muni	-1.4%	-1.0%	1.6%	1.7%

Throughout the month interest rates drifted higher but closed off their highs. The 10-Year US Treasury yield reached a fresh multi year and 2023 high of 4.34% before retreating and ending the month at 4.11%.[2] As such, most bond returns were negative in August. Standing out in the fixed income crowd was the Bloomberg High Yield index which was up 0.3%, as the coupon income compensated for the decline in price due to higher interest rates. Even if the Fed pauses in its rate rising activities, coupon income should remain the main driving source of returns in the months ahead.

CONCLUSION & OUTLOOK

As the summer winds down and the markets look toward the year's end there are many hurdles we must face. September could bring us a government shutdown as politicians battle to spend money they don't have and continue to put the USA deeper in debt. The American consumer is fully employed, credit card debt is rising, and student loans will once again demand their share of paychecks. Corporate America continues to surprise on the earnings front but with China's economy (the world's second largest economy) in a down trend, Europe set to enter a recession, and the Fed trying to slowdown economic growth, will profit margins continue to support current stock prices? With U.S. Treasury bills yielding over 5%, it would be easy to cash in our chips and run for the safety of cash, but history teaches us that at inflection points the easy answer usually is not the best decision. During such times when markets can be most volatile, it can be better to be in the market than watching from the sidelines.

SOURCES

1 Fitch Ratings, August 1, 2023.
2 Bloomberg LP
3 Reuters, August 8, 2023
4 https://www.federalreserve.gov/newsevents/speech/powell20230825a.htm
5 Bureau of Economic Analysis, Personal Consumption Expenditures Price Index