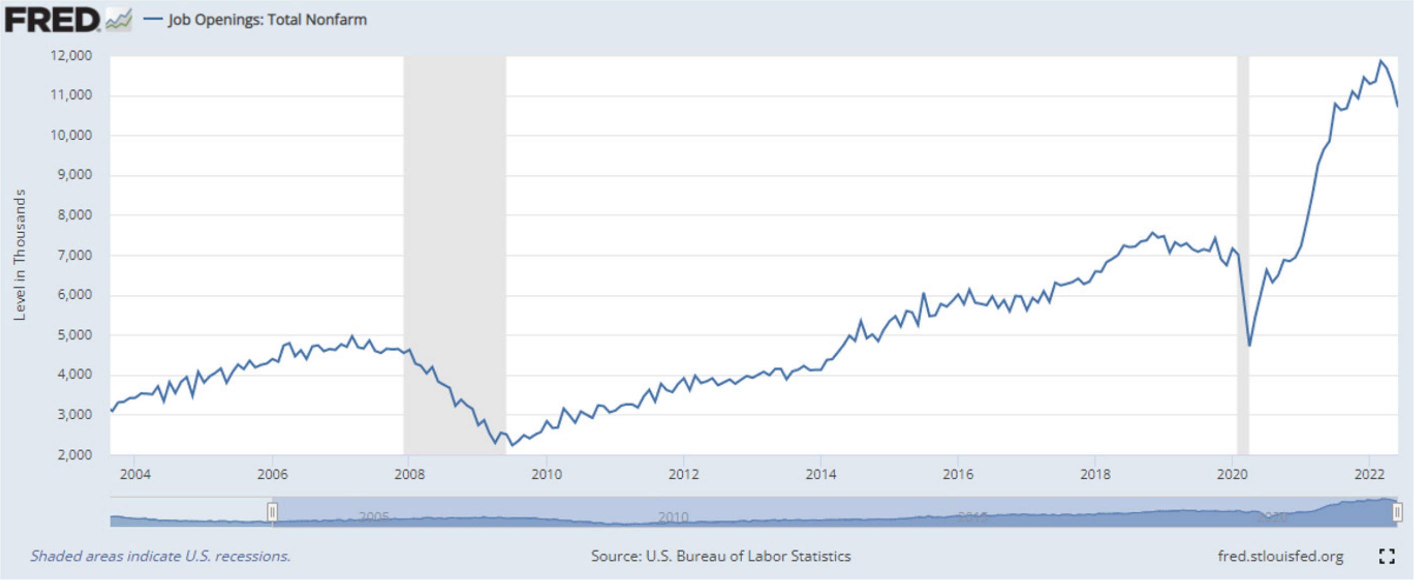
Week in Review

Friday, September 2nd, 2022

1. Powell Maintains Hawkish Tone in Jackson Hole, "Acting with Resolve Now"

In a highly anticipated speech Friday morning, Federal Reserve Chairman Jerome Powell reiterated the Committee's intention to continue raising the federal funds rate until heightened inflation begins returning to the long-term target of 2%. Powell acknowledged that the actions of the Committee "will also bring some pain to households and businesses" but commented that this is a necessary externality to restoring overall price stability. The main takeaway from the speech is that until a sustained period of decreasing inflation can be achieved, the FOMC will be forced to act by raising the federal funds rate, thus stunting economic growth and financial activity in the short term.

Powell expressed the importance of economic data during this time, saying that the Committee will need to see more than "a single month's improvement" in inflation data and that "the September meeting will depend on the totality of the incoming data".



'Incoming data' consists of more than just inflation metrics, with Powell emphasizing that the labor market will need to see a 'softening" in growth in the coming period. The market will be very attentive to the release of weekly labor market data and especially the upcoming consumer price index (CPI) report in September, as the Committee looks to gauge the impact of their actions.

The Friday meeting provided transparency during the blackout period between Committee meetings, with the next meeting on September 20-21st. Markets reacted negatively to the hawkish tone Friday, with all three major indices closing lower by more than 3% on the day. Markets continued to sell off into the start of the week as investors digested the new information.

2. Relief Rally Under Fire, Stocks Turn Negative in August

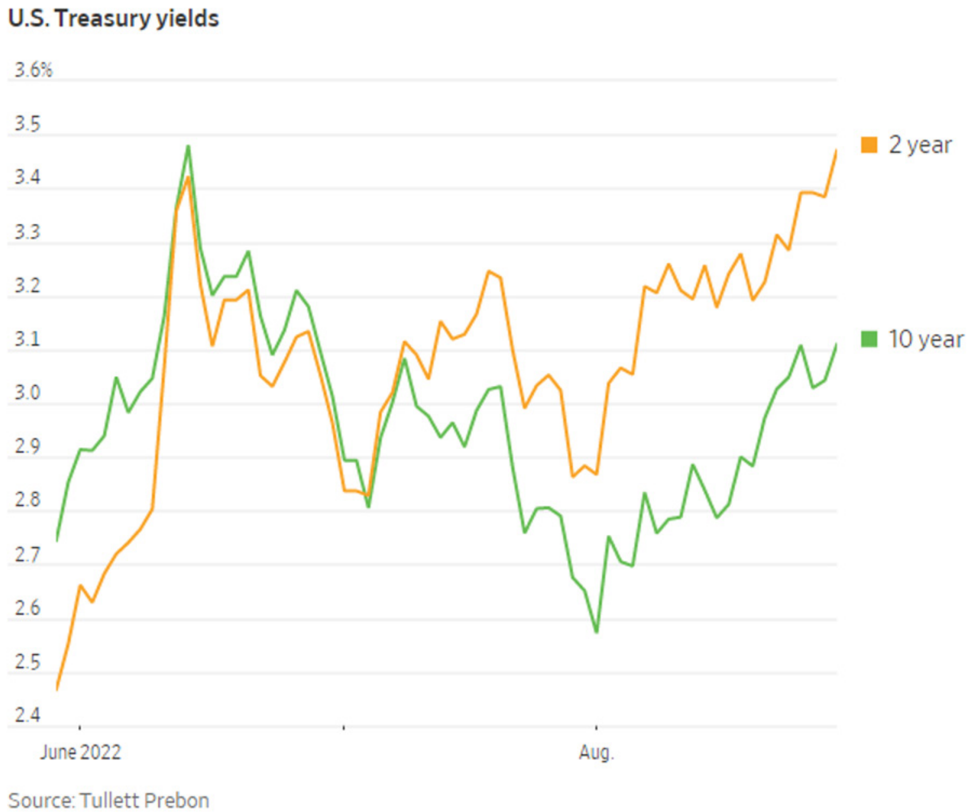
The market rally that started in mid-June propelling stocks out of historically poor annual performance has reversed course in August. Markets have once again turned lower with the S&P 500 and Dow both down roughly 5% and the Nasdaq down 7% off its mid-August high. All three indexes are now negative on the month.

Source: TradingView

Markets performed exceptionally well in early August on the back of a better-than-expected consumer price index (CPI) print, strong 2Q earnings performance, and attractive valuations enticing investors. It was also an active month on Capitol Hill, with two material legislative actions being signed into law. The CHIPS and Science Act will provide outsized investment into the American semiconductor sector, while the Inflation Reduction Act focuses on reducing costs in health care and energy while incentivizing investment into clean energy.

Stocks turned lower in mid-August following the release of hawkish FOMC notes and a continued slowdown in housing market data. The real push lower in the month came on Friday when Fed Chair Powell cemented the hawkish position of the FOMC in his speech at the Jackson Hole Symposium.

The sell-off within the bond market accelerated in August, with treasury yields rising nearly fifty basis points across the board on fears of continued aggressive monetary action by the Fed. The inversion on the two-year and ten-year treasuries widened towards the end of the month, indicating growing fears of a short-term recession despite the solid performance in equities last month.



Housing data was pessimistic on the month, with new home sales coming in lower than expected and growth in residential housing prices continuing to slow. Financial institutions such as Blackstone have begun to slow down their reinvestment into the American residential sector, adding to the growing concerns of demand destruction within the housing market. The rising rate environment continues to put pressure on the buyer in the market, with the average thirty-year fixed mortgage now at 5.55%.

Thinking Ahead

The recent volatility that has entered markets is a reminder to investors that despite a few key positive data metrics over the summer, the Fed will continue to apply pressure until they have successfully hindered inflation. Central banks around the world are navigating unprecedented inflation on top of a growing energy crisis in Europe, with supply chains still under pressure from the bottleneck in China. History will show that a global effort to mediate price stability has been successful in the past, but not first without economic growth bearing the weight of aggressive action.

Pallas Capital Advisors will continue to monitor economic, political, and corporate data for implications to markets.