Convergence Commentary
August 2024 Market Recap

Quick Hits:

- The Fed foreshadows lower rates
- Risk-off sectors lead the market higher
- Volatility returns in August

Market-Moving Highlights

Each year in August, the Federal Reserve Bank of Kansas City hosts some of the world's most important central bankers, policymakers, academics, and economists at its annual symposium in Jackson Hole, Wyoming. Beneath the shadow of the Tetons, participants discuss economic issues, implications, and policy options pertaining to the current environment. This year's edition featured the Fed Chair giving the clearest indication yet that rate cuts are on the horizon. According to Mr. Powell,

"The upside risks to inflation have diminished. And the downside risks to employment have increased... The time has come for policy to adjust."

The question is no longer when the Fed will cut interest rates, but by how much?

The answer will depend on the totality of data received before the mid-September FOMC meeting. Last week, second quarter GDP was revised up to 3%, with growth driven by strong consumer spending. Economic activity is still healthy. The Personal Consumption Expenditures Price Index, meanwhile, increased at a 2.5% annual rate in August. By that measure, inflation is no closer to the Fed's 2% annual target than it was in July. Together, those two releases support a slower pace of rate cuts.

Continued weakness in the labor market could outweigh all that, though. This Friday, the Bureau of Labor Statistics will publish the latest nonfarm payrolls report. If jobs growth shows further signs of deterioration in August, Powell & Co. may decide it's best to move more quickly.

Index Performance

Index	1 Month	YTD	1 Year	5 Year
S&P 500	2.73%	19.53%	26.96%	15.92%
Nasdaq Composite	0.74%	18.57%	27.30%	18.29%
Russell 2000	-1.49%	10.39%	18.28%	9.68%
MSCI ACWI ex US	-0.22%	11.40%	18.45%	8.07%
Bloomberg US Aggregate Bond	0.08%	3.15%	7.88%	-0.03%

In August, there were signs of a continued rotation out of the Tech sector at the index level. Both the S&P 500 and the International MSCI ACWI ex USA index outperformed the Nasdaq. This international outperformance can be attributed to the index's heavier weighting in Financials, which benefited from anticipated rate cuts. These expected rate cuts also contributed to the strong performance of the bond index. Meanwhile, small caps underperformed, likely due to a stabilization after their impressive 10.16% gain in July. As we previously discussed, after a year and a half of strong flows into Tech, the broadening of performance is a healthy sign for the market.

S&P 500 Sector Highlights & Commentary

Best-Performing Sectors		Worst-Performing Sectors	
Consumer Staples	5.73%	Energy	-2.07%
Health Care	5.06%	Consumer Discretionary	-0.97%
Utilities	4.81%	Technology	0.07%

In August, risk-off sectors led the market, with 9 out of 11 S&P 500 sectors posting gains. Consumer Staples and Health Care, often seen as safe havens, saw strong performance as ongoing concerns about a potential recession drove investors to diversify. Real Estate benefited from falling rates spurred by good inflation numbers.

The Energy sector is under pressure as continued strength in US oil production kept a lid on oil prices. As a cherry on top, OPEC+ is likely to proceed with a gradual oil production increase from October. The Consumer Discretionary sector's performance is somewhat misleading, largely due to Amazon's 20% weighting. After an impressive run, Amazon dropped 15% on the first day of August, which impacted the sector's overall results. Meanwhile, the rotation out of Information Technology continued into August, although the sector still managed positive performance. Overall, it was a strong month for the S&P 500 sectors, with signs of broadening gains, but also some risk-off sentiment as investors seek clarity on rate cuts and a slowing economy.

What to Watch in September

[Click here to read our reference guide for economic indicators.]

09/03 – Manufacturing PMI
The Manufacturing sector continued its slump with a 46.8 reading in July, down from 48.5 and below forecasts of 48.2. Lower numbers across the board, while prices faced by factories rose, with costs of metals increasing.

09/05 – ISM Services PMI
The Services PMI surprised to the upside with a July reading at 51.4. In the last commentary we mentioned the June reading being the worst since April 2020 at 48.8. This report was welcomed after the Manufacturing PMI and labor market data were pointing to a slowdown. Employment levels for service providers rose, challenging the view that the labor market is slowing too fast.

09/06 – Non-Farm Payrolls, Unemployment Rate
The US economy added 114,000 jobs in July, below forecasts of 190,000. The unemployment rate rose to 4.3% from 4.1%, above forecasts of 4.1%. This report was the first that showcased a strong case for labor market cooling, which is what the Federal Reserve needed to see before cutting rates. However, the unexpected report raised some recession concerns, making upcoming reports crucial in determining if the labor market is cooling as needed, or if it is cooling too quickly.

09/11 – CPI and Core CPI
Both CPI and Core CPI were better than expected this month. While the focus is shifting, inflation still remains the most important economic reading.

09/16 – Michigan Consumer Sentiment Prel
Consumer sentiment rose to 67.8 in August, up from 66.4 in July. Overall, expectations were strengthened for personal finances and the 5-year outlook. After 4 consecutive readings of consumer sentiment falling, it is nice to see it stabilize.

09/17 – Retail Sales
During the last market commentary, we explained how due to the CDK attack, it is possible that the extent of a consumer slowdown is overstated. It appears that might be the case, as retail sales beat expectations by a large margin for the July reading, at 1% month-to-month instead of 0.2% that was expected. This is the biggest gain since January 2023. Since the market has shifted somewhat to fearing about a potential slowdown, retail sales have inflated importance.

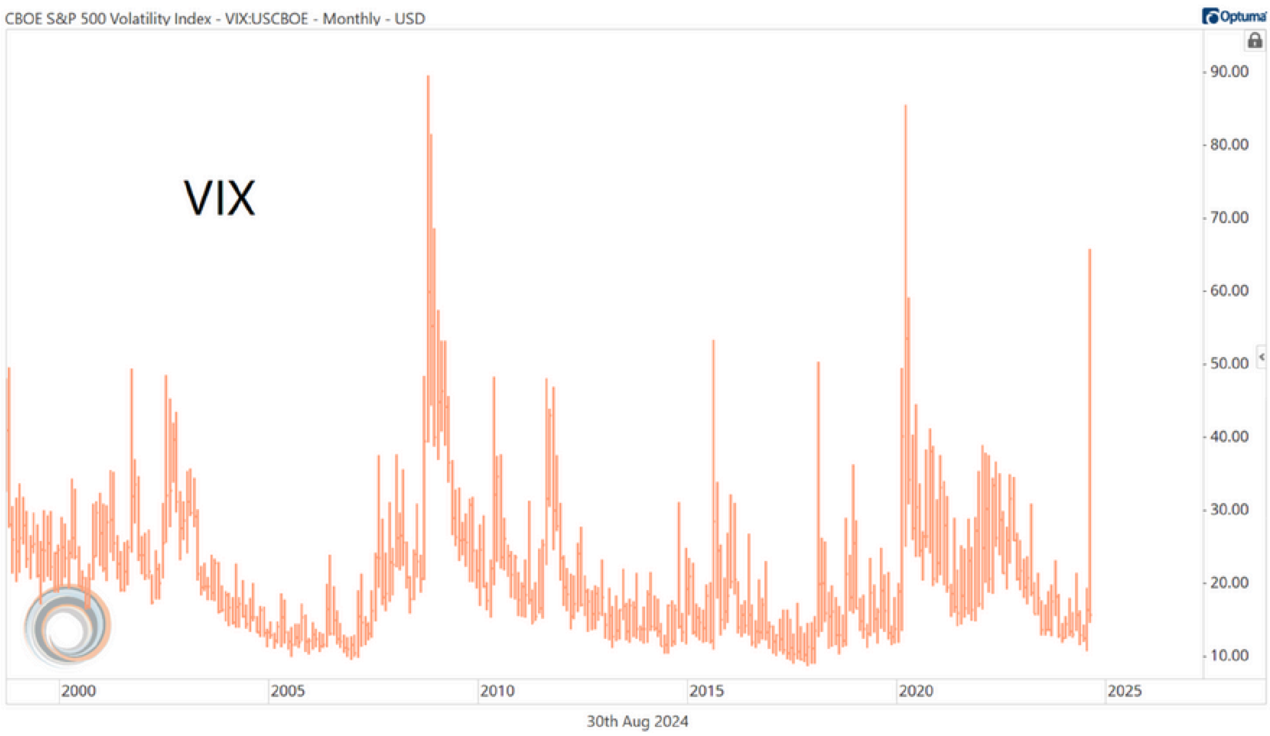
Market Wrap

Equity markets are supposed to be quiet during the heat of the summer - since the inception of the S&P 500 Index in 1950, volatility has been below average during the months of June, July, and August.

Not so much this time around. In the first week of August, stocks experienced their worst 1-day selloff in nearly two years. That was followed up just a few days later by the best 1-day rally since 2022.

The consensus on Wall Street is that a strategy called 'the carry trade' was largely to blame for the mayhem. If you aren't familiar with how a carry trade works, don't fret - you aren't alone. All you really need to know is that a lot of money was borrowed and invested under the assumption that Japanese interest rates would stay relatively low and the Japanese yen would stay relatively weak. Those assumptions were upended when the Bank of Japan raised interest rates by more than expected at the end of July, and the US reported slower jobs growth just a few days later.

The yen strengthened sharply as investors unwound their positions, Japan's benchmark stock index (the Nikkei 225) suffered its worst drop since 1987, and the VIX, a measure of expected stock market volatility here in the US, rose to levels not seen since the epicenter of the 2020 COVID collapse. For context, a VIX level of 65 like the one we saw last month implies an expected weekly move of +/-9% in the S&P 500! So much for that sleepy summer.



Fortunately, the madness was over nearly as soon as it began. The Nikkei has more than recovered from that fateful Monday's drop, and the VIX is back to where it started. All that's left is a reminder of how quickly the market can change directions.

Sources

Bureau of Economic Analysis
Bureau of Labor Statistics
OPEC+ likely to proceed with October output hike - Reuters
Institute for Supply Management
University of Michigan
Census Bureau
Market performance data sourced from Ycharts and Optuma

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Travis Cook, CFP®, CMFC®
CEO, Financial Advisor

Tyler Hoffmann, MBA
President,
Financial Advisor

Dr. John Stansfield, CFA®
Director of
Investments

Austin Harrison, CFA®, CMT®
Director of
Investments

Chris Repka
Investment Research
Analyst

Convergence Financial
Investing. Planning. Service.

3919 S. Providence Rd, Columbia, MO 65203
573-818-2264
www.convergence-financial.com