Market Commentary

It's funny how escaping the heat can provide great summer memories — spending time on the beach, stopping at a favorite ice cream shop, or maybe taking a bike ride.

Markets have also been heating up lately, but there's nothing fun about it. Following weakness in US markets late last week, Japan's stock market declined sharply Monday, further disrupting global markets. There are no easy escapes from market uncertainty. It's part of the experience of investing. But understanding what's happening can at least help maintain perspective.

It's important to remember periods of market volatility are normal. Historically, the S&P 500 Index averages a little over one 10% correction a year. Last year the S&P 500 fell 10% between late July and late October, but still finished the year with just over a 26% return. Declines feel like they'll turn into something bigger, but it's usually the other way around. Still, they happen for a reason and there are a few behind this one.

First, we've seen some weaker-than-expected economic numbers lately, capped by disappointing jobs data on Friday. The economy created 114,000 jobs in July versus a consensus expectation of 175,000 and the unemployment rate rose from 4.1% to 4.3%. Those aren't horrible numbers, but they do suggest economic growth is slowing.

Then there's the Fed. With inflation improving, markets are likely telling the Fed it's not paying enough attention to the impact high rates are having on the economy. Back in 2018 a policy rate of just 2.5% was enough to start breaking the economy. The current economy has endured a 5.5% policy rate for over a year. Aggressive rate hikes were necessary to help fight inflation, but the greater risk now is on the growth side.

Finally, Japan's central bank raised its policy rate on Friday for the first time in over 15 years, from -0.1% to 0.25%. That might not seem like much, but Japan's low rates had attracted a lot of borrowing in Japanese yen, which was then invested in other countries. That rate hike sparked fears that the cost of borrowing could quickly become more expensive if the yen started appreciating, leading to heavy selling of riskier investments.

While economic risks have increased, we do think there's still a lot of good economic data out there. Household and business balance sheets remain solid. Layoffs remain extremely low. Productivity growth looks good. The most recent earnings season has surprised to the upside, and earnings growth is the main driver of stock gains in the long run. We don't think this economy needs an artificial boost from the Fed to keep the expansion going, just a lighter touch on the breaks.

Overall, we don't believe recent market events should lead anyone to make changes in their long-term investment plan. It might even create opportunities. In the meantime, we'll continue to monitor market conditions closely and share our perspective.

Please reach out to your trusted financial advisor if you have any questions.

Very truly yours,

From Your NWCM Team

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