OBSERVATIONS: *Markets rallied last week to close out August, employment still healthy but downward revisions persist.*

- Markets traded higher in the final week of August and into the Labor Day weekend led by tech stocks. The NASDAQ gained +3.3%, S&P 500 gained +2.6%, and small caps (Russell 2000 Index) gained +3.7%.[1]
- The most recent S&P CoreLogic Case-Shiller U.S. National Home Price Index showed that home prices posted a -1.2% year-over-year (YoY) decline in June, which was up from the -1.7% YoY loss recorded in May.[1]
- The Fed's preferred inflation gauge, the Personal Consumption Expenditure (PCE) index, was in-line with expectations, but did not show much additional progress towards lower inflation. The headline PCE was +3.3% YoY in July up from June's +3.0% YoY reading and core-PCE—which excludes food and energy—registered +4.2% YoY in July up from June's +4.1% figure.[1]
- The number of job postings decreased to 8.8 million openings in July, down from June's 9.2 million figure. Quits also decreased in July to 3.5 million, which is on par with the quit rate in pre-pandemic 2019.[1]
- Total non-farm payrolls rose 187k in August, better than expectations of 170k. The unemployment rate rose to 3.8% from the previous month's reading of 3.5% amid an increase in the labor participation rate which rose from 62.6% to 62.8%—reflecting more people entering the labor market.[2]
- Meanwhile, July's employment was revised lower by -30k jobs from 187k to 157k while June was revised lower by -80k jobs from 185k to 105k, both of which represent a continued slowing in labor growth.[2]
- Activity in the manufacturing sector picked up in August from July with the ISM manufacturing index rising to 47.6 from July's 46.4 reading. This marked the highest level for manufacturing since February 2023 but remains below 50.0 (indicating economic contraction) for the 10th consecutive month.[1]

EXPECTATIONS: *Q2 GDP gets downward revision, China attempts to stimulate, and the September effect.*

- The second estimate of GDP growth in Q2-2023 was released last week and showed a downward revision to +2.1% (annualized rate) from the initial estimate of 2.4% real GDP growth. Despite the small downward revision, the US economy continues to grow at a faster pace than the Fed's estimate of the economy's long-run growth trend—which the Fed has estimated to be 1.8%—and expectations for Q3 growth have surged in recent weeks to well above trend growth—see Chart of the Week.[1]
- China enacted policy support to the housing sector by allowing individual Chinese cities to extend "first-time" home purchaser benefits—smaller downpayments and partially subsidized mortgage rates—to qualified families previously classified as second-time home buyers. Beijing has stepped up support for the property sector in recent weeks amid the continued property downturn and lingering financial risks.[3]
- September has historically been the worst month of the year for the S&P 500—since 1929 the S&P 500 has averaged a decline of -1.2% for the month of September. With notable headline risks of interest on federal student loans starting to accrue again starting this month and a looming government shutdown rapidly approaching, volatility may well make for a September that echoes Septembers of past.[1]

ONE MORE THOUGHT: *August pullback in markets and economic data likely to slow in September.[1]*

There were few places to hide in August as equity markets generally witnessed an unsurprising pullback led by declines in small cap stocks. The S&P 500 lost -1.6%, while the Russell 2000 (small cap index) fell by -5.0%. Overseas markets faced similar selling pressure with developed international stocks (MSCI EAFE Index) falling -3.8% and emerging markets (MSCI Emerging Markets Index) falling -6.2% in the month—emerging markets were pressured by

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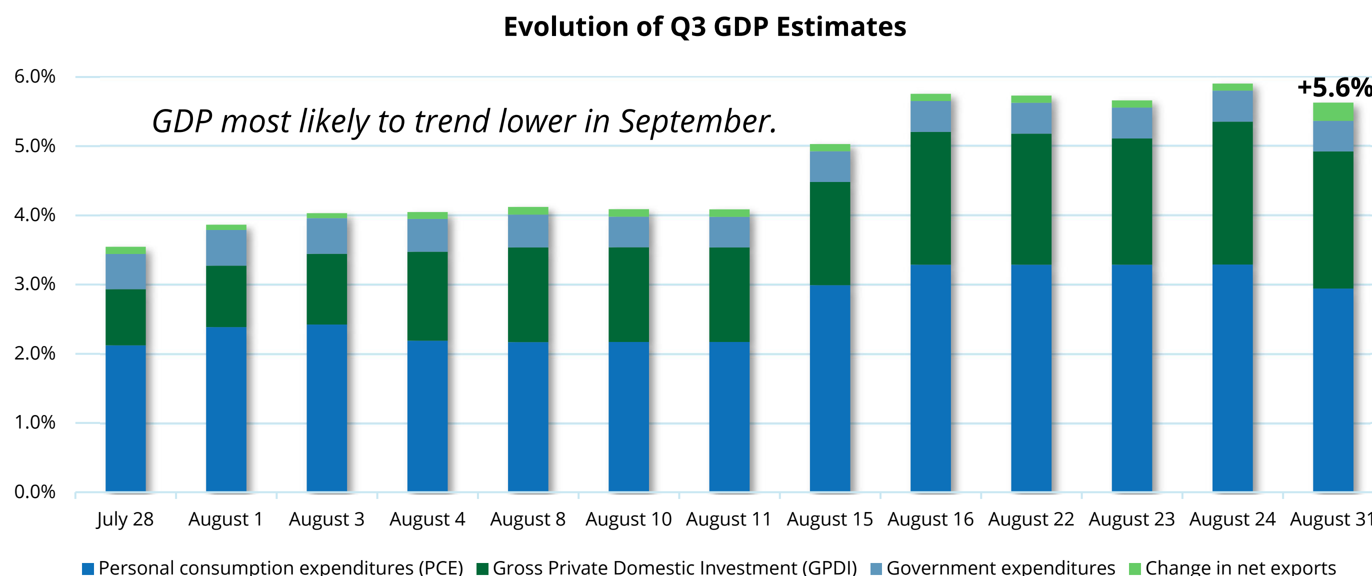
[1] *Bloomberg LP 9/1/2023*
[2] *https://www.bls.gov/news.release/empsit.nr0.htm*
[3] *Goldman Sachs "China: More (piecemeal) Housing Easing Underway" 8/30/2023*

China (MSCI China Index), which fell -8.5% amid continued economic weakness. In bond markets, rising rates—the 10-Year US Treasury yield rose from 3.96% to a 2023 high of 4.34% in mid-August before falling to 4.11% to end the month—weighed on bond markets as the Bloomberg Aggregate Bond Index fell -0.6%. The general negative tone was a bit inconsistent with incoming economic data in August, which has been mostly better than anticipated. Markets are generally considered leading indicators of the economy so the positive economic data we are witnessing are likely already priced into markets in our view—hence the rally to 4,500 on the S&P 500. We noted in the past that our target year end range was 4,000 to 4,500 and continue to think that is a reasonable expectation, with any near-term drawdown likely to find support around 4,200 on the S&P 500. In the meantime, GDP for this quarter continues to trend at a brisk pace (Chart of the Week), bolstered by consumer spending and business investment. The pace of GDP growth is likely to see a downward path in the coming weeks as we approach the end of Q3. That said, economic growth for Q3 is still likely to remain stronger than anticipated. The combination of strong economic data and sticky super core inflation (i.e., inflation ex. food, energy, and housing) has led to a 33% probability of another +25bps rate hike by the Fed's November meeting. Expect volatility to continue into September as we head into a budget showdown, one that seems likely to lead to a government shut down.

CHART OF THE WEEK



Source: Clearstead, Federal Reserve Bank of Atlanta GDPNow forecast, Seasonally Adjusted Annual Rate, as of 8/31/2023

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