Commentary

Recession Fears Put Investors on Edge

- The NASDAQ is in correction and the S&P 500 isn't far away.
- Friday's unemployment report sparked recession fears on top other mounting risks.
- We expect more volatility, but do not expect a bear market. Stay diversified in times like this.

Stock markets opened deep in the red to start the week, continuing where they left off on Friday when the S&P 500 lost 1.84% and the tech heavy NASDAQ composite lost 2.43%. Investors are not short of things to worry about. Weaker than expected earnings guidance, lack of tangible results in artificial intelligence, mid-east fighting, a war in Europe, U.S. political uncertainty, and recession fears were stoked by a weak labor report. Asian stock markets saw deep drops on Monday with Japan's Nikkei 225 making headlines falling 12.40%, its worst single day loss since 1987. The Bank of Japan recently raised interest rates and the Japanese Yen surged.

To expand on our commentary we wrote last Friday, where we spoke about expectations, valuations and earnings causing added risks, the risk of recession and weakening labor market are of concern. Geopolitical tensions and election volatility tends to be shorter lived in market fluctuations. The Fed has a dual mandate to keep inflation under control and maximize employment. Investor and Fed focus has been on inflation for a long time now as the labor market was strong with the unemployment rate under 4% for a long time. Now that has changed. Inflation appears to be under control and the unemployment rate, while still low, is starting to climb. Historically, when it starts to rise, it can rise quickly. This has investors speculating and hoping the Fed will do an intra-meeting Fed rate cut because the Fed is seemingly behind the curve again. As you recall, they were late to raise interest rates, calling inflation transitory, and now they still appear to be late in cutting rates and could be inducing unnecessary harm on the economy and labor market. Fed officials have pushed back on this intra-meeting rate cut, as they do not put so much weight into one economic reading or data point.

The unemployment data point has its skeptics too. Department of Labor officials said the increase in unemployed had nothing to do with Hurricane Beryl which hit Texas in the middle of the payroll survey period, but many respondents in the labor survey claimed they were either not working or working only part-time due to weather in July. So perhaps some of this spike in unemployment will reverse in the next data release.

With markets opening down so much, investors may have overlooked an economic release this morning that was encouraging. The ISM Services PMI index beat expectations and went from contraction to expansion in July. The forward-looking metric, new orders, climbed from 47.3 to 52.4, also rising out of contraction into expansion. With the service industry making up much of our economy, this should have relieved some of the recession fears. While the economy and labor markets are weakening, GDP projections are still not bad. The Atlanta Fed is projecting third quarter growth to be 2.5% and the consensus Blue Chip among economists is slightly under 2%.

So, while the NASDAQ is in correction, losing more than 10% from its recent peak, and the S&P 500 not far away from a correction, investors are worried about where markets are going from here. No one has a crystal ball, but much of this pull back so far has been because of risks that we have been warning about. High earnings and economic expectations, high valuations and large concentration in indices. Earnings have been less than spectacular and did not support the high valuations. With large companies dominating index weights, this sent large cap stocks down quickly and investors reacted by selling all equities including small caps which did not have as high of valuations. Investors have flocked to bonds, pushing down yields and pushing prices higher. Bonds have done well during this market sell-off.

More volatility is likely if the economy continues to weaken. Diversification can help mitigate this volatility, as we have seen with bonds doing well. If volatility escalates, we think it could be short-lived as the Fed is likely going to cut rates soon and the labor market is still relatively healthy, despite some weakening. Corrections and pullbacks are a normal part of investing. Your financial professional can help you stay focused on your personal financial goals. As always, please contact your financial professional with any questions about tailoring your portfolio to your personal situation.

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Additional risks are associated with international investing, such as currency fluctuations, political and economic instability, and differences in accounting standards.

A diversified portfolio does not assure a profit or protect against loss in a declining market.

Glossary

The **S&P 500** is an index of roughly 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of large cap universe.

The **Russell 1000** index is a stock market index that tracks the top 1,000 stocks by market capitalization in the Russell 3000 Index, which represent about 90% of the total market capitalization of that index.

The **Russell 1000 Growth** index is a subset of the Russell 1000 as measured by three factors: sales growth, the ratio of earnings change to price, and momentum.

The **Russell 1000 Value** index is a subset of the Russell 1000 as measured by three factors: the ratios of book value, earnings, and sales to price.

The **Russell 2000** index is comprised of 2000 small-capitalization companies. It is made up of the bottom two-thirds in company size of the Russell 3000 index.