Looking Back at the Markets in July and Ahead to August 2023

Presented by Christopher Phelps

July was another good month for stocks across the board. The U.S. indices were up in the low single digits, while international markets also did well. Riskier investments like the Nasdaq and emerging markets did best. Fixed income, on the other hand, was much weaker for the month as interest rates rose and the Fed hiked base rates. Financial markets were clearly in a risk-on mode and benefited from riskier investments like tech stocks at the expense of more boring ones.

Looking Back

The economy. A mix of good economic news drove the strong performance in July. Second-quarter growth was reported at 2.4 percent—up from the first quarter's 1.8 percent—showing an acceleration instead of the feared slowdown. Job growth remained strong, while consumer confidence rose to the highest level in two years. With business confidence staying solid, the economic data was almost uniformly positive.

Inflation. Even with the continued growth, we also received good news on inflation, which continued to trend down. While still too high, the improvement continued. And while the Fed increased rates last month, there is a growing conviction that there will be few, if any, increases in the future. Looking back, July was full of good news, and markets responded.

Looking Ahead

Job and wage growth. Looking forward, August may be more mixed. The jobs report for July showed slowing job growth—still healthy, but slower, especially for the private sector. Even with this slowdown, wage growth was high again. This result could keep service inflation high, which was one of the worries from the last report. Many of the tailwinds we saw for the economy and markets last month are now subsiding, and we see that in recent performance.

The Fed and interest rates. As we move into August, the key issue will be whether inflation continues to decline and what that means for the Fed and interest rates. Market expectations are changing rapidly, and if the Fed starts to act more hawkishly, markets could react negatively. That said, given that the underlying reason for the Fed's hawkishness will be continued growth, markets have an economic cushion. So, while volatility is likely, the downside could be limited.

The economic news should stay positive for August. Job growth remains healthy, with some stats very strong. Consumer and business sentiment have improved, which could help spending and investment. If the underlying economy continues to grow, which is likely, any Fed actions will have some effect, but likely a limited one.

A Positive Outlook

And that is the bottom line here. Last month and the year so far have been very positive, and much of that good news continues. Because of that, however, the Fed may keep tightening, which will have a slowing effect. Even with that headwind, any recession is likely some time away, which should keep markets healthy.

In short, while July was a good month, August may be more challenging. Even if it is, conditions remain favorable overall. And while volatility may show up during the month, the trend will likely remain positive over the longer term.

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Authored by Brad McMillan, CFA®, CAIA, MAI, managing principal, chief investment officer, at Commonwealth Financial Network®.

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