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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **September 13, 2023**

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Last week's S&P 500 Index: -1.3%

Hope for good, but not great

Key takeaways

- It all comes down to what potential effect an accumulation of data might have on the Federal Reserve's (Fed) monetary policy decisions.
- Stronger-than-expected economic news is likely to be interpreted as giving the Fed a green light to hike rates further.

The trading week of August 28 through September 1 is a good example. Economic data showed that the number of job openings tumbled, consumer confidence fell, personal income was weaker than expected, and the gain in average hourly earnings was down from the prior month. In addition, second-quarter growth was revised noticeably lower than initially reported. The stock market's reaction to all this weaker-than-expected economic data? The S&P 500 Index finished the week with a robust 2.5% gain. The following week (last week), the economic data overall was stronger than expected and the S&P 500 Index lost more than 1%.

You might be asking yourself, "That trading week is a good example of exactly what?" It is a good example of the equity market reacting to economic news differently than many investors might expect. The reports were weaker than expected, but stocks rallied. Then, with better-than-expected data, equities fell. This strategist would argue that, right now, economic news that is too good is being taken as a negative by investors while weaker news is a positive. That may sound strange and nonsensical. After all, how can stronger economic data be considered anything but a big positive for the stock market?

It all comes down to what potential effect an accumulation of this data might have on the Fed's monetary policy decisions. These decisions, in the vast majority of occasions, decide whether a cycle lives or dies. Monetary policy that is too tight can create headwinds. Inflation generally starts to increase as the economy accelerates, input costs rise, and the labor market tightens. That was especially true in the pandemic period, where the government pumped trillions of dollars into the economy and resulting demand for goods overwhelmed global supply chains. And currently, post-pandemic stimulus spending by the U.S. government has helped drive consumer spending.

The Fed and the stock market have been laser-focused on wages and inflation. Our central bankers believe that strong wage increases put meaningful upward pressure on inflation. Investors know that higher wage costs cut into corporate profit margins. Housing and shelter inflation has also fueled the fire. Higher inflation that sticks around for longer and forces the Fed to continue to hike interest rates and leave them higher for longer is a combination that is rarely good for stocks. We continue to see a higher-for-longer rate environment leading to a recession at some point over the next 12 months.

At this point, we believe that stronger-than-expected economic news is likely a negative for stocks. We expect investors will interpret strong economic news as giving the Fed a green light to hike rates further. In our view, for now, especially in terms of economic growth, hope for good, but not great.

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