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Stocks pulled back a little in August. Large cap stocks in the S&P 500 index declined -1.6% for the month resulting in a year-to-date gain of 18.7%. Small cap stocks in the Russell 2000 declined sharply, down -5.0% in the month, reducing their year-to-date gain to 9.0%. International stocks in the MSCI EAFE index were down -3.8% in August and are now up 10.9% for the year. Meanwhile, emerging market stocks fell the most at -6.2% for the month reducing their gains to 4.6% for the year. Yields on the Barclays US Aggregate Bond Index rose so the index lost -0.6% in the month and is up just 1.4% year-to-date. The yield on the 10-year Treasury bond ended the month at 4.1%.

As we approach the end of the 3rd quarter, earnings estimates are firming up. Even though earnings are expected to decline for the 4th straight quarter, it is projected by Zacks to be the smallest decline of the year at -1.5% year-over-year, Furthermore, they are projecting positive earnings growth in subsequent quarters. This better-than-expected earnings news is undoubtedly a factor in the strength of the stock market this year.

With earnings down so far this year, the robust returns of the stock market have been largely a result of multiple expansion. Price earnings ratios are again stretched above their long-term averages. Stocks seem to be priced for a scenario where the Fed will be successful in fighting inflation and where higher interest rates do not result in a recession.

This month, the Bureau of Economic Analysis revised second quarter GDP growth lower from 2.4% to 2.1%. Expectations for growth for the remaining two quarters of 2023 continue to be flat as leading economic indicators and high frequency data both show meaningful signs of weakness. While inflation has shown some improvement, it continues to be persistent. In addition, some analysts are seeing signs that we may see higher inflation numbers again in coming months.

Even though the jobs market remains strong, the most recent jobs report revealed some weakness in employment is beginning to materialize. Most notably, the unemployment rate moved up from 3.5% to 3.8%. U.S. employers added 187,000 jobs in August but payrolls in June and July were both revised lower to a combined 110,000 according to the Labor Department. Over the three months of summer, only 150,000 jobs were added on average compared to an average of 238,000 from March through May.

The Fed's main tool for fighting inflation has been raising interest rates. After the July hike of 0.25%, the current Fed Funds rate stands at a range of 5.25%-5.5%. Savers are enjoying the increased interest income while borrowers are having to pay much higher rates for new and adjustable loans. If the jobs market is slowing, the Fed should be pleased to see this sign that their policy is having the desired effect. We may see another increase before year-end, but most believe the Fed will begin to lower rates next year either because we enter a recession or because inflation is under control.

Despite a modest pullback this month, Stocks have had a good year. With a recession not out of the picture, this may be a good time to rebalance back to risk tolerance targets. We continue to encourage investors not to try and time the market by trading in and out and instead invest according to risk tolerance. This is also an attractive time to make gifts of appreciated stock. If you have questions about the strategy for your account, please contact your advisor.