



Our insights on current capital market volatility

Key takeaways

- Global capital markets continue to reflect investor concerns about growth and policy steps from major central banks.
- We outline a three-phase framework to help contextualize the current capital market dynamics and provide focal areas we are watching to help shape views.
- We see the current path forward as a gradual growth slowdown rather than a growth scare, but we respect capital market messages and continue to take a global view as we evaluate implications.

Last week's broad capital market agita continued into Monday's trading. Asia opened first, with Japan's Nikkei Stock Index falling 12.4%, followed by a more modest retreat in Europe's Euro STOXX 50 index (-1.4%). U.S. markets opened lower as well, with the S&P 500 declining as much as 4.3% in early trading before recovering some of the day's losses to finish down 3.0%. Ten-year Treasury yields, which move in the opposite direction of price, have fallen from 4.17% one week ago to 3.78% Monday, reflecting expectations for more aggressive Federal Reserve (Fed) rate cuts.

Why

Equity prices began to drop following Thursday's downbeat U.S. manufacturing data, while Friday's disappointing U.S. jobs report spurred additional investor concerns that the decelerating, but still satisfactory, labor market may deteriorate further. We note the labor market is a key catalyst for consumer spending, and consumers compose the primary engine for economic and corporate earnings growth. Monthly new job creation is slowing, but the July jobs report may reflect weather-related factors. Credit card delinquencies remain near historically average levels after rising from low levels. Loan growth is tepid, while inflation-adjusted consumer savings returned to pre-COVID trends, emphasizing the importance of jobs and current income on the ability of consumers to spend. Interest rate markets suggest the Federal Reserve is late in cutting interest rates as the focus shifts from inflation concerns to labor market health, as the Fed alluded to during last week's policy announcement.

Global central bank policies are diverging, transitioning from a period of broadly tightening measures to thwart inflation pressures to policymakers now addressing disparate growth and inflation outlooks across major economies. Last week, the Bank of England enacted its first interest rate cut of this cycle in a narrow 5-4 vote, the U.S. Federal Reserve kept interest rates unchanged in a unanimous decision but signaled a September cut, while the Bank of Japan (BoJ) hiked its target interest rate to 0.25%, exceeding analysts' forecasts. The BoJ also announced plans to cut its monthly asset purchases in half by early 2026 as it starts to wind down its historic era of easy monetary policy. Across the globe, we have witnessed more policy rate cuts than rate increases starting in the fourth quarter last year as inflation began decelerating in earnest.

Market reactions reflect rapidly shifting Federal Reserve expectations and knock-on effects from the BoJ's more-hawkish-than-anticipated decision. After last week's softer data releases and resultant capital market concerns, interest

Client call: Insights on current capital market volatility

We invite you to a call featuring Chief Investment Officer Eric Freedman, who will discuss recent market events.

Date: Tuesday, August 6

Time: 11 a.m. PT | 1 p.m. CT | 2 p.m. ET

Call-in number: 888-790-1867

Passcode: 5330798

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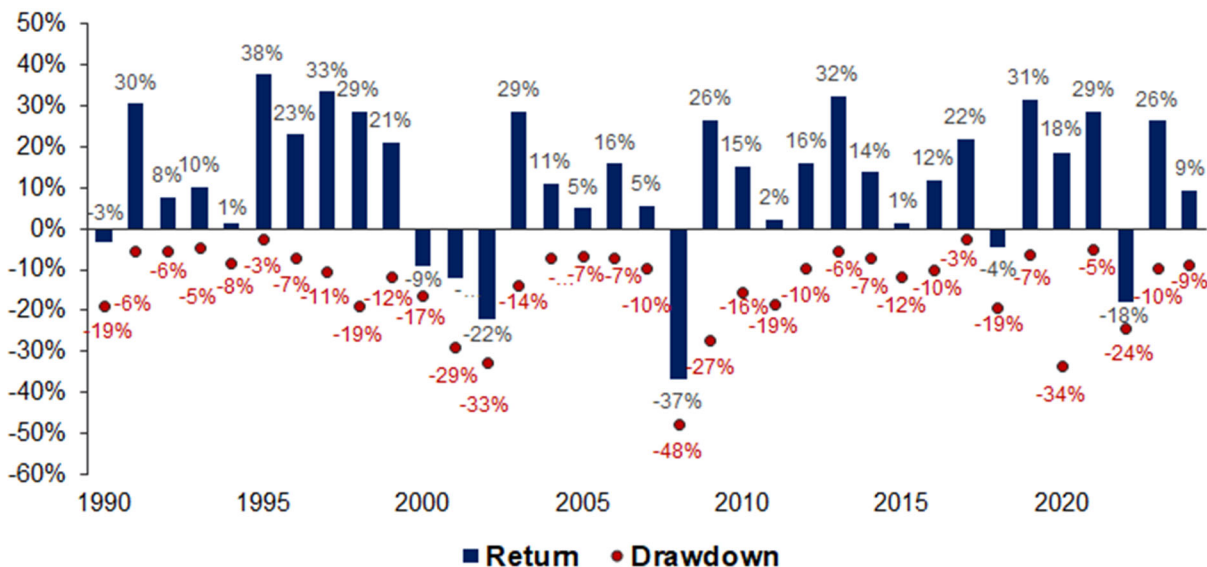
rate markets priced in aggressive expectations for Fed rate cuts, including 0.50% of cuts by the September meeting (twice the normal 0.25% incremental change) and between four and five 0.25% cuts prior to year-end.

Additionally, the BoJ's surprise rate hike and changes to its balance sheet strategy triggered capital market volatility. Japan's negative interest rate policy and depreciating currency previously provided global investors an opportunity to borrow at low Japanese interest rates and in Japanese currency to fund investments in other higher-yielding opportunities, known as a carry trade. The BoJ's surprising decision led to a quick appreciation in Japan's currency, the yen, with higher interest rates and an appreciating currency abruptly increasing global traders' borrowing costs, resulting in a quick reversal as investors unwound some of these speculative trades.

Historical perspective

Intra-year drawdowns, while unsettling, are normal features within generally upward trending equity markets. The current decline of 8.5% from the S&P 500's all-time high on July 16 to today's market close is within a normal historical range. Even a correction, often defined as a 10% decline from a recent market peak, can (and often does) occur within an overall positive return year and represents an arguably arbitrary numerical change within the more complex context of economic and capital market considerations.

Annual S&P 500 returns and intra-year drawdowns



Sources: U.S. Bank Asset Management Group, Bloomberg, December 31, 1989-August 5, 2024.

We find it helpful to frame sharp market declines within a three-phase process to develop an informed decision on any potential changes to our forward outlook:

- **Event/trigger** – Last week's central bank activity followed by weaker-than-expected manufacturing and jobs data spurred an initial decline across global equity markets. Declines accelerated into this week as global investors unwound carry trades and leveraged investors faced margin calls. Selling pressure was most intense in popular trades and among assets with the highest valuations, such as artificial intelligence-related companies.
- **Fundamental assessment** – Normally, capital markets take signals from the underlying economy, but economic activity can change based on recent market volatility. While market action bears watching, we retain a glass-half full outlook on diversified portfolios. The economic outlook is slowing but still-constructive, inflation pressures are easing and the labor market is solid despite the recent deceleration. We are nearly three-fourths of the way through second quarter earnings reports for large companies as measured by the S&P 500, with sales rising 4.9% and earnings gaining 11.3% to date. While we must remain attentive to the impacts of elevated interest rates on

consumer and corporate behavior, recent trends remain constructive, as we discussed in [our August 2 commentary](#).

- **Individual circumstances** – While we retain a constructive forward view for diversified portfolios and monitor events as they unfold, market events provide an opportunity to reassess your financial assets relative to goals to help ensure your investment portfolio is aligned with your long-term objectives. As we graphically represented above, market drawdowns and corrections are a normal feature within an upward trending market and typically don't necessitate a portfolio change, but each individual situation is unique. Please do not hesitate to discuss your unique financial situation with your wealth management advisor.

Our views

We continue to observe an orderly deceleration in economic activity. Incoming data suggests that labor markets are coming into better balance, relieving inflationary pressures, while not yet manifesting recessionary conditions that would necessitate a strong reaction from the Federal Reserve.

We believe this environment provides a positive setup for diversified portfolios. While the recent equity decline is notable, equity performance remains positive year-to-date and bond investments help offset recent equity price volatility. We are not observing disorderly moves across broad capital markets (especially credit), but we need to respect that selling can beget more selling if investor sentiment further deteriorates.

Finally, we continue to observe economic and capital market movements relative to potential [election outcomes](#) and recent activity will likely add to the political rhetoric between candidates in the lead up to the Democratic National Committee meeting in Chicago August 19-22. Election odds continue to narrow, with recent polls suggesting close races in battleground states that will likely determine the electoral college winner.

Key considerations

Our investment process is a mosaic approach incorporating historical evidence, current conditions, and inferences regarding future outcomes. We monitor global macroeconomic and capital market activity and within the current situation the following are four key considerations within our evolving forward outlook:

- Consumers, evidenced through labor market conditions, consumer spending and credit trends
- Inflation and resultant central bank policy changes
- Investor sentiment, corporate earnings growth and credit markets
- Known risks including commercial real estate stresses and geopolitical conflicts

As always, we value your trust and are here to help with your unique financial situation.

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