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# Wealth Advisory Market Update

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Market Update

**Equities**

The month of August snapped a five-month winning streak in both the S&P 500 and the NASDAQ. The market, measured by the S&P 500 index, fell 1.53%, the first down month since February. Even with the down month the market is still up 18.73% for the year. The equities markets fall coincided with weakening economic data along with inflation data that continues to show signs of stickiness.

Market valuations remain overextended. This is mostly due to the "Magnificent Seven," these well-known stocks account for 28.1% of the market cap in the index, which is just below their highest concentration of 28.9% two years ago. We have definitely reached the fear-of-missing-out stage. Market participants are chasing these companies higher even as valuation metrics point to extreme overvaluation. Currently the P/S (price to sales) ratio of the market stands at 2.58x, well above the twenty-year average of 1.81x. When taking a deeper dive, we can clearly see the main driver is the technology sector. It is trading with a P/S ratio north of seven, double that of its twenty-year average. Why is this such an important metric? A P/S ratio of seven means if every company in the technology sector paid out all of there revenue and had zero expenses it would take seven years of sales to get your money back. In our opinion, that is absurd and we will see a correction just like we did in 2021-2022.

As we have said before "*just because the tech sector is expensive relative to history does not a mean a correction is imminent."* This delay can be at least partially attributed to the rise in exchange traded funds over the past decade. The top ten stocks of the S&P 500 index make up 25% of the roughly 1,750 existing ETFs. Passive investing has become a bubble in our opinion and just like other bubbles, it runs the risk of popping. Due to the large exposure of those stocks in the ETFs, when the selling does occur it will create a "liquidity vacuum" in which there are more sellers than buyers. Prices will decline until there is someone willing to buy at the lower price.

Valuations are not the only risk to the market. Economic and Geopolitical risks continue to be headwinds. Economic indicators continue to flash recession signals and geopolitical tensions continue to be present. The war in Ukraine shows no signs of slowing. US and China tensions are not going away, whether economically (semiconductor sales) or geopolitically (Taiwan). These situations can turn quickly and drive further volatility. Also, U.S. dollar hegemony was challenged again. The BRICS (Brazil, Russia, India, China, and South Africa) summit expanded membership to Saudi Arabia, the UAE, Argentina, Egypt, Ethiopia, and Iran. This has caused speculation about moving towards another global reserve currency that replaces the U.S. dollar.

**Monetary Policy and Economic Indicators**

The Federal Open Market Committee (FOMC) did not meet this month but there was still a notable press conference in Jackson Hole, Wyoming. It was here that last year FOMC Chair Jerome Powell sent the markets into turmoil with his speech on inflation. Many were looking to this event to see if Powell would once again take a hawkish tone and put the market on notice.

While he was not as hawkish as he was last year, Powell still emphasized that inflation is too high. He followed up this remark by stating that the Committee is prepared to raise rates further if appropriate and intends to hold them at a restrictive level until they are confident inflation is coming down. The Chairman noted that looking at headline inflation can be misleading as food and energy are volatile and can be moved by global influences.

The Chairman then turned his attention to Core inflation, which excludes food and energy. He said that Core PCE has declined gradually but two months of good data is only the beginning. He went on to add that core inflation still has a substantial way to go to reach their two percent target. When looking at inflation for non-housing services, the segment that accounts for half of the Core PCE index, the twelve-month data has moved sideways. The past three- and six-month data has had a modest decline, but further progress is needed to achieve price stability.

Economic indicators over the last few months have weakened. The most recent jobs data showed some troubling signs for the labor market. The Bureau of Labor Statistics (BLS) revised non-farm payroll data lower for every month in 2023. When looking at full-time jobs, the drop was more pronounced. They were down 670,000, the most since Covid lockdowns. Non-seasonally adjusted hiring was the second worst number since the Financial Crisis in 2008. Consumer sentiment and manufacturing surveys continue to give recessionary signals. We thought the US economy would enter a recession earlier this year, but that call was premature. Current indicators, however, are pointing to severe weakening in the economy and we still see a recession on the horizon.

**Strategy**

Markets remain overvalued on nearly every metric. The performance has been led by a handful of companies that are detached from underlying fundamentals. The rest of the market is not painting the same rosy picture. The S&P 500 equal-weight index is only up five percent YTD and the Russell 2000, which is one of the best indicators on how the overall economy is doing, is up 7%. We will continue to stick to our discipline. This means we will not chase returns or buy companies that do not meet our investment criteria.  We still believe a recession is on the horizon. Because of this, we want to hold companies that have strong balance sheets, produce strong free cash flow and trade below their intrinsic value.

Fixed-income markets remain attractive. We have not seen rates this high in well over a decade. We are using this opportunity to extend our duration and lock in higher rates for a longer period of time. It is our belief that bonds offer a better risk/return profile than equity markets due to both the overvaluation of the equity markets and our belief that interest rates will be lower five years from now. We will continue to buy high-quality credits as we still think a recession is on the horizon. In times like these, we do not think less than investment-grade credit offers proper compensation for the underlying risk.

As always, we strive to navigate this challenging environment to the best of our ability. The team at AMB expresses gratitude for your support and the opportunity to collaborate with you in achieving your financial goals.

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