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Weekly Market Flash

And Now…The Dog Days of Summer

July 31, 2015

Yes, it is already that time of the year. August is upon us, otherwise known as the dog days of summer. This is the season of potato salad, beach volleyball and light-volume trading sessions on equities exchanges. Those light volumes have a habit of cutting short hard-earned vacations as random unexpected events pop into existence and cause exaggerated price swings. Are we due for another August of surprises, or will the relatively benign sideways market that has prevailed for the last seven months carry us gently into September?

Dog Days By the Numbers

The numbers tell us: volatile Augusts are not just another fanciful chestnut of Wall Street mythology. For the last quarter century, August has been the most negative month of the year on average (as measured by the price return from 7/31 to 8/31 each year from 1990 through 2014). The average August return for this period was -1.49 percent versus an average overall monthly return of 0.67 percent. August had two of the 10 worst monthly returns of any month during this period, and five of the top 25. By comparison October, that ghoulishly famous month of tricks and treats, made only one appearance (2008, of course) in the Worst 25 months over this quarter century span (which time period, of course, does not include the carnage of Octobers past in 1987 and 1929). So yes, August has earned its reputation as the month where the best laid plans of R&R go to die.

All Eyes on September

Two years ago, the event keeping investors off the beaches was the "taper tantrum" – the largely irrational spike in bond yields that followed from then-Fed Chairman Bernanke's musing over a possible curtailing of QE3. Now the chatter is all about the real thing – an actual rate hike program for the first time since the sequence of 17 consecutive increases from 2004-06. The Fed has studiously avoided making specific time commitments even as the consensus forms around a likely increase before the end of the year. Coming into today's 2Q GDP report, the question was whether the program would start in September or December.

According to the Bureau of Economic Analysis, real GDP grew 2.3 percent in the second quarter. That was slightly below consensus estimates, but at the same time the BEA revised first quarter GDP growth from the previous -0.2 percent estimate to a haler 0.6 percent. Still, this year's Q2 is a far cry from the 4.6 percent growth we saw a year ago, also coming off a seasonally challenged Q1. How does this information affect the likely timing of a September rate move? A scan of financial media headlines this morning reveals a healthy dose of "economy bounces back" narratives. We, however, believe that if the needle has moved at all today it has moved closer to a December start.

Time Is On Their Side

What the Fed has said time and again is that it will raise rates when it is good and ready, based on the data, and not before. Inflation remains below two percent, there is still slack in the labor market and capacity utilization hovers in the low 70s. In other words, there is no gun to the head. We believe a 2Q GDP number in excess of three percent would have been the needle-mover closer to a September event, but such was not the case.

Then there are all those other things that could spook the market and cause the dog days to live up (down?) to their reputation. Volatility has been relatively muted throughout the Greece and China dramas of the past several weeks. But if something comes out of left field in the next four weeks and sends the S&P 500 into a five percent-plus reversal, expect that to weigh further still against any moves by Yellen & Co. to move up the starting gate.

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