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Weekly Market Flash

Yields Rise for (Mostly) Non-Downgrade Reasons

August 4, 2023

A strange thing happened when we came into work on Wednesday morning this week and plugged into the daily news cycle: we learned, as the rest of the world was learning, that the credit rating agency Fitch Ratings, something of a third wheel to the more well-known Standard & Poor's and Moody's, had issued a downgrade on US government debt. Fitch was of course the second US rating agency to deprive Treasury securities of the coveted triple-A rating, fully twelve years after the S&P shock downgrade took place in August 2011. This was not telegraphed in any meaningful way, nor did there seem to be any news of the moment to warrant the timing. Fears of a major market swoon, though, were brief and mercifully shallow.

2011 This Is Not

For a quick refresher on that turbulent summer of 2011: Congress and the White House were locked in an implacable standoff over the debt ceiling for most of the summer, finally cobbling together an agreement to raise the debt ceiling (subject to all sorts of conditions that would come back to bite a couple months later) on August 2 of that year. On August 5, a Friday, S&P published the report downgrading Treasuries to AA+ status. The following Monday, August 8, the S&P 500 stock index plunged seven percent in a single day. The total damage to US stocks during this period would amount to about 19 percent from peak to trough, just shy of the threshold for a bear market.

Oh, and while all this was going on, the single-currency Eurozone was in the middle of its own crisis with the future of four of its members – Greece, Italy, Portugal and Spain – very much in doubt.

The market reaction to this week's Fitch downgrade was a few magnitudes less dramatic than 2011. Stocks retreated on Wednesday, with the S&P 500 falling 1.4 percent and the Nasdaq Composite dropping 2.2 percent. But if the Fitch downgrade had anything to do with that, it would seem to be more along the lines of providing an excuse for investors who were looking for a reason to sell and book some profits from the market's recent rally. Overall market sentiment continues to be more focused on the direction of the economy (better than expected) and corporate earnings (decent, but with a high expectations bar).

Supply Concerns Hit Yields

Over in the bond market, intermediate Treasury yields have been rising this week, but the key driving factor there seems to be the government's lifting of its issuance target for the third quarter, beginning with a $103 billion issue to cover refinancing of $84 billion in notes coming due on August 15. A higher than anticipated supply of new government debt has some observers skeptical that it can be accomplished without rates going up some more (though similar issuance increases in recent months have not had the effect of moving rates as much as some had anticipated).

At the same time, a jobs report on Wednesday (the ADP National Employment Survey) revealed continued strength in the jobs market. That news, when translated into bond market-speak, offers no real reason to expect interest rates will be coming down any time soon, and thus nothing to counter the upward pressure on rates from the Treasury Department's increased issuance report.

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As we are fond of saying, though, it's always best not to read too much into one report, or even one day's worth of financial news. Today we got a different perspective on the jobs market from the Bureau of Labor Statistics, reporting job gains of 187,000 in July against economists' forecasts of 200,000. The BLS number fits more squarely into the macroeconomic narrative that drove investor optimism in July – slower but still positive growth in the economy, with inflation continuing to trend down (we will learn more about that second aspect next week, when the July Consumer Price Index report comes out). On the heels of the BLS report, stocks are in modestly positive territory today and bond yields are down a bit. So it goes.

We expect there will be a few more twists and turns in the coming weeks. August is often a tricky time for markets, with lower volume and more potential for outsize price swings. Then comes September, which historically is the worst calendar month of the year for stocks (always remember that "historical average" is not the same thing as "what will happen this year"). We will see what risks and opportunities lie ahead.

Masood Vojdani
President & CEO

Katrina Lamb, CFA
Head of Investment Strategy & Research

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