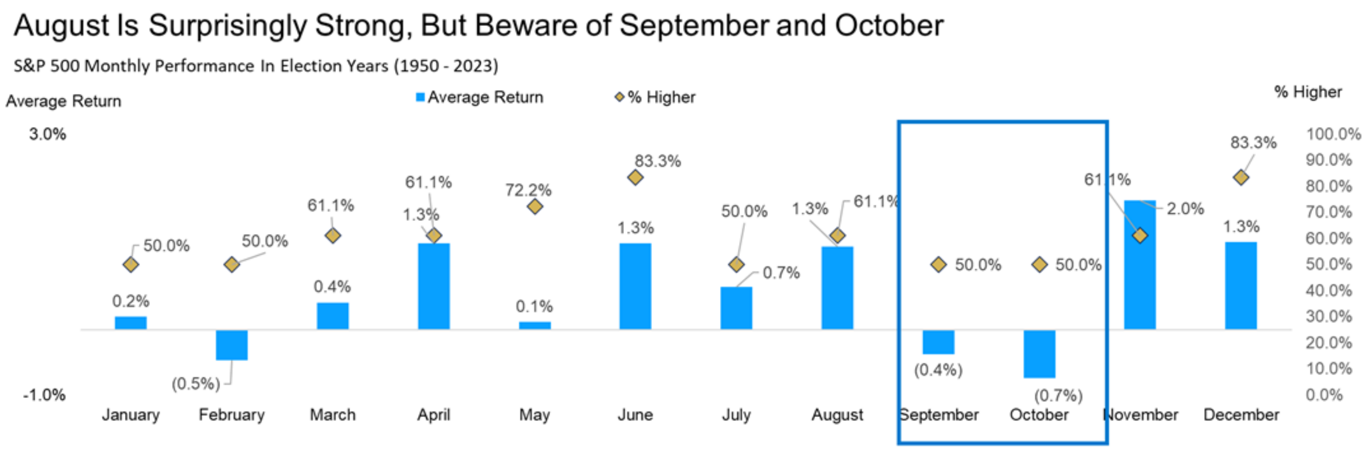
Summer Rally Extending or Extended?

As we enter September, investors who resisted the urge to "sell in May and go away" have been rewarded. In our [June newsletter](), we highlighted that during election years, June through August has historically been strong for the market. True to form, the S&P 500 gained 7.0% over this period, closely aligning with the historical election-year average of 7.3%.

Now, with the election just about 8 weeks away, we're approaching the phase of the cycle where the markets have historically shown some weakness.



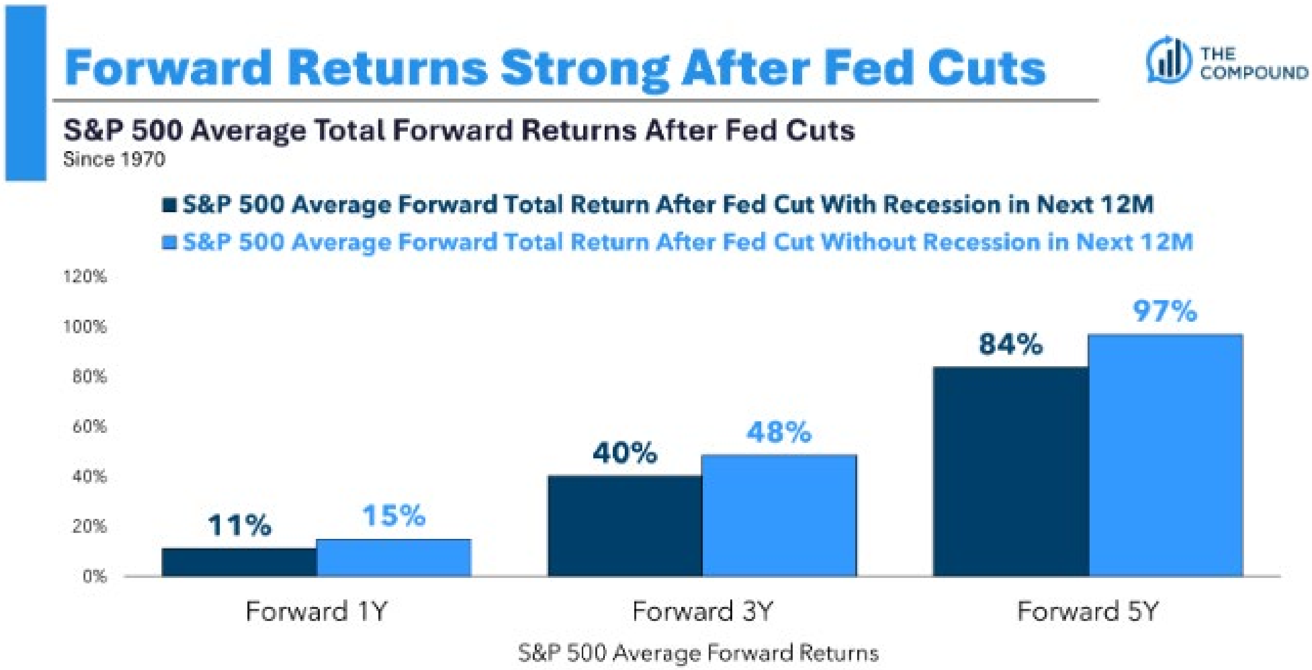
(Source: [Carson Investment Research]())

The chart above illustrates the average monthly returns during election years, shown in the blue bars, while the gold diamonds represent the percentage of months that saw gains. As we shift our attention to September and October, both months tend to have lower averages in election years, with roughly even odds of the market being up or down. The takeaway is that market weakness leading up to an election is historically normal, but strength often builds as the year closes. Markets dislike uncertainty, and until the election outcome is known, history suggests a period of increased volatility.

Markets and Rate Cuts

As we approach the September Fed meeting, markets are currently pricing in a 55% chance of a 25bps rate cut and a 45% chance of a 50bps cut. While the outcome will be known in a few weeks, we wanted to explore how the market typically reacts when the Fed begins an easing cycle. It's important to note that the Fed can cut rates for a variety of reasons. In a recession, rate cuts are used as a tool to support the economy. However, this cycle has been different.

The recent rate hikes were primarily aimed at curbing inflation, and now, with data showing inflation is falling, the Fed is looking to cut rates to prevent a potential recession. Although the distinction is subtle, it's crucial: cuts can either be in anticipation of a slowing economy or after a slowdown has already occurred. This difference matters because markets tend to behave differently during recessionary easing cycles compared to periods when cuts are made without a recession.



(Source: [A Wealth of Common Sense])

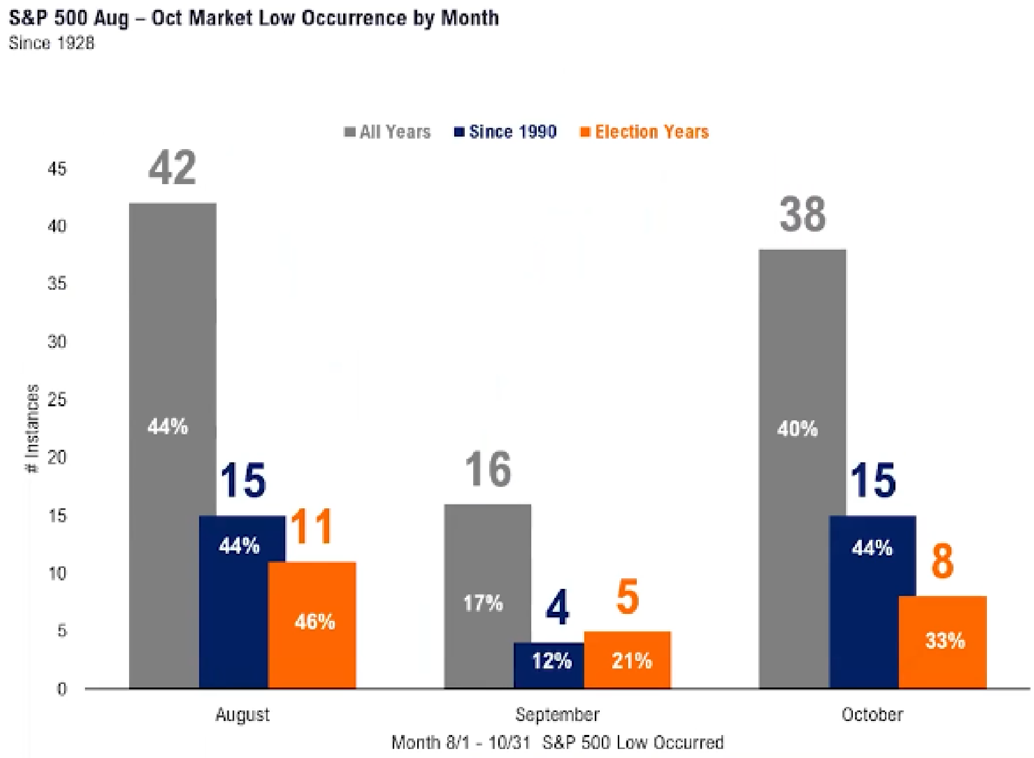
In the chart above, each bar represents the return of the S&P 500 following the first rate cut. The first bar indicates recessionary periods, while the second bar represents non-recessionary periods.

Key takeaways: If a recession is avoided, the maximum drawdown is just 4% in a 12-month period, which is relatively modest compared to historical averages. When including recessions, the average drawdown increases to 11%, which aligns closely with the typical 9% drawdown observed in any 12-month period. In both cases, the market marched forward on a 1-, 3- and 5-year period.

In summary, rate cuts alone don't determine future market performance—the underlying reason for the cuts is what ultimately drives returns.

August to October: A Historical Window for Market Lows

In our first article, we discussed the challenging 8-week period that often occurs leading up to an election. We wanted to dive deeper into this topic and examine when market lows are typically reached during the August to October stretch.



(Source: Fundstrat)

The chart above shows the percentage of times the market has hit its lows since 1928 (in grey), since 1990 (in blue), and specifically in election years (in orange). Historically, the market has most often reached its low point in August, happening 46% of the time. This suggests that, while volatility may still be ahead, the market has likely already experienced its low in August, which was triggered by the sharp decline early in the month due to the unwinding of the Japanese yen.

Articles We're Reading

OPEC+ leaning towards proceeding with October output hike as planned (Bloomberg, Reuters)

Bill Ackman seeking to resurrect IPO of Pershing Square USA, offer investors extra additional incentives (FT)

Disney and DirectTV fail to reach new distribution deal for ESPN, ABC and other Disney-owned networks (Reuters)

OpenAI, Anthropic sign deals with US government to provide AI models for research (Reuters)

Market Snapshot

For the Month Ending 8/31/2024 (Cumulative Returns)[1]

United States Markets	1-Month	3-Month	YTD	1-Year
Dow Jones Industrial Average	1.76%	7.44%	10.28%	19.70%
S&P 500	2.28%	7.03%	18.42%	25.31%
The NASDAQ Composite	0.65%	5.85%	18.00%	26.21%
U.S. Mid Cap	2.21%	5.38%	10.77%	18.00%
U.S. Small Cap	-0.33%	5.14%	7.63%	15.09%

Global Markets	1-Month	3-Month	YTD	1-Year
Nikkei 225	-1.16%	0.42%	15.49%	18.48%
Hang Seng	3.72%	-0.50%	5.52%	-2.14%
Shanghai Comp	-3.28%	-7.92%	-4.46%	-8.90%
FTSE 100	0.10%	1.22%	8.32%	12.60%
DAX	2.15%	2.21%	12.87%	18.56%

Fixed Income	1-Month	3-Month	YTD	1-Year
Corporate Bonds	1.87%	5.18%	3.12%	9.49%
Municipal Bonds	0.24%	2.60%	1.05%	5.10%
High Yield Bonds	1.55%	4.43%	6.29%	11.99%

Market Indicators	Rate	Market Indicators	Value
10 Year Treasury	3.91%	WTI Crude Oil	71.03
Fed Funds Target	5.25 to 5.50%	Gold - Spot Price	2,517.50
Inflation Rate	2.90%	U.S. Dollar	101.64
Unemployment Rate	4.3%	CBOE Volatility Index	15.00

[1]Source – Morningstar, Inc. Corporate Bonds is presented as the iShares iBoxx $ Investment Grade Corporate Bond ETF. Municipal Bonds is presented as the iShares National Municipal Bond ETF. High Yield Bonds is presented as the iShares iBoxx $ High Yield Corporate Bond ETF. 10 Year Treasury refers to the valuation of a 10 Year Treasury Note, a debt obligation issued by the U.S. Department of the Treasury. Fed Funds Target represents upper limit of the federal funds target range established by the Federal Open Market Committee. Inflation Rate provided for the purposes of this report by the U.S. Bureau of Labor Statistics. Unemployment Rate calculated by the U.S. Bureau of Labor Statistics. WTI Crude Oil refers to the price of a barrel of West Texas Intermediate NYMEX) Crude Oil. Gold – Spot Price relates to the valuation of an ounce of gold, as traded on the NYSE Arca Exchange. U.S. Dollar refers to the U.S. Dollar Index (DXY). All Returns are denominated in USD (United States Dollar), unless otherwise explicitly noted.

Did You Know?

Labor Day originated in the 1880s when American workers began organizing parades and rallies to demand better working conditions and fair pay. The first official Labor Day was celebrated on September 5, 1882, in New York City. It became a federal holiday in 1894, partly in response to the Pullman Strike, a major labor conflict that year. Today, Labor Day marks the unofficial end of summer and is celebrated with parades, picnics, and relaxation, but it also serves as a reminder of the labor movement's impact on workers' rights.

Presented by the Investment Committee of Lake Street, an SEC Registered Investment Adviser