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SEASONAL SLUMP?

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KEY TAKEAWAYS

Last week's stock market slide begs the question whether this August will fit its historical pattern of seasonal weakness.

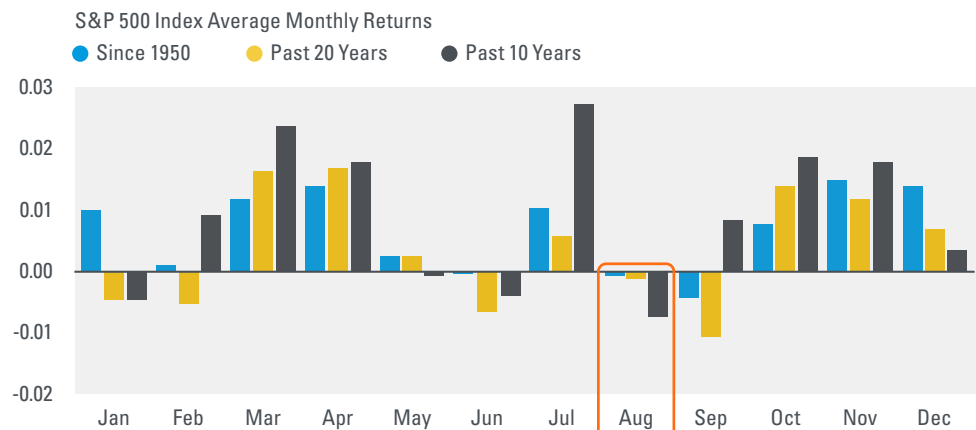
With the latest escalation of trade tensions, investors should be prepared for more market volatility this month.

Other keys for stocks this month include the Fed and earnings, although the impacts of both are likely to be drowned out by trade concerns.

August has been one of the worst months for the stock market historically.

In fact, it has been the worst month on average for the past 10 years, with the S&P 500 Index down an average of 0.78% for that month [Figure 1]. Last week's 3.1% slide for the index certainly fit that pattern, which begs the question whether investors should buckle up for more seasonal losses this month. Despite last week's losses, 2019 has been a good year for stocks—the S&P 500 is up 17% year to date through August 2 and, excluding any losses Monday, still stands just 3% from its all-time closing high on July 26. Here we summarize August's lackluster track record and discuss whether this August will fit the pattern.

1 AUGUST HAS BEEN A SEASONALLY WEAK MONTH HISTORICALLY



Source: LPL Research, FactSet 07/30/19

The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90. All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

UPDATE

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LATE SUMMER LULL

We have some painful August market memories: most recently, the Chinese yuan crisis in August 2015, which sent the Dow Jones Industrial Average down 1,000 points in one day. Prior to that, rating agency Standard & Poor's downgraded its credit rating on U.S. debt in August of 2011, sending the S&P 500 down 5.7%.

And this is not just a recent phenomenon. Since 1950, the S&P 500's average monthly move in August has been a decline of 0.05%. Perhaps just as worrisome, the only month that's worse over that time is the one coming next: September.

As if that's not enough bad news, when August is down, it has been down quite a bit. Since 1990, when the S&P 500 has fallen in August, it has fallen 4.6% on average, again the worst of all months. Some of the lowlights include:

- **August 1990:** Iraq invaded Kuwait and the S&P 500 fell 9.4%.
- **August 1997:** The Asian currency crisis—known as Asian contagion—drove the S&P 500 down 5.7%.
- **August 1998:** The Russian debt crisis and collapse of the hedge fund Long-Term Capital Management pummeled stocks to the tune of a nearly 15% S&P 500 decline, the worst August in the S&P 500's history.

Of course we don't know why so many significant negative events have occurred in August, but some of the long-term historical weakness can perhaps be explained by summer vacations and fewer market participants. Regardless of the reasons for it, the key takeaway is to be prepared for more volatility.

THREE KEYS FOR MARKETS THIS MONTH

Short-term market movements are always very difficult—if not impossible—to predict, but we would not be surprised if stocks pulled back a bit more from where they are now. Here are our three keys for markets this month:

Trade

Tariffs and trade risk, though not new, will be a very important factor driving stocks in August. U.S. and China negotiators have a meeting scheduled for September, which takes on greater importance after President Trump's latest tariff threat. On September 1, a 10% tariff will be placed on the remaining roughly \$300 billion in U.S. imports from China. That tariff could be removed, as President Trump noted last week, though that is unlikely to happen before formal talks.

Our take: We expect progress on trade and reductions in tariffs in the coming months, but the dispute could drag well into 2020 and lead to more market volatility in the interim.

The Federal Reserve (Fed)

The rally to new highs in late July was driven in large part by expectations for a series of Fed rate cuts. After the expected 25 basis point (0.25%) cut July 31, Fed Chair Jerome Powell's comments in his post-meeting press conference left bond market participants questioning whether another cut was in the cards. (This probably had something to do with the timing of the president's latest tariff threat, as he may have been trying to push the Fed to cut more and weaken the U.S. dollar).

Our take: Expect at least one more Fed rate cut this year as trade tensions continue to simmer, which may help support stock and bond markets. However, bouts of volatility around shifting rate cut expectations would not surprise us, with three additional cuts mostly priced in by March of 2020.

Earnings

Earnings season is winding down, but it could still move markets this month, especially given that threatened tariffs impact many consumer goods, and many retailers report results late in the season. S&P 500 earnings for the second quarter are tracking to a fractional gain, according to FactSet. However, given some sizable headwinds (trade, slower global growth, strong U.S. dollar, Boeing's losses, and Apple's earnings decline), earnings under the surface have been pretty good in our

opinion. With 110 S&P 500 companies remaining to report, we hope to learn more about the potential impact of the latest proposed tariffs.

Our take: The market impact of the rest of earnings season may be mixed amid tariffs and other headwinds. However, we expect earnings to improve later this year and into 2020 as trade risks potentially abate.

CONCLUSION

August has historically been a rough month for stocks. That track record and the strong gains year

to date suggest risks of a pullback (5–9%) or a correction (10–19%) have risen. Corrections tend to occur this time of year, so even though we expect stocks to move higher between now and year-end, some bumps can be expected. If we do see some volatility, then tariffs, the Fed, and earnings will likely be the culprits. We expect the Fed to generally support markets, earnings probably won't hurt, and trade will still be a wildcard. Given a still solid fundamental backdrop overall with steady economic growth, our belief that earnings will improve, and low interest rates with support from the Fed, buying dips may be rewarded. ■

Thank you to Ryan Detrick for his contributions to this report.

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INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

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