August Market Review: Stocks Hit Record Highs Amid Fed Policy Shifts and Strong Earnings

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August delivered impressive gains for both equity and fixed income markets, with stocks reaching record territory despite ongoing policy uncertainties. The month kicked off with new tariffs taking effect on major trading partners following the expiration of a 90-day grace period. A federal appeals court subsequently declared these "reciprocal tariffs" unconstitutional, potentially setting up a Supreme Court challenge.

Mid-month volatility emerged as investors worried the Federal Reserve might maintain elevated rates longer to combat inflation pressures. Recent data, including the Producer Price Index, indicates businesses are starting to transfer tariff-related expenses to consumers. Nevertheless, markets recovered strongly thanks to robust corporate earnings results and increased optimism about potential Fed rate reductions at the September policy meeting.

Economic indicators presented a mixed picture. Second-quarter GDP growth received an upward revision from 3.0% to 3.3%, marking a substantial recovery from the first quarter's 0.5% contraction. Conversely, the monthly employment report revealed disappointing payroll additions along with significant downward adjustments to previous months' data. This development prompted the White House to dismiss the Bureau of Labor Statistics Commissioner, contributing to the uncertain policy landscape.

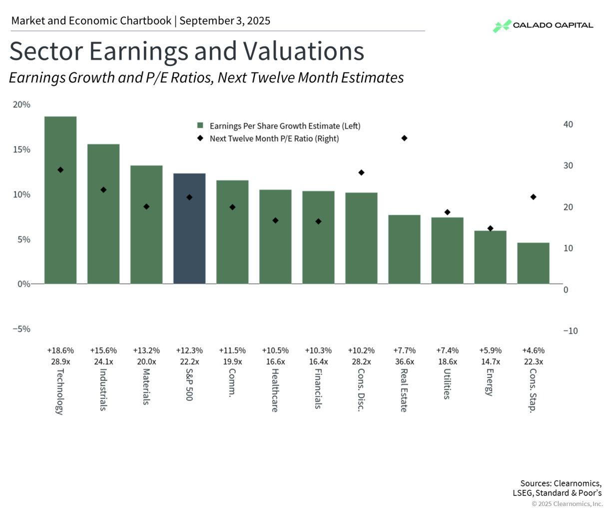
Nevertheless, market volatility stayed relatively contained compared to historical norms. The strong August performance across multiple asset classes highlights the value of maintaining diversified portfolios with a long-term perspective.

Key Market and Economic Drivers

- The S&P 500 rose 1.9% in August, the Dow Jones Industrial Average 3.2%, and the Nasdaq

1.6%. Year-to-date, the S&P 500 is up 9.8%, the Dow is up 7.1%, and the Nasdaq is up 11.1%.
- The Bloomberg U.S. Aggregate Bond Index gained 1.2% in August. The 10-year Treasury yield ended the month lower at 4.2%.
- International developed markets jumped 4.1% in U.S. dollar terms using the MSCI EAFE index, while emerging markets gained 1.2% based on the MSCI EM index. Year-to-date, the MSCI EAFE index has gained 20.4% and the MSCI EM index 17.0%.
- The U.S. dollar index ended the month lower at 97.8.
- Bitcoin fell in August, ending the month at 109,127 after experiencing a "flash crash" on August 24.
- Gold prices ended the month at a new all-time high of $3,487.
- The Consumer Price Index rose 2.7% on a year-over-year basis in July, in line with economist expectations.
- The jobs report showed that the economy added only 73,000 jobs in July. Significant downward revisions to the May and June figures mean that the labor market was much weaker than originally reported. The unemployment rate remained low at 4.2%.

Strong corporate earnings drove market advances

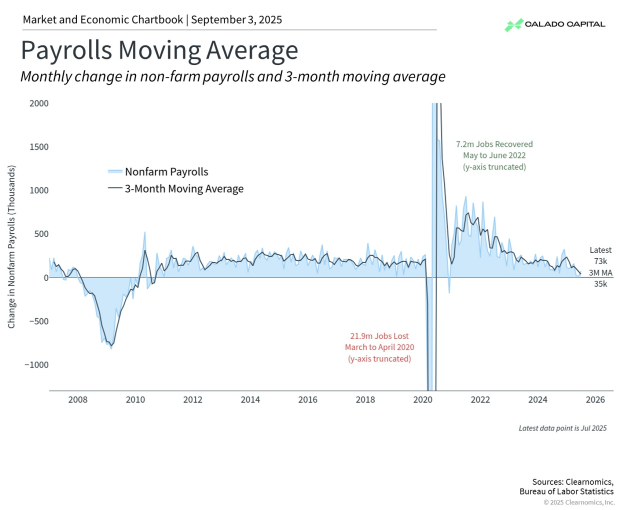


Although short-term news cycles can influence daily market movements, underlying fundamentals such as corporate profitability and market valuations ultimately determine long-term investment returns. Current equity valuations remain elevated by historical measures, yet this premium appears justified given companies' sustained earnings expansion.

Recent quarterly results demonstrate impressive corporate performance, with 81% of S&P 500 companies surpassing analyst projections, according to FactSet data. This represents the highest beat rate since the third quarter of 2023, indicating economic and business fundamentals have proven more resilient than anticipated.[1] These results also highlight corporate agility in navigating tariff implementation, managing cost pressures, and maintaining growth amid policy volatility.

Investor attention has centered on the Magnificent 7 technology giants, whose combined market capitalizations exceed one-third of the S&P 500's total value. While earnings results varied across this influential group, several of these "hyperscalers" delivered better-than-expected performance. Despite ongoing concerns about artificial intelligence valuations, these positive surprises helped fuel the late-August market rally.

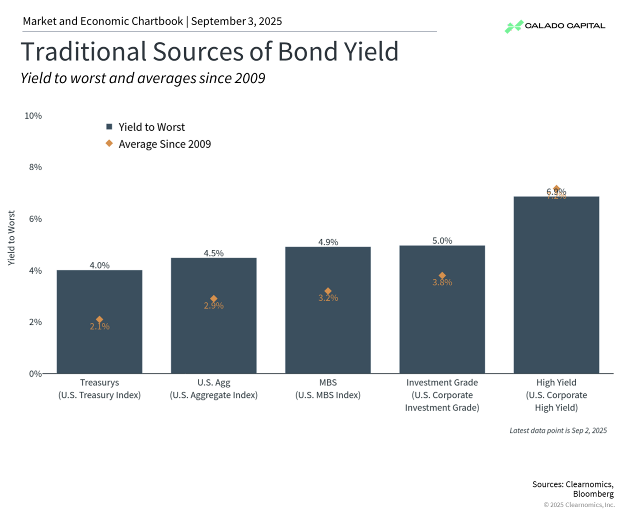
Central bank policy pivot anticipated



Meanwhile, consumer-oriented companies reported more variable outcomes reflecting shifts in household spending behavior. Tariff implementation has intensified these pressures as businesses increasingly pass costs along to end consumers. Combined with disappointing employment data, these developments have led markets to price in more aggressive rate reductions starting in September.

Federal Reserve Chair Jerome Powell delivered his most explicit indication yet that the central bank stands ready to resume monetary easing during his Jackson Hole symposium address. The Fed operates under a dual mandate targeting both price stability and full employment. Having maintained restrictive policy due to persistent inflation and labor market strength, emerging signs of employment weakness could shift the Fed's calculus toward measured rate cuts.

Rate reduction cycle may benefit multiple asset classes



Anticipated Fed rate cuts could unlock value across various investment categories. Beyond supporting broader economic expansion, lower borrowing costs can improve corporate financing conditions, reduce project implementation barriers, and enhance the net present value of future earnings streams. For fixed income investors, declining rates typically boost prices of existing bonds issued at higher coupon rates.

Treasury yields have traded within a relatively tight band this year, with the 10-year benchmark oscillating between 4.0% and 4.5%. While short-term rates may decline as the Fed eases policy, numerous bond sectors continue offering attractive income opportunities. The U.S. aggregate bond index currently yields 4.4%, with investment-grade corporate debt at 4.9% and high-yield securities at 6.7%. These levels significantly exceed long-term averages and provide valuable portfolio diversification.

For comprehensive portfolio management, investors should maintain focus on balancing various risk and return factors. Challenges including tariff policies, monetary policy uncertainty, and potential government funding disruptions represent just some of the issues ahead. Rather than responding reactively to individual events, maintaining well-diversified portfolios designed to weather volatility while generating income and long-term appreciation remains the optimal approach for achieving financial objectives.

The bottom line? August saw markets achieve new record highs despite significant policy headwinds. Solid corporate earnings and economic fundamentals continue supporting investment portfolios through ongoing uncertainty.

1.https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_082925.pdf

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