

August 29, 2022

Weekly Viewpoint

Hawkish Fed, Bearish Reaction

Performance for Week Ending 8.26.2022

The Dow Jones Industrial Average (Dow) finished off 4.22%, the Wilshire 5000 Total Market IndexSM (Wilshire 5000SM) fell 3.74%, the Standard & Poor's 500 Index (S&P 500) dipped 4.04% and the Nasdaq Composite Index (NASDAQ) shed 4.44%. Sector breadth was negative with 10 of the 11 S&P sector groups closing lower. The Technology sector (-5.58%) was the worst performer followed by Communication Services (-4.82%) and Consumer Discretionary (-4.75%). On the upside, the Energy sector (+4.27%) bucked the trend.

Index*	Closing Price 8/26/2022	Percentage Change for Week Ending 8/26/2022	Year-to-Date Percentage Change Through 8/26/2022
Dow	32283.40	-4.22%	-11.16%
Wilshire 5000	40598.79	-3.74%	-6.22%
S&P 500	4057.66	-4.04%	-14.87%
Nasdaq	12141.71	-4.44%	-22.39%

Market Observations: 8/22/22 – 8/26/22

The major market indices finished the week broadly lower after Fed Chair Powell's much anticipated speech in Jackson Hole, Wyoming was viewed with a hawkish tilt. Powell underscored the Fed's intention to tighten policy enough to bring inflation down to target and then keep it here, acknowledging that this likely means "some pain to households and businesses." Powell also appeared frustrated by market expectations that the Fed will begin to ease policy next year, noting that policy will have to be restrictive for "some time as the historical record cautions strongly against prematurely loosening policy." The Fed Chair also remained worried about the risk of embedding high inflation expectations, emphasizing that the costs of reducing inflation are greater when it has become entrenched. While Powell gave no hints on how aggressive the Fed will move at the September meeting, he did say the decision will hinge on the "totality" of incoming data. Prior to the September meeting, the Fed will get a chance to review the August Payroll report (due out on September 2) as well as the August Consumer Price Index report (due out on September 13), both of which are likely to be highly influential on how aggressive the Fed will

hike rates at the meeting. According to Bloomberg's World Interest Rate Probability tool, Fed Funds Futures are currently discounting a 66% chance of a 75 basis point move.

Not All is Bad: The University of Michigan's index of consumer sentiment increased by 3.1 points to 58.2, continuing its rise from a historic low of 50.0 in June. Encouragingly, the inflation expectations components of the report moderated as gas prices fell and inflation decelerated. Households' year-ahead inflation expectation fell 0.4% to 4.8%, the lowest since December of last year, while expected inflation over the next five to ten years was unchanged at 2.9%. Meanwhile, the number of Americans who applied for unemployment benefits last week fell to a one-month low of 243K, indicating layoff activity remain relatively muted. On the inflation front, the Commerce Department reported that its measure of consumer the Personal Consumption Deflator (PCE), which is the Fed's preferred inflation gauge, fell 0.1% in July from June. That put it at 6.3% on a year-over-year basis, but down from the high of 6.8% hit in June. Core prices, which exclude food and energy items, rose by 0.1% from a month earlier, marking the smallest monthly gain since November 2020, and were up 4.6% from a year earlier, which was the lowest on-the-year gain since October 2021.

Q2 Earnings Season: With earnings season almost wrapped up, second quarter results are likely to finish the quarter at a much better than feared pace. Through Friday, 485 members of the S&P 500 have reported with 75% surprising to the upside. Aggregate earnings for the group are up 7.3%, solidly ahead of the 4% consensus estimate at the start of reporting season. The strongest quarterly results have come from the Energy, Industrials, and Materials sectors.

Market View: Our cautiously optimistic view on the markets remains intact. While not ruling out a retest of the recent lows, we have been encouraged by the strong rebound off the mid-June trough. While equity valuations have perked up a bit in recent weeks, they remain well below levels at the start of the year and suggest a lot of negative news and uncertainty has already been discounted in the markets. With inflation still running well above the Fed's target level, rate hikes are likely to continue although the recent string of aggressive hikes could begin to moderate at future meetings.

The Week Ahead: Following Fed Chairman Powell's pledge that the Fed will be data dependent, the focal point in the week ahead will be Friday's August nonfarm payrolls release in an effort assess the near-term path for interest rates. According to consensus expectations from Bloomberg, nonfarm payrolls are forecast to rise by 300K while the unemployment is expected to remain steady at 3.5%. In addition to the employment report, markets will also digest the Dallas Fed manufacturing activity index on Monday; the S&P CoreLogic house price data, consumer confidence, and JOLTS job openings figures on Tuesday; the first ADP employment change release under the new methodology and the MNI Chicago PMI on Wednesday; jobless claims, the final look at Q2 productivity and unit labor costs, the S&P Global and ISM manufacturing PMIs, construction spending, and vehicle sales on Thursday; and factory orders on Friday. There will also be a handful of Fed speakers sprinkled throughout the week and the earnings calendar will be light with just 10 members of the S&P 500 scheduled to report results.

Definitions

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Wilshire 5000 Total Market IndexSM represents the broadest index for the U.S. equity market, measuring the performance of all U.S. equity securities with readily available price data. The index is comprised of virtually every stock that: the firm's headquarters are based in the U.S.; the stock is actively traded on a U.S. exchange; the stock has widely available pricing information (this disqualifies bulletin board or over-the-counter stocks). The index is market cap weighted, meaning that the firms with the highest market value account for a larger portion of the index.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

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