Push and Pull.

If there were still any market participants out there that were interpreting the Fedspeak from over the summer as a more "dovish" tone, then it seems as if the Fed's symposium in Jackson Hole helped correct their misguided view. It wasn't a punishing hawkish message or tone, in our view. But we also didn't see much reason to be dovish coming out of the June FOMC. In the shortest Fed Chair speech at the annual symposium on record, Jerome Powell reassured the commitment of the Federal Reserve to push forward until clear signs of inflation dissipating. It only took him 1,301 words to deliver this message[1]- a year after many thought he delivered the wrong message in his speech at the same podium. So, we're going to follow up on our recent commentaries regarding volatility and some of the signals investors need to be aware of amid these pullbacks in equity prices. And we're going to do our best to be even shorter than J-Powell in doing so.

Resistance

Here's Powell's words[2] for you to interpret for yourself:

"Restoring price stability will take some time and requires using our tools forcefully to bring demand and supply into better balance. Reducing inflation is likely to require a sustained period of below-trend growth. Moreover, there will very likely be some softening of labor market conditions. While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses. These are the unfortunate costs of reducing inflation. But a failure to restore price stability would mean far greater pain."

Between this and the 700 commentaries and interviews from various Fed members over the last several weeks, if you weren't picking up what the Fed has been putting down, then I'm not so sure things are going to get any easier for you. On the way up, for more than a decade, the mantra "Don't Fight the Fed" was adopted by so many market participants, spectators, and pundits. Yet, for about a year now, those same individuals have seemed to pushback against the Fed every step they've made. Seems like quite the illustration of confirmation bias.

But I digress.

How'd equity markets respond to the statements on Friday? Well at about 2:00 o'clock, selling began quite expeditiously. But if you've been reading along with us throughout the year, you'll know there are a few indicators we think investors need to be mindful of to even try to begin to determine the future trend of prices for risk assets. Staying on theme of short and sweet, we've compiled 3 of those indicators along with the S&P 500 on the quadruple stacked chart below:

[1] Wall Street Journal, for Jackson Hole Symposiums dating back to 2010, when the data set was first tracked.

[2] This excerpt was pulled from the transcript of Jerome Powell's speech in Jackson Hole on 8/26/2022.

[3]

The S&P 500 first ventured below its 200-day moving average (DMA) in January of this year, which as we all should know by now, nothing good happens below the 200 DMA. Volatility is higher. Equity returns are lower. Uncertainty is higher. Anxiety can become suffocating.

In recent weeks we specifically highlighted the U.S. 10-Year yield (second panel) and the VIX (third panel). As a reminder, we've maintained the thesis that stocks won't be able to meaningfully resume a trend that points up and to the right, until we've seen a peak in the 10-Year. Since the Great Financial Crisis (GFC), fixed income investors have struggled to be able to purchase a piece of U.S. government debt with a yield above 3% for a 10-Year maturity[4]. So, when the risk-free rate begins to climb above 3% for the last 14-ish years, we've seen capital thrown at the fixed income universe. Simply because investors are given the opportunity to allocate to an asset class that's less risky than equities and generate a potentially useful return.

This should help explain why for stocks to continue their march higher, yields need to stop moving higher. The alternative to stocks needs to stop looking attractive to any investor who's risk averse. We saw a near-term peak in yields in June when stocks put in their trough (for now) this year. On Friday afternoon (8/26) and into Monday's session (8/29) we've still yet to see a greater high in yields be reached. For the moment, a silver lining for equity investors.

As this yield begins to track back above 3%, we think investors need to be mindful of the previous hiking cycle peak (3.25% in 2018[5]) and the peak from June of this year. If yields remain near the former, and below the latter, stocks will be given a fighting chance to continue to form a bottom in price.

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[3] Data provided by Bloomberg database. 8/29/2022.

[4] The average yield on the 10-Year Treasury since Jan 1, 2008 has been 2.38% through 8/28/2022.

[5] Data provided by Bloomberg database.

We've also highlighted the behavior of the VIX this year, and why the recent calmness in markets seemed a bit too subdue, considering the high-volatility regime we've been living in.

What's happened on just the last half of 8/26 and the opening hours of 8/29 has been a reversion to the mean (50 DMA and 200 DMA) for the VIX. The spike shown in panel 3 (orange line) in the last two days is a 44% jump in the VIX in just the last 6 trading sessions[6].

The final indicator we've revisited throughout this year has been the dollar (USD). The strength in the USD (panel 4) is normally a headwind for equities and a factor of divergence in U.S. monetary policy vs non-U.S. policy. So, it shouldn't come as a surprise that dollar strength has been a dominant trend this year. However, like the 10-Year, we still haven't seen recent highs get taken out by the index.

If the 10-Year and USD can each be kept at bay, then equity investors will be given a much-needed boost in order to tread water while we see if a higher low is set in equity prices. A bit of tug-of-war is likely to unfold here with the S&P 500 bouncing between its 200 and 50 DMAs. Not getting whiplash trying to follow each and every tick of the market should be priority number one for investors here. Keeping a short list of signals to be mindful of is one way to avoid needing a neck brace[7].

[6] Data provided by Bloomberg database, as of 8/29/2022.

[7] That's 1092 words, for those of you keeping score.

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