MARKETS AND ECONOMY

Schwab Market Update: Stocks Dropped After Comments from Powell

August 26, 2022

U.S. stocks finished sharply lower, marking the second-straight weekly loss.

U.S. stocks finished sharply lower, marking the second-straight weekly loss. Today's drop followed the keynote address from Fed Chairman Jerome Powell, who suggested further aggressiveness to restore price stability that could last longer than the markets had anticipated. Powell reiterated that another "unusually large" rate hike could be appropriate at next month's Fed meeting. Earnings reports continued to pour in, with Ulta Beauty topping forecasts and offering upbeat guidance, while Dell Technologies issued a disappointing outlook. Gap posted a positive earnings surprise, but withdrew its full-year guidance amid changes in leadership and the uncertain macro-environment. The economic calendar delivered some upbeat inflation news, as well as a favorable revision to August consumer sentiment, while personal income and spending both increased but by a smaller amount than expected. In other economic news, the advance goods trade deficit narrowed much more than forecasted and wholesale inventories rose by a smaller amount than predicted. Treasury yields and the U.S. dollar were lower. Crude oil prices traded higher, while gold prices decreased. Asia finished mostly higher, but China dipped, and Europe ended in negative territory in the wake of Chairman Powell's remarks.

The Dow Jones Industrial Average sharply declined 1,008 points (3.0%) to 32,283, the S&P 500 Index fell 141 points (3.4%) to 4,058, and the Nasdaq Composite dropped 498 points (3.9%) to 12,142. In moderate volume, 3.8 billion shares of NYSE-listed stocks were traded, and 4.5 billion shares changed hands on the Nasdaq. WTI crude oil gained

$0.54 to $93.06 per barrel. Elsewhere, the gold spot price decreased $21.70 to $1,749.70 per ounce, and the Dollar Index rose 0.4% to 108.83. Markets ended noticeably lower for the week, as the DJIA dropped 4.2%, the S&P 500 fell 4.0%, and the Nasdaq Composite tumbled 4.4%.

Ulta Beauty Inc. (ULTA $411) reported Q2 earnings-per-share (EPS) of $5.70, above the $4.99 FactSet estimate, as revenues rose 16.8% year-over-year (y/y) to $2.3 billion, north of the Street's forecast of $2.2 billion. Q2 same-store sales grew 14.4% y/y, above the expected 10.5% gain, as the company noted strong consumer demand and broad-based momentum across its business. ULTA raised its full-year guidance. Shares were lower.

Dell Technologies Inc. (DELL $42) posted adjusted Q2 EPS of $1.68, above the forecasted $1.64, with revenues rising 9.0% y/y to $26.4 billion, just shy of the projected $26.5 billion. The company noted record Q2 revenue, driven by continued growth across its client and infrastructure business units. However, DELL issued a Q3 outlook that came in below estimates. Shares of DELL dropped.

Gap Inc. (GPS $10) announced adjusted Q2 EPS of $0.08, north of the expected $0.05 per share loss, as revenues declined 8% y/y to $3.9 billion, slightly better than the forecast of $3.8 billion. The clothing retailer—which owns Old Navy, Gap, Banana Republic, and more—noted a $0.10 adjusted EPS loss related to transitory elevated air freight expenses during the quarter. Executive Chairman and Interim Chief Executive Officer (CEO) Bob Martin stated, " We are taking actions to better optimize profitability and cash flow in the near term, reducing operating costs as well as impairing unproductive inventory." The company withdrew its prior full-year guidance amid a CEO transition and the uncertain macro-environment, though did mention an improvement in sales trends in July and into August. Shares of GPS declined.

Q2 earnings season is mostly in the books and of the 485 S&P 500 companies that have reported thus far, roughly 63% have topped revenue forecasts and approximately

75% have bested profit projections, per data compiled by Bloomberg. Compared to last year, revenue growth is tracking to be up 13.9% and earnings are 8.9% higher.

Schwab's Chief Investment Strategist, Liz Ann Sonders points out in her latest article, **Fade: Market Hits Resistance as Breadth Waned**, how the stock rally since mid-June has looked healthier from a breadth perspective, but low-quality leadership and deteriorating economic data have kept downside risks elevated. You can follow Liz Ann on Twitter: @LizAnnSonders.

Read all our market commentary on our Insights & Education page, as well as our latest article, **Stock Market Volatility: Investors Nervously Eye Fed**, from the Schwab Center for Financial Research. Additionally, you can follow us on Twitter at @SchwabResearch.

Personal income and spending miss, but inflation cools, Fed Chief's speech in focus

Personal income (chart) rose 0.2% month-over-month (m/m) in July, below the Bloomberg consensus forecast calling for a 0.6% gain, and south of June's upwardly revised 0.7% increase. **Personal spending** increased 0.1%, below expectations calling for a 0.5% increase, and compared to the prior month's downwardly adjusted 1.0% gain. The July **savings rate** as a percentage of disposable income was 5.0%, matching June's downwardly revised rate.

The **PCE Deflator** dipped 0.1% m/m, versus expectations of a flat reading, and following June's unadjusted 1.0% rise. Compared to last year, the deflator was 6.3% higher, below estimates of a 6.4% gain, and compared to the prior month's unadjusted 6.8% rise. Excluding food and energy, the **PCE Core Price Index** rose 0.1% m/m, south of expectations of a 0.2% increase and versus June's unadjusted 0.6% gain. The index was 4.6% higher y/y, compared to estimates to dip to a 4.7% increase after June's unrevised 4.8% rise.

The August final **University of Michigan Consumer Sentiment Index** (chart) was revised much higher than expected to 58.2, from the preliminary 55.1 figure, compared to estimates calling for a modest upward adjustment to 55.5. The upward revision came as both the current conditions and the expectations components of the survey were revised solidly higher from the preliminary estimate. The overall index continued to come off June's record low of 50.0 as current conditions improved but expectations made a noticeable m/m rise. The 1-year inflation forecast was revised lower to 4.8% from the preliminary estimate of 5.0%, where it was expected to remain, and down from July's 5.2% rate. The 5-10 year inflation forecast was revised slightly lower to 2.9%, from the preliminary read of 3.0%, where it was expected to remain, and matching July's rate.

The **advance goods trade balance** showed that the July deficit shrunk much more than expected to $89.1 billion, versus estimates calling for it to contract slightly to $98.5 billion from June's upwardly revised shortfall of $98.6 billion.

Preliminary wholesale inventories rose 0.8% m/m for July, compared to expectations of a 1.4% gain, and versus June's upwardly revised 1.8% increase.

The markets digested the headlining event at the **Fed symposium** in Jackson Hole, Wyoming, which culminated with the keynote address from Fed Chairman Jerome Powell. Amid the backdrop of the mixed inflation data and the still strong job growth figures we have seen since the Central Bank's July monetary policy decision, Powell noted that the Central Bank will remain aggressive with its monetary policy to fight inflation pressures even if it means some pain on the economic front. Powell reiterated that another "unusually large" rate hike could be appropriate when Fed officials meet again next month, but stopped short of committing to the size of the increase.

He also restated that restoring price stability is its top priority and that restrictive monetary policy is needed to last as it focuses on bringing aggregate demand in line with supply. He noted that even though there will be some economic pain, if the Fed does not accomplish price stability, the pain could be a lot worse. Powell tried to downplay the time frame for when the Fed would begin to consider loosening monetary policy and signaled that rates could run higher than their neutral rate to bring inflation down. He did acknowledge the continued strong economic momentum—especially the labor environment—and the recent favorable July inflation data, but stressed that more evidence is needed to confirm that price stability is being restored.

Treasuries have been choppy recently with the yield curve steepening but remaining decisively inverted, and the U.S. dollar has remained noticeably elevated, hitting a new multi-decade high early on in the week, as the markets grapple with how aggressive the Fed will be for the rest of the year.

Schwab's Chief Fixed Income Strategist Kathy Jones discusses in our **Schwab Market Perspective: Mixed Signals**, how the Fed has embarked on one of the most rapid tightening cycles in over 40 years, and with inflation continuing to outpace wage growth, more rate hikes are likely on the horizon. Kathy also offers analysis of the greenback in her commentary, **The Strong Dollar: Can It Continue?** You can follow Kathy on Twitter: @KathyJones, and check out our latest edition of our Financial Decoder podcast, **When Interest Rates Rise, What Should You Do with Bonds?**, featuring Kathy.

Treasury yields declined, as the yield on the 2-year note edged 2 bps lower to 3.37%, the yield on the 10-year note ticked 1 bp lower at 3.04%, and the 30-year bond rate declined 4 bps to 3.20%.

Europe closed lower following Fed speech

Stocks in Europe ended the day lower as the markets digested today's key commentary from Fed Chairman Jerome Powell at the Central Bank's annual symposium in Jackson Hole, Wyoming, during which he suggested restrictive policy will continue for longer than the markets were expecting. The markets also remained skittish amid the festering energy crisis that has unfolded in the region due to tighter gas supplies and surging energy costs as Russia continues to restrict flows from its Nord Stream Pipeline. This has exacerbated inflation concerns that has forced the Fed, Bank of England, and European Central Bank down the monetary tightening path.

Schwab's Chief Global Investment Strategist Jeffrey Kleintop, CFA, notes in his article, **Shortages Have Led to Gluts**, how inventory gluts have been bad news for the stocks of companies experiencing them, but could also be indicating an inflation peak, which tends to be an ingredient for market bottoms. Also, Jeff discusses in his latest article, **The End of Rate Hikes?**, how the signals from central banks that rate hikes, which began last year, may be coming to an end could be welcome news for investors looking ahead to the next 12 months. You can follow Jeff on Twitter: @JeffreyKleintop. In economic news, German consumer confidence for September deteriorated further into deep negative territory, though August consumer sentiment reports out of France and Italy both improved. The euro traded higher versus the U.S. dollar after dropping below parity with the greenback earlier this week, and the British pound moved to the downside. Bond yields in the Eurozone rose, while rates in the U.K. dipped.

The U.K. FTSE 100 Index was down 0.7%, Germany's DAX Index dropped 2.5%, France's CAC-40 Index declined 1.7%, Spain's IBEX 35 Index decreased 1.5%, Italy's FTSE MIB Index fell 2.5%, and Switzerland's Swiss Market Index traded 1.1% lower.

Asia mostly higher ahead of key Fed speech out of the U.S.

Stocks in Asia finished mostly higher to close out the week despite some caution ahead of today's speech from Fed Chairman Powell, while a continued rally in Tech stocks helped Hong Kong markets add to a weekly advance. Reports continued to swirl that U.S. and Chinese regulators could be making progress on their auditing dispute and potentially avoiding delisting of some Chinese stocks on U.S. exchanges, which continued to buoy the Tech sector. Meanwhile, mainland Chinese markets bucked the trend, giving back some of yesterday's advance that came from China's stepped-up stimulus with a further $146 billion aimed at improving infrastructure that was hampered by COVID-induced lockdowns.

China has diverged from a monetary policy standpoint compared to several global central banks as economic concerns have remained and been exacerbated by the disruption of COVID-induced lockdowns on the world's second-largest economy. Schwab's Jeffrey Kleintop notes in his article, **China's Yo-Yo Economy**, that its economy and stock market may remain volatile. Meanwhile, geopolitical tensions between the U.S. and China remained elevated, mostly due to the evolving situation in Taiwan, with the U.S. set to begin trade negotiations in September, of which China has expressed opposition. In economic news, Japan's consumer price inflation out of Tokyo came in hotter than expected for August, while Hong Kong's July export growth fell more than anticipated.

Japan's Nikkei 225 Index increased 0.6%, with the yen giving back a recent gain versus the U.S. dollar. The yen remains near multi-decade lows versus the greenback following a sharp drop that began in March as the Bank of Japan lags other key global central banks in monetary policy. The Hong Kong Hang Seng Index rose 1.0%, India's S&P BSE Sensex 30 Index ticked 0.1% higher, Australia's S&P/ASX 200 Index went up 0.8%, and South Korea's Kospi Index advanced 0.2%. However, China's Shanghai Composite Index declined 0.3%.

Stocks fall for a second-straight week

Coming off a noticeable bounce since mid-June, equities fell, with the S&P 500 pulling back for a second week in a row, as the markets grappled with whether the Fed's aggressive actions will force the U.S. economy into a recession. The markets sold off following Friday's speech from Fed Chairman Jerome Powell, who suggested the Central Bank will remain aggressive with monetary policy tightening to try to restore price stability. This comes as economic data remained mixed, with global August preliminary reports on manufacturing and services sector activity continuing to show slowing activity, housing continued to slow, while preliminary durable goods orders were mostly better than anticipated, and initial jobless claims unexpectedly moderated. Inflation data, which has been the main driver of the aggressive monetary policy actions, continued to show signs of cooling, with the Fed's favored gauge—the PCE Deflator—decelerating more than expected, and consumer expectations for both the short-and-long-term decreasing more than expected as reported by the University of Michigan.

The Energy sector was the lone gainer, as crude oil prices rebounded from recent weakness, while growth sectors—Information Technology, Communication Services, and Consumer Discretionary—weighed on market performance as Q2 earnings season headed down the home stretch and provided mixed results. Treasury yields were mixed, with short-term rates rising, while long-term rates dipped, and the yield curve flattened and the inversions remained. The U.S. dollar gained ground but did trim an early advance that took the greenback to fresh multi-year highs. Gold prices moved modestly lower.

Next week, with earnings season exiting stage left, the economic calendar will likely garner heavier scrutiny, amplified by the backdrop of the Fed remaining more aggressive until the data says otherwise. Some key reports that could command attention include, August's **Consumer Confidence Index**, and the **job openings and labor turnover survey** (JOLTS). However, with the calendar shifting to September, the headlining data points could be the August **ISM Manufacturing Index** and this month's key **nonfarm payroll report**. Finally, we will get some **Fedspeak** to follow the tone set during this week's Fed annual symposium in Jackson Hole.

The international economic calendar next week will also deliver some data points that could move the markets, headlined by **China's** industrial profits and Manufacturing and Non-Manufacturing PMIs, **India's** Q2 GDP and Manufacturing PMI, **Japan's** industrial production, retail sales, and Q2 capital spending figures, the **Eurozone's** consumer price inflation estimate for August, along with **German** retail sales, inflation statistics, and trade balance.