A Look Back at the Markets in August and Ahead to September 2019

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August was a tough month pretty much across the board, with politics rocking markets around the world. So, what should we expect for September? Let's take a closer look.

A look back

The trade war. China imposed tariffs on U.S. goods, and the U.S. doubled down on its own tariffs. The transition from a cold war to a hot one shocked markets, which had more or less assumed some compromise would emerge.

The White House versus the Fed. Then, we had the slanging match between the Fed and the White House. The Fed cut rates, but it didn't do so fast enough to please the president. This dispute really was different. We have never before seen a president refer to the Fed chair (his own appointee) as an "enemy." Markets struggled to process what that position might mean for monetary policy.

Brexit. Brexit heated up again in a big way. Boris Johnson took office as prime minister, only to lose his majority in Parliament almost immediately. What will happen next? We don't know, since, once again, we have never seen this situation before. A hard British exit from the European Union could shake the global financial system. At month-end, that possibility looked like a real risk.

Market declines. Given these three earthquakes, it was a pleasant surprise that markets didn't get hit harder than they did. U.S. markets were down between 1 percent and 3 percent, and international markets were down between 2 percent and 5 percent. Not great results, but it could have been worse. In fact, it was worse. At three points during the month, markets pulled back between 4 percent and 6 percent, only to bounce back.

A look ahead

Politics still at play. Politics can and will rock markets, and they are likely to keep doing so. The trade war has not been resolved, and Brexit keeps getting worse. The U.S. election campaign has not even really begun. We can expect plenty more headlines to shake markets. At the same time, the factors that kept bringing the markets back in August—a growing U.S. economy, for example—are also likely to persist.

Economy remains strong. A recession has historically been necessary for a sustained market pullback. Here, the news is good. Hiring continues to be strong enough to absorb new entrants to the labor force, and wages continue to rise. People have money to spend. And, with confidence still at very high levels, they are willing to spend it. We see evidence of this ability in the better-than-expected retail sales and consumer spending data. Consumers are more than two thirds of the economy. When they are able and willing to spend, a recession is still a ways away. This spending is the underlying strength in the U.S. economy that has kept pulling markets back up even as the headlines knock them down, as we saw in August.

Headlines may have an upside. The lesson of August for September, then, is this: we can expect the headlines and the associated volatility to continue, but as long as the economy remains sound, we should expect that volatility to be limited. The downside of the headlines also has an upside, however. If the worries were to be resolved (e.g., if a trade deal was cut between the U.S. and China or if a Brexit deal was reached), then markets might well revert to a positive stance—and move back up. Right now, politics is pulling us down. But as long as the economy remains sounds? Politics could also pull us back up.

Rough month ahead? I don't expect that positive scenario for September. September is historically one of the weakest months for financial markets. With everything going on, it could be a rough one. But even if it is a rough one, as long as the economy remains sound, the prospects for conditions to improve over the rest of the year are very real.

That outcome will largely depend on confidence, especially among consumers. In turn, consumers will depend at least partially on job growth. Those areas are what I will be watching most closely.

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