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August's Rally Left Fed Fears In Distant Past

BY DAVID UBERTI

As economists wrung their hands in August over President Trump's escalating pressure campaign on the Federal Reserve, markets sent a different message: Let the good times roll.

A Friday selloff in artificialintelligence- linked shares before traders jetted for the Labor Day weekend wasn't enough to derail stocks' monthly climb. Notching five of its 20 records this year in August, the S&P 500 ground 1.9% higher for the month, while the tech-heavy Nasdaq composite climbed 1.6%. The Dow Jones Industrial Average advanced by 3.2%.

All of them were outpaced by the Russell 2000, where small- and midsize companies that have borne the brunt of pain from higher interest rates suddenly look more appealing to Wall Street.

Weakening economic data and so-far muted price impacts from tariffs have given investors more confidence that the Fed will cut rates at its meeting next month. At the same time, Trump's effort to pack the central bank with officials who favor lower rates— epitomized this week with an attempt to fire Fed governor Lisa Cook—has helped fuel the hope that additional rate cuts may be on the horizon.

Note

Economists warn a central bank more beholden to the White House is more likely to lower rates too much, ultimately boosting inflation. If August was any indication, the stock market views that possibility as tomorrow's problem.

Robert Barbera, director of the Johns Hopkins University Center for Financial Economics, said investors' recent calm about Fed independence hints at the flip side of the aphorism coined by former longtime Fed Chair William McChesney Martin Jr. The job of the Fed is to take away the punch bowl just when the party is getting good. Note

Barbera jokingly said that "Trump wants to kill the chaperone" responsible for keeping the party under control by raising rates as needed. "Surprise, surprise, the party is getting a little more raucous," he said.

Note

In Treasury markets, something of a Trump effect has begun to take hold in recent weeks. Investors expecting rate cuts have snapped up 2-year Treasurys, weighing down the yield on those notes. Those expecting higher rates over time have sold 30-year Treasurys, boosting the yield there.

The spread between the 2year and 30-year yields—a key component of what is known as the yield curve—hovered near its widest level since early 2022, according to Dow Jones Market Data. Still, yields for long-dated government debt are trading safely below 5%.

On Friday, a University of Michigan consumer-sentiment reading for August came in slightly below expectations. The Fed's preferred inflation measure for July moved no closer to its 2% target.

The stock-market retreat instead stemmed from what has been a consistent source of strength: firms that sell chips, servers and other tools for the AI boom. The Nasdaq led declines, dropping 1.1%, while the S&P 500 retreated 0.6%. The Dow Jones Industrial Average lost 0.2%, or 92 points.

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