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August 2024 Market Commentary

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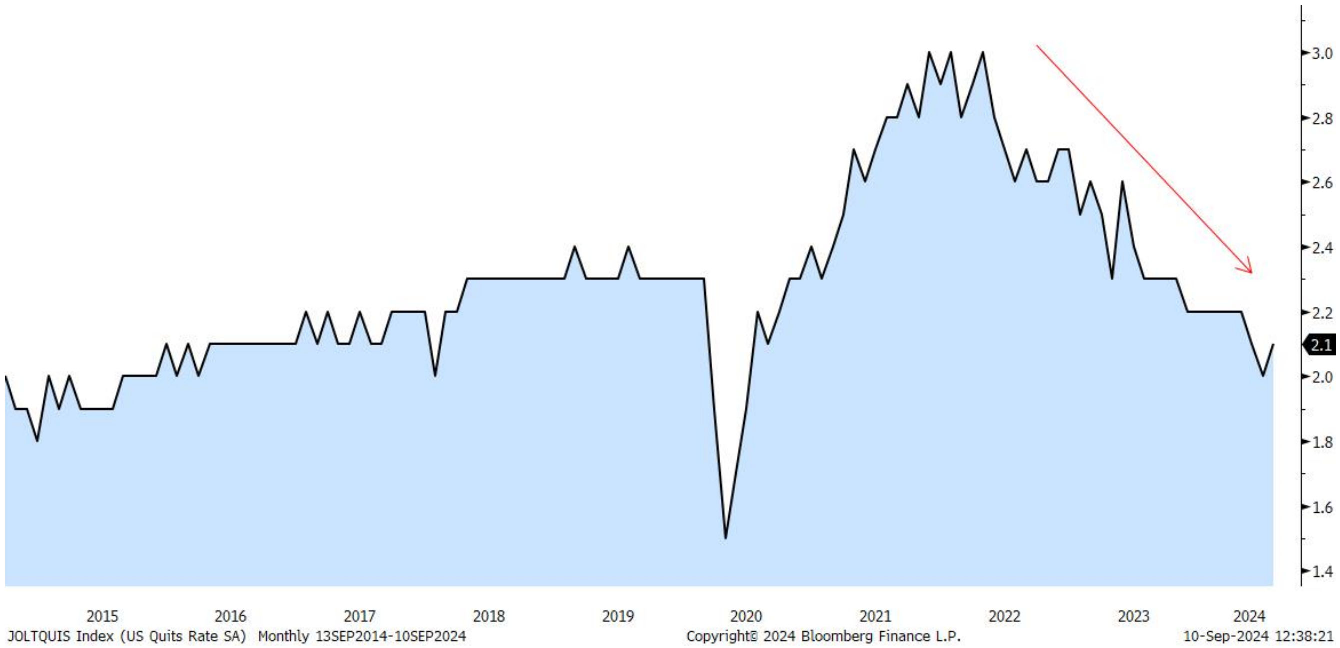
September 10, 2024

Stocks rebound, erasing the early August drop. The unwinding of the crowded Yen carry trade, coupled with a few weak economic data points raising recession fears, sent stocks sharply lower at the beginning of August. Yet benign inflation readings, calming central bank remarks, and the confirmation of upcoming interest rate cuts allowed stocks to recover by month's end. The S&P 500 finished August 2.4% higher, the NASDAQ edged up by 0.7% and the Dow Jones Industrial Average climbed 2.0%. From a sector perspective, there was a rotation into more defensive sectors. The classic places investors seek shelter, including Consumer Staples (+6.0%), Healthcare (+5.1%), and Utilities (4.8%), were among the best-performing sectors, while Energy (-2.1%), Consumer Discretionary (-0.2%), and Technology (0.7%) lagged.

Further labor market weakness unwelcome. Just as equity markets recovered from their early August swoon, September ushered in another bout of selling as investors fretted over further signs of slowing economic growth, particularly the deterioration in the recent labor market data. Last week was the worst week for the S&P 500 since the March 2023 regional banking crisis, with the index falling 4.3%, and globally, stocks around the world lost $4.1 trillion of market value, the largest drop in 2 years. There is a newfound emphasis on the labor market as Federal Reserve Chairman Powell noted in his address at an annual economic confab in late August that any additional labor market weakness would be "unwelcome," yet this is precisely what the data released last week suggests. The July Job Openings and Labor Market Turnover (JOLTS) report showed a larger-than-expected drop in job openings to 7.67 million, the lowest level since January 2021, and a pickup in layoffs. While the Quits Rate did improve, it was from a downwardly revised number in June, which was the lowest reading since June 2020, and the falling trajectory since peaking at 3.0 in 2021 is clear. The quits rate foretells workers' confidence in their ability to find a new job and is often considered one of the best gauges of the labor market's strength. The ADP report also missed expectations, with the payroll processing company reporting that private payrolls increased by 99k in August, well below the 145k expected and the lowest reading since January 2021. Lastly, the nonfarm payroll report showed employers added 142k new jobs in August, below the 165k expected. Moreover, the prior two months' numbers were revised lower by 86k, bringing the 3-month average monthly gain to 116k, well below the 12-month average monthly increase of 198k.

Falling Quits Rate indicates workers losing confidence in finding new roles



Source: Bloomberg

In addition to the weaker labor market numbers, manufacturing continues to be in the doldrums. The August US ISM manufacturing reading remained in contraction territory, coming in at 47.2 (readings below 50 indicate contraction), with new orders (a good forward indicator of demand) falling for the third consecutive month. The Fed's Beige Book release was also lackluster, with economic activity reported as "flat or declining" in nine of twelve Federal Reserve districts. In addition, consumer spending "ticked down in most districts," and manufacturing activity "declined in most districts."

While the labor market is still generally healthy, the pace of cooling needs to be watched closely as unemployment can spiral quickly. Workers nervous about their jobs or their ability to find new ones will pull back on spending, putting pressure on corporate profits, leading to layoffs, additional spending cuts, and so on. We would note cautious comments from several management teams that seemingly corroborate the cooling labor market data and the comments from the Beige Book. Home Depot's CEO, speaking about the company's second quarter, noted, "During the quarter, higher interest rates and greater macro-economic uncertainty pressured consumer demand more broadly resulting in weaker spend across home improvement projects…There's just a lot of noise with political and geopolitical environment, unemployment ticked up, inflation keeps eating away at disposable income, and I think people just took a pause as we've progressed through the quarter – or more of a pause because of these macro uncertainties". In addition, SEELAUS

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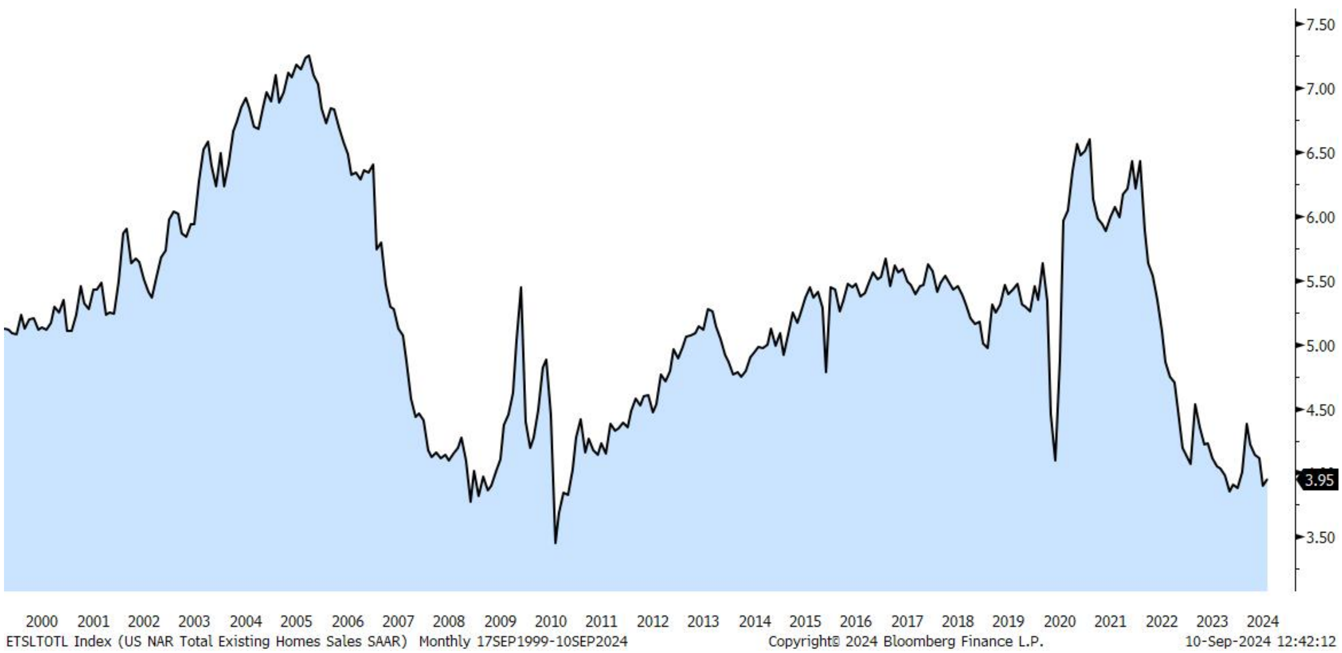
Citigroup's CFO recently observed that "The nature of [consumer] spend is evolving… it's going from discretionary to a more staple-type spend.".

Slowing growth, but still growing for now. Stocks will likely remain sensitive to incremental economic data points over the next few weeks. We would not be surprised to see another round of softer economic numbers, particularly given that corporate executives may take a wait-and-see approach ahead of the presidential election. This will add to investor angst about the Fed's ability to engineer a soft landing and spur additional debate over the necessary size and pace of rate cuts. However, interest rate cuts are undoubtedly coming, starting at the Fed's next meeting later this month with a 25 or 50 basis point reduction, and we could then see another 2% reduction in the fed funds rate over the next year or so. While growth is slowing and recession warnings are starting to materialize, including a steepening of the yield curve with 2-year yields falling below 10-year yields for the first time since July 2022, we still believe a soft landing is possible. Yet, if a recession looks more likely, we also believe the Fed will take a more aggressive approach to cutting rates. Historically, if the economy can avoid a recession, interest rate cuts have been good for stocks looking out 6-12 months after the initial cut. An increasing focus for us on any pullbacks will be some of the sectors hardest hit by the higher rate environment, including manufacturing, transportation, and housing-related areas, which will be key beneficiaries as rates come down.

Existing home sales (below) and associated housing related areas are likely to benefit from lower rates



Source: Bloomberg

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