

Doll's Deliberations[®]

Weekly Investment Commentary



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Summary:

U.S. equities ended lower last week (S&P 500 Index -2.05%). Small stocks and NASDAQ underperformed. Sentiment moved decidedly negative with a focus on growth and recession concerns punctuated by Friday's nonfarm payrolls' miss and the spike in unemployment. Best sectors were utilities (+4.36%) and real estate (+2.80%); worst sectors were consumer discretionary (-4.28%) and technology (-4.02%).

Key takeaways:

- During the FOMC's July meeting press conference, Fed Chair Powell laid out the groundwork for the Fed to begin a cutting cycle at its September meeting, in line with market expectations. History suggests Powell is walking a very fine line on potentially waiting too long to start cutting rates before it is too late.
- U.S. nonfarm payrolls rose a moderate +114,000 m/m in July, a big disappointment (consensus was +175,000) with downward revisions to prior months. The unemployment rate rose to 4.3%.
- The ISM Manufacturing Index missed expectations for a move up to 48.8, instead falling to a weak 46.8. The details were just as ugly with production, new orders, and employment coming in sluggish.
- We have argued that, absent a recession, the inflation rate will not fall to the Fed's 2% target. With the recession probability rising, perhaps 2% will be achievable (along with disappointments in earnings).
- With over 70% of S&P 500 companies having reported earnings, 75% are beating 2Q estimates and 56% are beating revenue estimates. Note: Second half of 2024 (2H24) expected earnings have been revised down -1.2% (consensus is still +12% for 2024 and 15% for 2025).
- Over the next four quarters, the consensus believes that revenues will grow 5.2%, 5.5%, 5.9%, and 6.2%. We are already beginning to see companies lose pricing power; the consumer has reached a more fragile state; and AI enthusiasm is beginning to wane. The path to achieving these increases is unclear.
- Warning: The stock market tends to perform better during the period between the last hike in a Fed tightening cycle and the first cut in rates than it does after the first cut in the Fed funds rate. Fed easing is usually associated with economic and market stress. On average, the market bottoms 23% lower after the first Fed cut in a series of rate cuts.
- The NASDAQ officially entered a correction, down more than 10% from its record high, reached roughly a month ago.
- Many strategists are already back-peddling on their recently upward revised S&P 500 targets. In our view, it is possible that the mid-July S&P 500 high could be the high for the year.
- The U.S. election is no longer a referendum on the incumbent and is instead becoming a choice election, with both candidates racing to define their opponent as the candidate of chaos.

EQUITY MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
DJIA	-2.10	6.56
S&P 500	-2.05	12.99
NASDAQ	-3.34	12.20
RUSSELL 1000	-0.32	14.24
RUSSELL 1000 GROWTH	-2.52	13.99
RUSSELL 1000 VALUE	-1.95	9.05
RUSSELL 2000	-3.26	8.67

S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.26	20.33
CONSUMER DISCRETIONARY	-4.28	0.15
CONSUMER STAPLES	1.17	13.27
ENERGY	-3.64	7.94
FINANCIALS	-2.99	12.87
HEALTHCARE	0.65	11.60
INDUSTRIALS	-2.77	8.54
INFORMATION TECHNOLOGY	-4.02	18.93
MATERIALS	-1.38	6.19
REAL ESTATE	2.80	6.36
UTILITIES	4.36	19.24

Recession talk resurfaces (finally!)

We were beginning to get nervous about our first prediction for 2024 suggesting a recession to start before year-end and the unemployment rate rising to 4.5%. Unfortunately, it looks like the second part of that will come true, and the first part might as well. The list of economic weaknesses has been accumulating (in rough order of occurrence): inversion of the yield curve, weak money growth, rising inventory levels, temporary employment declines, weakening consumer surveys, monthly payroll revisions, corporate revenue disappointments, corporate earnings releases, weakening payroll growth, rising unemployment rate, and now the triggering of the Sahm rule. This all raises the probability that the economic slowdown will lead to a bumpy landing, if not a recession, and not a soft landing. To be fair, the jury on a recession is still out—but the word “recession” has quickly resurfaced in Wall Street vocabularies. Remember, the average amount of time from the first Fed rate hike to the onset of recession is 10 quarters (with wide variation)—we are in the eleventh.

Last week was notable for a marked divergence at three key DM central banks. The BoJ took another small tightening step in its slow policy normalization process and, atypically, provided hawkish forward guidance. The Fed held back from lowering rates, while signaling a likely September cut. And the BoE finally cut rates as we had thought was likely, but the vote was close.

Global equity markets have recently been volatile, as hopes for more policy rate cuts (excluding Japan) were offset by turbulence in the high-flyers that had generated a large portion of overall market gains this year. Sentiment toward the latter flipped from chasing ever-higher stock prices to unloading, as investors finally started to challenge growth expectations and valuations.

The narrative of a struggling U.S. consumer sector continues to gain adherents, reliant mostly on the deceleration in economic indicators from the unprecedented heights reached in 2022 after the economy reopened. These measures are well off their best for the cycle.

Conclusion

Markets had been discounting a Goldilocks environment, believing that inflation would move down to the Fed's 2% goal, that the economy would be reasonably firm, and that earnings growth would achieve the consensus double-digit gains forecast for this year and next. At a minimum, these assumptions will be questioned (the inflation one excepted). We continue to think equity selection should focus on earnings predictability, earnings persistence, and strong free cash flow profiles.

Data from Bloomberg as of Aug. 2, 2024

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INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.00	11.61
MSCI ACWI EX U.S.	0.52	6.93
MSCI EAFE	0.21	6.66
MSCI EM	1.47	8.12

FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	1.26	2.03
BLOOMBERG U.S. CORP HIGH YIELD	0.25	4.57
BLOOMBERG U.S. GOV/ CREDIT	1.20	1.92
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06	3.16

ALTERNATIVES (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	2.13	6.08
COMMODITIES (DJ)	-1.18	-0.87
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-0.90	9.79
CURRENCIES (DB CURRENCY FUTURE HARVEST)	-1.53	8.17