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Doll's Deliberations®

Weekly Investment Commentary

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Summary:
Stocks were down last week (S&P 500 -0.02%), although they nearly recovered from a significant decline on Monday (worst day in two years). A weaker-than-expected payroll report ignited fears about a behind-the-curve Fed and a potential hard landing. Best sectors were industrials (+1.22%) and energy (+1.19%); worst sectors were materials (-1.68%) and consumer discretionary (-1.00%).

Key takeaways:

1. The causes of the sell-off included: escalating concerns about an economic slowdown in the U.S., heightened Mideast tensions, and increasing uncertainty about the November elections.
2. The yen hit a 38-year low in early July. In response, Japan's MOF instituted significant currency intervention, and the BOJ raised rates. The yen rebounded more than 10%, hurting carry traders who were effectively short the yen, forcing them to sell the assets they purchased with borrowed yen. This was a major factor in the magnitude and speed of the equity market decline.
3. The latest Conference Board measure of consumer confidence suggests that consumers are increasingly downbeat about economic conditions but expect stock prices to increase over the next 12 months.
4. Bank assets are now only 35% of private sector debt outstanding, down from 55% in 1980. (Private credit has picked up the difference.)
5. The possibility of private credit loan problems is a debatable subject. Our view is that there are credit problems in private credit that will get exposed in a notable economic slowdown.
6. An interesting factoid: Warren Buffet now owns more T-bills than the Federal Reserve.
7. Macro conditions (supply and demand) continue to determine the price of oil and therefore energy stocks. (There seems to be no premium in energy stocks for potential disruption in the Middle East.)
8. 3Q earnings gains have been cut from 8% to 5% just since July 1.
9. Among the reasons stocks and interest rates reversed course from the big decline is that the BOJ said that the central bank will not raise rates when markets are unstable. However, since we think there is deterioration in labor market and consumer credit conditions, we would not chase the rally in stocks of recent days.
10. Trump is behind in the national polls for the first time in nearly a year, although he continues to lead in swing state polls, but by a falling and much reduced amount.

EQUITY MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.56	5.95
S&P 500	-0.02	12.96
NASDAQ	-0.17	12.00
RUSSELL 1000	-0.43	11.55
RUSSELL 1000 GROWTH	0.37	14.41
RUSSELL 1000 VALUE	-0.30	8.72
RUSSELL 2000	-1.16	3.64

S&P EQUITY SECTORS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	0.78	21.27
CONSUMER DISCRETIONARY	-1.00	-0.85
CONSUMER STAPLES	-0.29	12.94
ENERGY	1.19	9.22
FINANCIALS	0.63	13.58
HEALTHCARE	-0.62	10.90
INDUSTRIALS	1.22	9.86
INFORMATION TECHNOLOGY	-0.22	18.67
MATERIALS	-1.68	4.41
REAL ESTATE	-0.14	6.22
UTILITIES	-0.88	18.19

The stock market recovery is almost as impressive as the recent decline

The choppy up and down stock market briefly erupted into a full-fledged panic, as investors abruptly soured on U.S. economic prospects and became impatient with Fed and BoJ policies. The sell-off was aggravated in time and amount by the yen carry trade. Calmer heads prevailed and risk assets have largely recovered.

The global PMI service sector surveys last week showed ongoing expansion and overall healthy trends and countered the declining PMI manufacturing survey. The risk-off phase can be mostly attributed to overbought conditions in equity markets, which included pockets of speculative excesses that built up over the past year or so.

Expectations for the U.S. fed funds rate for year-end 2025 have returned to the levels that were expected at the turn of this year, when recession fears were running high. Current expectations may be once again too aggressive, even for a dovish Fed.

While the unwinding of overbought conditions has been steep, net losses are not historically large, especially relative to prior gains. U.S. A.I.-related stocks had become vulnerable to a correction following their huge run-up and extended valuations. Sadly, "Wall Street" usually exaggerates the economic impact from movements in the equity market, especially relative to "Main Street". The latter responds to income trends, job security and availability, borrowing costs, and to a much lesser extent on changes in wealth. So far, there are low odds of any contagion into the real economy and the banking system.

After the excitement of the past two weeks, the GDPNow estimate for Q3 U.S. real GDP growth from the Atlanta Fed was upwardly revised. The estimate rose to 2.9% from 2.5% on August 8. This forecasting model inputs hard data and generates an estimate.

As the dust settles after this bout of turbulence, bond yields will be lower than before, the pressure on central banks to ease will have increased, risk asset prices will be slightly less expensive, and the already positive backdrop for global corporate profits may have been further boosted as a consequence of lower borrowing rates. In addition, despite a further escalation in Middle East tensions, crude oil prices have remained soft, rather than up sharply, which is supportive of growth.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN) (%)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-0.67	8.63
MSCI ACWI EX U.S.	-1.05	3.42
MSCI EAFE	-1.16	3.13
MSCI EM	-1.36	4.05

FIXED INCOME MARKETS (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-1.12	2.05
BLOOMBERG U.S. CORP HIGH YIELD	0.19	4.46
BLOOMBERG U.S. GOV/ CREDIT	-1.10	1.94
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.05	3.27

ALTERNATIVES (INDEX TOTAL RETURN) (%)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-0.61	5.46
COMMODITIES (DJ)	0.93	0.05
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-1.30	3.63
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.37	6.94

Conclusion

The near-run financial market outlook is clouded by the abrupt souring in investor sentiment related to increased bearishness on the economic outlook. So far (although it is early), there is little new evidence that the economy is weakening significantly, although the trend is a lower upward economic trajectory.

Data from Bloomberg as of Aug. 9, 2024