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Wealth Advisory Market Update

September 9, 2024



Market Update

Equities:

Volatility was the headline throughout the month of August. Weak employment data coupled with unwinding of the yen carry trade led to a steep sell off early in the month. However, the market rebounded to finish the month. The volatility in the markets could be contributed to a few factors including low volume normally associated with summer months, recession concerns, and the Jackson Hole summit. After last month, which saw a broadening of the market rally, this month saw the market cap weighted index outperform, led by big tech while the small caps, as measured by the Russell 2000 index, declined over 2%.

Earnings season is mostly complete with all the largest companies having reported. As we mentioned last month, “much of the technology sector continues to show big spending for AI, but so far revenues have not followed.” In our view, if spending continued and revenues did not follow, they would start to get punished. That is what happened this quarter, as capital expenditures expanded yet margins contracted. The big tech names were sold off across the board. With those companies being priced to perfection, their reports showing shrinking margins, and revenue growth slowing quarter over quarter, their stock prices were pushed lower.

We have been keeping an eye on many retailers this earnings season as they provide insights into the state of the consumer. The commentary from retailers is concerning. Lodging company Airbnb said they are seeing slowing demand from U.S. guests. Dollar General’s CEO said they are seeing core customers feeling financially constrained. Home improvement companies Lowe’s and Home Depot are expecting weaker sales.

The US economy is driven by the consumer. Over 70% of GDP is from consumer consumption. If the consumer is struggling, it is only a matter of time before we see it across the entire economy. This is evident in the personal savings data, which is now at 2.9%, a historically low level. Revolving credit data was negative for the first time since COVID. A negative print is a rare occurrence, and usually signals trouble ahead.

Economic Indicators and Monetary Policy:

While the Federal Open Market Committee (FOMC) did not meet this month, one could argue that Fed Chairman Jerome Powell’s speech at Jackson Hole was the most awaited Fed press conference in some time. The Chairman discussed where monetary policy is relative to the economy and what they expect moving forward. Powell stated, “the time has come for policy to adjust.” He stated that his confidence has grown that inflation is on a sustainable path towards their 2% target. These comments do not line up with previous statements that their progress on inflation had stalled earlier in the year. The Chairman mentioned that the Fed’s mindset on higher interest rates have changed. He believes that the distortion of supply and demand can unwind itself and does not require a weakening of the labor market. This is also out of line with previous statements. In our view, the FOMC is driving blind once again and is already late in adjusting monetary policy.

What was interesting was that the Chairman did not appear to be overly concerned about the state of the labor market, considering the latest employment data triggered the “Sahm rule.” Instead, he pointed out that the Fed believes the reasons for the rise in the unemployment rate include a substantial increase of workers coming back into the labor market and a slowdown in hiring.

What was odd in our opinion was that there was no mention of the job revisions. They showed that the job

market was not as strong as originally thought, as there were 818,000 fewer jobs than reported the last twelve months through March. This was the second largest revision in history, only behind the 824,000 revision in 2009. Powell did say they do not welcome further cooling in labor market conditions and that they will do everything they can to support a strong labor market. He believes the Fed has ample room to respond to these risks.

We disagree with his statement, as cutting rates cannot immediately fix a problem in the economy after it has already happened. Changes in interest rates have a considerable lag time before they come into effect, usually ranging between 12-18 months. The same goes for rate hikes, considering we just went through the fastest rate hike cycle in history. There are lag times with the effects, and it is our belief we are seeing them now. The consumer is cracking, the labor market is weakening, and the only thing keeping the economy afloat is the Federal government spending a trillion dollars every 90 days.

Strategy:

We continue to remain steadfast in our approach, as volatility has picked up. In this type of market, we tend to be overweight sectors that have pricing power and inelastic demand for their goods. We target companies that have strong balance sheets, robust free cash flow, and dominant market positions. Interest rates have come down from the beginning of the summer, as it seems inevitable that the FOMC will begin cutting rates in September. While rates have come down, we still believe this is a good time to lock in yields in the middle of the curve. Credit spreads continue to point towards choosing higher credit names.

As we navigate this challenging environment, we appreciate the opportunity to collaborate with you in achieving your financial goals.

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