MARKET MATTERS

ECONOMIC ANXIETY WEIGHS AS MARKETS SPECULATE ON THE SIZE OF THE 'RATE-CUT-RABBIT' TO BE PULLED FROM HAT!

Market oveview: It's becoming clear that each time I'm drafted to write one of these updates, the market suffers some massive crisis of confidence and normalcy returns alongside McGrath!

My original draft was some 3000 words and covered every geographical region. For brevity and to save a suffering editor, I've cut this down to cover the primary moving pieces in the US, which have largely dictated the direction of travel globally.

So, let's deal with the primary data point clients will notice –the S&P 500 Index suffered its worst weekly drop in 18 months.

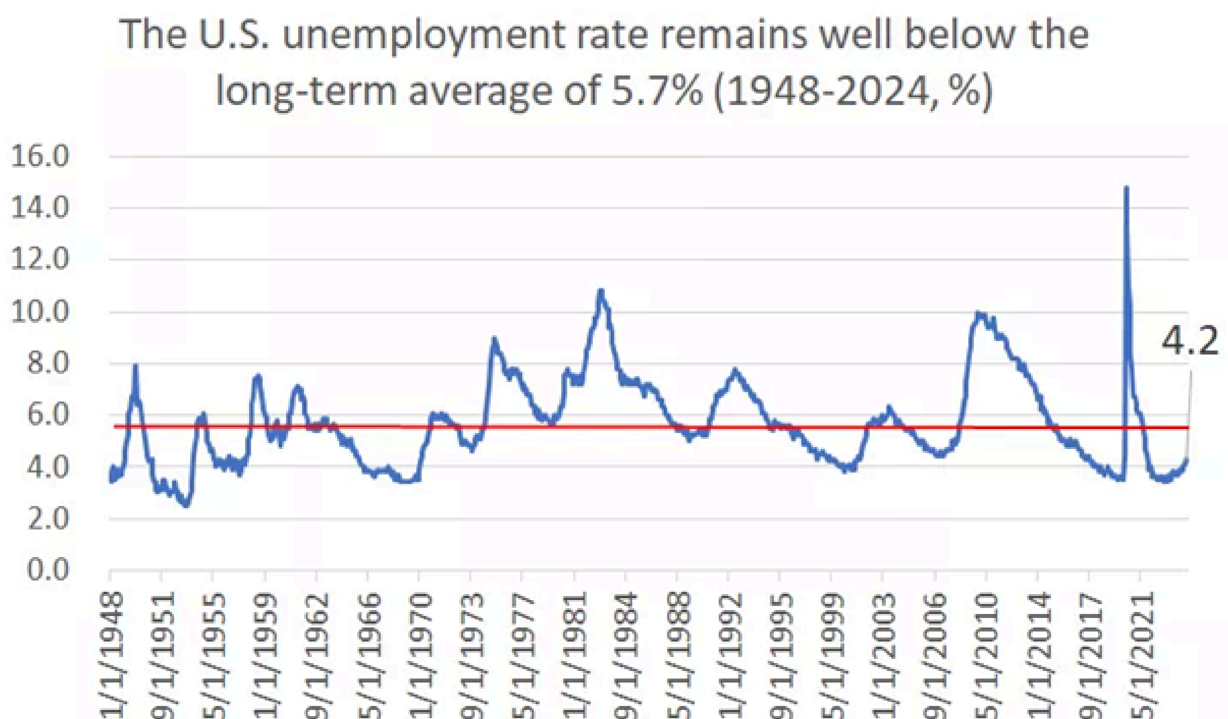
It cascaded out to other global markets as worries over a potential US economic slowdown (again) weighed on sentiment. Technology shares led the declines, driven in part by a drop in NVIDIA following rumours that it may be the subject of a Justice Department antitrust investigation, which led to a roughly USD 300 billion drop in its market cap. Energy shares were also fragile due to a decline in oil prices.

Conversely, typically defensive utilities, consumer staples, and real estate sectors held up better, alongside other less tech-dependent regions, Again, the benefits of diversification rear their head!

Apart from Nvidia, the US labour market was a key focus point for investors last week, with Friday's August nonfarm jobs report being the week's most highly anticipated data point. Overall, the jobs report confirmed signs of a weakening US labour market – a drop in the unemployment rate from 4.3% to 4.2% offset by a clear softening trend in new jobs added and several downward revisions. The slowing labour market certainly adds risk to the economic outlook, but the figures thus far don't point to an imminent collapse or recession.

There were some silver linings in the US jobs report. The unemployment rate, for example, did tick lower from 4.3% to 4.2%. While this is still above last year's lows of 3.4%, the unemployment rate remains well below the long-term average of a US unemployment rate of 5.7%. Also, the unemployment rate has increased mainly because new entrants have entered the workforce, not because layoffs or job losses have climbed meaningfully. Finally, although the 142,000 jobs added last month were below expectations, they remain in line with the 10-year pre-pandemic average of around 180,000. This indicates that while the labour market is softening, we are not yet at negative job growth or recession-like levels.

Source - Bloomberg



Whilst the labour market is clearly softer than predicted, real anxiety about potential economic collapse seems misplaced. Much like the last market drop I wrote about, the jobs news in isolation would have likely produced a more muted response, but when viewed in the same week as the latest dramatic instalment of the ongoing (possibly) toxic affair between markets and AI, it compounded the effect. Does this fundamentally change the likely statistical outcome for the US (and global) markets that we've covered previously?

No – not really.

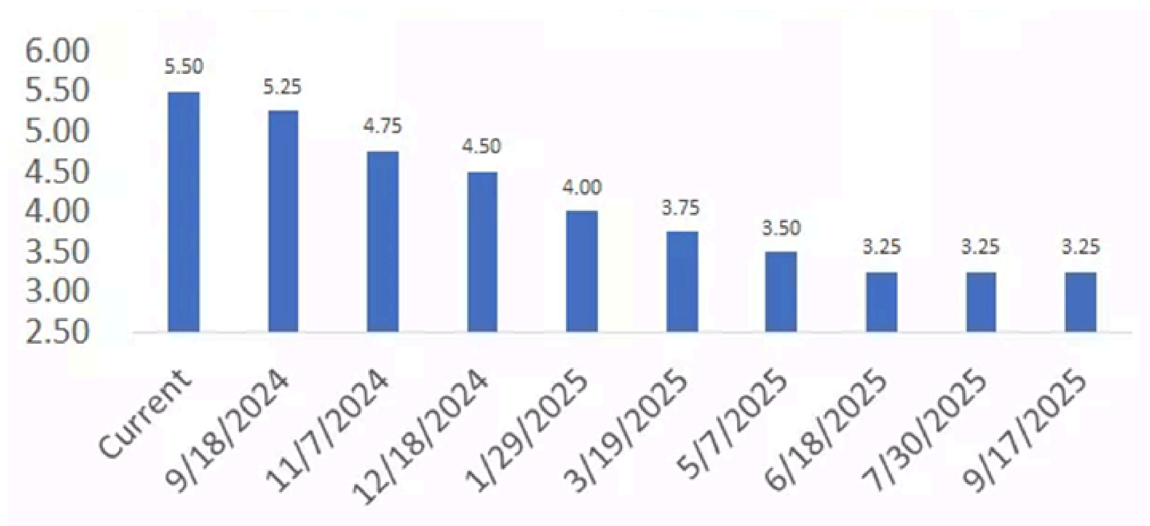
It's intriguing to note that last Tuesday witnessed a record-breaking day in corporate bond issuance.

It was the highest number of issuers (27) ever seen in one day, while it was the third-busiest day by total volume (USD 43 billion across 52 tranches). Nevertheless, issues were, on average, oversubscribed. The high-yield market saw a heavy slate of new issues, while volumes picked up following a slow start to the week. Traditionally, this would signal an uptick in corporate economic activity as businesses sell debt to fund new projects. However, it's worth noting that something else is at play here. Institutional investors are making strategic moves, showing an unprecedented appetite for bonds and attempting to add higher-yielding instruments to their books ahead of the (now accepted) start of rate cutting in the US – further cementing these expectations.

Fed cuts on the horizon!

The key driver of better market sentiment ahead will come from the Fed through rate cuts and supportive commentary. The Fed has clarified that it is now more squarely focused on the labour market side of its dual mandate (which includes both stable prices and full employment). In fact, at last month's Jackson Hole symposium, Fed Chair Jerome Powell noted, "We do not seek or welcome further cooling in labour market conditions." Given the further weakening of the labour market last month, the Fed remains poised to offer support to help bring job market stability.
The Fed will likely cut rates by 0.25% at the September 18 FOMC meeting, bringing the fed funds rate to 5.0% – 5.25%. If market conditions deteriorate substantially between now and the Fed meeting, a 0.50% rate cut may become more likely. In addition, Powell may signal in his press conference the cadence of rate cuts and why outsized rate cuts could be appropriate going forward. We expect the Fed to signal unequivocal support for the labour market and economic growth, providing a welcome shift in tone for markets.
The graph below shows market expectations for the upper limit of the Federal Reserve federal funds target range at various points in the months ahead. The target range is expected to decline from 5.25-5.5% today to a steady state of 3.0%- 3.25% by mid-2025.

Source - CME FedWatch and Edward Jones 09/06/2024



The UK, no really!

I'll resist writing reams about the continued opportunity offered by the UK – or rather, the argument for holding anything above a passive, market cap weighted 4% as others have abandoned their allocation to chase returns in the US. Perhaps these stats will aid the reader;

YTD, the UK is within 2% of the S&P 500. Over the last six months, it has significantly outperformed the S&P 500 (see below). My point is not to issue a rallying cry to continue to hold a significant position in the UK forever but to reiterate the advantages raised by Tom and others over the past months, highlighting the unique and privileged position we find ourselves in now relative to the global stage and the power and importance of diversification globally.

Presently, other multi-asset investors we survey as part of our ongoing research maintain a sensible UK allocation. This is not due to any outdated principle of holding a certain percentage of the portfolio in the home market to aid investor transparency and build trust through scrutability. Rather, most providers we've surveyed hold UK exposures because of the current opportunity it presents. As the UK's value prospect becomes more fully realized and approaches fair value, this exposure will likely decrease.

The medium and long-term prospects for the UK economy and market perception are outside the remit of a weekly market update, but it's safe to say we resisted the urge to soften the position at the last AQ review.

Source - FE FundInfo - 06/09/2024

06/03/2024 - 06/09/2024 Data from FE fundinfo2024

Stock markets remain volatile, but investors will lean into any weakness and keep momentum positive if the Fed can pull off anything like the soft landing predicted.

In conclusion, after a strong rally in the first eight months of 2024, the markets are now entering a period of heightened anxiety. With a seasonally weaker period of September and October ahead, followed by U.S. elections on Nov. 5, and considering the uncertainty in the economic and political data, we anticipate a market pause or correction in the coming weeks. Our current AQ committee (ongoing at the point of writing) is actively addressing this concern through some timely defensive tweaks, which we'll cover as we finalise the data.

Despite the potential for a market pause or correction, the fundamental data continues to support an ongoing market expansion. Inflation is moderating, the Fed is poised to cut rates, and economic growth, while cooling, does not seem negative or recessionary. This positive trend should instil confidence in long-term investors, who can benefit from market weakness and lower interest rates, leading to a further re-acceleration of economic growth.

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