September 2024

MONTHLY MARKET INSIGHTS

Key takeaways:

- The S&P 500 rebounded strongly from a steep market sell-off to start the month, ending the month with a modest gain.
- The Federal Reserve (“Fed”) signaled that rate-cuts are likely for the September Federal Open Markets Committee meeting.
- The Harris campaign experienced significant momentum in August, but the election is still too close to call.

August proved to be a volatile month for US stocks as recession concerns and the unwinding of the Yen carry trade led to a sharp sell-off to begin the month. The S&P 500 closed on August 5 at 5186, an -8.45% decline from its all-time high close of 5,667, which was reached on July 16.[1] The equity market sell-off was sparked by weak employment data for the month of July, which intensified investors’ concerns regarding the health of the economy. July non-farm payrolls showed the US created 114,000 jobs versus expectations of 175,000, while June payrolls were revised lower to 179,000 from 206,000.[2] The unemployment rate ticked up to 4.3% from 4.1%, a near three-year high.[3]

Simultaneously, Japan’s Nikkei index suffered its worst day since 1987, falling 12.4% on August 5, accompanied by a surge in the Japanese Yen.[4] For years, global investors have taken advantage of ultra-low interest rates in Japan to finance investments in riskier assets, such as US stocks. This strategy, known as the carry trade, proved fruitful for investors while Japanese rates were muted and the Yen weakened versus the dollar. However, the Bank of Japan hiked rates on July 31 while the Federal Reserve looks poised to begin cutting rates amid weakening labor-market data, narrowing the spread between the two countries’ interest rates. In turn, this dynamic has made the Yen relatively more attractive, causing it to surge to around 142 to the dollar, compared to 161 to the dollar in early July.[5] We believe the draconian movement in the Yen led to a broad unwinding of the carry trade, adding additional selling pressure to US assets and forcing US markets into oversold territory.

The early-month concerns proved to be overstated, as US markets rebounded strongly from the August 5 month-low while the Nikkei was able to recover most of its early-month losses. In fact, across the board, US large-cap stocks posted a modest gain for August. The S&P 500 returned 2.28% in August, while the tech-laden Nasdaq 100 advanced 0.65%. On the other hand, small-cap stocks, as measured by the Russell 2000 index, declined -1.63% for the month, while the VIX Index[6], the market’s fear gauge, closed the month at 15 after reaching levels north of 60 at the beginning of the month. Notably, the market’s rebound has shown renewed breadth as the equal-weight S&P 500 index returned 1.53% for the month and reached an all-time high.[7]

1. Bloomberg
2. Jasinski, Nicholas. “Jobs Report: U.S. Economy Added 114,000 Jobs in July, below Expectations; Unemployment Rate Jumps to 4.3%.” Barrons, 5 Aug. 2024, www.barrons.com/livecoverage/july-jobs-report-today.
3. Id.
4. Narioka, Kosaku, and Rebecca Feng. “Japan’s Nikkei Suffers Worst Day since 1987, Hit by U.S. Concerns.” Wall Street Journal, 5 Aug. 2024, www.wsj.com/finance/stocks/japan-stocks-fall-sharply-after-weak-u-s-jobs-data-yen-strengthening-3903689f.
5. Id.
6. The VIX is a market index measuring expected volatility for the stock market.
7. Bloomberg

As we noted in previous commentaries, the strength of the equity market this year can largely be attributed to the Technology sector and the Artificial Intelligence ("AI") trend. However, the recent stock rebound has seen Technology cede its leadership as bellwethers, such as Microsoft, Amazon, and Nvidia, have shown relative weakness to the S&P 500. The market's decoupling from the AI trend was showcased on August 29 when the market was able to eke out a small gain following a disappointing Nvidia ("NVDA") earnings print that led the stock to drop nearly 6% on the day. Many investors believed a weak NVDA print would roil markets, but nonetheless, the market remains firm despite the weakening internals of the Technology sector. As we head into September, market leadership has shifted to interest-rate-sensitive sectors, such as Financials and Real Estate. The expanding breadth of the market leads us to believe that this rebound will hold.

Inflation remains above the Fed's 2% target as the July core Personal Consumption Expenditure Index rose 0.16% month-over-month, implying a year-over-year increase of 2.62%, falling roughly in line with expectations.[8] Services inflation remains stubborn, with core services excluding housing rising 0.21% month-over-month.[9] We still believe this area of inflation will remain elevated until we see a more significant rise in layoffs. Notably, personal income beat expectations, rising 0.3%, while the savings rate declined to 2.9%, the lowest level since June 2022, implying consumers are growing increasingly strained to support their spending.[10] Overall, consumer spending appears to be solid, but we have observed signs of weakening, especially amongst lower-income consumers. We anticipate that further labor market weakening will weigh on consumer sentiment and, in turn, could likely lead to a slowdown in spending over the next few quarters.

The Fed provided its strongest signal that rate cuts are coming when Chairman Powell announced the "time has come" for rate cuts at the Jackson Hole summit press conference.[11] Powell noted that the cooling in the labor market is unmistakable, implying the Fed will now prioritize supporting the labor market over fighting inflation. A Fed rate cut at their September meeting looks to be a certainty; however, its magnitude is still debatable. We believe the magnitude of the September cut will be highly reliant on the August Jobs report, which will be released on September 6. As of now, our base case is a 25-basis point cut in September; however, a weak jobs report could compel the Fed to make a more dramatic 50-basis point cut. With the US 2-year Treasury Yield at 3.92%, the market is pricing in an aggressive Fed rate-cutting campaign.[12] We view a slower-than-expected rate cutting cadence from the Fed as a potential risk to markets through year-end.

On the political front, Kamala Harris's campaign has shown early signs of momentum, with most polls placing her as the likely winner in the 2024 election. On the other hand, Robert F. Kennedy's exit from the race and endorsement for President Trump should prove accretive towards the Republican's odds of winning the White House in November. We anticipate the presidential race will remain too close to call as we approach election day. Nonetheless, the election should prove to be a backstop for both markets and the economy as the current administration does everything in its power to increase the likelihood of a Harris victory.

Elevated fiscal stimulus through the election cycle and strong market internals lead us to believe equity market returns will remain firm through year-end. Yet, we remain vigilant on weakening economic fundamentals and above-target inflation, which together could lead to weakening economic activity in 2025. For that reason, we remain cautious in investment portfolios with a bias towards quality and downside protection.

8. Hatzius, Jan, et al. "USA: Core PCE Roughly in Line With Expectations; Saving Rate Declines to 2.9%; Boosting Q3 GDP Tracking to +2.7%." Goldman Sachs, 30 Aug. 2024, www.gspublishing.com/content/research/site/search.html?facets=()&limitTo=%5B%22%22%5D&filter=(title+EQ+$%7B(briefly)%7D$+AND+sources+EQ+$%7B(%22ad68d69c-e1fd-4a2a-a90d-eae33ee4442c%22)%7D$+AND+totalPages+IN+%5B1,99999%5D)&page=1&sort=time&language=%5B%22en%22%5D.

9. Id.

10. Id.

11. Kiernan, Paul. "Fed's Powell Declares 'Time Has Come' for Rate Cuts." Wall Street Journal, 23 Aug. 2024, www.wsj.com/economy/central-banking/powell-issues-strongest-signal-yet-that-rate-cuts-are-on-the-way-62952bd6.

12. Bloomberg.

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