OBSERVATIONS

- Markets traded lower last week and volatile with the S&P 500 falling -2.1% and small caps (Russell 2000) losing -6.7% as interest rates dropped sharply—the yield on a 10-year Treasury fell -40 basis points to end the week at 3.80%—as the Fed opened the door for a rate cut in September (see Expectations) and the US economy showed signs of weakening.[1]
- ISM Manufacturing PMI came in below expectations at 46.8—any reading below 50 signals a contraction in net activity—suggesting the manufacturing sector remains in a soft patch.[1]
- The number of job openings stood at 8.2 million in the most recent Job Opening and Labor Turnover Survey (JOLTS), higher than expectations of 8.0 million. Hiring and total separations continue to trend lower, with the former near levels last seen in 2014 (when excluding 2020).[2]
- Initial unemployment claims—while still low by historic standards—moved higher last week as 249k people filed for unemployment, reinforcing the view that the labor market is gradually weakening.[1]
- July saw one of the weakest jobs reports since Dec-2020 with only 114k new jobs created, which was below expectations, and the job figures for both May and June were revised lower. The unemployment rate rose to 4.3%—the highest rate since Oct-2021—while average hourly wages fell to 3.6% year-over-year (YoY) down from June's revised figure of 3.8% YoY, which also had been revised lower.[1]
- Preliminary data showed the Eurozone's economy grew by +0.3% in Q2 (vs. expectations of +0.2%) even after considering the Eurozone's largest economy, Germany, saw its economy shrink by -0.1% in Q2.[1]

EXPECTATIONS

- The Fed met last week and, as markets expected, left interest rates unchanged but during the press conference Fed Chairman Powell explicitly noted that recent progress in lowering the inflation rate and that a -25 basis point rate cut "was on the table" at the Fed's next meeting in mid-Septemeber.[1]
- The Bank of Japan (BOJ) raised its policy interest rate to 0.25%, the highest level since October 2008. The BOJ also disclosed plans to slow its government bond buying program—after 23 years and counting of so called quantitative easing, the BOJ now owns over 53% of outstanding Japanese government bonds.[1]
- About 75% of the S&P have reported and 78% have beaten earnings estimates—above the 5-year (77%) and 10-year (74%) averages—but the level of the beats (+4.5% above estimates) is below the 5-year beat average of 8.6%, and companies missing earnings are seeing above average declines in their share prices. Despite several high-profile misses by large tech firms, overall earnings for Q2 are on pace to be +11.5% YoY.[3]
- The Congressional Budget Office's fiscal year (FY) update released on June 18 now pegs the US budget deficit at 6.7% of GDP for FY2024—the highest peacetime deficit in US history outside of the Great Financial Crisis and COVID-19 pandemic. More on this can be read on our recent blog.[4]

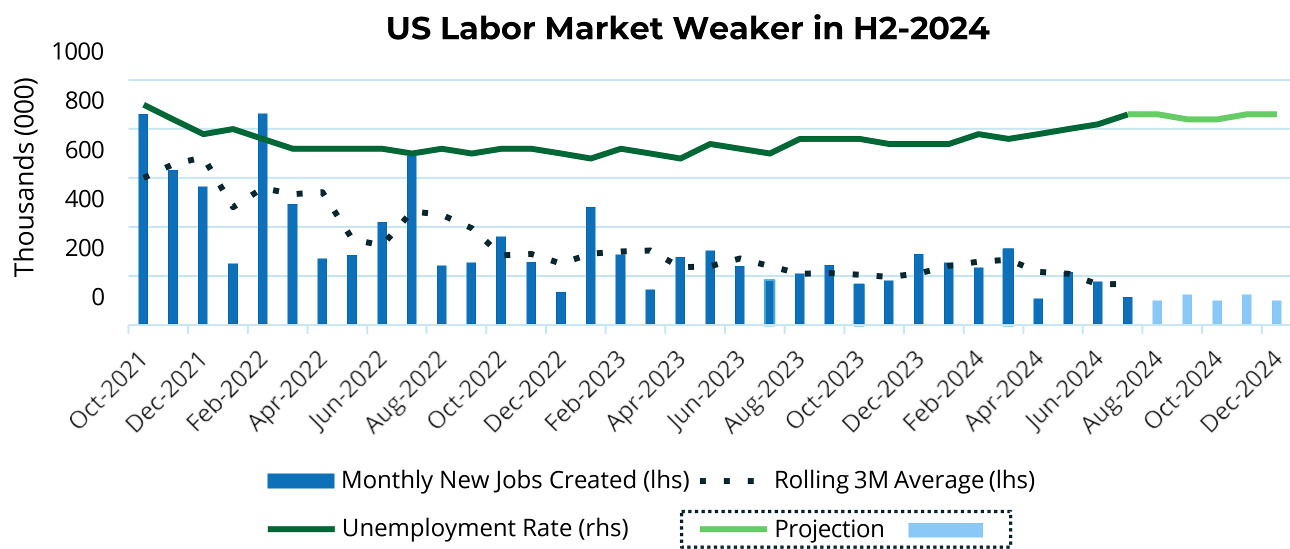
ONE MORE THOUGHT: The economy is growing slower, and the labor market is weaker, but does a recession loom?[1]

There is mounting evidence the US economy is weakening. From a variety of labor market data to surveys of purchasing managers and hard data on retail sales and industrial production, recent data show an economy that is losing momentum. But slower growth does not necessarily mean that this will end in the US economy slipping into

[1] *Bloomberg LP*
[2] *https://www.bls.gov/news.release/jolts.a.htm, as of July 30, 2024*
[3] *https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_080224A.pdf*
[4] *Congressional Budget office Updates Baseline: Deficit Spending is 27 Percent Higher Than Previously Estimated, June 18, 2024*

a recession. The Fed's rate hikes have slowed the economy in effort to bring supply and demand, particularly in the labor market, into better balance and ease inflationary pressures. Most inflation measures—CPI, PPI, PCE, etc—show that the Fed's efforts are paying off—inflation is slowing most likely in a sustainable way. Overall, while there are signs of slowing growth there are not yet the telltale signs that recession is looming. The stock market sell-off last week seemed more emblematic of profit taking and a rotation away high growth stocks than the start of a recession-oriented bear market (though that point of view is very fluid given where markets appear to be headed this week). The Atlanta Fed's GDP Now indicator still suggests growth of over 2% for Q3, corporate and high yield bond spreads still suggest overall corporate health, and while the market is punishing earnings misses with a vengeance, on balance most companies are still beating estimates and projecting reasonable growth ahead. However, it is worth noting that the Fed's track record of easing the economy into a soft-landing—a few quarters of low growth and falling/stable inflation—rather than tipping the economy into a recession is rather poor. The history of Fed tightening cycles shows that they typically keep rates too high for too long and a subsequent recession is the end result. It is also true that the Sahm Rule—see RC 8-July—has been triggered, which is historically a reliable, coincident indicator that the US economy has entered a recession. We are constantly challenging ourselves to see if conditions have sufficiently changed to warrant a change in guidance to clients as well as monitoring geopolitical risks that could tip a slowing but still healthy economy into a more negative economic scenario.

CHART OF THE WEEK



Source: Clearstead, BLS; Note: projection assumes the 3-month moving average stabilizes at the most recent job gains figure (≈115k).

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