OBSERVATIONS

- Markets gained ground last week, with the S&P 500 hitting a new record high last Friday (close above 5,800) and ending the week +1.1% higher, while small caps (Russell 2000) also gained +1.0%. Meanwhile the yield on the 10-Yr Treasury climbed +13 basis points (bps) to end the week at 4.10%.[1]
- Inflation in September came in marginally higher than expected with the headline CPI registering 2.4% year-over-year (YoY) down from August's 2.5% YoY reading. Core-CPI, which removes the volatile food and energy components, increased to 3.3% YoY, which was slightly higher than August's 3.2% YoY figure.[1]
- Producer prices also came in slightly higher than expected, with headline PPI registering 1.8% YoY in September, which was down from August's 1.9% YoY figure. Core-PPI, which also removes food and energy, registered 2.8% YoY which was an increase from August's core-PPI reading of 2.6% YoY.[1]
- Initial unemployment claims spiked up by +33k last week to 258k from the previous week's 225k level. This is the highest level since August-2023, but it may have been elevated due to the impact of Hurricane Helene the week prior, which caused torrential flooding in much of Florida, Georgia, and the Carolinas.[1]
- Small business optimism was largely unchanged in September at 91.5 and has now been below its 50-year average (98) for 33 consecutive months. Small businesses also noted a record level of uncertainty if business conditions would either improve or deteriorate over the coming months.[1]
- Meanwhile, the University of Michigan consumer sentiment index showed a decline in October to 68.9, well below its 50-year average of 85. Consumers also registered declines in their assessment of their current situation as well as a weaker outlook for future expectations.[1]

EXPECTATIONS

- The minutes from September's Fed meeting indicated a healthy debate over whether the Fed should have cut -50 bps or enacted only -25 bps policy cut. In the end 11 of 12 Fed committee members backed the larger -50 bps rate cut, but the minutes shed light on the fact that several members favored a more gradual pace, in part, to avoid confusing the markets that the Fed was inclined toward larger cuts moving forward.[2]
- Florida was hit with back-to-back hurricanes as Hurricane Milton moved onshore last week just two weeks after Hurricane Helene ripped through the Florida Panhandle. These two hurricanes will probably distort several economic indicators over the coming weeks and months and will likely spur significant construction expenditures in H1-2025 as large areas of Florida, Georgia, and the Carolinas rebuild after damaging high winds and widespread flooding.[3]
- Q3 earnings season kicked-off last Friday with several large banks—JPMorgan, Wells Fargo, and BNY Mellon—reporting that they beat expectations but signaled that it will be harder for them to lend as profitably going forward as interest rates fall in 2025.[1]
- Beijing announced new stimulus measures over the weekend—in keeping with pledges from last month to further economic support and bolster market sentiment—but have provided few details on funding levels.[1]

ONE MORE THOUGHT: Does the Fed easing mean volatility is here to stay?[1]

The Fed has signaled that it will likely be easing rates over the next year or so, but it is possible that markets will react differently than they have in the past easing cycles given the state of the US economy. Examining Fed policy

[1] *Bloomberg LP, 10/11/2024*
[2] *https://prod-i.a.dj.com/public/resources/documents/fomcminutes20240918.pdf*
[3] *https://www.wsj.com/us-news/climate-environment/hurricane-milton-makes-landfall-in-florida-as-category-3-storm-3d75b819?mod=hp_lead_pos7*

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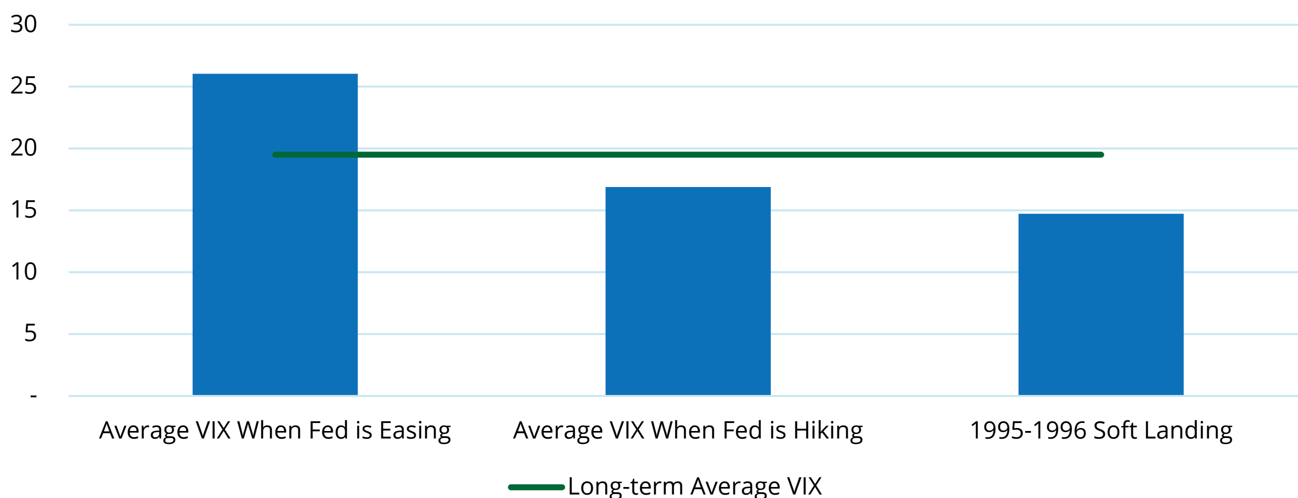
cycles beginning in 1990 it is typical to see above average levels of volatility—see Chart of the Day—as the Fed is cutting interest rates. In general, the VIX—a common measure of S&P 500 volatility (sometimes referred to as the Fear Index) that was introduced to the markets in 1993, but which has a track record going back to Jan-1990—tends to be above average during the months that the Fed is cutting its main policy rate. Over the past 35 years, the VIX has averaged 19.5, but in periods of Fed policy easing it has averaged 26. A plausible explanation for this is that in most cases, the Fed is easing due to economic weakness that is manifesting itself, at least in part, in a weaker and more volatile stock market. A notable exception to this pattern was in the mid-1990s when the Fed engineered a soft-landing for the US economy, cutting its main policy rate from June-1995 to Jan-1996 and volatility remained muted. Conversely, during Fed hiking cycles—which are typically associated with strong economic growth and inflationary pressures—the VIX tends to be below its long-run average as the stock market tends to be buoyed by the tailwinds from a robust economy. So, as we enter into a new Fed easing cycle, is it more likely that the VIX will move above its long-run average or will it mirror its experience from that last soft landing in the mid-1990s. Time will tell, but our analysis suggests that it is the underlying conditions of the economy that drive the VIX, and we currently judge the current conditions for the US economy to be solid—real GDP growth >2%, unemployment <4.5%, and retail sales growing by ≈3% YoY. Given this, we assess that it is more likely that the VIX moves below its long-run average in H1-2025 than spikes to above-average levels.

CHART OF THE WEEK



Source: Clearstead, Bloomberg LP, as of 10/11/2024

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