Market commentary notes

Monthly call notes
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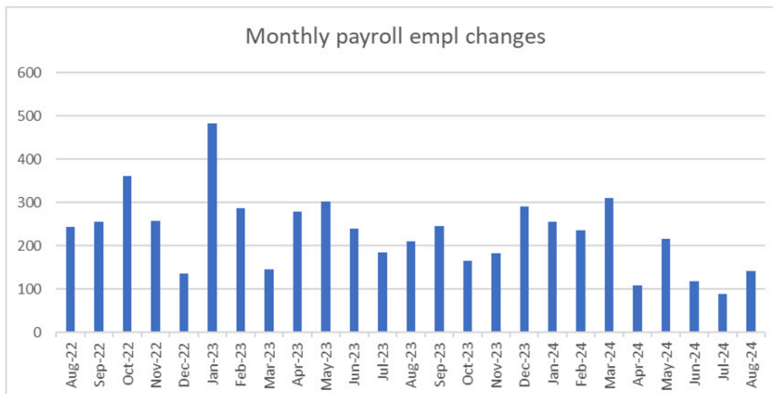
Key issues summary:

Let's start with jobs. Friday's jobs report was a mixed bag. Estimates for the previous two months were reduced, but the August numbers at +142,000 were okay. Unemployment went from 4.3% to 4.2%, but if you dig below the surface, it was really 4.26% to 4.22%, so no meaningful change at all.

There's been some weakness in the new jobs figures but it's easy to exaggerate the extent. Here's a chart of monthly new jobs for the last two years.

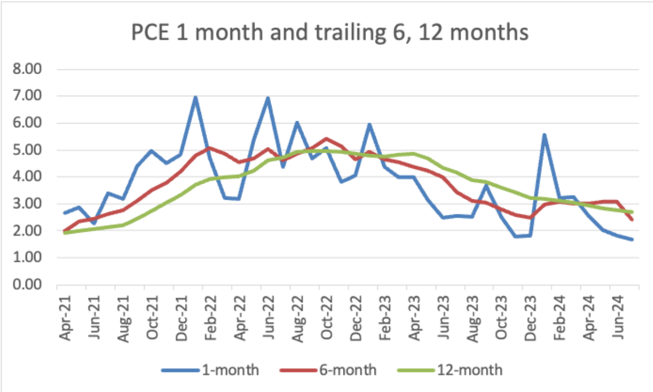


Source: BLS Employment, Hours and Earnings from the Current Employment Statistics survey (National), September 6, 2024.

Current levels are lower than when the Fed started raising rates, but not by a lot. In statistical terms, the two-year average has been 230,000 new jobs per month. In August, we saw 142,000, which is less, but it is only one standard deviation less than the average. That indicates a dip but not a powerful trend.

Average hourly earnings were up 0.4% for the month, which is well above current inflation. Average hours worked were up 0.1 per week. It doesn't sound like a lot but with 160 million workers, that's the equivalent of about 400,000 workers. [BLS Table B-2, September 6, 2024].

Inflation—How much has inflation come down, really? Looking at the Personal Consumption Expenditures (PCE) inflation measure, the answer is "not that much in the last year."



Source: Federal Reserve Dallas PCE inflation measures, September 7, 2024. [https://www.dallasfed.org/research/pce]

My chart shows the monthly inflation reading—which is very spikey, as well as the 12-month average and my favorite, the 6-month average. It has been pretty flat so far this year, ranging from a high of 3.1% (three times) to a low of 2.4%, most recently. In the last two months, the single-month change has been below 2% annualized but, given how volatile those numbers are, it's impossible to know if that's a trend or just a blip.

The bottom line is that as we enter the Federal Reserve sweepstakes later this month, it looks like inflation has been mostly tamed giving the Fed an opening to start to lower interest rates.

The Fed—we should expect the expected—The FOMC will meet next week, September 17/18, and then November 6/7 and December 17/18. The most open secret in Washington, D.C., these days is that the Fed is going to begin reducing rates shortly. My guess is that we will see a 25 bp decline with each meeting or at least for two of the three. That'll bring overnight rates down to mid/high fours. If inflation continues to be beaten back, I'd guess that the Fed will want to get to about 3.5% or 3.75% by the end of 2025.

Key to how the markets interpret Fed actions will be the narrative that goes with these reductions. My guess is that they will say reassuring words about the state of the economy, coupled with the idea that core inflation is moderating to the point that they are comfortable reducing rates even though we haven't hit the 2% inflation target rate.

With a message along those lines, we can expect the stock market to pick up slightly while longer-term interest rates, which have already come down in anticipation, stay stable or come down a little.

Further evidence of a slowdown—The Fed's Beige Book, published September 4 reported that while three regions reported growth, nine (up from five last time) reported flat or declining activity. Labor markets appeared to be stable with no reports of increased layoffs. Labor and other input costs were reported to be up slightly to moderately. Consumer spending ticked downward, as did manufacturing activity. However, nine of the 12 districts reported that they expected economic activity to pick up in coming months. As a whole, I think this will be used by the FOMC to support a narrative that the economy has slowed enough and prices moderated enough that their work is done and interest rates can be safely reduced. [Federal Reserve Beige Book, September 4, 2024, https://www.federalreserve.gov/monetarypolicy/files/BeigeBook_20240904.pdf].

August partial recovery, but then a big downdraft—In August, we saw a weak start to the month in terms of stock markets, then improvement. The S&P ended up 2.4%, while midcaps were about flat and small caps were down 1.4%. International markets did a little better with the all-country index up 2.9%. Interest rates came down some more, meaning bonds rose in value by 1.3%, for 3.5% so far this year. With the beginning of September, we saw some of the froth come off the stock market, especially for tech stocks. Last week, the S&P was down 4.25%, NASDAQ was down 5.8% and small caps were down 5.7%. [FactSet, September 6, 2024]. Some of this may be because investors are coming to realize that AI won't likely be a highway to immediate growth or profits. Some might also be seasonality: September and October historically have been the most likely months for us to see a weak stock market in the U.S.

Global stock indexes

Total Index	August %	YTD %	1 yr %	2023 Est PE Trailing/ Projected
S&P 500	2.43	19.53	27.14	23.27/21.76
S&P Mid Cap	-0.08	12.24	18.75	18.25/16.49
S&P Small Cap	-1.44	8.41	17.31	26.69/16.44
FTSE All REIT	5.63	10.73	21.44	
MSCI All Country xU.S.	2.85	11.22	18.21	
MSCI Emerg Mkt	1.61	9.55	15.07	

Source: Morningstar as of August 31, 2024. Estimated PEs are 12-month values from S&P Dow Jones Indices. Trailing PEs are as of September 29, 2023. Projected PEs are as of December 29, 2023. Figures are provided for comparisons over time.

Fixed income and alternatives

Total Return Index	August %	YTD %	1 yr %
Bloom Agg Intermed	1.30	3.48	7.24
ICE BofA U.S. Convertibles	1.29	5.52	9.57
S&P GSCI	-1.72	5.32	-2.11
Bloom U.S. Corp HY	1.63	6.29	12.55

Source: Morningstar as of August 31, 2024.

Sector performance—In August, the best sectors were consumer staples, real estate and health care. The worst were energy, consumer discretionary and communications services. However, on a YTD basis, communications and IT are still at the top, along with financials and utilities. Real estate, consumer discretionary and materials brought up the rear once again. [https://www.spglobal.com/spdji/en/documents/performance-reports/dashboard-us.pdf, September 7, 2024]. [https://digital.fidelity.com/prgw/digital/research/sector, September 7, 2024].

Commodities

Commodity and food price changes, current month and YoY

Total Index	August%	YoY %
Copper	1.4%	7.1%
Lumber	-4.7%	-2.1%
Cotton	1.4%	-20.7%
Sugar	4.5%	-29.2%
Coffee	-2.0%	62.8%
Wheat	2.6%	-7.9%
Corn	1.4%	-16.5%
Oil	-10.0%	-21.5%
NatGas	7.7%	-23.1%

Source: https://tradingeconomics.com/commodities, September 7, 2024.

Only three of these nine major commodities saw prices decline in August. For these nine, the average one-year price change was a decline of 5.7%, which points to both a decline on average in commodity prices and reflects their extreme recent volatility.

Looking more broadly at commodities, when we look at 22 categories of agricultural commodities and 26 categories of industrial commodities, only 15 of the 48 saw price declines in August, compared to 29 last month. And 24 saw lower prices than a year ago versus 23 last month. So, it looks to me like the short-term input price declines are tapering off. That tells me that further inflation improvements might be harder to come by. That's a change from what we were seeing earlier in the year.

U.S. economy

The U.S. economy at a crossroads ...

GDP estimates

[https://www.bea.gov/data/gdp/gross-domestic-product, September 7, 2024]. [https://www.atlantafed.org/cqer/research/gdpnow, September 7, 2024]. The second estimate for the 2Q2024 GDP growth rate came in at 3%, which was definitely encouraging. This was an upward revision mostly because consumer spending was strong. The current estimate for the quarter that we're currently in is +2.1%. That sounds about right to me, meaning it's consistent with the other measures we're seeing.

U.S. PMI statistics

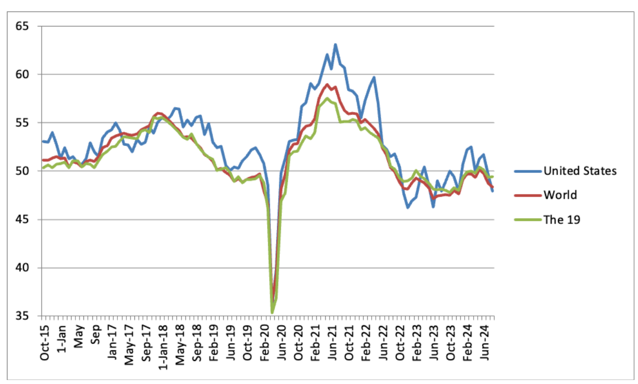
The August PMI Manufacturing number dipped to 47.9, which is mildly into contraction territory. The Services PMI remained strong at about 55.6. That represents about 80% of our economy, so it suggests that we are still in good shape overall despite manufacturing weakness. [Trading Economics, PMI statistics, September 7, 2024]. [Trading Economics, https://tradingeconomics.com/country-list/services-pmi, September 7, 2024].

International

Manufacturing PMI

Every month I look at global Purchasing Managers Index (PMI) statistics. The August numbers indicate that manufacturing expanded in 17 of our 38 countries. That's up from 15 last month but still shy of the 21 or 22 previously. The Eurozone was stable though under 50 at 45.8. Germany and France seem to be continuing a downward trend. In Germany's case there is a lot of consternation over what seems to be a broad-based decline in their auto industry. Different companies are having different types of issues, so it is not all one thing. Italy and Spain appear to be stable or improving. Our GDP-weighted average Manufacturing PMI dipped slightly more to 48.4, while our measure of the 19 major economies was at 49.5—up a little. EU's Services PMI stayed solid at 52.9, and Germany, France, Italy and Spain all had Services PMIs above 50, with Italy and Spain solidly above 50. [https://tradingeconomics.com/country-list/services-pmi, September 7, 2024].

Here's our updated graph of Manufacturing PMIs



Source: Author's calculations based on published PMI statistics, as of September 7, 2024.

Table summary

Region	Manu PMI	Last month	12 mo. Ago
U.S.	47.9	49.6	47.9
19 majors	49.5	49.3	48.1
38 world	48.4	48.7	47.5
EU	45.8	45.8	43.5
China	50.4	49.8	51

Source: Author's calculations based on published PMI statistics, September 7, 2024.

The trend over the last six months in PMIs globally has been gently downward. However, we shouldn't lose sight of the fact that compared to a year ago, we're no worse off. In fact, Europe is slightly better off.

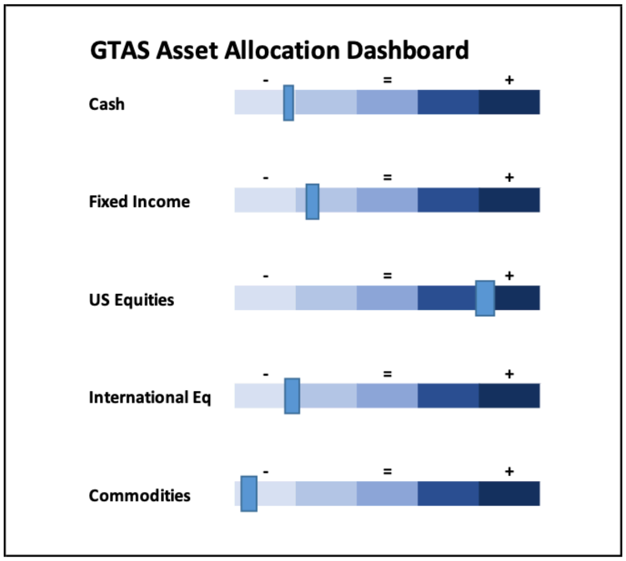
So, while this news isn't bad, it will probably cause the major central banks to start thinking about cuts sooner and perhaps more than they would otherwise.

Investment strategy

September started with a downdraft in the stock market, probably due to profit taking in Tech stocks and general worries about the economy. September and October have also historically tended to be weaker months for the U.S. stock market. Looking forward, however, there are two trends in opposing directions that may set the tone for markets, both stocks and bonds.

The first is that the economy is probably not (so far) headed for a recession and indeed, the Fed's likely upcoming interest rate reductions ought to hearten the markets somewhat. On the other hand, we've entered the election season in earnest now. There will be uncertainty on policy, on popularity and on public opinion. It behooves us to think about hedging at least a little bit as political risk grows. A secondary issue here is Germany and to a lesser extent the rest of the EU. Growth there has been meager and fleeting. That doesn't look to be changing for the better. That's a worry for international investing as well as for our export trade.

GTAS Allocation chart



(+/=/-) represents our group's views over a 6- to 18-month time horizon concerning tilts relative to our strategic positions.

+ implies an overweight in that asset class.

= implies a weighting similar to our strategic weight.

- implies an underweight.

Index definitions

Past performance is no guarantee of future results. You cannot invest directly in an index.

Bar Agg Intermed — Bloomberg Barclays U.S. Aggregate Intermediate Total Return index is composed of the BarCap Government/Credit Index, the Mortgage-Backed Securities Index, and the Asset-Backed Securities Index. The returns for the index are total returns, which includes the daily reinvestment of dividends.

Bar U.S. Corp HY — Bloomberg Barclays U.S. Corporate High Yield Total Return index includes all fixed income securities having a maximum quality rating from Moody's Investor Service of Ba1, a minimum amount outstanding of $100 million, and at least one year to maturity.

FTSE All REIT — FTSE Nareit All Equity REITs Total Return index is an index of publicly traded Real Estate Investment Trusts (REITs) that own commercial property. All tax-qualified REITs with common shares traded on the NYSE, AMSE or NASDAQ National Market List are eligible. Additionally, each company must be valued at more than $100MM USD at the date of the annual review.

ICE BofA U.S. Convertibles — ICE BofA U.S. Convertible Bonds Total Return index tracks the returns of U.S.-traded convertible debt issued by companies with a significant presence in the United States. The index is composed of various combinations of convertible structure and credit quality (e.g., it includes investment-grade, speculative-grade, and non-rated issues). The returns for the index are total returns, which include reinvestment of dividends.

MSCI All Country xU.S. — MSCI All Country World Index Ex USA NR is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. The index consists of 48 developed and emerging market country indices. The returns for the index are total returns, which include reinvestment of dividends.

MSCI Emerg Mkt — MSCI Emerging Markets NR index consists of 26 developing economies including Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and the United Arab Emirates.

S&P 500 — S&P 500 Total Return index is a market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenues are based in the U.S.; it's often used as a proxy for the U.S. stock market. Total Return (TR) indexes include daily reinvestment of dividends.

S&P GSCI — S&P GSCI Total Return index is a composite index of the commodity futures. It represents unleveraged, long only investments in commodity futures that are broadly diversified.

S&P Mid Cap — S&P MidCap 400 Total Return index is comprised of stocks in the middle-capitalization range, and includes approximately 10% of the capitalization of U.S. equity securities. Total Return (TR) indexes include daily reinvestment of dividends.

S&P Small Cap — S&P SmallCap 600 Total Return index consists of 600 domestic stocks chosen for market size, liquidity, and industry group representation. Total Return (TR) indexes include daily reinvestment of dividends.

Wealth Management

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