MULVIHILL

By the Way

Monthly commentary from Jack Way

"It is a tale told by an idiot, full of sound and fury signifying nothing"

As I looked back at the month of August I was reminded of my English Lit class and this line from "Macbeth"; "It is a tale told by an idiot, full of sound and fury signifying nothing". Certainly, within the month we experienced the largest decline and largest rally of the last two years, but the S&P 500 entered August at 5522 and exited at 5648 (with a stop at a low of 5186 mid-month). For all intents and purposes, the Index made a round-trip and ended up almost flat. The VIX, which attempts to measure investor concern traced a similar pattern (although inverted) starting August at 16, spiking to 65 and finishing back at 15. Having said that, if we look more closely below the broad averages it appears there has been a significant change in the character of this market. The decline in the S&P aroused anxiety in many investors and led to a noteworthy amount of derisking and deleveraging, which wasn't reversed when the market itself went back up. As a consequence, for the first time in a long while an equally weighted index of stocks is outperforming the high tech and communications sectors that have been leaders, it seems like forever. Is this a good thing because more stocks are participating as the market broadens out, or is it a negative because the ascendancy of these more defensive stocks traditionally has meant there is less upside to come?

In large part the market collapse of August 5th was precipitated by a much lower than expected growth in U.S. July payrolls that raised concern about the health of the economy. That concern has not disappeared, and in fact the original release of 114,000 has now been revised down to 89,000 and August reported a still moderate 142,000. It is important to keep in mind that this is a deceleration and not an actual decline, and there has been no perceptible increase in layoffs as yet. We continue to keep an eye on the Purchasing Manager surveys which are almost universally below 50, indicating economic contraction.

While these reports don't suggest a recession is around the corner, it has raised questions that maybe the FED should have started to cut rates in July and now might need to cut by 50 basis points in September rather than just 25. Quotes from FED members, included Chairman Powell himself are very clear. Inflation is controlled and anchored, and the pace and amount of rate cuts will be dependent on the outlook for the labor market. In any case the path is now set to lower rates. Two recent quotes from Chairman Powell are demonstrative: "The time has come for policy to adjust.", and "We do not seek nor welcome further cooling in labor market conditions." Given the latest releases by the Bureau of Labor Statistics, it would seem incumbent for the FED to get on with the job. Ominously, former CEO of the New York FED, Bill Dudley has said that the FED has historically had a hard time acting fast enough once the first signs of weakness arise. In any event, rate cuts are coming; will they be the benign "mid-cycle adjustment" type that keeps the "soft landing" on the flight path, or suggest the FED sees more concerning outcomes are possible?

The elephant in the room, or at least everyone's favorite topic of discussion is the U.S. Presidential election. That's not to discount the many other contests taking place: a sweep of the House and Senate along with a Presidential win would be the one outcome that would lead to a major revision in tax rates and spending legislation. Harris has put the Democrats in a much better position than when Biden was the candidate, but the outcome is far from predictable. Getting voters to the polls will be of utmost importance for both parties, and neither wants to peak too soon. The so-called swing state polls are going back and forth between Trump and Harris, but all remain within the "margin of error" (which means we shouldn't have bothered with this poll except to give CNN something to talk about).

I haven't written about "Project 2025"; maybe because it scares me. Alternately titled the "Presidential Transition Project" it was written by right-wing Conservatives tied to Donald Trump, but even he is trying to distance himself from its more extreme proposals. It is a large document, and I certainly haven't read it but here are just a few things it hopes to accomplish if Trump becomes President (or even if he doesn't):

1. The Executive Branch (the President) consolidates power above the legislative and judicial branches.
2. All departments will come under the purview of the President (e.g. The DOJ, FBI, DOE, etc. etc.)
3. All civil service workers become political appointees getting rid of the "Liberal Bureaucracy".

There's lots more, but in summary the group is calling for a "second American revolution" which will be "bloodless if the left allows it to be". Like I said – scary stuff.

As usual, here's some things I didn't get in elsewhere:

1. What good or bad is already priced into these markets?
2. Historically, the U.S. unemployment rate has proven "non-linear"; i.e. once going in a new direction, it explodes.
3. U.S. household net worth is up $50 trillion since the start of the pandemic, that's support for consumer spending.
4. U.S. Treasury interest payments averaged $1 billion per day pre-pandemic; $2 billion per day in 2023; and $3 billion per day today.
5. Don Rissmiller of Strategas points out that once CPI exceeds 6% (it did) there is an 85% chance we will experience another round of high inflation.
6. Here comes another debate.

Disclosures