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By the Way

Monthly commentary from Jack Way

The third quarter of 2024 resulted in a change in character for the market, but not a change in direction. The high-tech sector, and in particular the so-called "Magnificent 7" stocks that had been responsible for a lions share of the strength in stocks for many years had started to show signs of weakness relative to the rest of the S&P 500 Index. Stepping into the breach to keep this bull market on track were sectors like real estate, utilities and financials. In many ways, I sensed markets were drifting this year, but in fact the return on the S&P as of early October has been the best since 1997. I'm a firm believer that excess liquidity in the financial system will filter into equity markets and raise stock prices. Currently, almost every major economy is increasing liquidity through some kind of stimulus package already in place or in the plans. Valuation measures are often of little use in predicting short-term markets, but we shouldn't overlook the current P/E multiple on the S&P 500 ranks in the top decile since 2000. That's not a problem at present as no one seems to care. Market commentator, Ryan Detrick of the Carson Group, notes that "The FED has cut rates with stocks near all-time highs 20 times. The S&P was higher a year later 20 times." (I haven't checked his work, but he said it on CNBC so it must be so 😊.)

In a similar fashion the summer turned the consensus economic outlook from a fear growth was too hot for the FED to cut rates, into a concern the FED waited too long to cut and now the possibility of a recession was more realistic. Much of that unease was the result of a couple of weak payroll numbers in July and August from the U.S. Bureau of Labour Statistics. Fortunately, the Bureau's most recent report for September rebounded to a stronger 254,000 and also revised up the previous releases by 72,000. That has had a calming effect on those worried about a recession being on the horizon. These large revisions are making it difficult to use data as first reported. Evidently there has been a marked decline in responses and response times making the information more unreliable. I assume PMI's have been similarly affected. Nonetheless PMI releases have been a mixed bag with manufacturing remaining weak, well below the 50% mark indicating expansion, but services is at 54.9% a new 2-year high. The east coast dock strike was mercifully short, and almost all U.S. GDP estimates are between 2.5% and 3% for the next 12 months. As someone put it, the U.S economy is "slowing but growing", which is the best chance for a soft landing.

The FED is feeling good about these recent reports as their policies seem to be working. In particular the Board's favourite measure of inflation, the PCE Deflator, was 0.1% for the month of August and only 2.2% year-over-year. The FED's other mandate, employment, has also reached a level that would indicate growth without overheating. We, and the Board, must keep in mind that the target is jobs and not GDP growth as such. Also helping the FED in its quest for a soft landing is the fact that where once its policies were something of an outlier internationally, today almost all major central banks are on the same page. Most importantly, for global growth, China has initiated monetary policies to boost its economy with suggestions that fiscal spending is not far behind. Japan has a new Prime Minister who has demanded a package of growth programs to eliminate the country's chronic disinflation. The Eurozone continues to limp along with slow to no growth, but is considered likely to soon enact more aggressive stimulus policies. All of which should enhance global economic growth, and thus by inference equity markets. Nevertheless, the current geopolitical environment is fraught with potential negative outcomes; e.g. wars, elections and economic volatility.

The U.S. federal election continues to be too close to call, especially at the Presidential level. The vagaries of the U.S. Electoral College system of selecting a Chief Executive only serve to further confuse the issue. The state-by-state winner-take-all method means that it only takes a very small difference

in a state's popular vote to move one party's slate of electors to that candidate and effectively disenfranchising all in that state who voted for the other party. Such a small margin of error, particularly in the "swing states", means the final result could be anywhere from an actual tie in the College to an easy win for one candidate or the other. There is still time for a misstep by either side to make the outcome more obvious.

The origin of the Electoral College is interesting and frankly unpleasant. At the convention to write the U.S. Constitution it became apparent that the southern states did not have enough voters/representatives to ever win an election. While the population was approximately equal between the north and south, roughly one third of those living in the southern states were in slavery. Since slaves were considered property and not eligible to vote, a popular vote system wouldn't work. After fierce debate, a compromise was reached known as the "Three Fifths Clause". The Constitution did not use the word "slave" but rather "a person who was not free", (it is still actually in the Constitution though) who would be counted as three fifths of an individual for purpose of determining representation. That made one-man-one-vote impossible, and the Electoral College necessary. It took almost a century for the compromise to come apart resulting in the Civil War.

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