MVF Special Update

August 6, 2024

To Our Valued Clients:

As you are no doubt aware, there has been a considerable amount of volatility in global investment markets over the past several days. While we endeavor to keep you informed about important market developments on a weekly basis every Friday, we thought that the unusual amount of choppiness, along with some at times (in our opinion) overblown chatter in financial media outlets, merited a special comment a few days ahead of our regular Friday commentary. The key point we want to emphasize here it that yesterday's big pullback, with the S&P 500 declining by 3.0 percent from its close last Friday (and just about 8 percent from its recent July 10 high), had less to do with the state of our economy than some of the stories you may have seen in the news suggest. Yes – last week we did see several pieces of data, culminating with Friday's monthly jobs report, pointing to a slowdown in the economy. That is not necessarily surprising; indeed, the entire goal of the Fed's monetary tightening policy over the past two years has been to cool off the economy enough to bring inflation down to the target rate of 2.0 percent. That goal is nearing its end, and at the most recent Fed monetary policy meeting last week, Fed chairman Jay Powell indicated that the central bank's dual goals of low inflation and a healthy labor market are close to being in balance. The Fed believes – and we concur with their assessment – that reaching its target inflation goal can be achieved without triggering a US economic recession. That view continues to be our base case assumption, though of course we continue to follow the data closely and challenge our thinking on a regular basis.

So what happened in these past couple days of trading? Well, at the same time that the Fed held interest rates steady last week and hinted at a September rate cut, the Bank of Japan raised interest rates. That move prompted a radical jump in the value of the Japanese yen, which rose more than 12 percent against the dollar. Here's why this matters. For a long time, with interest rates in Japan being either zero or in negative territory, international investors have favored a strategy called the "carry trade" in which they borrow money cheaply in yen-denominated securities and then invest in higher returning opportunities elsewhere in the world. When the yen rose by so much in such a short time frame, those carry trades became instantly unprofitable and triggered a major wave of selling. Much of the selling took place among some of the most profitable investments to date in 2024, including the hitherto artificial intelligence sector. As often happens, selling begat more selling. Stocks in Tokyo were down 12 percent on Monday, which was the main catalyst for the sell-off as markets opened in Europe and then the US.

As we write this on late morning Tuesday, market conditions have at least temporarily stabilized. That does not mean that there won't be more volatility in the days ahead, particularly as August tends to be a lighter trading month where thinner volumes can exacerbate market moves. But we see a higher likelihood of this being one of those periodic pullbacks that happens with relative regularity, rather than a more structural and protracted decline like the conditions prevailing in 2022, when the Fed began its tightening policy. We will note that last year, which was overall a very strong year for US stocks, saw two occasions (in March and October) when the S&P 500 fell by more than 5 percent in a concentrated period of selling. On that second occasion, in October last year, the benchmark index fell by more than 10 percent, which is the technical threshold for a "correction" in Wall Street speak.

We will continue to keep you informed as to our thinking in this important period leading to the end of the year. As always, we are available to speak with you in further detail should you have ongoing concerns or questions.

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