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Weekly Market Flash

Any Excuse to Sell

August 2, 2024

Sometimes, bad news is good news. A macroeconomic data point comes out below what was forecast, but all Mr. Market can see is a juicy rate cut on the near horizon. Other times, though, bad news is bad news. And good news is bad news, and so-so news is bad news. We seem to be in one of those times now. Fortunately, perhaps, it is happening in August rather than in the historically trickier months of September and October. Let the market blow off some steam during the dog days of beach reading and low trading volumes, and then head into Labor Day weekend with a clearer perspective. We shall see. In the short term, of course, anything can happen. But so far, at least, we don't see enough evidence to buy into some of the gloomier narratives out there about an impending hard landing for the economy. Let's look at what the latest batch of data are telling us.

The Bad…

Yesterday's bad vibes started with a piece of data called the Manufacturing ISM Report on Business, a survey of sentiment among purchasing and supply executives at over 400 industrial companies. That number came in lower than expected, a contractionary reading of 46.8. At the same time, the weekly report of new unemployment claims showed more filings than had been predicted, 249,000 versus the 235,000 forecast.

The previous day, Wednesday, had also supplied some data reflecting a general cooling of the labor market with a weaker than expected ADP Employment Survey. And for the cherry on top, this morning's jobs report from the Bureau of Labor Statistics, which is the headline data point for labor market conditions, validated those prior reports with a relatively weak payroll gains number of 114,000 (175,000 expected) and a rise in the unemployment rate to 4.3 percent from 4.1 percent last month. A year ago, the unemployment rate was at a 55-year low of 3.5 percent.

…And The Good

But there was one very important piece of data yesterday that seemed to get lost in the midst of all the negativity, and in many ways it was the most important report. Productivity for the second quarter grew by 2.3 percent, more than the 1.8 percent forecast. For the past four quarters, productivity has grown by an average of 2.52 percent, a rate substantially above the 30-year average of 2.05 percent. Why is this important? Because long-term growth comes from only three sources: an increase in the overall population, or an increase in the percentage of the population participating in the labor force, or an increase in productivity.

The population isn't growing by much, and the demographics are ageing, so no help is coming any time soon from either of those. That leaves productivity as the only viable source of long-term growth. The good news is that productivity does seem to be trending up. Amid all the recent hype about artificial intelligence, those optimistic about AI's impact on the economy point to the potential for a sustained boost to productivity. As we noted in our commentary a couple weeks ago, this is by no means a unified viewpoint among those paying close attention to developments in AI. But if we keep seeing better than expected growth in productivity, we may have solid evidence that something is working here.

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A Global Sea of Red

Investors are finding plenty of reasons to not like things happening in other parts of the world, as well. Earlier this week the Bank of Japan raised interest rates by a quarter of a percentage point, to its highest level since the 2008 financial crisis. The BoJ's move came even as recent data show a cooling economy, and the news sent the Japanese stock market into a tailspin. The Nikkei 225 stock index lost about eight percent over the course of Thursday and Friday, and the index is now 15 percent below its recent July 11 high point.

Not much good news has been coming out of China, either, with the country's vast manufacturing sector in contraction for the third straight month, and new home sales falling by more than 19 percent in July. Beijing's economic policy leaders don't seem to have a viable solution for perking things up, at least in the near term, as they remain laser-focused on strategic manufacturing initiatives while paying little attention to the country's moribund household consumer sector. Despite heroic attempts by the so-called "national team" of financial institutions called in periodically to prop up the Chinese stock market, shares remain mired in double-digit losses for the year to date.

And here at home? As things stand right now (and they will no doubt be different one way or the other by the end of the day) the S&P 500 is down around five percent from its recent high. Pullbacks of 5-10 percent are not unusual during a bull market, and it has been more than a year since we last had met the threshold of a technical correction, which is a peak-trough pullback of 10 percent or more. This is hitting most corners of the market, including the recently high-flying small cap sector. The Russell 2000 small cap index is off more than 3.5 percent today as we write this in mid-morning. We will not be unduly surprised to see more volatility in the coming days.

So far, though, this does not look to us like much more than letting off a bit of pressure after a sustained upward trend. And for investors who want to countenance the potential silver lining, there is always that "bad news is good news" refrain to fall back on, with a rate cut looking more and more likely when the Fed meets on September 18.

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