“Dodged A Bullet”

Market Commentary – August 2024

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The advance estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 2.8% in the second quarter of 2024. This is stronger than 1.4% in 2024 Q1. The components of the 2024 Q2 GDP number are: consumer spending +1.57 percentage points, investment +1.46 percentage points, net exports -0.72 percentage point, and government spending +0.53 percentage point. The sum of these numbers equals +2.84%. The investment figure includes +0.82 percentage point for inventory, which is not sustainable (the average inventory measurement from 1994-2024 was +0.07 percentage point). Overall, the U.S. economy is not in recession and is muddling through a fog of political and economic crosscurrents.

Today, the Federal Open Market Committee (FOMC) kept its benchmark federal funds rate at a target range of 5.25% to 5.5%. The Fed has signaled, however, that the next move will be a cut. Futures markets assign a 68% probability of a 0.25% cut at the next FOMC announcement on monetary policy scheduled for September 18, and a 100% probability of a 0.25% cut by the November FOMC meeting. This should begin a series of cuts totaling 1.75% by February 2026, putting the federal funds rate at a range of 3.5% to 3.75%. Meanwhile, the Fed’s balance sheet had $7.205 trillion in assets on July 24, down $26 billion from $7.231 trillion in assets on June 26 (much less than the Fed’s new reduction commitment of $60 billion per month as of June 1). The stock market is eagerly anticipating lower interest rates.

Technical factors of the market are bullish (more demand than supply), while fundamentals are fairly priced – therefore, we are mildly bullish on the market. The Standard & Poor’s forecast for S&P 500 operating earnings per share (EPS) through September 30, 2025 is $268.29, which implies a price-to-earnings (P/E) ratio of 20.6 with the S&P 500 at 5,522. The earnings yield (E/P) of 4.86% represents fair value relative to the 10-year U.S. Treasury note yield of 4.09%. The yield spread is 0.77%. Seven of the eight largest companies in the S&P 500 make up $15.4 trillion of the $48.7 trillion index market capitalization with a weighted P/E of 30.3. If 31.6% of the index has a P/E of 30.3, then 68.4% of the index has a P/E of 16.1 for the overall P/E to be 20.6. A P/E of 16.1 is an E/P of 6.21%, which is attractively priced compared to the 10-year Treasury note yield of 4.09% (a yield spread of 2.12%).

The S&P 500 peaked on July 16 at an all-time high of 5,667 before pulling back in the second half of the month. Starting with July 17, there have been five distribution days (declines on high trading volume), which show that the internals continue to deteriorate. Still, the uptrend since October 2023 remains intact. The index found support at 5,399 (around the 50-day moving average). Moving forward, additional support should be found near 5,250 (March 2024 high), 4,997 (200-day moving average), 4,970 (April 2024 low), 4,800 (January 2022 high), and 4,600 (July 2023 high). There is much more to the stock market than the S&P 500! Value, mid, and small cap stocks finally received some love from market participants over the past few weeks as money flowed out of mega-cap tech stocks. It remains to be seen whether this particular rotation is short or long-lived, but it is favorable for our investment management style.

A massive black swan event was averted when President Trump dodged a bullet in his attempted assassination at a political rally on July 13. In a way, financial markets dodged a bullet, as well. Had President Trump been killed, Wall Street (and Washington D.C.) would have been thrown into turmoil. The stock market would have likely dropped severely and reversed the bullish speculation we have been observing for many months. Consumers and businesses would have likely pulled back from spending and investment projects as they “wait and see” what happens next. This void of spending could have triggered a recession, which would have dominoed into other consequences. Fortunately, none of this happened. While it is impossible to predict which black swan will strike next or when it will strike, we can plan for it by having a balance of stocks and cash in our portfolios. It is great to own stocks in a rising tide, and the cash would help us buy at lower prices should a sale on stocks suddenly present itself.