Monday, July 8, 2024

SUMMARY-

I. Stocks make new highs with help from big tech names and cooling economic data.

II. Services joins manufacturing in mild contraction mode.

III. Labor markets continue to support disinflation.

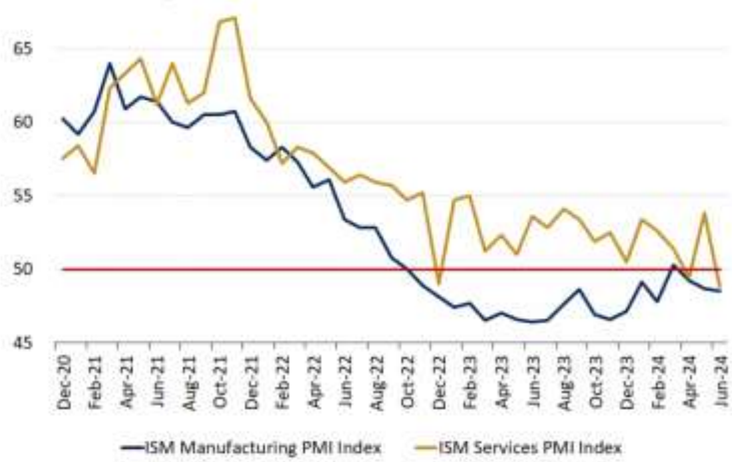
IV. Inflation report, Powell testimony, and earnings kickoff on deck this week.

Good morning:

Thanks to help from a few of mega-cap Magnificent 7 tech stocks, the NASDAQ and the S&P 500 pushed their record levels higher again in last week's holiday-shortened trading, posting weekly total returns of 3.5% and 2.0%, respectively. For the NASDAQ, it was the tenth positive week out of the past eleven. Meanwhile, the Dow gained 0.7% and remained 1.6% below its record set in mid-May. Market strategists continued to find support for an improving inflationary outlook in several new economic reports which may have sparked some of the buying. Cooling data from both the manufacturing and services sectors, as well as the labor market prompted bond yields to decline and bolstered hopes for Fed rate cuts later this year.

Two key leading indicators of U.S. economic growth are the ISM (Institute of Supply Management) monthly reports on the manufacturing and services sectors. For June, both readings came in below 50, indicating contraction in the manufacturing and non-manufacturing economies. Keep in mind, the U.S. manufacturing sector has been weak for some time, with the ISM manufacturing index in contraction for 19 of the last 20 months. While U.S. consumers had initially spent more on goods during and following the pandemic, households have since shifted their spending to services, including travel, dining, and entertainment. After 17 of the past 20 months had shown expansion in the services data, two of the past three months have now shown contraction. This may be due to a combination of normalizing spending patterns, depleted excess savings, along with households feeling the pinch of recent high inflation. With U.S. services accounting for over 70% of gross domestic product (GDP), such a slowdown would likely bring the overall GDP to below-trend levels of 1.5 - 2.0%. As this is still a positive growth rate, it could confirm the soft-landing narrative and be a welcome result for domestic equity and fixed income markets.

The ISM Manufacturing and Services Indexes have been softening and fell into contraction last month



Source: Bloomberg

Similarly, the U.S. labor market is showing early signs of cooling from a position of recent relative strength. June's gain of 206,000 jobs exceeded economists' consensus forecast for around 190,000, but a rise in unemployment to 4.1% left the jobless rate at the highest level since November 2021. Moreover, April's and May's initially reported jobs growth figures were revised downward by a total of 111,000, adding to the recent data indicating a modest slowdown in jobs growth. Clearly, the supply and demand dynamics of the labor market now seem to be more in balanced. Labor supply has improved since the pandemic as workers return to the labor force, as seen in the rising labor force participation trends. The surge in immigration has also been a steady source of supply in the labor market in recent years. Meanwhile, the demand for labor has moderated, with companies pulling back job openings across many sectors. As a result, we have seen unemployment rates grind higher while wage growth figures have slowed. This gradual softening is the outcome that would be most favored by the Fed and markets as it points to a labor market that has cooled but not collapsed. An easing labor market implies consumption may soften which supports lower inflationary pressures.

Better supply and demand in U.S. labor market: Participation rates have climbed higher, while job openings have moved lower

Source: Bloomberg

With job growth slowing, investors will be closely watching the release of June's Consumer Price Index (CPI) on Thursday. This follows two days of testimony this week from Fed Chair Powell before the Senate Banking Committee on Tuesday and the House Financial Services Committee on Wednesday. However, the earliest market expectations for an initial rate cut are currently in September. As usual, economists will be paying close attention to Powell's exact words and phrasing for any hints of a change in Fed policy or tactics. Markets have been known to react abruptly to such comments causing traders to also tune in and be ready.

This week also marks the start of Q2 earnings season. Like always, some of the nation’s largest banks will be reporting their results this week, along with several other key blue-chip consumer staples and industrial names. Any signs of improving fundamentals and bullish outlook in these reports could spark renewed interest in value stocks as many investors and portfolio managers attempt to find bargains within a market dominated recently by AI-fueled mega-cap tech enthusiasm. As we continue to suggest, a broadening out of equity sector participation is both healthy and long overdue.

Have a great week and enjoy some beautiful summer weather!

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