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Situation analysis

August 2, 2024

Our views on the global market selloff

Key takeaways

- Disappointing job market growth depressed equity markets and pushed down interest rates today. The technology-heavy NASDAQ 100 Index entered correction territory, while the two-year U.S. Treasury yield fell to its lowest level in more than a year.
- Despite the softer job market, the economic data remains constructive; hiring continues, consumer spending is solid and inflation is slowing.
- We maintain a glass-half full view on markets reflecting solid corporate earnings trends and the likely start to Federal Reserve interest rate cuts in September, which support a broadening in equity market gains.

Investors anticipate that after a full year of interest rates at close to 5.5%, the Federal Reserve (Fed) will lower its interest rate target in September. Following Wednesday's Federal Reserve Open Market Committee meeting conclusion, investors are particularly attuned to economic data. Fed Chair Jerome Powell said the committee is watching both inflation and the labor market to confirm the Fed's interest rate policy intent, a shift from its primary focus on high inflation in recent quarters.

Today's disappointing July jobs data spurred concerns that the decelerating, but still satisfactory, labor market may deteriorate further and harm consumer spending, which has been the engine for economic and corporate earnings growth. These fears pressured equity markets and increased odds of a 0.5% interest rate target cut (a potential departure from the Fed's typical 0.25% incremental adjustment tendency) in September and investor anticipation of the target rate dropping by 0.75-1.00% by year end. This brought the two-year U.S. Treasury yield to below 4% for the first time since May 2023 and the 10-year U.S. Treasury yield back to its 2024 lows. The equity market selloff has yet to reach correction territory (commonly defined a more than 10% below recent peaks) for the S&P 500 or the small company Russell 2000 Index, although the volatile and technology-heavy NASDAQ 100 Index is down more than10% from its July 10 all-time high.

Investors fear the Federal Reserve is "behind the curve" for interest rate cuts, meaning they have waited too long to ease policy, and a more pronounced economic slowdown may be close at hand. Some companies cannot sustain the pace of capital spending required to support business investment plans including the artificial intelligence revolution. Our view is the recent equity market volatility is a more normal reset in valuations, though we must continue to evaluate incoming economic data and interest rate expectations. Our optimistic view centers on buoyant S&P 500 second quarter earnings growth, companies delivering on full-year 2024 earnings, the slowing but still-positive labor market environment and healthy consumer spending.

While the Fed anticipates some economic weakness, investors are concerned the slowdown may be more widespread than desired. We would highlight two key contemporary variables as focal points for investors: Jobs and consumer spending.

- The July jobs report saw just 114,000 new jobs added to payrolls, representing the second-lowest monthly increase of 2024. The unemployment rate ticked up to 4.3% as the labor force grew by more than 400,000 individuals. Slower year-over-year average hourly earnings growth, up just 3.6% from 3.9% in June, is a constructive sign on dissipating inflation. While weaker momentum can breed concern, payrolls are still gained an average of 202,000 per month in

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2024. Lastly, the growth in unemployment is consistent with new labor force entrants, typically a positive sign for the labor market.

- We are closely monitoring consumer spending, the lynchpin for overall economic activity. June personal consumption expenditures rose 5.2% over the past year, contributing to the economy's 5.8% nominal growth. The 3.4% savings rate from the June personal income report is back to the lowest level since 2022, indicating many consumers are likely taking on credit or dipping into savings accounts to maintain current consumption. Our proprietary consumer strength ranking highlights the migration from abnormally robust aggregate consumer health to a more normal backdrop. Consumer borrowing has stalled, while inflation-adjusted savings has returned to pre-COVID trend, increasing the reliance upon the job market and incomes to retain current spending levels.

Consumer strength rankings (10 = strongest)

	2019				*2020*				*2021*				*2022*				*2023*				*2024*		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Last
Labor market	7	6	7	6	2	1	2	3	3	7	8	10	10	9	9	9	9	9	8	8	8	6	**6**
Income	8	6	6	4	5	10	9	9	9	4	5	5	3	3	4	4	7	8	7	6	5	5	**5**
Borrowing	5	5	5	6	5	1	0	0	0	4	6	7	9	9	9	8	7	6	5	4	3	2	**1**
Spending	4	4	6	8	2	1	3	4	10	10	9	10	8	6	6	5	3	2	5	7	5	6	**5**
Delinquencies	6	7	6	5	5	9	9	9	9	10	10	10	10	9	9	8	7	6	5	4	4	4	**4**
Average	**6**	**6**	**6**	**6**	**4**	**4**	**5**	**5**	**6**	**7**	**8**	**8**	**8**	**7**	**7**	**7**	**7**	**6**	**6**	**6**	**5**	**5**	**4**

Scores reflect a 1 to 10 ranking of proprietary blends of indicators (10 = strongest).
Sources: U.S. Bank Asset Management Group analysis, Bloomberg data. Data period: July 31, 2004-July 31, 2024.

While the data bears watching, the overall trends remain constructive. Job openings still far outpace the number of unemployed, indicating strong labor demand from companies. Incomes and spending remain elevated and inflation data is slowing.

Equity markets primarily rely on positive earnings and earnings expectations to drive forward returns. We are nearly three-fourths of the way through second quarter earnings reports for large companies as measured by the S&P 500. According to Bloomberg, company reports indicate sales rising 4.9% and earnings gaining 11.3%. These results are slightly ahead of pre-reporting season expectations for 4.4% and 8.6% growth for sales and earnings, respectively. Investor attention this week turned to somewhat disappointing forward growth projections from key artificial intelligence companies, including Microsoft and Alphabet. These concerns also hit much of the Technology sector, pushing the technology-heavy NASDAQ 100 Index into correction territory, typically defined as a decline of more than 10%. However, we note investor expectations for S&P 500 earnings for the full year of 2024 remain stable and constructive at $243 per share, up 10% over 2023. While some companies are struggling, most sectors are still growing. Bloomberg reports seven of 11 S&P 500 sectors posted positive earnings growth in the quarter. The potential for Federal Reserve interest rate cuts is also a positive factor for a broadening in company earnings performance as debt financing becomes cheaper for many companies.

Today's jobs report was certainly disconcerting for investors as they adjusted Fed rate cut expectations and sought shelter in bonds at the expense of equities and other traditionally riskier asset classes. While we must remain attentive to the impacts of elevated interest rates on consumer and corporate behavior, recent trends remain constructive. We maintain our glass-half full view on markets on solid earnings trends and prospects for Fed rate cuts starting in September. The equity market trend likely broadens from the Technology and Communication Services sectors from the first half of the year to other sectors of the market that benefit from the growth in earnings amid this modest economic expansion. We continue to closely evaluate incoming economic data for signs or concerns of consumer hiccups, especially weekly jobless claims data and retail sales, as we head into the back-to-school spending season. We will keep you informed of our views as incremental data becomes available and as we update our assessment of market conditions.

As always, we value your trust and are here to help in any way we can. Please do not hesitate to let us know if we can help address your unique financial situation or be of assistance.

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