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STRATEGAS insight

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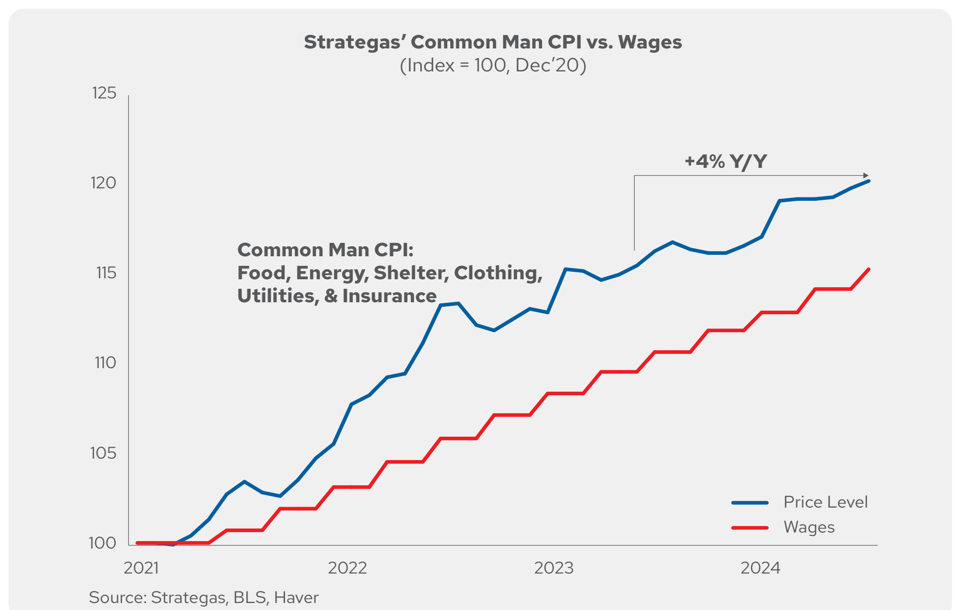
Corrections Happen. What's Next?

July was an eventful month. From the start, August appears it could be even more so. The collision of political, economic and, ultimately, market volatility has raised serious concerns among investors on the integrity of the bull market. Should we be so worried? And, if so, about what?

On the political front, the last month has brought both clarity (Harris/Walz or Trump/Vance) and uncertainty (from Trump +3 to Even or Harris +1). We'll leave the political prognosticating to the experts but to draw any conclusion from President Biden's departure from the race and Kamala Harris' nomination is that the Election is shaping up to be a choice between two candidates – as opposed to a referendum on the incumbent. This favors the Vice President (as evidenced in recent polling). Trump's challenge will be to shift voters' focus back to the impact of the Administration's policy outcomes through the lens of the economy and national security, i.e., softer labor and consumer data, escalating tensions in the Middle East and drawing renewed focus on the crisis at the U.S. southern border. Regardless of one's political views, it could be argued that both candidates have their weaknesses as candidates. We anticipate the race to be tight through Election Day and – *brutally* – the object of endless focus. If there is one action item for investors it is draft the playbook for either outcome. To date, however, the vice president has not distanced herself in a substantive way from platform Biden was running on (though it has been intimated that the campaign may push, or pull, on key themes around Labor Day to make the agenda more her own). For now, while the dynamics of the race have changed the investment implications have not.

Following several years of OK-to-strong (not gangbusters) economic growth, we have taken note in recent months of emerging pockets of weakness – manufacturing, jobs, etc. The economy has certainly been robust enough to provide the Fed "cover" to maintain their "higher-for-longer" approach to monetary policy. Remember, at the start of the year, the market was pricing in as many as six rate cuts from the Fed. Rather, Chair Powell stood tall in the pocket and took a wait-and-see approach while still-elevated levels of inflation remained too far above the Committee's (unachievable?) 2% target. Case in point: Strategas

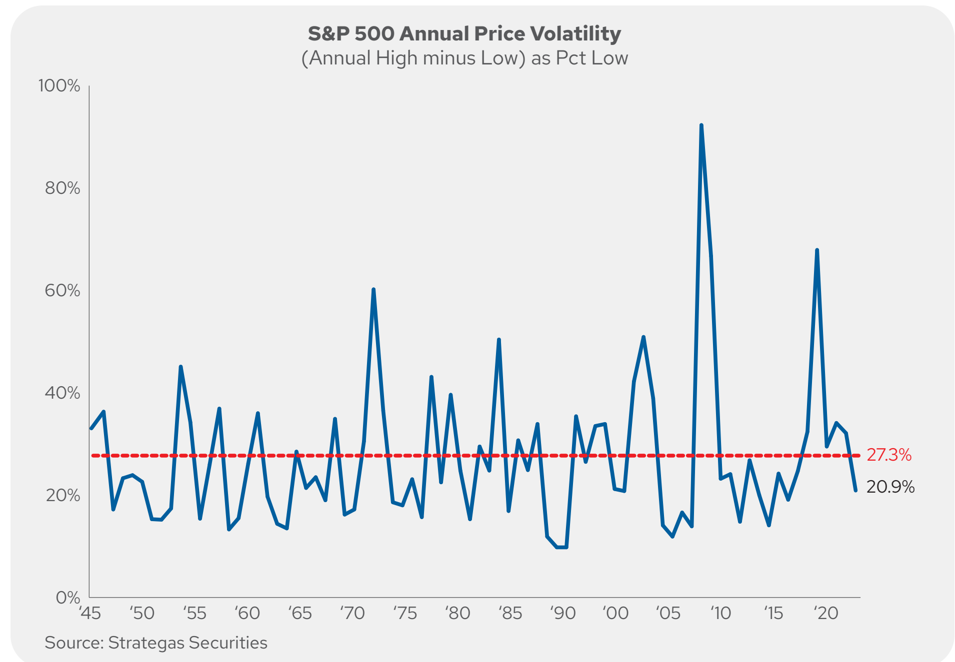


"Common Man" CPI, a subset of the headline basket, which focusses on have-to-have staples, e.g., food, energy, shelter, clothing, etc., is up +4% Y/Y, +100 bps above the BLS headline CPI (+3% Y/Y) and +70 bps above the "Core" ex. Food and Energy (+3.3% Y/Y). This suggests inflationary pressures remain tough on households.

Softer data on the labor front will dampen any extant economic currents. As Strategas chief economist Don Rissmiller has noted, we had been expecting Fed rate cuts to resemble previous mid-cycle adjustments – *as opposed to pre-recession/panic cuts*. That remains our base case. The Bank of Japan's decision to hike rates has put pressure on the "carry trade," which has stoked market volatility globally. This certainly has the potential to spill back to the U.S. economy, but we would need to see further evidence that this is impacting the real economy, e.g., weakening payrolls, blowout claims, widening spreads, etc., before calling on the Fed to make an emergency rate cut. To put some context around credit levels, high yield spreads roughly +400 bps; ~125 bps below what we consider fair value in the current environment but ~300 bps below the start of recession. Moreover, the Atlanta Fed GDPNow estimate for 2Q growth remains at 2.9% (and was revised higher from July).

All of this activity on the political, geopolitical, and economic front has conspired to stoke a volatile start to the month. So much so that investors of all stripes have been setting off alarm bells that the bull market has found its end. We're not so sure.

Investors should consider that we have been in a period of unprecedented policy accommodation. Despite our intensity for identifying organic drivers of growth, the economy and the market have not needed them. Be sure, 13 years of largely uninterrupted QE was the exception rather than the rule. So too, we believe, will be the relative calm in the markets enjoyed during that time. Moreover, the normalization of monetary policy (fiscal policy remains broadly accommodative) was not likely to occur without reversion to the historical market patterns associated with a neutral – even restrictive – policy backdrop, i.e., volatility. As Strategas' chief investment strategist Jason Trennert recently wrote, "using an 'English major's' measure of volatility – the market's high minus the low as a percentage of the low –that the S&P trades, on average, in a ~27% range in any given year. Thus far in 2024, the market has traded in a ~17% range, suggesting further market gyrations are to be expected even in the best of times. Increasing political tensions both here and abroad only heighten those odds." While much is made of the "cost" to investors of missing the best days in the market it should be noted that missing the worst days aids a great deal in performance as well. Since there have historically been more up days than down days since 1928, fortune tends to favor staying invested but not as much as one might think. (52.4% up, 46.4% down, 1.2% unchanged.)



Source: Strategas Securities

The severity of geo-political dynamics in the company of pronounced macro dislocation, reminds us of the importance of marrying long-term financial planning with the flexibility to adjust course as needed.

With expectations for both GDP and earnings robust in 2H'24 and long rates lower, we are hesitant to get too bearish despite the recent rise in volatility. While further market declines in the short-term seem likely, in the intermediate-term, we believe investors should be careful about fading the combined impact of further fiscal and regulatory stimulus ahead of the Election and the Fed rate cuts. By our lights, this remains a correction in a broader uptrend. We remain overweight Equities in our tactical allocation portfolios, though it is prudent to reduce exposure to international markets given the epicenter of the sell-off.

About Strategas

Strategas is a global institutional brokerage and advisory firm. The Firm provides macro research, capital market and corporate advisory services, and investment management solutions to institutional investors and corporate executives in more than twenty countries around the world.

Founded in 2006 by Jason DeSena Trennert, Nicholas Bohnsack, and Don Rissmiller, the Firm was acquired by Baird Financial Group in 2018. Strategas operates independently as a wholly-owned subsidiary of Baird and offers institutional securities services through Strategas Securities, LLC, a broker-dealer, and investment management solutions, including this commentary, through Strategas Asset Management, LLC, a registered investment advisor.

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Index Overview & Key Definitions

Fed, The Fed or FED refers to the Federal Reserve System, the central bank of the United States. Fed Funds Rate, the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The Gross Domestic Product (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. Real Gross Domestic Product (GDP) is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy in a given year. Nominal Gross Domestic Product is gross domestic product (GDP) evaluated at current market prices. The S&P 500 Index is an unmanaged index comprised of 500 widely held securities considered to be representative of the stock market in general. The Russell 1000 Index is a market capitalization weighted benchmark index made up of the 1000 largest U.S. companies in the Russell 3000 Index. The Russell 2000 Index is an unmanaged index considered representative of small-cap stocks. The PCE (Personal Consumption Expenditure) Index of Prices is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data including U.S. Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures; essentially a measure of goods and services targeted towards individuals and consumed by individuals. The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services. FAANG is an acronym for the five of the market's most popular tech stocks, namely Facebook, Apple, Amazon, Netflix and Alphabet's Google. The North American Free Trade Agreement (NAFTA) is an agreement signed by Canada, Mexico, and the United States, creating a trilateral trade bloc in North America. The Seasonally Adjusted Annual Rate (SAAR) is a rate that is adjusted to take into account typical seasonal fluctuations in data and is expressed as an annual total. SAARs are used for data affected by seasonality, when it could be misleading to directly compare different times of the year. The Atlanta Fed GDPNow forecasting model provides a "nowcast" of the official estimate prior to its release by estimating GDP growth using a methodology similar to the one used by the U.S. Bureau of Economic Analysis. GDPNow is not an official forecast of the Atlanta Fed. Rather, it is best viewed as a running estimate of real GDP growth based on available data for the current measured quarter.

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