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ARGUS ECONOMIC COMMENTARY

September 23, 2024

Rates Begin to Come Down

July, August, and September all featured some rough patches for stocks, and yet the S&P 500 is flirting with all-time highs. The stock market is nowhere near a consensus, as some investors fear the sky (recession) is falling while others are happy that the four-year wait for a Fed rate cut is finally over. Bulls argue that a broadly diversified market appears well-positioned to carry year-to-date gains into year-end. Bears counter that diversification historically has not worked in a falling market (think 2008). What to make of it all?

Into this uncertain environment comes the presidential election along with control of the House and Senate. The stock market often has its worst year of the four-year cycle in the actual election year, yet 2024 is a better-than-average year, so far. With the election too close to call, investors are rolling into fall 2024 hopeful but apprehensive.

The "Three Es" as the New Hierarchy

Throughout 2023, we reduced the stock market's challenges to a pair of vowels. Basically, the "three Es" -- the economy, employment, and earnings -- were seeking to offset the negative effects of the "two Is" -- inflation and interest rates. In 2023, earnings were the laggard, employment was surging, and the economy was uneven. Meanwhile, inflation and interest rates were familiar but weakening foes in 2023. How are our battling vowels faring in 2024?

In fall 2024, the jobs economy is plainly cooling. August nonfarm payrolls were much worse than expected and, along with prior-month revisions, paint a weakening jobs-demand environment into 2025. Revisions announced in August 2024 suggested that monthly data had overstated prior-year jobs creation by over 800,000.

At the same time, unemployment remains subdued at 4.2%. Weekly jobless claims are in the 225,000 area, off from the 200K range a year ago but not at the 300K level that would trigger recession alarm bells. Wage growth is slowing, which is helping reduce the annual change in inflation while keeping workers' wages running ahead of higher prices.

Earnings, by contrast, are growing. S&P 500 earnings from continuing operations, which comprise the earnings of companies making up about 85% of U.S. market capitalization, rose in high-single to low-double digit percentages for 2Q24 earnings season. That was the best earnings growth in nine quarters and the fourth straight quarter of year-over-year EPS growth.

Revenues rose in mid-single-digits in 2Q24, which we think mainly reflects a "normal" supply chain -- not the shortage crisis of 2022, nor the over-supply glut of 2023. About four-fifths of companies beat EPS expectations, better than the 10-year average; and the magnitude of that beat was also above average. Two sectors -- Materials and Energy -- disproportionately weighed on earnings as both faced tough comps and slack demand. Comparisons get easier going forward and demand looks better for these sectors, contributing to our confidence that second-half 2024 EPS will grow in low-double-digits year over year. We continue to forecast low-double-digit EPS growth for all of 2024, followed by high-single-digit growth in 2025. That could easily turn into double-digits if rate cuts are stimulative, as investors are hoping they will be.

Among the "Es," the economy has been the Steady Eddie in this environment. GDP did slip to 1.4% in 1Q24 as the consumer experienced a post-holiday spending hangover. But GDP rebounded to 3.0% in 2Q24, reflecting nearly across-the-board strength. Personal consumption expenditures rose by 2.9%, doubling the 1Q24 performance. Strength was broad-based across durable and non-durable goods as well as consumer services.

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Non-residential fixed investment, a proxy for corporate capital spending, rose 4.6% in 2Q24, consistent with 4.4% growth in 1Q24 and growth in the 4.5%-5.2% range across 2023 and 2022. Companies continue to invest in the future, perhaps anxious to avoid being left behind in the age of generative AI. Government spending also has been a consistent low-level contributor to GDP, rising about 2.3% in 1H24.

The one ongoing laggard in the GDP accounts continues to be housing. Although mortgage rates have come down from 2023 peaks, they remain well above the rates prevailing from 2020 through most of 2022. A majority of mortgages are below 4%; and many homes owned by boomers no longer carry mortgages. Until interest and mortgage rates come down to something like that magic 4%-5% level, industry watchers fear that housing is frozen.

A chart of home ownership since 1960 compiled by the St. Louis Fed show that ownership usually runs between 64% and 66% of households in the U.S., with some outlier periods. Between 1960 and 1995, home ownership was remarkably steady as the level never exceeded 66% and never fell below 63%. According to Argus Fixed Income Strategist Keven Heal, U.S. government efforts to encourage more people to own homes pushed ownership higher beginning in the mid-1990s. Home ownership peaked above 69% in the 2005-07 period -- right before the sub-prime crisis that triggered the housing collapse and the Great Recession.

Home ownership fell below 63% in the mid-2010s, spiked to 68% in the pandemic year of 2020 (as Millennials migrated to the suburbs), and currently sits near the long-term average at 65.5%. Millennials who do not yet own homes would love to see housing prices come down, but the two-thirds of Americans who own their homes are a powerful buffer against lower prices.

The "Two Is" On the Run

Returning to our other vowels, inflation is in retreat, allowing the U.S. Federal Reserve to start its long-awaited rate-cutting cycle. On 9/18/24 at 2 PM, the Federal Open Market Committee (FOMC) announced that it was cutting central tendency in the fed funds rate by 50 basis points. The rate cut was perhaps the most anticipated in history. In decades past, Fed rate cuts were noted only by economists, and consumers were oblivious. In our media age, even TikTok influencers weighed in the Fed move, and consumers likely grew a little more optimistic about buying that pickup truck, boat, or new house.

The Fed felt free to pivot to accommodative from restrictive monetary policy thanks to its success in bringing down inflation. The Fed's most closely watched inflation gauge is the annual change in the core PCE price index. For August, core PCE prices rose 2.6% year over year, one tick better than consensus and in line with the revised July price change. CPI data reported earlier in the month further confirmed that inflation continued to moderate year over year, both on an all-items and core basis.

Speaking at the Jackson Hole Economic Symposium in August, Fed Chairman Powell signaled that the Fed has shifted its concern from inflation to the potential for a broad softening in the economy. We are thus not surprised that the Fed elected to cut rates before the U.S. economy had returned to its 2% inflation target. In this case, close enough was good enough.

Conclusion

The stock market had some very jittery phases in July, August, and September. The election is looming, there has been a second attempt on former President Trump's life, and polls suggest an election outcome that is too close to call. For those and other reasons, the VIX volatility index remains elevated.

This measure of market volatility currently is in the upper-teens range, closing on 9/17/24 at 17.61. The VIX briefly spiked to the mid- 30s in August following a weak July jobs report. Keep in mind that this fear and volatility gauge spent nearly all of the late-2020 through mid-2024 period below 12.

Recession fears also are likely contributing to the VIX spike. But one key "recession indicator" appears to be unwinding. The two-year Treasury yield climbed above the 10-year yield in April 2022. Economists and strategists have long argued that this inversion signals an economy out of joint, as rational investors should not be willing to accept lower returns on longer-term fixed-income investments than on shorter-term investments.

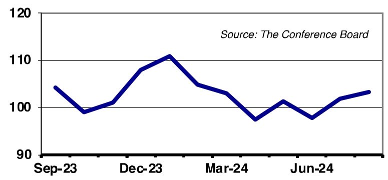
The financial press, citing precedence, was filled with warnings that recession was imminent -- in 2023. The more than two-year inversion in the twos-10s spread finally broke in August 2024. As of mid-September, the two-year yield was at 3.56%, and the 10-year yield was at 3.65%.

We do not expect the yield to "re-invert" now that the Fed has started its rate-cutting cycle. Amid election uncertainty and recession fears, bulls have one mantra: the era of Fed rate cuts has begun.

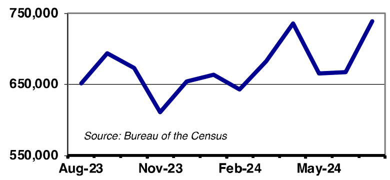
Jim Kelleher, CFA,
Director of Research

ECONOMIC TRADING CALENDAR

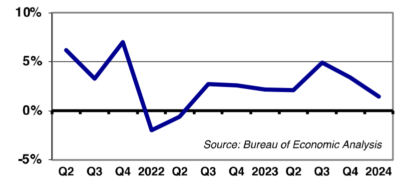
Release: **Consumer Confidence**
Date: 9/24/2024
Month: September
Previous Report: 103.3
Argus Estimate: 104.0
Street Estimate: 102.7



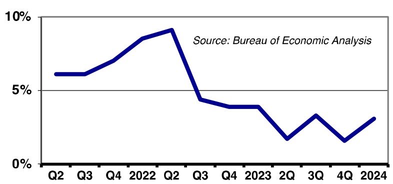
Release: **New Home Sales**
Date: 9/25/2024
Month: August
Previous Report: 739000
Argus Estimate: 650000
Street Estimate: 698000



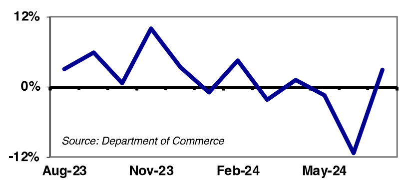
Release: **GDP Annualized QoQ**
Date: 9/26/2024
Month: 2Q
Previous Report: 3.0%
Argus Estimate: 3.0%
Street Estimate: 2.9%



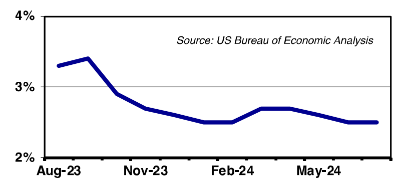
Release: **GDP Price Index**
Date: 9/26/2024
Month: 2Q
Previous Report: 2.5%
Argus Estimate: 2.5%
Street Estimate: 2.5%



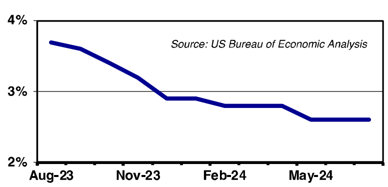
Release: **Durable Goods Orders**
Date: 9/26/2024
Month: August
Previous Report: 2.9%
Argus Estimate: -4.0%
Street Estimate: NA



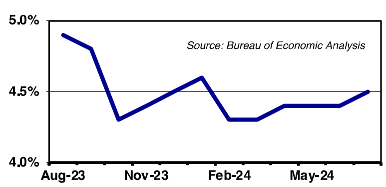
Release: **PCE Deflator**
Date: 9/27/2024
Month: August
Previous Report: 2.5%
Argus Estimate: 2.3%
Street Estimate: 2.3%



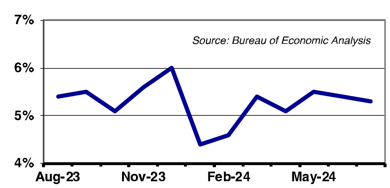
Release: **PCE Core Deflator**
Date: 9/27/2024
Month: August
Previous Report: 2.6%
Argus Estimate: 2.8%
Street Estimate: 2.7%



Release: **Personal Income**
Date: 9/27/2024
Month: August
Previous Report: 4.5%
Argus Estimate: 4.4%
Street Estimate: NA



Release: **Personal Spending**
Date: 9/27/2024
Month: August
Previous Report: 5.3%
Argus Estimate: 5.2%
Street Estimate: NA



Previous Week's Releases and Next Week's Releases on next page.

Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
17-Sep	Industrial Production	August	**-0.7%**	0.2%	NA	**0.0%**
	Capacity Utilization	August	**77.4%**	77.6%	77.9%	**78.0%**
	Retail Sales	August	**2.9%**	2.4%	NA	**2.1%**
	Retail Sales ex-autos	August	3.1%	2.6%	NA	**2.3%**
	Business Inventories	July	**2.0%**	2.4%	NA	**2.5%**
18-Sep	Housing Starts	August	1,238K	1,300K	1,310K	NA
19-Sep	Leading Index	August	-0.6%	-0.4%	-0.3%	NA
	Existing Home Sales	August	3.95 Mln.	4.05 Mln.	3.97 Mln.	NA

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
1-Oct	ISM Manufacturing	September	47.2	NA	NA	NA
	ISM New Orders	September	44.6	NA	NA	NA
	Construction Spending	August	6.7%	NA	NA	NA
3-Oct	ISM Services Index	September	51.5	NA	NA	NA
	Factory Orders	August	2.2%	NA	NA	NA
6-Sep	Nonfarm Payrolls	September	142 K	NA	NA	NA
	Unemployment Rate	September	4.2%	NA	NA	NA
	Average Weekly Hours	September	34.3	NA	NA	NA
	Average Hourly Earnings	September	3.8%	NA	NA	NA
	Total Vehicle Sales	September	15.13 mln.	NA	NA	NA

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