➢ Market and Economic Update – August 2024

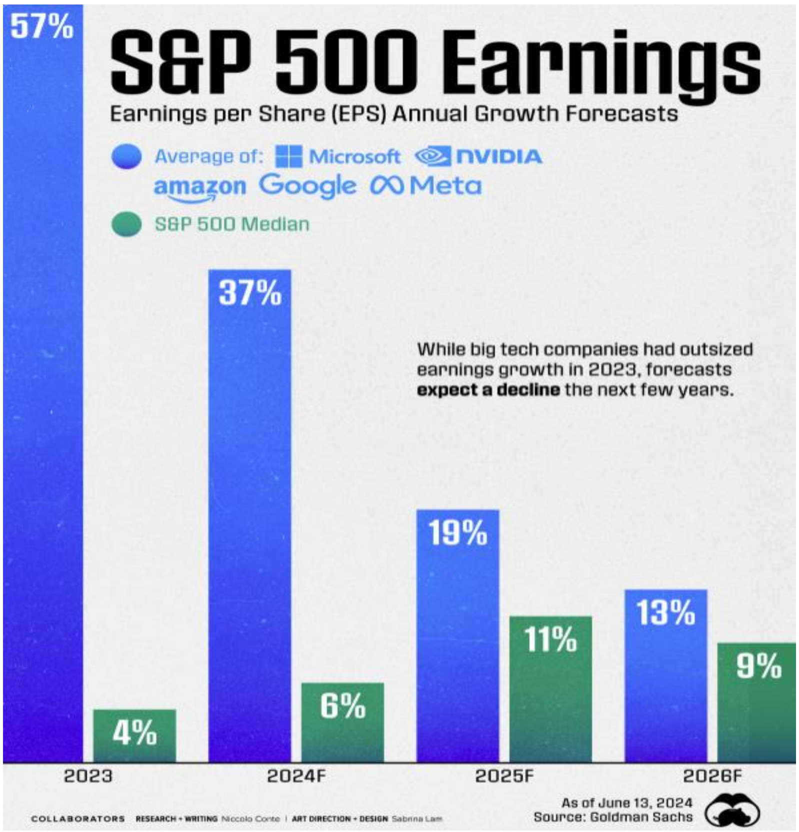
Peter Flannery CFP, FA

"People calculate too much and think too little."

-Charlie Munger

The Markets

Earnings, projections, trading prices



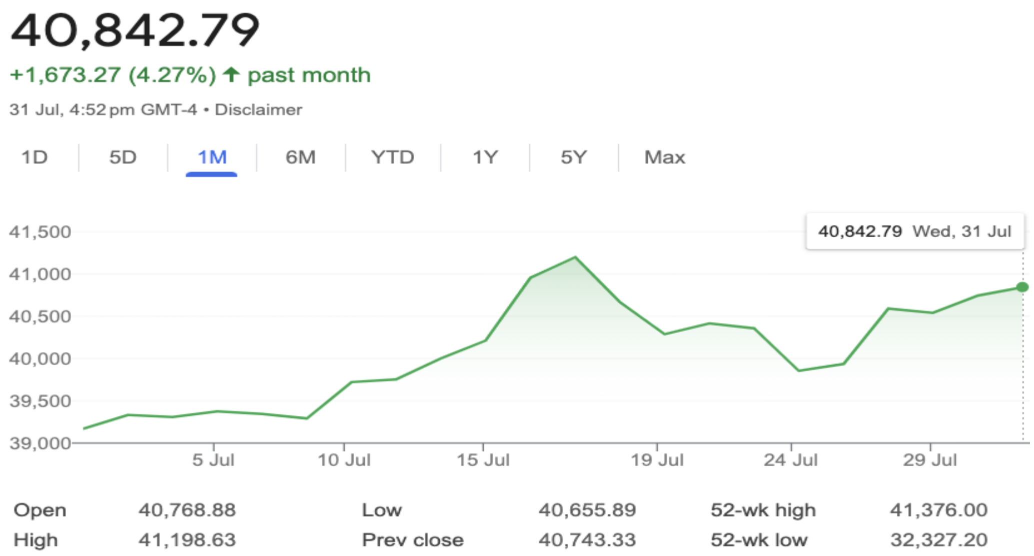
The graph above shows earnings per share growth rate projections, comparing the main large tech companies with the rest of the market.

Projections are only projections. Still, we can see EPS growth slowing from huge growth to good growth for the large tech companies. The EPS growth projections for the broader S&P 500 are improving from low to OK/good.

The point I am getting to is that we want to invest in businesses that grow long term, not just popular stocks that have fast rising but potentially unsustainable trading prices. Not always easy. Quality businesses that show future long term earnings reliability are less easy to identify but are key to long term investment success.

Note: This market update was written before the recent market correction. However, we have left the content unchanged as it highlights the importance of focusing on long-term growth and quality investments, regardless of short-term market fluctuations.

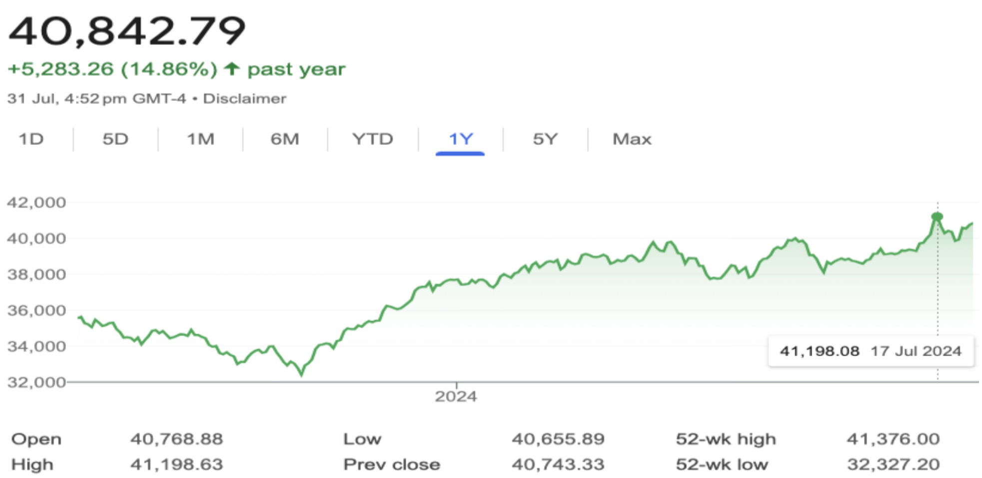
The US Share Market Over July 2024



The above graph tracks the movement in the Dow Jones Industrial Index over July 2024

Markets are up, enjoying the surge in popularity of chip manufacturing companies and AI. Hopefully, improving business fundamentals will spread more widely across other sectors and other businesses.

The US Share Market August 2023 – July 2024



The above graph tracks the movement in the Dow Jones over the last 12 month's, showing another all-time high reached July 17, 2024.

The volatility over July 2024.
This was how it went for the seventh month of 2024:

- The Dow Jones finished the month + 4.27%
- The S&P500 by + 0.86%
- The Nasdaq by - 1.57%

The upside volatility over June 2024.
This was how it went for the sixth month of 2024:

- The Dow Jones finished the month + 1.97%
- The S&P500 by + 4.27%
- The Nasdaq by + 7.13%

The upside volatility over May 2024.
This was how it went for the fifth month of 2024:

- The Dow Jones finished the month + 0.78%
- The S&P500 by + 3.97%
- The Nasdaq by + 6.89%

The downside volatility over April 2024.
This was how it went for the fourth month of 2024:

- The Dow Jones finished the month –3.23%
- The S&P500 by –3.60%
- The Nasdaq by –3.91%

The upside volatility over March 2024.
The third month of 2024:

- The Dow Jones finished the month + 2.08**%**
- The S&P500 by + 3.10%
- The Nasdaq by + 1.79%

The upside volatility over February 2024.
This was how it went for the second month of 2024:

- The Dow Jones finished the month + 1.84**%**
- The S&P by + 3.93%
- The Nasdaq by + 4.34%

The upside volatility over January 2024.
This was how it went for the first month of 2024:

- The Dow Jones finished the month + 1.22**%**
- The S&P by + 1.59%
- The Nasdaq by + 1.20%

The upside volatility over December 2023.
This was how it was for the last month of 2023:

- The Dow Jones finished the month + 3.98**%**
- The S&P by + 4.40%
- The Nasdaq by + 5.90%

The upside volatility over November.
Here is what happened:

- The Dow Jones finished the month + 6.30**%**
- The S&P by + 5.24%
- The Nasdaq by + 5.82%

The downside volatility over October.
Went like this:

- The Dow Jones finished the month down -1.14**%**
- The S&P by -2.21%
- The Nasdaq by -3.43%

The downside volatility over September.
Here is how it went:

- The Dow Jones finished the month down -3.5**%**
- The S&P by -4.9%
- The Nasdaq by -5.8%

From the peak of 35,630 on August 01, 2023, The Dow Jones Industrial Index declined to 32,417 by the end of October 2023. The Dow Jones currently sits at 40,842 as of August 01, 2024.

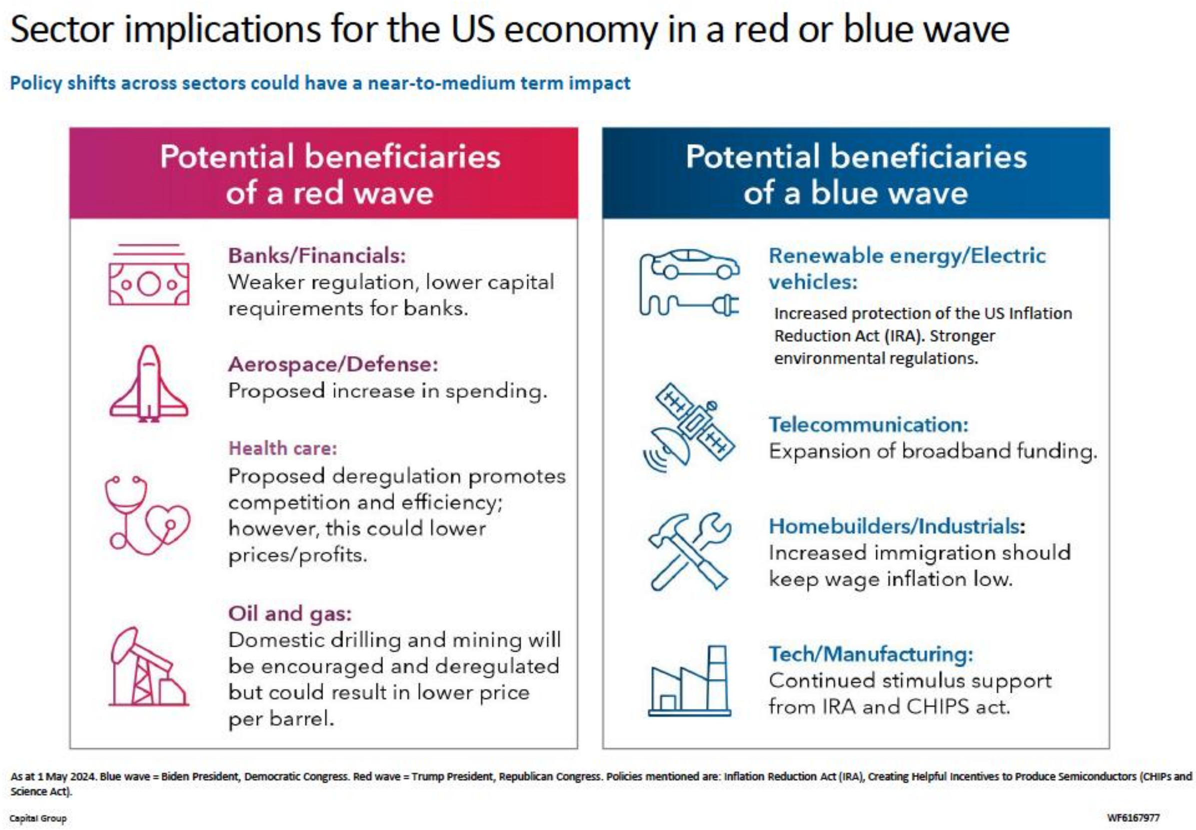
US presidential elections

The outlook for (US) company earnings generally (as per the above graph at the start) looks good. The general market and economic narrative though might sound less encouraging (e.g. middle east conflict, elevated inflation and interest rates, geopolitical tensions …).

Then there is … Donald Trump, US elections and the potential implications.

If you google Donald, what is a common name that comes up?

DUCK 😉



The above table provides a simple snapshot of some possible impacts if either party wins.

There is the potential for considerable disruption over the coming months.

I believe we can relax though.

The evidence from the past suggests short term volatility around election time is temporary.

Whilst the markets are typically slow to grow in the year following elections, the remaining three years show good returns for investors, regardless of which political party wins.

Donald Trump can have an impact as president, but he is not the system. The system is bigger than Donald Trump.

We are invested across a number of quality businesses. They will ride through turbulent markets. That means our capital is secure.

Further, last time I checked, lower trading prices can mean better buying for longer term gain.

Despite what you see and read across the popular media; it is not all bad. Quality businesses continue to grow, regardless of short term 'noise' and volatility.

Interest rate cuts (US)

In the most recent update from Jerome Powell, an interest rate cut in September looks increasingly likely. The market has already built it into trading pricing. A disappointment would see markets drop – a buying opportunity for us.

Meantime let's keep in mind that the US Federal Reserve will want to avoid cutting rates too soon and by too much. The recent rebound in US economic growth will put some pressure on the decision to cut.

As I mentioned elsewhere, inflation needs to continue to decline, unemployment needs to rise in the US. We are not there yet.

Where to next?

It seems like forever but, markets are still very focused on the next interest rate cut. Depending on who we listen to, the probability is close to 100% for a rate cut in September this year currently, and becoming a matter of by how much?

Markets appear to be happy but will need ongoing rising earnings growth to stay at current levels, let alone keep rising sustainably.

That more broadly based improvement is company earnings is required to help make current market pricing sustainable. It looks like they might be on the way although not in any hurry.

Being reasonably fully invested with some cash to the side to take advantage of market volatility looks about right currently.

The Global Economy

By Morgan Edwards – brief bio

Crowdstrike, fragility, and the COVID inflationary episode

On Friday July 19, 2024, the world was struck by a technological glitch perhaps rivalling the hysteria predicted to occur in 2000 (Y2K). A failed update from Crowdstrike, an antivirus company responsible for securing the IT systems of many businesses, banks and government departments worldwide, led to widespread disruption.

The graph above depicts Crowdstrike's share price for 2024, with the share price for 19 July highlighted.

While the failure was estimated to have impacted 85 million devices, the impact was much wider. Those 85 million devices were central 'nodes' required for the operation of everything from bank accounts, payment systems and flight control systems.

I couldn't help but think of the parallels between this and another disruptive event – the post-COVID inflation. As discussed often (monthly), the COVID inflation has largely been the result of fragile supply chains and disruptions in the international supply system. Delays, shortages, and everything else resulted in price increases – ***not*** bond buying programmes to keep interest rates low (although that did result in considerable asset price inflation).

Here's another way of looking at this: the post-COVID inflationary episode was baked into the pie 30-40 years ago when the international production/trading system employed 'just-in-time' production methods to keep production costs down (largely through cheaper labour and other regulatory niceties).

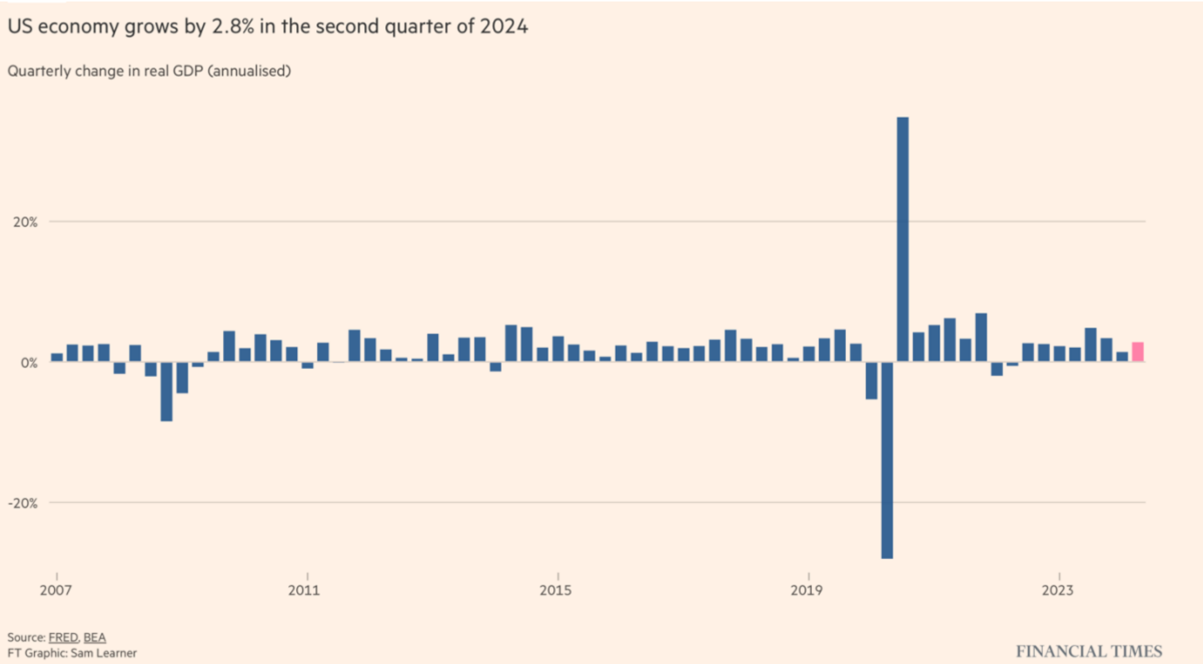
It was only a matter of time where disruption to trade and employment (like a pandemic) resulted in considerable dysfunction within the international economy.

The Crowdstrike update is a further lesson in the dangers of embedded fragility within the international economy.

With that, on to our monthly tour of the global economy.

United States

Economic growth and inflation was a source of good news from the United States, and perhaps the biggest economic news of the month.

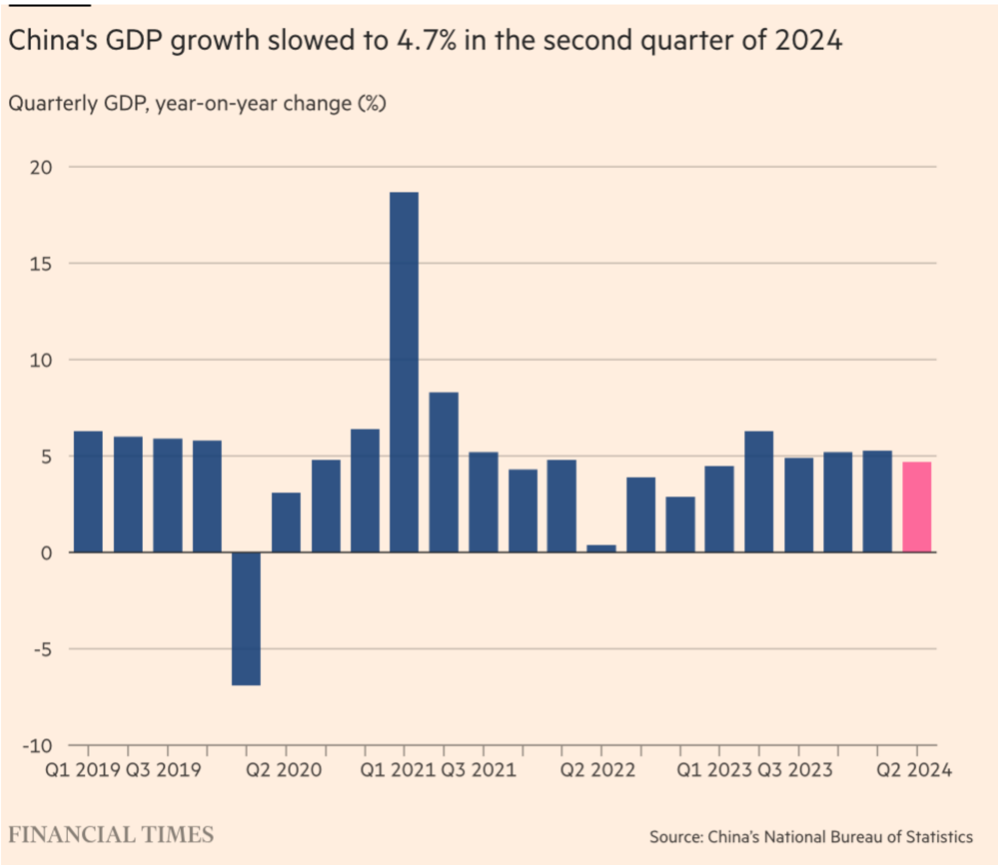


The graph above shows US GDP growth from 2007 to the present.

PCE inflation, the Fed's preferred measure of inflation, was at 2.5%. This puts it slightly above the 2% 'inflation target' and has got many commentators and market participants excited for rate cuts in the coming months.

China

The Chinese Communist Party are grappling with China's economic woes. This comes after the latest GDP data for Q2 2024 was released earlier in July.

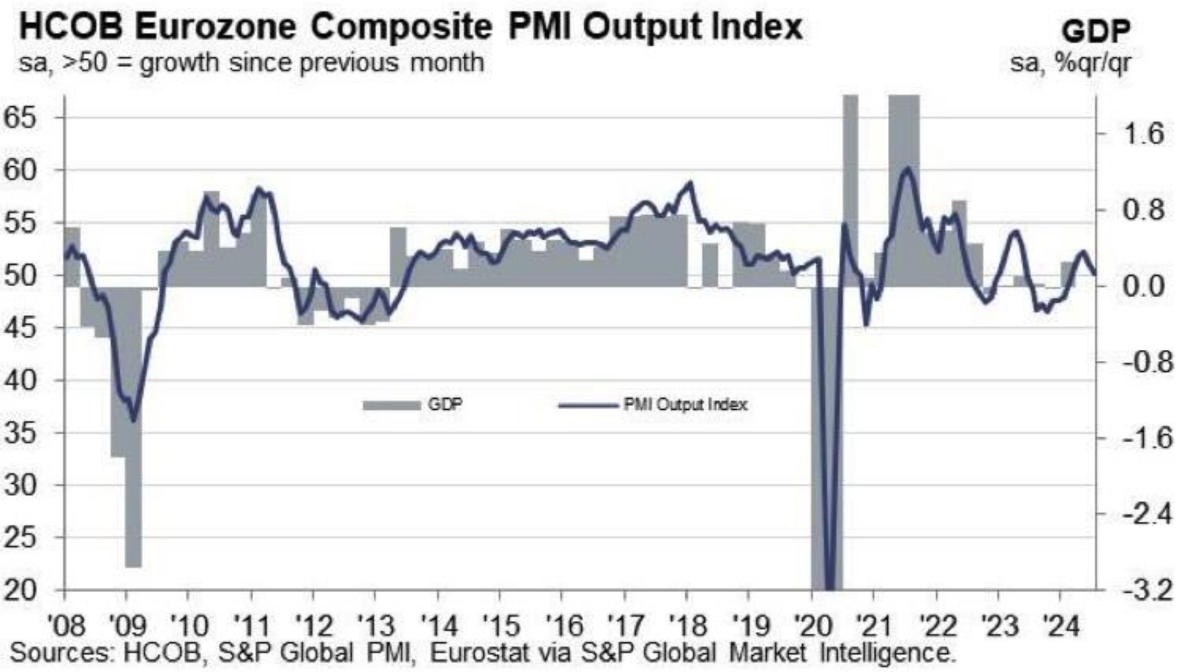


The graph above depicts China's quarterly annual GDP data from Q1 2019.

I'm sceptical of the 'existentialism' surrounding China's economic health. However, credit(debt) is central to this story. If there were to be a private debt crisis in China, then the alarm bells will really start to ring. 'Socialism with Chinese Characteristics' has known very little bounds in the past. If a private debt crisis were to occur, I would be surprised if something like a 'People's QE' (where the central bank acquires non-governmental sector debt rather than government bonds) wasn't followed.

Euro Area

The 'flash' Purchasing Managers' Index (PMI) indicates that activity in the Eurozone decreased despite an expected uptick. As an introduction, the PMI is 'a survey-based indicator of business conditions, which includes individual measures ('sub-indices') of business output, new orders, employment, costs, selling prices, exports, purchasing activity, supplier performance, backlogs of orders and inventories of both inputs and finished goods, where applicable'. The magic number is 50 – anything above indicates growth but anything below indicates contraction.

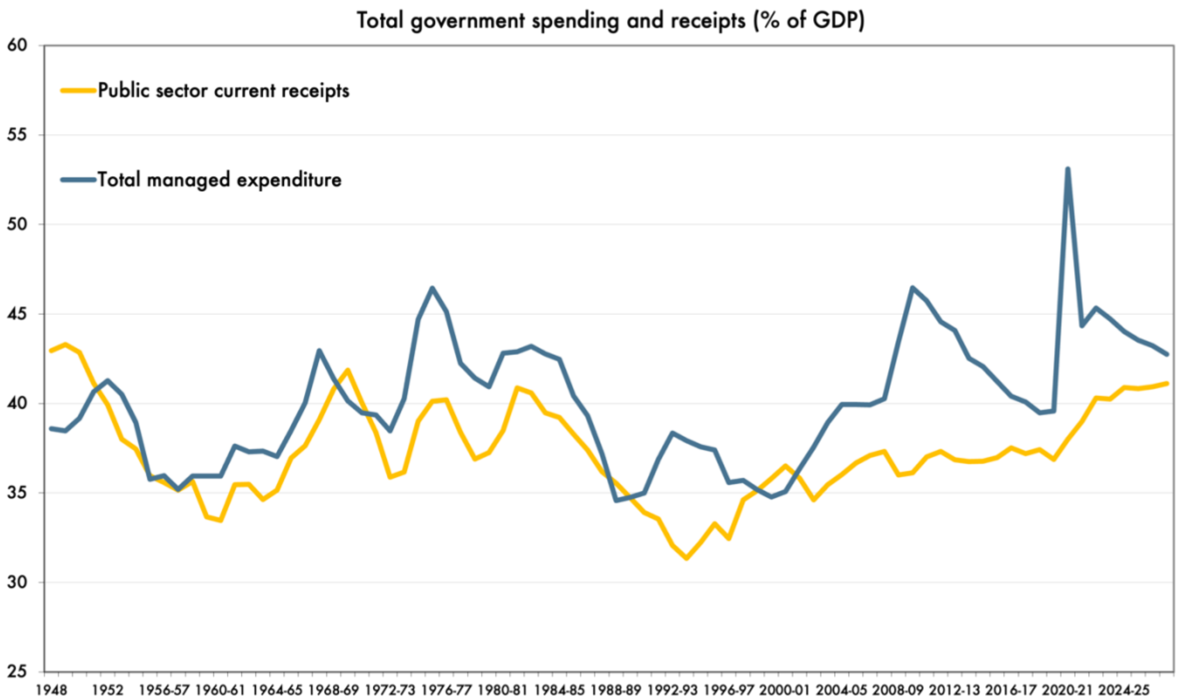


The graph above depicts the PMI and GDP within the Euro Area since 2008.

The PMI ticked downwards in data released on July 24, sitting at a five-month low of 50.1. While it's too early to say of course, this may indicate a slowing down of the Eurozone economy, which may in turn lead to further ECB interest rate cuts. Moreover, Germany's GDP was also lower unexpectedly. Perhaps further fuel for interest rate cuts.

United Kingdom

To no one's surprise, Rishi Sunak and the Conservatives are out, and Sir Kier Starmer and Labour are in. However, Labour is sounding the alarm over a 20 billion 'fiscal hole', which will undoubtedly impact government expenditure over the medium term.

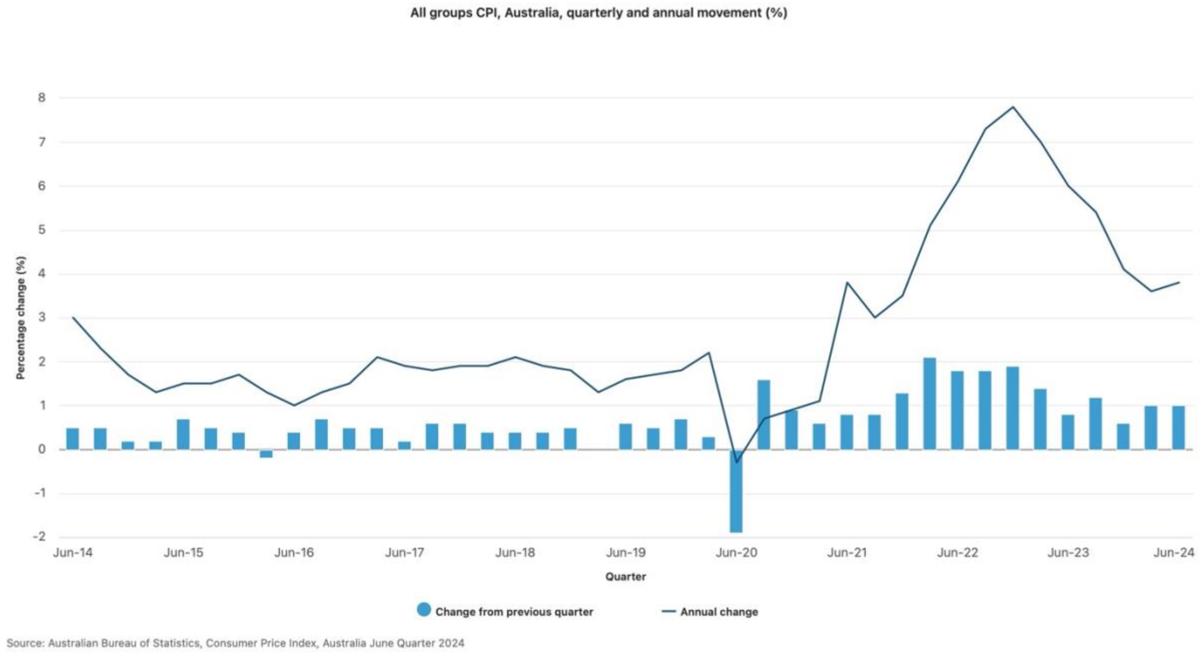


The above graph shows UK government income (receipts) and expenditure from 1948 to the present.

As we've touched on over the last few months, this perspective on government finance isn't how it works in reality – the state is self-financing. However, that matters little when cuts are being made to expenditure.

Australia

A shift away from the monthly CPI data to the 'official' June (Second) Quarter CPI number. There was a slight uptick – from 3.6% to 3.8% - on an annual basis. However, the change was stable

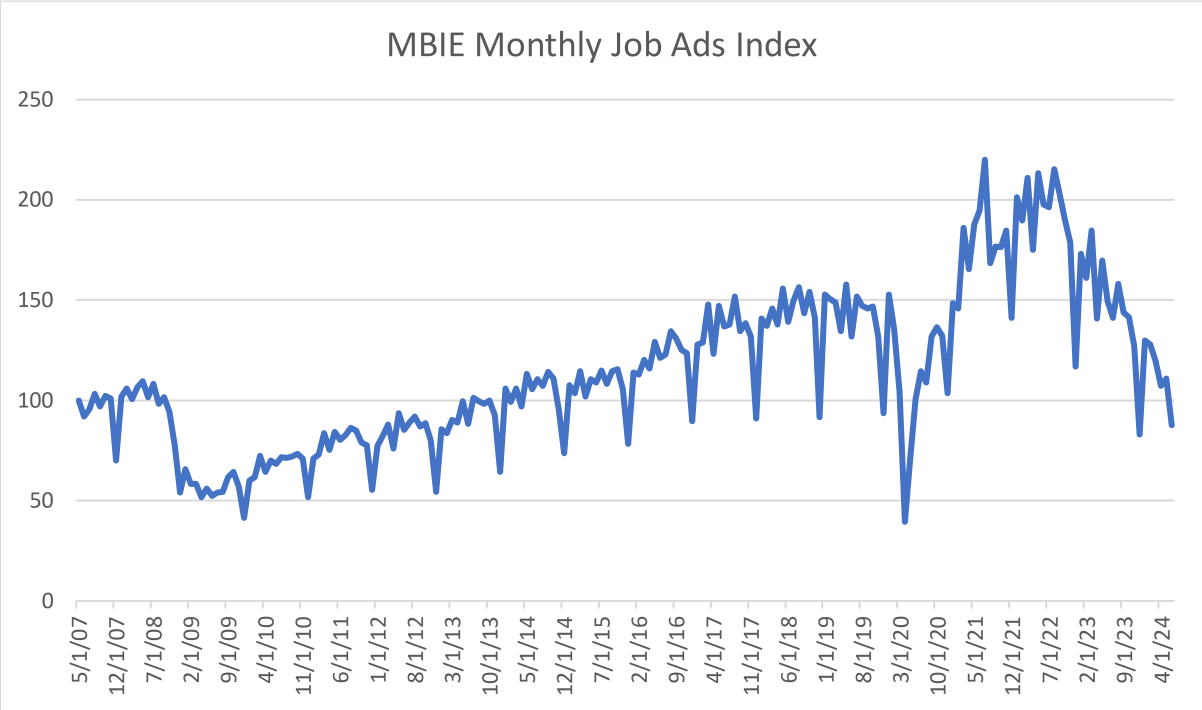


The graph above shows both annual and quarterly CPI change.

The commentators will go crazy over this, clamouring to predict how 'hawkish' the Reserve Bank of Australia will be over this data. However, the trend is still down (as touched upon last month), and monetary policy isn't the best tool to bring down housing costs and the price of shoes, alcohol, tobacco and food (the key drivers of these latest numbers).

New Zealand

Still reasonably gloomy on many fronts in New Zealand. An example of this is in the Ministry of Business, Innovation and Employment's (MBIE's) Job Ads Index. The Jobs Index depicts trends in online jobs advertisements, with data derived from SEEK, Trade Me Jobs, the Education Gazette and Kiwi Health Jobs.



The graph above depicts MBIE's Job Ads Index from May 2007 to June 2024.

Simply, the data shows the advertisements are very weak – the weakest since 2015 (outside of the COVID era). This is a further signal of the economic troubles facing New Zealand at present. Cyclicism is the name of the game (all things must pass), but it may be a while longer yet.

Conclusion

Some bright spots in the international economy this month, with a few tinges and undercurrents of trouble still evident.

Financial Advisor compliance!

email admin@wiseplanning.co.nz