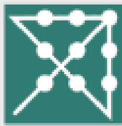

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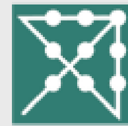

July 8, 2024

Morning Briefing

It's Still A Bull Market Until Further Notice

Check out the accompanying chart collection.

Executive Summary: Signs that the Fed might lower the federal funds rate soon have sent stocks soaring, even though those signs were weak economic data. So the Fed Put is back. We're concerned that the Fed might ease too soon, switching its mandate focus from inflation to unemployment. That could be a wrong move given the likelihoods that the soft patch won't grow into a recession and that trade policies next year are bound to be inflationary. … Our S&P 500 targets might be too conservative if the slow melt-up continues. Then again, the dearth of bears in the market is a contrarian bearish sign. … As for the labor market, we don't see weakness in the data but normalization. … Dr. Ed reviews "Cabrini" (+ + +)

YRI Weekly Webcast. Join Dr. Ed's live webcast with Q&A on Mondays at 11 a.m. EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

Strategy I: Slow-Motion Meltup. The S&P 500 and Nasdaq have been climbing slowly but steadily to new record highs over the past few weeks (*Fig. 1* and *Fig. 2*). It has been a slow-motion meltup. Stock prices should have been falling on the recent batch of weaker-than-expected economic news, but the bad news has been greeted as good news since it increases the odds that the Fed will start easing monetary policy sooner rather than later. In other words, investors are counting on the Fed Put again.

The Citigroup Economic Surprise Index dropped to -46.8 on Friday (*Fig. 3*). That's still well above the previous two recession lows, but it might be heading in that direction. If the economy gets much weaker, then the Fed will lower rates. It can do so now that inflation continues to moderate toward the Fed's 2.0% inflation target. Indeed, the core CPI and PCED inflation rates excluding shelter were 1.9% and 2.0% in May on a y/y basis (*Fig. 4*). Rent inflation is also declining, albeit slowly.

We acknowledge that the current economic soft patch has been softer than we expected. But we are not convinced that it is leading to a recession that the Fed would need to avert by lowering the federal funds rate. Nevertheless, more Fed officials are saying that keeping unemployment low can take priority over containing inflation since inflation is approaching the Fed's target rate of 2.0% y/y. Its dual mandate is to keep both low.

Inflation isn't there yet, however, and Fed officials have said that they prefer to see it at 2.0% for a few months before they start cutting rates. That makes sense, especially since the labor market is doing very well with the unemployment rate at only 4.1% in June.

We still don't expect a rate cut in July; we give it a 25% probability. Our subjective probability of a rate cut in either September or November (after the election) is 40%. By the way, Fed officials might want to consider that no matter whether President Donald Trump or President Joe Biden wins in November, fiscal and trade policies are likely to be inflationary next year. Both are talking about increasing tariffs, and Trump aims to extend his 2017 tax cuts beyond 2025 when they expire.

In other words, the Fed might be making a mistake rushing to cut the federal funds rate until inflation is sustainably at 2.0% given that Washington will be inflation-prone next year. For now, the federal funds futures market is currently discounting two and four rate cuts of 25bps over the next six and 12 months (*Fig. 5* and *Fig. 6*).

And what about the stock market? Our year-end target of 5400 for the S&P 500 was exceeded on June 12. The index closed at 5567.19 on Friday. That's another new record high. So far, the current bull market has proceeded even as the Fed raised the federal funds rate (*Fig. 7*). The federal funds rate was 3.08% on October 12, 2022, when the S&P troughed. It has been at 5.3% since July 27, 2023 yet stock prices continued to advance. This time, if the Fed lowers the federal funds rate to successfully avert a recession, the bull market is likely to continue. In the past, a falling federal funds rate didn't always end bear markets because it confirmed that the economy was in a recession.

Eric, Joe, and I aren't raising our year-end target for the S&P 500 just yet. But we are learning to live with the S&P 500 outpacing even our bullish projections. It did so last year: Our year-end target of 4600 was reached on July 31, 2023, and the index closed the year at 4769.83. Now we are rethinking whether our current projections of 6000 by the end of 2025, 6500 by the end of 2026, and 8000 by the end of the decade might be too conservative. The market may be discounting our Roaring 2020s scenario faster than we expected.

Like everyone else, we would like to see a broadening of the bull market from the S&P 500's MegaCap-7 (i.e., Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla) to the rest of the index, i.e., the S&P 493. The former is up 118.6% since the start of the bull market, while the latter is up 36.4% (*Fig. 8*). That's still a bull market excluding the MegaCap-7. In other words, part of the breadth problem is that the prices of seven stocks have increased much faster than those of the rest of the S&P 500. Is that really a breadth problem?

Strategy II: Some of Our Best Friends. Some of our best friends are bears. To their credit, they were bearish during the bear market from the start of 2022 through October 12 of that year. However, they overstayed their welcome and mostly missed a fantastic bull market. The premise of their bearishness was logical: The Fed raised the federal funds rate from zero in March 2022 to 5.25% in July 2023. It made sense to expect that such an extraordinary tightening of monetary policy would cause a recession. But that didn't happen for numerous reasons that we have previously analyzed.

A few of the diehard hard-landers are saying that the economy is in a recession now or soon will be. They are counting on the "long and variable" lags between monetary policy and the economy finally to prove they were right after all. Such an outlook was bearish for stocks in the past. This time may be different (yet again) because inflation has moderated significantly, allowing the Fed to lower interest rates to avert a recession. The Fed doesn't need to engineer a recession to bring inflation down because inflation has come down without a recession.

Meanwhile, there has been some news among our band of brothers and sisters in the investment strategy business. We weren't happy to see Marco Kolanovic, JP Morgan's investment strategist, leave his job last week, presumably because he has been too bearish. His boss, Jamie Dimon, has been bearish too since May 2022. We also note that Michael Kantrowitz at Piper Sandler & Co. announced that he will no longer publish year-end targets for the S&P 500.

We view both these developments as possible bearish signals from a contrarian perspective. We need more bears to keep the bull market going. During the July 2 week, the Investor Intelligence Bull/Bear Ratio was back up at 3.73 (*Fig. 9*). The percentage of bulls rose to 63.1%, and the percentage of bears fell to 16.9% (*Fig. 10*).

US Labor Market: Weakening or Just Normalizing? The pandemic threw the US economy and labor market into pandemonium. It caused a sharp but brief recession that sent the unemployment rate soaring to 14.8% during April 2020 (*Fig. 11*). The

unemployment rate always soars during recessions. Since the 1960s, those recessions were often caused by the tightening of monetary policy, which triggered financial crises that morphed into full-blown credit crunches; they in turn caused the recessions. The drop in business activity forced employers to cut their payrolls, causing the unemployment rate to soar, which depressed consumer spending.

This time has been different so far. There was a mini-banking crisis during March 2023 that had the potential to turn into a widespread bank run. But that didn't happen because the Fed responded very quickly with an emergency bank liquidity facility. So far, there has been no credit crunch and no recession.

What about all the recent signs showing that the labor market is slowing? In our opinion, they are actually indicating that the labor market is normalizing following the pandemic's pandemonium. Consider the following:

(1) *Unemployment claims.* There have been unsettling upturns in initial and continuing unemployment claims in recent weeks (*Fig. 12*). The four-week moving average of the former rose to 236,700 during the June 28 week, the highest since September 2023. We aren't concerned given that the unemployment rate was 3.8% back then versus 4.1% in June of this year.

A wee bit more worrisome is that continuing jobless claims rose to 1.86 million during the June 21 week, the highest since November 2021, when the unemployment rate was 4.1%. That suggests that it may also be taking longer for the unemployed to find a job. Nevertheless, both the average and median duration of unemployment remained low during June at 20.7 weeks and 9.8 weeks, respectively, while the number of unemployed workers also remained relatively low at 6.8 million (*Fig. 13*).

We suspect that seasonal adjustment factors for the claims data haven't completely normalized since the pandemic. We note that the seasonally unadjusted series for initial unemployment claims and continuing claims are closely tracking last year's comparable series (*Fig. 14*).

(2) *Job openings, quits & hires.* What about the decline in the JOLTS measure of job openings and the scuttlebutt that many of those listings are no longer even open? Job openings totaled 8.1 million in May, down from 12.2 million in March 2022 (*Fig. 15*). They remain above the 7.2 million opening in January 2020, just before the pandemic. We think that June's jobs plentiful series included in The Conference Board consumer confidence survey as well as May's job openings series in the NFIB survey of small businesses (at

38.1% and 42.0%) confirm the strength of the JOLTS series, although all have normalized from their abnormally high readings during 2022 and 2023.

While the JOLTS measure of total job openings edged up in May to 8.1 million, the series excluding government continued to fall to 7.1 million, which still exceeds the pre-pandemic levels during 2018 and 2019 (*Fig. 16*).

Some economists view the drop in quits from 4.5 million in April 2022 to 3.5 million currently as another sign of weakness in the labor market. We view it as another sign of normalization, as quits are now about the same as they were just before the pandemic.

(3) *Payroll employment.* The same goes for payroll employment: It rose 206,000 in June. The previous two months were revised down by 111,000. So the average monthly increase during Q2-2024 was 177,300, down from 267,300 during Q1-2024 (*Fig. 17*). That's comparable to the average monthly increases during 2018 and 2019 of 190,300 and 165,700.

By the way, Debbie and I have devised another measure of the monthly change in payroll employment by simply subtracting the monthly JOLTS data of total separations from total hires (*Fig. 18*). This JOLTS payroll series is available through May and shows a solid increase of 334,000 during the month, exceeding the 218,000 gain in the Bureau of Labor Statistics' (BLS) payroll data. During April, it was up 278,000 versus 108,000 for the BLS series.

(4) *Household employment & unemployment.* While the JOLTS data suggest that payroll employment is better than shown by the BLS series, the household measure of employment continues to suggest that the labor market is much weaker than suggested by either of these series. We are losing our confidence in the accuracy of the household data. It is based on a monthly estimate of the civilian population, which is probably undercounting illegal immigrants. If so, then the household measure of employment should be higher while the comparable measure of unemployment should be lower. Eric and I will discuss this issue in the coming days.

(5) *YRI Earned Income Proxy & disposable personal income.* Finally, our Earned Income Proxy for nominal private wages and salaries in personal income rose 0.4% m/m during June. That implies a slight increase in inflation-adjusted disposable income for the month, which in turn implies that consumer spending continued to grow last month.

Movie. “Cabrini” (+ + +) (*link*) is a fascinating docudrama about Francesca Cabrini, an Italian immigrant who arrived in New York City in 1889. She was also a Catholic nun who was authorized by the Pope to start an orphanage in New York City. Despite numerous challenges and obstacles, some from within the church hierarchy and some from City Hall, she succeeded in creating a remarkable network of charitable orphanages and hospitals first in New York City and then around the world. She died on December 22, 1917 in Chicago and was buried on the grounds of her orphanage on the Hudson River in New York. In 1946, she was canonized a saint by Pope Pius XII in recognition of her holiness and service to mankind and was named “Patroness of Immigrants” in 1950.

Calendars

US: Mon: Auto Sales 15.8mu; Consumer Credit $10.7b; Consumer Inflation Expectations. **Tues:** NFIB Small Business Optimism Index 89.2; API Weekly Crude Oil Inventories; Powell; Yellen; Bowman; Barr. (FXStreet estimates)

Global: Mon: Eurozone Sentix Index -0.6; UK BRC Retail Sales Monitor 0.2%; Eurogroup Meetings; Haskel. **Tues:** China CPI 0.0%m/m/0.4%y/y; China PPI -0.8%; Eurogroup Meetings; Mauderer. (FXStreet estimates)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index rose 1.9% for the week and has traded at a record high since Tuesday; the previous record high was fairly recently, June 19. The AC World ex-US index rose 2.0% w/w to 6.7% below its June 15, 2021 record high and is just 0.6% below its 28-month high on May 20. EMU was the best performing region last week with a gain of 2.9%, followed by EM Latin America (2.2%), EAFE (2.1), and the AC World ex-US. EMEA was the worst regional performer, albeit with a gain of 0.5%, followed by EM (1.7), EM Asia (1.9), and Europe (1.9). Among the major selected country markets that we follow, Korea and France performed the best last week with gains of 3.7%, followed by Japan (3.1), Brazil (2.7), Spain (2.3), and Taiwan (2.3). The worst country performers last week: Hong Kong (-0.8), Switzerland (0.5), China (0.7), Sweden (0.8), Mexico (1.2), and Canada (1.2). The 16.3% ytd gain for the MSCI United States remains well ahead of the AC World ex-US index (6.1). EM Asia is ahead of the pack as the leading region ytd with a gain of 12.0%, which puts it ahead of EM (7.9) and the AC World ex-US. The worst performing regions so far in 2024: EM Latin America (-16.3), EMEA (0.8), Europe (5.7), EAFE (5.7), and EMU (6.0). Looking at the major selected country markets that we follow, Taiwan is far and away the best ytd performer with a gain of 31.5%, followed by India (18.4), the United States (16.3), Japan (8.6), and Spain (7.0). The worst

performing countries so far in 2024: Brazil (-19.7), Mexico (-16.0), Hong Kong (-13.7), France (-0.4), and Switzerland (0.2).

US Stock Indexes (*link*): Twenty-two of the 48 major US stock indexes that we follow rose w/w, down from 24 rising a week earlier. The Nasdaq Industrials and Russell 1000 Growth indexes were the best performers with gains of 3.7%, ahead of Nasdaq 100 (3.6%) and S&P 500 LargeCap Growth (3.6). S&P 600 SmallCap Pure Value was the worst performer with a decline of 1.8%, followed by S&P 400 MidCap Pure Value (-1.6), Russell 2000 Value (-1.6), S&P 600 SmallCap Equal Weighted (-1.5), and S&P 600 SmallCap Value (-1.5). Looking at their ytd performances, 37 of the 48 indexes are higher so far, but that's down from 47 at the end of March. The S&P 500 LargeCap Growth index is the best performer so far in 2024, with a gain of 27.5%, ahead of Russell 1000 Growth (24.7), Russell 3000 Growth (23.7), Nasdaq Composite (22.3), and S&P 100 MegaCap (21.7). The worst performing major US stock indexes ytd: S&P 600 SmallCap Pure Value (-9.2), S&P 600 SmallCap Value (-7.2), S&P 600 SmallCap Equal Weighted (-5.6), and S&P 400 MidCap Pure Value (-5.5).

S&P 500 Sectors Performance (*link*): Six of the 11 S&P 500 sectors rose last week, and three were ahead of the S&P 500's 2.0% gain. That compares to four sectors rising a week earlier when the same four were ahead of the composite index's 0.1% decline. The outperformers last week: Communication Services (3.9%), Information Technology (3.8), and Consumer Discretionary (3.8). The underperformers last week: Energy (-1.3%), Health Care (-1.0), Industrials (-0.6), Materials (-0.5), Real Estate (-0.3), Utilities (0.6), Financials (0.9), and Consumer Staples (1.0). The S&P 500 is up 16.7% ytd, with 10 of the 11 sectors in positive territory but only two ahead of the index. That's down from five sectors ahead of the index during mid-May. Information Technology is the best ytd performer, with a gain of 32.7%, ahead of Communication Services (31.0). These sectors are lagging the S&P 500 so far in 2024: Real Estate (-4.4), Materials (2.7), Health Care (5.9), Industrials (6.4), Energy (7.7), Utilities (8.2), Consumer Staples (8.7), Consumer Discretionary (9.2), and Financials (10.3).

US Economic Indicators

Employment (*link*): Employment was stronger than expected in June, while there were downward revisions to both May and April payrolls. *Payroll employment* advanced 206,000 (vs 190,000 expected) in June, not far from the average monthly gain of 220,000 over the prior 12 months, led by government, health care, social assistance, and construction. Revisions show both May (to 218,000 from 272,000) and April (108,000 from 165,000) payroll increases were lower than previously reported, for a net loss of 111,000 over the two-month period. *Private payroll* employment added 136,000 in June, slower than the 160,000 expected and below May's 193,000 increase. Meanwhile, *government* jobs

increased 70,000, above the average monthly gain of 49,000 over the prior 12-month period, with state government employment climbing 26,000 during the month and local government employment, excluding education, rising 34,100. *Private service-providing* industries increased 117,000 in June, led by *health care*, which added 49,000 jobs—though lower than the average monthly gain of 64,000 over the prior 12 months—once again led by *ambulatory health care* services (22,000) and hospitals (22,000). Meanwhile, *social assistance* employment advanced 34,000 in June, roughly double the average monthly gain of 64,000 over the prior 12-month period. *Leisure & hospitality* employment barely budged in June, adding only 7,000 jobs during the month, with employment in *food services & drinking places* cutting 3,100 jobs. Retail trade employment dropped 9,000 jobs after trending higher earlier this year. *Goods-producing* jobs rose 19,000 in June, led by construction (27,000), while manufacturing employment fell 8,000, led by a 10,000 drop in the durable goods sector and employment in mining & logging was flat.

Wages (*link*): Average hourly earnings (AHE) for *all workers on private payrolls* increased 0.3% in June, while the yearly rate ticked down from 4.1% in May to 3.9% in June; that matched April's rate—which was the lowest since June 2021. It peaked at 5.9% in March 2022. *Private industry* wages rose 3.6% (saar) over the three months through June, accelerating from the 2.8% rate during the three months through April, though remained below the 3.9% yearly rate. *Service-providing industries showing three-month rates above their yearly rates*: professional & business services (5.4% & 4.3% y/y) and other services (4.8 & 3.6). *Service-providing industries showing three-month rates below their yearly rates:* utilities (0.0 & 1.8), information services (0.1 & 2.3), wholesale trade (1.1 & 2.2), retail trade (2.1 & 2.4), transportation & warehousing (2.4 & 4.6), leisure & hospitality (2.9 & 3.8), and financial services (3.4 & 5.1). The three-month annualized rate and yearly rate in education & health services (3.3 & 3.1) were nearly identical. Within *goods-producing* industries, the annualized three-month rate was below the yearly rate for *durable goods* manufacturing (5.1 & 6.0), while the rates for *nondurable goods* manufacturing (2.8 & 2.6) were comparable.

Earned Income Proxy (*link*): Our Earned Income Proxy (EIP), which tracks consumer incomes and spending closely, rose 0.4% in June to yet another new record high. *Average hourly earnings* in June advanced 0.3%, while *aggregate weekly hours* rose 0.1%—with private payroll employment increasing 0.1% and the average workweek unchanged at 34.3 hours. Over the past 12 months, our EIP advanced 5.1%—with aggregate weekly hours up 1.2% and average hourly earnings up 3.9%.

Unemployment (*link*): The number of unemployed rose 162,000 to 6.8 million in June, with the unemployment rate climbing to 4.1%—the highest since November 2021. The rate was

below 4.0% from February 2022 through April 2024, before reaching 4.0% this May. Household employment rose 116,000 in June, while the labor force was 277,000 higher than in May. The participation rate ticked up to 62.6% last month after slipping from 62.7% in April to 62.5% in May. *By race*: The unemployment rates for African Americans (to 6.3% from 6.1%) and Asians (4.1 from 3.1) moved higher in June, while the rate for Hispanics (4.9 from 5.0) ticked down and the rate for Whites was unchanged at 3.5%. *By education*: The unemployment rates dipped in June for those with a high school degree (to 4.2% from 4.3%), while the rate for those with less than a high school degree was unchanged at 5.9%. Meanwhile, unemployment rates rose for both those with a bachelor's degree or higher (to 2.4 from 2.1) and those with some college or an associate degree (3.4 from 3.1).

US Non-Manufacturing PMI (*link*): The US service sector contracted for the second time in three months, dropping below the breakeven point between contraction and expansion in April for the first time in 16 months. June's *NM-PMI* fell back below 50.0, to 48.8, after climbing from 49.4 in April to a nine-month high of 53.8 in May. The *business activity* measure sank 11.3 points (to 49.6 from 61.2) last month, after posting its strongest performance since November 2022 in May, while the *new orders* gauge dropped back below 50.0 for the first time since December 2022, falling 6.8 points (47.3 from 54.1). Meanwhile, the *employment* (46.1 from 47.1) measure contracted for the sixth time in seven months. The *supplier deliveries* (52.2 from 52.7) gauge remained in expansionary territory—indicating a slower supplier delivery performance for the second time in as many months. On the *inflation* front, the price index eased for the second month, to 56.3 in June from 59.2 in April and down from January's recent high of high 64.0. It was at a record-high 84.5 at the end of 2021.

Global Economic Indicators

Eurozone Retail Sales (*link*): Eurozone retail sales rose a smaller-than-expected 0.1% in May (vs 0.2% estimate), following an upwardly revised 0.2% decline in April—first reported as a 0.5% drop and a 0.7% increase in March. The *components of retail sales* show spending on *food, drinks & tobacco* following an up-and-down pattern, rising 0.7% during May following an April decline of 0.9% and a March rise of 1.1%. Sales of *automotive fuels* followed a similar pattern, climbing 0.4% last month after a 0.7% fall and a 0.8% increase during April and March, respectively. *Non-food products ex fuel* slipped 0.2% in May, after climbing three of the prior four months by 1.2%. May data are available for three of the *Eurozone's four largest economies*, and it's a mixed bag: Italy (0.1% mm & -0.8% y/y) was the only one of the three to show a monthly gain, albeit a small one, while *France* (-0.2% & 1.4%) was the only one to show a yearly gain. Meanwhile, *Spain* (-0.6% m/m & 0.0 y/y) showed the weakest monthly performance of the three, recording no growth y/y.

Germany Factory Orders (*link*): Germany factory orders in May contracted for the fifth straight month, falling to the lowest level since June 2020. Germany's M-PMI (43.5) in June continued to show a contraction in manufacturing activity, while Ifo's business climate index showed manufacturers were uncertain about the months ahead. *Factory orders* sank 1.6% in May, missing market estimates of a 0.5% increase, and plunged 14.3% over the five months through May. During May, foreign orders declined 2.8%, with orders from outside the Eurozone dropping 4.6% while billings from within the Eurozone ticked down 0.1%. Meanwhile, domestic orders increased 0.5%. May orders were dragged down by a sharp decline in orders for aircraft, ships, and trains (-19.2%), while orders within the auto industry slumped 2.9%. Meanwhile, there was a double-digit gain of 11.2% in billings for computer, electrical, and optical products. *By sector*, capital goods orders slumped 4.3% in May, while both consumer (4.9) and intermediate (1.4) goods orders rose.

Germany Industrial Production (*link*): German industrial production declined unexpectedly in May. Germany's *industrial production*, which includes construction, slumped 2.5% in May (vs +0.2% expected), after a 0.1% uptick in April, with May declines in autos (-5.2%) and machinery & equipment (-5.9) output major drags during the month. *Excluding energy and construction*, production contracted 2.9% m/m and 7.3% y/y. *Energy* production logged a 2.6% increase in May, while *construction* output sank 3.3%. Overall output fell 6.7% y/y, after a 3.7% shortfall in April. *By sector*, declines were widespread in May, with capital (-4.0%) and intermediate (-2.7%) goods production contracting sharply while output of consumer (-0.2) goods production recorded a slight downtick.

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