July 22, 2024

Morning Briefing

Dueling Views

Check out the accompanying chart collection.

Executive Summary: Characterizing the investing backdrop at this juncture are big unknowns about the near-term future, such as which administration will be controlling fiscal policy six months from now and what monetary policy will be at that time. So it's no wonder that multiple consensus viewpoints seem to be moving financial markets this way and that. Today, Dr. Ed examines what's been driving the commodities, fixed income, currencies, and equities markets and discusses his takeaways for the economic and financial market outlooks. ... And: Dr. Ed pans the movie "Civil War" (- - -).

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: More Than One Consensus. The notion of multiple consensus views may be an oxymoron, but there seems to be more than one consensus view about the financial and economic outlook holding sway in the financial markets currently. That's not surprising given that this is a presidential election year, the result of which might lead to significantly different outcomes given the radical differences in the policies likely under a Biden versus a Trump administration over the next four years.

For example, Trump's 2017 tax cuts will expire at the end of 2025. It is widely expected that Trump would extend them, while Biden would go the other way, letting them expire and raising taxes on the rich. Under Trump, trade policy is expected to be more protectionist than under Biden. Lower taxes and higher tariffs under Trump presumably would be more inflationary than a continuation of Biden's fiscal and trade policies. On the other hand, regulatory policy toward business would be loosened under Trump, which might be disinflationary. Of course, higher tariffs could also be deflationary if they trigger a global trade war, as resulted from the Smoot-Hawley Tariff Act of June 17, 1930.

However, no matter which party wins the White House, much will also depend on whether

Congress remains gridlocked or not.

In addition, there is a lot of uncertainty about what the Fed will do over the next year. Fed Chair Jerome Powell's term expires May 15, 2026. If Trump is re-elected, he might seek to replace Powell with a more dovish and pliable Fed chair. However, the president's authority to do so probably requires Powell's removal "for cause" rather than for policy differences. Alternatively, Powell might resign once inflation has been brought down to 2.0%, to seal his legacy as a successful Fed chair.

In any event, the financial markets and most economists seem to agree that the Fed's next move will be to cut the federal funds rate (FFR) by 25bps following the September 17-18 meeting of the FOMC. However, there is still a debate about whether restrictive monetary policy operates with a "long and variable" lag, thus requiring more rate cuts this year to avert a recession later this year or in 2025. If the Fed gets too dovish, that could be inflationary in 2025, particularly with Trump's tax-cuts and tariff-increases policies.

A known known is that the federal deficit will remain on an unsustainable path no matter who is in the White House. The known unknown is whether and when a debt crisis might result that would force Washington to fix the problem.

At the July 2 European Central Bank Forum on Central Banking in Sintra, Portugal, Powell warned: "The level of debt we have is not unsustainable, but the path that we're on is unsustainable." He reiterated that running large deficits during good economic times when the economy is at full employment cannot continue indefinitely: "In the longer run, we'll have to do something sooner or later, and sooner will be better than later."

Powell downplayed any worries about central bank independence that might arise if Trump were to be re-elected, stating: "I am not focused on that at all. And that's not just a talking point. I really think that we just keep doing our jobs." Powell also said: "Support for the Fed's independence is very high where it really matters on Capitol Hill in both political parties." He concluded by stressing his focus on getting the job right and maintaining the current economic trajectory.

By the way, Powell also discussed the biggest risks facing the US economy, highlighting cyber-risk as a significant concern: "We know how to deal with credit risk and market dysfunction, but a big successful cyberattack on a financial market, utility, or a bank is a major worry."

Sure enough, on Friday, we all got a glimpse of the turmoil that might occur during a cyberattack or during an attack of the AIs, if our AI-powered terminators were to decide to terminate us. Texas-based cybersecurity firm CrowdStrike experienced a major disruption following an issue with a software update. Computer screens around the world froze with an error message commonly known as the "blue screen of death." That temporarily disrupted the computer systems of airlines, banks, hospitals, and countless other critical systems around the world.

Now let's have a look at the consensus views that seem to be dominating the recent trading action in the commodity, fixed income, currency, and equity markets.

Commodity Markets I: Global Economy Muddling Along. From April 2023 through March 2024, the nearby futures price of copper had been trading below $4.00 a pound (*Fig. 1*). The price is very sensitive to manufacturing and construction activity in China, and its weakness confirmed that the country's post-pandemic recovery has been anemic at best. That's because the ongoing depression in China's property market has weighed on the economy.

The negative wealth effect on consumer spending has been exacerbated by a combination of falling home prices and stock prices (*Fig. 2*). China's major stock price indexes have been falling for the past few years, led by a significant drop in the stock prices of property developers (*Fig. 3*).

Then, because of a short-covering rally on the COMEX in New York, the price of copper jumped from $3.68 a pound in early February of this year to $5.08 in mid-May. That led many traders to conclude that China's economy might be reviving. We didn't buy it because the price of a barrel of Brent crude oil remained depressed despite mounting geopolitical risks in the Middle East (*Fig. 4*).

Sure enough, China's latest batch of economic indicators for June remained weak. Real retail sales rose just 1.8% y/y for the month (*Fig. 5*). While nominal exports rose 10.7% y/y, imports fell 0.6% y/y in June (*Fig. 6*). China continues to dump manufactured exports at deflated prices in global markets to offset the weakness in domestic demand.

China's cheap exports are depressing manufacturing activity in Europe (*Fig. 7*). It all adds up to relatively weak global economic growth, as confirmed by the lackluster performance of commodity markets so far this year (*Fig. 8*).

Commodity Markets II: The Outlook for the Price of Oil. The Trump 2.0 plan is to deregulate the energy industry to boost production of crude oil and natural gas. That could lead to lower energy prices. In the past, there was a strong inverse correlation between the price of a barrel of Brent crude oil and the US Dollar Index (DXY) (*Fig. 9*).

Over the past few years, the correlation has been much more positive than negative as in the past. That might be because the US has become energy independent and a growing exporter of crude oil and natural gas. Foreign buyers of US energy exports must pay in dollars, which increases the demand for dollars.

US oil field production is currently at a record 13.2 million barrels a day (mbd) (*Fig. 10*). US crude oil exports are at a near-record 10.6 mbd, exceeding crude oil imports by approximately 2.0 mbd (*Fig. 11*).

US natural gas production has more than doubled since 2010 (*Fig. 12*). US exports of natural gas are more than double US imports (*Fig. 13*).

Fixed Income Markets: Debate on Number of Rate Cuts. The convergence of the price of copper and the price of oil is helping to settle the alternative consensus views of global economic growth: It remains relatively weak. There is also a divergence between the outlook for interest rates that needs to be resolved.

The federal funds rate (FFR) futures market is currently anticipating five 25bps cuts in the FFR over the next 12 months (*Fig. 14*). The 2-year Treasury note yield suggests that three rate cuts are likely over the same period (*Fig. 15*).

The 10-year Treasury bond yield has been fluctuating around 4.25% since June's lower-than-expected CPI inflation rate was reported on July 11 (*Fig. 16*). It is discounting rate cuts later this year, but perhaps fewer than widely expected.

After the latest CPI report, Eric and I only grudgingly conceded that the Fed will cut the FFR during September. We still don't think it is necessary. But it will happen, because Fed officials, especially Fed Chair Jerome Powell, have been cooing dovishly more often and more loudly recently.

As for further rate cuts over the rest of this year, we are in the one-and-done camp for now. So we don't expect to see the 10-year Treasury bond yield fall below 4.00% over the rest of this year.

The difference between our outlook for monetary policy and the consensus view is that we don't believe that there are long and variable lags between monetary policy and its impact on the economy. Our view should prevail if the economy recovers from its recent soft patch and continues to display its underlying resilience. Sure enough, the Atlanta Fed's *GDPNow* tracking model is currently showing real GDP rising 2.7% (saar), up from its July 3 estimate of 1.5%.

Currencies: Central Banks out of Sync. We're not sure that there are any consensus views on the outlook for the dollar. There is certainly a debate between the dollar's bulls and bears. We lean toward the bullish camp. However, we recognize that in a Trump 2.0 scenario, the administration will be determined to weaken the dollar to boost US exports and reduce US imports.

That may be easier said than done. Favoring the dollar currently is that the US economy is performing better than most of the other major developed economies. We can see this in the widening divergence over the past couple of years between the rising forward earnings of the S&P 500 and the falling forward earnings of the S&P 500 Air Freight & Logistics industry (*Fig. 17*).

As noted above, the US is becoming a bigger net exporter of energy commodities, which increases the demand for US dollars. Also boosting the dollar is that other major central banks have been quicker to cut their official rates than the Fed (*Fig. 18*). If our one-and-done forecast for the number of FFR cuts over the remainder of this year is correct, then the dollar should remain firm in the foreign exchange markets.

In addition, foreign private investors continue to be significant buyers of US securities. Over the past 12 months through May, their net purchases of US bonds and equities totaled $832 billion and $168 billion (*Fig. 19*).

Equities: Assessing the Selloff. Foreign investors aren't the only ones buying US equities, of course. On a 12-month sum basis, equity mutual funds and equity ETFs had net inflows of $410.5 billion through May (*Fig. 20* and *Fig. 21*). That's the highest reading in this series since October 2022.

We view the recent weakness in the S&P 500 as a temporary selloff attributable to domestic and global political developments becoming somewhat more concerning, especially for the manufacturers of semiconductors and semiconductor equipment. Here are some related developments:

(1) From a technical perspective, the S&P 500 currently exceeds its 200-day moving average by about 10% (*Fig. 22*). Readings of 10% or more tend to be followed by selloffs. The selloffs tend to be corrections of 10%-20% when investors fear a recession that doesn't happen. The selloffs turn into bear markets of 20% or more when a recession does occur. We aren't expecting a recession anytime soon. The consensus view currently seems to agree with us.

(2) From a sentiment perspective, both the Bull/Bear Ratios compiled by Investors Intelligence and AAII showed recent extremely bullish readings of 3.81 and 2.25 (*Fig. 23*). From a contrarian perspective, such bullishness is bearish.

Movie. "Civil War" (- - -) (*link*) is a bad movie. It is very boring. The plot is nonsensical, and the acting is awful, partly because the dialogue is so trite. In this dystopian un-thriller, Kirsten Dunst stars as a photojournalist during a civil war between a secessionist movement (i.e., the "Western Forces" led by Texas and California) and an authoritarian federal government, led by a third-term president. Rather than encouraging viewers to root for either side, the movie seems to be aimed at convincing them to root for it to be over. Remarkably, the consensus reviews were much kinder to the film. The positive ones saw a reflection of our nation's current political mess in the movie.

Calendars

US: **Mon:** Chicago Fed Manufacturing Index. **Tues:** Existing Home Sales 4.00mu; Richmond Fed Manufacturing Index -7; API Weekly Crude Oil Inventories. (FXStreet estimates)

Global: **Mon:** Germany Retail Sales 0.0%; Germany Buba Monthly Report; Eurogroup Meetings. **Tues:** Eurozone Consumer Confidence -13.2; Eurogroup Meetings; Lane. (FXStreet estimates)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index fell 2.0% last week and ended the week 2.9% below its record high on Tuesday. The AC World ex-US index underperformed the US index with a w/w decline of 2.4% from a 30-month high and is now

7.0% below its June 15, 2021 record high. EMEA was the best performing region last week, with a gain of 0.3%, followed by EAFE (-2.4%) and the AC World ex-US. EMU was the worst regional performer with a decline of 3.7%, followed by EM Asia (-3.5), EM (-3.0), Europe (-3.0), and EM Latin America (-2.8). Among the major selected country markets that we follow, Canada performed the best last week, albeit with a decline of 0.6%, followed by Switzerland (-0.9), India (-1.0), Australia (-1.2), and Japan (-1.2). The US MSCI's 15.0% ytd gain remains well ahead of the AC World ex-US index's (5.7). EM Asia is ahead of the pack as the leading region ytd with a gain of 9.7%, which puts it ahead of EM (6.4) and the AC World ex-US. The worst performing regions so far in 2024: EM Latin America (-15.2), EMEA (2.7), EMU (4.3), Europe (4.9), and EAFE (5.6). Looking at the major selected country markets that we follow, Taiwan is far and away the best ytd performer with a gain of 26.7% but is the worst performer relative to its record high, with a drop of 8.4% from its July 11 record high. Taiwan is followed by India's ytd gain of 17.8%, the United States (15.0), Japan (9.6), and Spain (8.1). The worst performing countries so far in 2024: Brazil (-19.4), Mexico (-12.4), Hong Kong (-11.6), France (-1.6), and Korea (-0.7).

US Stock Indexes (*link*): Twenty-three of the 48 major US stock indexes that we follow rose w/w, down from 43 rising a week earlier. The Russell 2000 Value index was the best performer with a gain of 3.0%, ahead of S&P 600 SmallCap Pure Value (2.8), S&P 600 SmallCap Value (2.7), S&P 600 SmallCap Equal Weighted (2.5), and S&P 600 SmallCap (2.2). The Nasdaq 100 and Russell 1000 Growth indexes were the worst performers with declines of 4.0%, followed by S&P 500 LargeCap Growth (-3.8), Russell 3000 Growth (-3.8), Nasdaq Composite (-3.7), and S&P 500 LargeCap Pure Growth (-3.6). Looking at their ytd performances, 45 of the 48 indexes are higher so far. That's up from 43 indexes a week earlier, but 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 22.5%, ahead of S&P 400 MidCap Pure Growth (19.8), Russell 1000 Growth (19.3), S&P 100 MegaCap (19.0), and Russell 3000 Growth (18.9). The worst performing major US stock indexes ytd: S&P 400 MidCap Pure Value (-1.7), S&P 600 SmallCap Pure Value (-1.6), Dow Jones 20 Transports (-0.7), S&P 600 SmallCap Value (0.8), and S&P 500 Transportation (1.2).

S&P 500 Sectors Performance (*link*): Five of the 11 S&P 500 sectors rose last week, and eight were ahead of the S&P 500's 2.0% decline. That compares to 10 sectors rising a week earlier when six were ahead of the composite index's 0.9% gain. The outperformers last week: Energy (2.0%), Real Estate (1.3), Financials (1.2), Consumer Staples (0.9), Industrials (0.6), Health Care (-0.3), Materials (-0.5), and Utilities (-1.6). The underperformers last week: Information Technology (-5.1), Communication Services (-2.9), and Consumer Discretionary (-2.7). The S&P 500 is up 15.4% ytd, with all 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 26.5%, ahead of Communication Services (22.7). These sectors are lagging the S&P 500 so far in 2024: Real Estate (1.0), Materials (5.2), Consumer Discretionary (6.6), Health Care (8.3), Industrials (9.5), Consumer Staples (9.7), Energy (10.4), Utilities (10.7), and Financials (13.8).

US Economic Indicators

Leading Indicators (*link*): Leading Economic Indicators (LEI) fell again in June, not posting a gain since February 2022. The LEI sank 0.2% in June, following a 0.4% decrease in May and a 0.6% setback in April. The LEI is down 14.8% from December's 2021 record high—to its lowest level since April 2020. Over the first half of this year, the LEI fell 1.9%, smaller than the 2.9% drop over the second half of last year. June's decline in the LEI was fueled by a deterioration in consumer expectations, weak orders, a negative interest-rate spread, and rising jobless claims. However, the report notes that the rate of decline in the LEI's long-term growth rate is less negative and points to a slow recovery. The Conference Board expects economic activity will continue to lose momentum, with weak consumer spending pushing GDP growth down to around 1.0% (saar) this quarter.

Coincident Indicators (*link*): The Coincident Economic Indicators (CEI) index has posted only three declines over the last 18 months through June. The CEI climbed by 0.3% in June, following a 0.4% increase in May and a 0.1% downtick in April. It is up 2.7% over the 18 months through June to yet another new record high. All four of the CEI components—payroll employment, real personal income less transfer payments, real manufacturing & trade sales, and industrial production—once again contributed positively to June's CEI, with industrial production making the largest positive contribution for the second consecutive month.

Regional M-PMIs (*link*): The *Philadelphia district* has now released manufacturing data for July, and shows the general activity measure expanded and the future general activity reached its highest reading since July 2021. This report follows the *New York Fed's survey* of manufacturing activity for July, which showed manufacturing activity contracted for the eighth straight month. Looking at the *Philadelphia* survey for this month, the *general activity index* rose 12.6 points (to 13.9 from 1.3). Both the new orders (20.7 from -2.2) and shipments (27.8 from -7.2) measures swung from negative to positive, with new orders jumping 22.9 points and shipments 35.0 points, respectively, to their highest readings since

March 2022 and May 2022. The employment (to 15.2 from -2.5) gauge also moved into positive territory, advancing 17.7 points, showing an increase in jobs for the first time since October. *Turning to pricing*, the prices-paid index (to 19.8 from 22.5) eased slightly, while prices received (24.2 from 13.7) accelerated to its highest reading since January 2023. The *future activity* (to 38.7 from 13.8) measure jumped 24.9 points, to its highest reading since July 2021, as both new orders (31.3 from 16.2) and shipments (31.0 from -0.1) showed sharp accelerations in growth, while employment (23.8 from 19.0) continued to expand. The future prices-paid (60.2 from 56.3) gauge showed a slight acceleration in prices six months from now, while the prices received (43.7 from 58.8) measure showed a slowing.

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