September 30, 2024

Morning Briefing

No Hard Feelings

Check out the accompanying chart collection.

Executive Summary: The permabears have fueled much negativity about the outlooks for the US economy and stock market. Their analyses often don't hold up to scrutiny. Today, Dr Ed puts the prospects of a recession and a bear market into perspective, historically and in light of recent BEA data releases. The data show the economy to be remarkably resilient, including the goods producing sector. … With a strong economy and no recession in sight, why did the Fed ease last week? Answer: To boost demand for labor and reduce unemployment. But easing won't rectify a mismatch between the skills employers seek and the skills job seekers offer. ... And: Dr Ed reviews "The Perfect Couple" (+).

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US Economy I: Permabears vs Permabulls. Some of our best friends are permabears. They are smart economists and strategists who tend to be bearish. We look to them for a thorough analysis of what could go wrong for the economy and the stock market. They are very vocal and fuel lots of pessimism about the future among the financial press and the public.

In response, to provide some balance, we examine what could go right. Often, we find that the permabears have missed something in their analyses. Since they accentuate the negatives, they often fail to see the positives, or they put negative spins on what's essentially positive. We rarely have anything to add to the bearish case because the bears' analyses tend to be so comprehensive. So our attempts to provide balance often cause us to accentuate the positives while still acknowledging the negatives. Not surprisingly, we get criticized for being too positive when it comes to the outlook for the US economy and stock market and get called "permabulls."

That's alright with us, since the US economy often grows at a solid pace, and the stock market has been on a bullish long-term uptrend as a result. Consider the following:

(1) Recessions are infrequent and don't last very long (*Fig. 1*). In the US, the National Bureau of Economic Research (NBER) is the authority that defines the starting and ending dates of recessions. According to the NBER, the average US recession over the period from 1854 to 2020 lasted about 17 months. In the post-World War II period, from 1945 to 2023, the average recession lasted about 10 months. Since 1945, there have been 12 recessions that occurred during just 13% of that time span.

(2) The stock market has been in a secular bull market since the Great Crash of the early 1930s. Bear markets are also infrequent and don't last very long since they tend to be caused by recessions (*Fig. 2*). According to Seeking Alpha, there have been 28 bear markets in the S&P 500 since 1928, with an average decline of 35.6%. The average length of time was 289 days, or roughly 9.5 months. ABC News reported that since World War II, bear markets on average have taken 13 months to go from peak to trough and 27 months for the stock price index to recoup lost ground. The S&P 500 index has fallen an average of 33% during bear markets over that time frame.

US Economy II: Significant Upward Revisions Show No Landing. Among the recent pessimistic scenarios of the permabears is that real Gross Domestic Production (GDP) has been growing faster than real Gross Domestic Income (GDI). The two alternative measures of the US economy have increasingly diverged, suggesting that something is wrong with the real GDP data and that it is bound to be revised downward, consistent with the naysayers' pessimism. They haven't explained why they deem the GDI data to be a more accurate measure of economic activity than the GDP data.

Indeed, the Bureau of Economic Analysis (BEA), which compiles both series, favors GDP over GDI: "GDI is an alternative way of measuring the nation's economy, by counting the incomes earned and costs incurred in production. In theory, GDI should equal gross domestic product, but the different source data yield different results. The difference between the two measures is known as the 'statistical discrepancy.' BEA considers GDP more reliable because it's based on timelier, more expansive data."

Meanwhile, the permabears have also been ringing the alarm bell about the personal saving rate lately. It had dropped to 3.3% during Q2-2024, according to the previous estimate, the lowest since Q3-2022. One permabear wrote on September 25 that "history suggests when the SR sinks this low, it usually proves unsustainable with a subsequent rise triggering a recession. The slide in the SR from 4% at the start of this year was not due to households dipping into to their pandemic-era excess savings, which have been long since spent. But it seems that households have become used to running down their savings and can't break

the habit." His conclusion was that "the super-low US saving ratio [is] a ticking economic timebomb."

The very next day, on September 26, the BEA released its latest revisions of Q2-2024 GDP and GDI. Much to the chagrin of the permabears, real GDI was revised significantly higher, led by an upward revision in wages and salaries—which also caused a significant upward revision in the personal saving rate!

Here is the happy news from the BEA:

(1) *GDP & GDI.* Real GDI increased 3.4% (saar) in Q2, an upward revision of 2.1ppts from the previous estimate. Real GDP rose an unrevised 3.0% during Q2. The average of real GDP and real GDI—a supplemental measure of US economic activity that equally weights GDP and GDI—increased 3.2% in Q2, an upward revision of 1.1ppts from the previous estimate.

Even Q1's numbers were revised higher, likewise much to the bears' chagrin. Real GDP was revised up from 1.4% to 1.6%, and real GDI was revised up from 1.3% to 3.0%. The average of the GDP and GDI was raised from 1.4% to 2.3%. The statistical discrepancy between the two measures of the economy is tiny now (*Fig. 3* and *Fig. 4*). In current dollars, it was revised down to 0.3% from 2.7% during Q2.

(2) *Personal saving.* Personal saving was $1.13 trillion in Q2, an upward revision of $74.3 billion from the previous estimate (*Fig. 5*). The personal saving rate—personal saving as a percentage of disposable personal income—was 5.2% in Q2, compared with 5.4% (revised) in Q1. The previous estimates for the saving rate were 3.3% in Q2 and 3.7% in Q1 (*Fig. 6*).

(3) *Wages & salaries.* The upward revisions to both the GDI and the personal saving rate reflected an upward revision in nominal wages and salaries compensation. So consumer spending was strong during the first half of the year, while the personal saving rate remained relatively high, and certainly higher than the "timebomb" forecast.

(4) *Corporate profits.* There's more: After-tax corporate profits from current production (corporate profits with inventory valuation and capital consumption adjustments) was revised up by 3.5% to a record $3.1 trillion (saar) (*Fig. 7*). So corporate cash flow was also revised up, to a record $3.7 trillion (*Fig. 8*). Also rising to a new record high of $2.0 trillion was corporate dividends (*Fig. 9*).

(5) *Q3's GDP.* The current quarter will continue to frustrate any remaining hard-landers. The Atlanta Fed's *GDPNow* model shows real GDP up 3.1% (saar) during Q3. That's an upward revision from 2.9% on September 18 (*Fig. 10*). Real consumer spending is tracking at a still robust 3.3%, down from 3.7%.

(6) *No landing.* The latest BEA revisions even erased the technical recession during H1-2022 when real GDP fell 2.0% and 0.6% during Q1 and Q2 of that year. Those two numbers were revised to -1.0% and 0.3%.

The "Godot recession" continues not to show up. Instead, a rolling recession has hit a few industries that were most sensitive to the tightening of monetary policy. But the overall economy has remained resilient and less interest-rate sensitive than in the past.

As a result of the latest benchmark revisions, Q2's real GDP and real GDI are 1.3% and 3.8% greater than previously estimated. There's no hard or soft landing in the revisions. The economy is still flying high, as it has been since the two-month pandemic recession during March and April 2020!

US Economy III: Is the Goods Sector in a Recession? Even the goods sector of the economy has turned out to be remarkably resilient. Indeed, contrary to the bearish signal emitted by the national M-PMI, there has been no recession in real GDP goods:

(1) Real GDP goods remained at a record high during Q2 (*Fig. 11*). Even real consumer spending on goods rose to a record high during the quarter.

(2) In the past, there was a very high correlation between the M-PMI and the y/y growth rate of real GDP goods (*Fig. 12*). The former has been mostly below 50.0 since November 2022. Yet the growth rate of real GDP has hovered around 2.0% over the same period. That's a striking divergence from the past, when M-PMI readings below 50.0 were associated with negative growth of real GDP goods.

(3) In the past, there was a similar tight fit between the growth in real GDP goods and the y/y percent change in the Leading Economic Indicators (LEI) (*Fig. 13*). This time, they've diverged, with the LEI misleadingly forecasting a recession.

US Economy IV: So Why Did the Fed Ease? That's a good question given all the above. The answer is that Congress told the Fed to ease by mandating that monetary policy must aim to keep both the inflation and the unemployment rates low. Fed officials can certainly

claim that they have achieved this remarkable balancing act. In August, the unemployment rate was only 4.2%, and headline and core PCED inflation rates were down to 2.2% and 2.7% (*Fig. 14*).

Fed officials can declare "Mission accomplished!" And it was achieved without a recession as was required in the past to do the job (*Fig. 15*). However, the unemployment rate is up from last year's low of 3.4% in April and January. That's the main reason that Powell & Co. decided to lower the federal funds rate by 50bps last week.

They chose to ignore August's sticky readings of the "supercore" inflation rate (i.e., consumer price inflation for services excluding energy and housing), which was 3.3% for the PCED and 4.3% for the CPI (*Fig. 16*). So their mission isn't completely accomplished given that Fed Chair Jerome Powell first mentioned "supercore" inflation in his speech at the Hutchins Center on Fiscal and Monetary Policy at the Brookings Institution back on November 30, 2022. He made a big deal about it. He observed that it constituted more than half of the core PCE index. He no longer mentions it.

Meanwhile, layoffs remain subdued, as evidenced by the latest initial unemployment claims data (*Fig. 17*). Fed officials have acknowledged that the problem in the labor market is that unemployed new entrants and reentrants into the labor force are staying unemployed longer because job openings have declined.

So their easing of monetary policy is aimed at boosting economic demand and the demand for labor, i.e., job openings, which remained above the pre-pandemic levels in July (*Fig. 18*). That's great unless the unemployed don't have the skills and the geographical locations to match the job openings that are currently available. That could heat up inflation. So could the fiscal policies of the next occupant of the White House.

So why did the Fed officials decide to ease? And why might they continue to ease? They are willing to do so to avert a recession and to create more job openings. They are willing to risk inflating consumer prices as well as asset prices. We wish them luck. In any event, any remaining diehard hard-landers should remember the old adage: "Don't fight the Fed!"

Movie. "The Perfect Couple" (+) (*link*) is an entertaining who-done-it miniseries on Netflix starring Nicole Kidman and Liev Schreiber as the not-so-perfect couple. It is based on the 2018 novel of the same name by Elin Hilderbrand, who writes mostly romance novels and has been described as "the queen of beach reads." She resides on Nantucket, where most of her novels are set. A day before a lavish wedding at the couple's Nantucket mansion,

which is situated on the sea, the maid of honor is murdered by drowning and everyone is a suspect. See if you can catch the one clue early in the series.

Calendars

US: Dallas Fed Manufacturing Survey; Chicago PMI 46.1; Powell. **Tues:** ISM M-PMI & Price Index 47.6/53.7; JOLTS Job Openings 7.64m; Atlanta Fed GDPNow 3.1%; Bostic; Barkin; Colins; Cook. (FXStreet estimates)

Global: Mon: Germany CPI 0.1%; Germany Import Prices -0.4%; Germany Retail Sales; Italy CPI -0.2%; UK GDP 0.6%q/q/0.9%y/y; UK HPI 0.3%; Japan Unemployment Rate 2.6%; Japan Housing Starts -3.3%; Lagarde. **Tues:** Eurozone Headline & Core CPI 1.9%.2.7%y/y; Eurozone, Germany, France, Italy, and Spain M-PMIs 44.8/40.3/44.0/49.0/50.2; Schnabel; Nagel. (FXStreet estimates)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index rose 0.6% last week to just 0.1% below Thursday's record high. The AC World ex-US index soared 4.1% w/w to 0.7% below its June 15, 2021 record high. EM Asia was the best performing region last week, with a gain of 7.1%, followed by EM (6.2%) and the AC World ex-US. EM Latin America was the worst regional performer, albeit with a gain of 1.6%, followed by Europe (3.1), EMEA (3.1), EAFE (3.5) and EMU (4.0). Sixteen of the 17 major selected country markets that we follow rose last week. China performed the best, with a gain of 17.2%, followed by Hong Kong (11.0), South Africa (6.4), Japan (5.2), and Germany (4.6). Mexico was the worst performer, albeit falling less than 0.1%, followed by the United States (0.6), Canada (1.0), India (1.4), Brazil (1.4), and Australia (1.5). The US MSCI's 20.0% ytd gain remains well ahead of the AC World ex-US index's (12.9). EM Asia is still ahead of the pack as the leading region ytd with a gain of 19.5%, followed by EM (14.7) and the AC World ex-US. The worst performing regions so far in 2024: EM Latin America (-15.1), EMEA (7.9), Europe (11.4), EMU (11.9), and EAFE (12.1). Looking at the major selected country markets that we follow, Taiwan is the best ytd performer with a gain of 31.9%, and that country has recovered to 4.6% below its July 11 record high after bottoming at a 21.1% bear market low on August 5. Taiwan is followed by India (26.3), South Africa (21.4), China (21.3), the United States (20.0), and Spain (19.6). Mexico is the worst performing country so

far in 2024, with a decline of 19.8%, followed by Brazil (-16.4), Korea (-4.4), France (5.4), and Hong Kong (5.5).

US Stock Indexes (*link*): Forty-six of the 48 major US stock indexes that we follow rose w/w, down from 47 rising a week earlier and all 48 the week before that. The Dow Jones Transports index was the best performer, with a gain of 2.7%, ahead of S&P 500 Transportation (2.2%), S&P 500 LargeCap Pure Growth (1.4), and S&P 500 LargeCap Equal Weighted (1.2). The Russell 2000 Value index was the worst performer, with a decline of 0.4%, followed by Russell 2000 (-0.1), S&P 600 SmallCap Pure Growth (0.1), Russell 2000 Growth (0.1), and S&P 600 SmallCap Value (0.1). Looking at their ytd performances, all 48 indexes are positive so far. The S&P 500 LargeCap Growth index remains in the top spot as the best performer so far in 2024, with a gain of 26.9%, ahead of S&P 100 MegaCap (23.3), Russell 1000 Growth (23.3), Russell 3000 Growth (22.8), and S&P 500 LargeCap Pure Growth (21.9). The worst performing major US stock indexes ytd: S&P 400 MidCap Pure Value (1.6), Dow Jones 20 Transports (1.8), S&P 600 SmallCap Pure Value (1.9), S&P 500 Transportation (3.9), and S&P 600 SmallCap Value (4.0).

S&P 500 Sectors Performance (*link*): Seven of the 11 S&P 500 sectors rose last week, and six beat the S&P 500's 0.6% gain. That compares to eight sectors rising a week earlier when seven were ahead of the composite index's 1.4% gain. The outperformers last week: Materials (3.4%), Consumer Discretionary (1.8), Industrials (1.6), Information Technology (1.1), Utilities (1.0), and Communication Services (1.0). The underperformers last week: Health Care (-1.1), Energy (-0.8), Financials (-0.5), Real Estate (-0.2), and Consumer Staples (0.1). The S&P 500 is up 20.3% ytd, with all 11 sectors in positive territory and three sectors ahead of the index. During the September 6 week, a ytd high of five sectors were ahead of the index for the first time since mid-May. Information Technology is the best ytd performer, with a gain of 28.9%, ahead of Utilities (26.9) and Communication Services (26.9). These sectors are lagging the S&P 500 so far in 2024: Energy (4.8), Real Estate (10.6), Health Care (12.3), Materials (13.3), Consumer Discretionary (13.5), Consumer Staples (16.4), Industrials (18.3), and Financials (20.0).

US Economic Indicators

Personal Income & Consumption (*link*): Both personal income and spending fell short of expectations in August. *Personal income* advanced 0.2% last month, half the 0.4% forecast, while *disposable income* rose 0.2% for the third successive month in August, half May's 0.4% gain. *Personal consumption expenditures* increased 0.2% in August (vs 0.3%

expected), following July's 0.5% gain, which followed increases of 0.3% and 0.5% the previous two months. *Goods* consumption slipped 0.1% in August, after a 0.9% gain and a 0.2% loss the prior two months, with autos the major drag on August's goods spending. Both durable (-0.2%) and nondurable (-0.1%) goods spending fell during the month, while *services* spending continues to record solid gains, up 0.4% in August—averaging monthly gains of 0.5% since the start of the year. Adjusted for inflation, *real PCE* rose 0.1%, slowing from 0.4% in July, with both durable and nondurable *goods* consumption flat during the month. Meanwhile, real services consumption rose 0.2% following gains of 0.1% and 0.2% the prior two months. Real good consumption is up 0.9% ytd, while services spending is up virtually double that at 1.7%. Meanwhile, *real disposable income* rose 0.1% in August, July, and June following May's 0.4% increase. *Personal saving* fell for the fourth straight month by $14.0 billion in August and $90.0 billion over the period (to $1,053 billion from $1,143 billion). August's saving rate fell to 4.8% the lowest since December 2023, down from a recent peak of 5.5% at the start of the year.

Personal Consumption Deflator (*link*): Both the headline and core PCEDs increased 0.1% in August, which were in line with expectations. The *yearly rate for the headline* PCED eased from 2.5% to 2.2%—the lowest rate since February 2021—while the core rate ticked up to 2.7% from 2.6% in July and June, which were the lowest rates since March 2021. The headline and core rates peaked at 7.2% and 5.6%, respectively, during June 2022 and September 2022. *Goods* prices fell 0.9% y/y in August, with the yearly durable goods rate at -2.2% and the nondurable goods rates falling to -0.2%, dropping below zero for the first time since last June. There's deflation in *durable goods* prices: used motor vehicles (-9.5% y/y), furnishings & durable household equipment (-3.6), motor vehicles & parts (-3.3), other durable goods (-1.2), and recreational goods & vehicles (-0.5)—with motor vehicles parts & accessories (1.2) the one outlier, moving back above zero. Within *nondurable goods* prices, most rates are down dramatically from recent peaks: household supplies (-2.9% y/y from 10.0% y/y), clothing & footwear (0.4 from 6.9), and personal care (0.2 from 8.1); two, however, have spiked higher in recent months from recent lows: magazines, newspapers & stationary (to 4.7 from -2.1) and recreational items (0.2 from -2.6), though the latter headed back toward zero in August. Services PCED rose 3.7% y/y for the second month in August, from a recent peak of 6.0% in in February 2023. Within *services*, *housing* costs remain stubbornly high but are down from recent peaks: owners' equivalent rent (to 5.4% from 8.2%), tenant rent (5.0 from 8.8), and housing & utilities (5.3 from 8.3). Looking at *non-housing* services, transportation (1.9 from 15.3) and personal care (5.2 from 10.4) services showed noticeable drops in the rate of inflation, though the latter has been more volatile recently; the communication services (0.4) rate has moved just above zero in recent months.

Consumer Sentiment Index (*link*): Consumer sentiment for the entire month of September was slightly above the mid-month reading, advancing to its highest level since April, as inflation expectations fell to the lowest percentage since December 2020. *Consumer sentiment* rose for the second month, from 66.4 in July to 70.1 in September—slightly above its 69.0 in mid-September reading. *Expectations* moved up for the second month, to 74.4 (vs 73.0 in mid-month), after sliding three of the prior four months, from a recent high of 77.4 in March to 68.8 in July. *Current conditions* improved for the first time in six months, climbing to 63.3 (vs 62.9 mid-month), after falling the prior five months from 82.5 in March to 61.3 in August—which was the lowest since December 2022. As consumers' expectations for the economy have brightened, consumers have reported that their expectations hinge on the result of the upcoming election. "Relative to August, consumers across political parties are increasingly expecting a Harris presidency, though about two-thirds of Republicans still expect Trump to win." *Turning to inflation*, year-ahead inflation expectations fell for the fourth successive month, dropping to 2.7% in September, the lowest since the end of 2020 and down from 2.8% in August. Long-run inflation expectations rose from 3.0% to 3.1% in September—reaching the highest level since last November.

Durable Goods Orders & Shipments (*link*): Durable goods orders beat expectations in August. *Orders* were flat last month around record highs, considerably better than the expected 2.8% drop. These billings had soared 9.9% in July following a 6.9% slump in June, led by a 34.6% jump in *transportation equipment* orders following June's 20.6% plunge. Excluding transportation, orders rose 0.5% in August following a 0.1% downtick and a 0.1% uptick during July and June, respectively, remaining around record highs. Outside of transportation, there were signs of strength in August, with electrical equipment orders (1.9%) posting their biggest gain since January 2023, followed by fabricated metals (0.6) with machinery orders (0.5) moving higher following the increase in motor vehicle billings (0.2%) after two months of decline. Meanwhile, *nondefense capital goods orders excluding aircraft* (a proxy for future business investment) climbed two of the last three months, rising 0.2% m/m and 0.6% over the period and continuing to bounce around record highs. *Nondefense capital goods shipments excluding aircraft* (used in calculating GDP) has drifted lower, though it's within 1.6% of January's record high.

Regional M-PMIs (*link*): The *Kansas City* district, the fourth Fed district to release manufacturing data for September, revealed that factory activity fell moderately this month, while expectations for future activity stayed positive; its composite manufacturing (to -8 from -3) measure showed activity fell at a slightly faster pace this month, though not as fast as July's -13. The *Richmond* district, the third Fed district to release manufacturing data for

September, showed activity improved a bit but remained solidly in negative territory. The *Philadelphia* Fed, the second to report, released data showing that its general activity index moved from contraction to expansion, though barely. The first to report, the *New York* district saw business activity in the state expand for the first time in nearly a year—with its general activity index moving to its highest reading since July 2021. All month-over-month indexes were negative and lower than August's readings: production (to -18 from +6), orders (-14 from -12), shipments (-12 from -1), and employment (-11 from -7)—with production showing the biggest swing from expansion to contraction. The *future* composite index ticked up from 8 to 9, as production and employment are expected to increase substantially.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Indexes (ESIs) for the *EU* was unchanged in September at 96.7, while the Eurozone (-0.3 to 96.2) weakened a bit in September. ESIs among the *six largest EU economies* were a mixed bag—Poland (+2.0 points to 102.1), Spain (+1.9 to 107.3), Italy (+1.2 to 100.2), and the Netherlands (+0.5 to 101.1)—while sentiment in both France (-1.4 to 97.2) and Germany (-1.2 to 89.3) deteriorated. By *sector*, for the overall EU, consumer (+0.5 to -11.7), construction (+0.4 to 96.7), and services (+0.2 points to 6.6) sentiment rose, while industry (0.8 to -10.6) sentiment fell and retail trade (-0.1 to -6.5) sentiment barely budged.

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