August 2024 Update

Too Little, Too Late?

The Fed laid the groundwork for a September rate cut at last week's Federal Open Market Committee meeting. The Fed is currently communicating that forthcoming rate cuts will be "maintenance cuts" that prioritize continued economic growth over the 2% inflation target. Monetary policy will remain restrictive, just less so.

- US GDP growth accelerated from 1.4% in Q1 to 2.8% in Q2 and appears to have maintained similar momentum into the third quarter.

We are not dismissive of recent weakness in economic data. Most recessions over the last 100 years have been catalyzed by overly restrictive Fed policy and it is possible that the Fed has waited too long to normalize monetary policy.

- Last week's jobs report signaled that hiring slowed considerably, and the unemployment rate shifted higher to 4.3%.
- We don't believe policy cuts are urgently needed to prevent a US recession, but market participants have priced in a 60% chance of a Fed rate cut before the next scheduled meeting.
- Highly leveraged parts of the US economy are showing continued weakness, but, as we discussed during our third quarter live stream, we believe the three-legged stool supporting the US economy (households, firms, and banks) remains intact.
- Aggregate household income continues to grow at a healthy annualized rate of +4%.
- After two years of stagnant earnings growth, consensus forecasts imply S&P 500 earnings growth of 15% data for the next 12 months.

The equity market decline that began in mid-July picked up steam over the last few trading days. Based on Monday morning equity futures, the S&P is down approximately 8-9% from mid-July. Despite this retracement, the index remains up 10% year-to-date.

- These equity market declines currently fall into the category of "normal volatility." We expect a 10% decline in US equities every year and a 15-20% decline every 3-5 years.
- US equity weakness has been concentrated in large cap growth stocks. As of Friday, the Magnificent 7 had appreciated over 20% year-to-date, but were down nearly 15% from their early July highs. The non-Magnificent 493 other stocks in the S&P had fallen about 3%.
- Japanese stocks led the sell-off internationally and have declined 27% since mid-July.

The ongoing equity sell-off is likely due to a confluence of factors:

- First and foremost, it appears as though a Japanese Yen-funded carry trade is being unwound. Investors had leveraged their portfolios by borrowing yen to buy other assets, including the Magnificent 7 (Mag 7). The Yen has risen 14% over the last few weeks, forcing investors to sell risk assets to cover Yen losses.
- Second, weaker-than-expected economic data has led to concerns that the Fed is falling behind in reducing policy rates.
- Finally, there is profit-taking in US large-cap growth due to the Mag 7.

We believe the overall backdrop remains supportive of risk assets.

- Financial conditions have been easing since early 2023, the Fed will soon cut policy rates, and the economic cycle remains intact. Lower bond yields will also support growth.
- Our target asset allocation, which is a starting point for customization, remains neutral equities, underweight fixed income, and overweight private debt.
- Within equities, we are overweight US and US small cap, funded from an underweight to international equities.

This week's contributor: Michael Crook, CAIA

DISCLOSURES & IMPORTANT INFORMATION

Any views expressed above represent the opinions of Mill Creek Capital Advisers ("MCCA") and are not intended as a forecast or guarantee of future results. This information is for educational purposes only. It is not intended to provide, and should not be relied upon for, particular investment advice. This publication has been prepared by MCCA. The publication is provided for information purposes only. The information contained in this publication has been obtained from sources that MCCA believes to be reliable, but MCCA does not represent or warrant that it is accurate or complete. The views in this publication are those of MCCA and are subject to change, and MCCA has no obligation to update its opinions or the information in this publication. While MCCA has obtained information believed to be reliable, MCCA, nor any of their respective officers, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this publication or its contents.

© 2024 All rights reserved. Trademarks "Mill Creek," "Mill Creek Capital" and "Mill Creek Capital Advisors" are the exclusive property of Mill Creek Capital Advisors, LLC, are registered in the U.S. Patent and Trademark Office, and may not be used without written permission.