Ropes Wealth Holds Out Hope Among the Cracks

If cracks in the sidewalk are how the city breathes, then maybe the current cracks in the stock market are just investors exhaling after a breathless run since October 2022. Selling pressure was most intense for technology stocks and sectors with heavy exposure to megacap companies, like consumer discretionary and communication services. Earnings from a trio of key U.S. companies contributed to the selloff, as Visa offered fresh warnings about the strength of the American consumer, Alphabet (Google)'s results fueled concerns about its aggressive investment in artificial-intelligence-related infrastructure, and Tesla reported a -40% drop in profits as the company's global electric vehicle sales tumbled despite price cuts and low-interest financing.

Skittish investors are now wondering how much longer this selloff will continue. It had been widely anticipated, and could even be construed as healthy for markets, given large-cap stocks' lofty valuations. The rotation away from megacap names and into more affordable corners of the market will help to ease concerns about market concentration. Many are already saying this selloff will ultimately present another opportunity for investors to buy, especially with a looming interest rate cut on the horizon. Falling interest rates are usually a big tailwind for stock prices and rising earnings.

And yet, let's think about those cracks again. Are these those benign cracks that give character to the landscape, or the start of something more sinister?

To the latter scenario, former New York Fed Chief Bill Dudley offered some alarming comments this week. He said the Federal Reserve should strongly consider cutting rates – potentially as soon as next week's meeting. While the former Fed official obviously no longer casts a vote, his comments were notable given he was previously a consistent advocate of a higher for longer scenario. *"The facts have changed, so I've changed my mind,"* Dudley wrote in a Bloomberg Opinion piece. *"The Fed should cut, preferably at next week's policy-making meeting."*

Why? According to Dudley, there has been a concerning slowing in labor market conditions. There has also been a slowdown in spending *"except for the upper income rung of the spectrum."* Finally, there has been a 0.43% rise in the three-month average unemployment rate from its low point in the prior 12 months. This increase is near the threshold of 0.50 which suggests a forthcoming recession as indicated by the so-called "Sahm Rule." For those not as familiar with obscure Federal Reserve academic research, the Sahm Rule identifies an onset of a recession when the three-month moving average of the national unemployment rate rises by 0.50 percentage points or more relative to its low during the previous 12 months. Under this theory, the Fed should begin to cut rates as soon as possible to avoid an unnecessarily sizable downturn.

While Dudley's remarks were jarring, investor anxiety was a bit eased when it was reported that GDP rose 2.8% on an annualized basis in the preliminary Q2 report, surpassing the 2.0% gain expected and a two-quarter high. While still moderating from last year's more robust activity levels, the pickup in momentum from Q1 to Q2 underscores the resilience of the U.S. consumer and the broader domestic economy. But it was also coupled with a faster-than-expected pace of inflation still stubbornly elevated near 3%.

While GDP was positive, it was a bit numbing to see the ghastly numbers in the pace of new and existing home sales recorded in June. Limited inventory and high prices continue to restrain activity. In fact, it was reported that the typical "starter home" — defined as being among those in the lowest third of home values in a given region — is now worth at least $1 million in 237 cities, the highest number of cities ever. Five years ago, there were only 84 such cities. This is certainly why the Fed must feel torn in this moment, contemplating a next move when there are so many conflicting signals on growth and inflation. The pressure is on for them to make the right choice on rates, and deliver it with the right timing, as we need some pocket of stability in a world where things seem so unstable.

I would be remiss not to mention President Biden's remarks on Wednesday evening addressing why he abandoned his reelection campaign. *"I revere this office,"* Biden said. *"But I love my country more."* While Biden's legacy will be debated in the years to come, his half-century in American politics is best summed up by one of his favorite lines from his favorite Irish poet, Seamus Heaney: *"History says/ Don't hope on this side of the grave/ But then, once in a lifetime/ The longed-for tidal wave/ Of justice can rise up/ And hope and history rhyme."* And as the Olympic torch winds its way to Paris, and for a few weeks we are captivated by the competition, may we all earn a small reprieve from the wars, attempted assassinations, political unrest, and worries over global inflation to find hope again.

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