Wellington Shields

TIME TO CUT RATES

While the major averages again performed well during the second quarter, breadth continued to narrow. In early June the number of stocks outperforming the S&P was at its lowest level since 1980. We believe this type of market action cannot continue, and is usually resolved by some sort of correction or at least consolidation in the current market leaders.

The Federal Reserve's interest rate hikes have now begun to slow the economy. On July 5th it was reported that the unemployment rate had climbed three months in a row to a fresh high of 4.1%. The last time the unemployment rate rose for three consecutive months was in 2016, when the Fed backed off from interest rate hikes. Payroll growth has slowed with the three-month moving average of nonfarm payrolls at 177,000—the slowest in over two years. The risks are in one direction, and the Fed ought to lean against those risks. It is questionable, given recent rhetoric, that the Fed will cut in July, but it can use the July meeting to strongly signal a cut is coming in September. We believe any further delay risks losing the Fed's hoped-for "soft landing".

While Federal Reserve policy and the direction of interest rates are paramount in our thinking, there are many reasons to believe this is still a decent environment for stock returns. Economic growth may slow in the coming quarters, but we are not looking for an economic contraction, and although the unemployment rate has ticked up, there are still 161.2 million people working in our country, close to the record amount of 161.8 million attained last November. There is also ample liquidity in the system with money market funds reporting a record $6.4 trillion in early June. Nor are we seeing any signs of stress in the banking system, with credit spreads acting well and the stock prices of most major banks near all-time highs. In addition, analysts are still projecting S&P 500 earnings growth of 9-to-10% this year and next.

We are at that time of year when some weakening can be expected in the popular averages, and recent winners in particular. But stocks have finished positively in every election year since 1944, with average returns of 16%. With the long-term drivers of stock returns, earnings and interest rates going in the right direction, we expect that any pullbacks will likely be a contraction in an ongoing bull market.

July 2024

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