Market Commentary
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English Version

Insigneo Weekly Dispatch

Update from Jackson Hole: “The Time Has Come”

Our thoughts on the Federal Reserve Chairman Jerome Powell’s speech from Jackson Hole this morning.

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Update from Jackson Hole: "The Time Has Come"

The markets' current behavior reminds me of the feeling of anticipation I used to have as a child a few weeks before Christmas. I could not wait to open the presents under the tree. I remember picking them up, shaking and poking at them, sometimes even making a tiny little hole in the corner, just to try to get a sense of what was hidden inside. The possibility that one of them was my most desired toy made my heart race, while the thought that it could instead be "boring" clothes made my heart sink...

Markets are emotional creatures. Just like children anticipating Christmas, markets cannot wait for the beginning of the Federal Reserve's monetary easing cycle, prodding and examining the data for any clues as to its timing, size, and pace. For over a year now, we have been hearing market participants' expectations change from three cuts by March of 2024, to zero cuts, to the current expectation of 100 basis points starting next month. A slew of new data came Wednesday, after the Bureau of Labor Statistics reported a larger than average revision in payroll numbers for the one-year period between March 2023 and April 2024. The preliminary data showed that as much as 818,000 fewer jobs were gained during that period than previously reported, meaning that the labor market was weaker than people thought. To provide some context, this was the largest downward revision in payroll numbers since 2009, when economic conditions were very weak. Additionally, most of the revisions came in cyclical sectors like leisure and travel, sectors of the economy on which the Fed focuses to determine the strength of the consumer. Granted, Wednesday's number was likely influenced by several factors that were not present in 2009, namely the large number of undocumented immigrant workers that increase the supply of the labor force but are not included in payroll statistics. However, Bloomberg reported that in thirty years' worth of data accumulated by the company "…there has never been a cumulative one-year downward revision of 500,000 jobs or more without a recession." Coupled with the recent triggering of the unemployment-based Sahm rule, which also has an impeccable record at predicting recessions, these are two data points that financial markets cannot afford to ignore.

The labor market, and underlying consumer behavior, should provide a better sense of the extent of monetary easing that is needed. During a recent interview, Diane Swonk, Chief Economist at KPMG, rightly stated that "The consumer remains defiant but not defeated", as we continue to see a positive response of consumers towards price discounts. We saw a clear representation of this dynamic earlier in the week when Macy's and Target reported earnings on the same day. Macy's saw its stock more than 10% lower after reporting a weak quarter and outlook based on weak consumer spending trends. On the other hand, Target saw its stock 15% higher, after reporting a strong quarter and outlook based on increased consumer traffic. Target's lowering of prices on nearly 5,000 items was helping them weather the storm better than peers with higher price points. The moves in these stocks represented a 25% differential between two companies whose stores are often found in the same mall. The message was that consumers did not stop spending; they were just being more cautious about how they were spending. The consumer is clearly being discerning and trading down the value chain, even higher-end consumers, a dynamic which was also evident in Walmart's recent strong quarterly earnings. These earnings reports can give us a pulse on the underlying health of the consumer. Consumer sentiment is clearly trending lower, and although the rate of job firings is not alarming just yet, the pace of job hirings has slowed to the lowest level in nearly five years.

Enter Federal Reserve chairman Jerome Powell to quell market anticipation and allay uncertainty. This very morning, in his much-anticipated speech in Jackson Hole, Wyoming, chairman Powell addressed the market's impatience regarding monetary policy. "The time has come" Powell stated with unambiguous assurance, addressing the need for the Fed to cut interest rates, adding that the signs of a slower labor market were "unmistakable" and that the Fed "does not seek or welcome further cooling in labor market conditions." He also emphasized a shift in focus, from one mostly based on taming inflation, to one that also values strength in the labor market. "Upside risks to inflation have diminished and downside risks to employment have increased" he stated, furthering a shift he brought to light during the Fed's last meeting. "The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, evolving outlook, and the balance of risks. We will do everything we can to support the labor market" he added.

The markets got what they wanted in terms of clarity regarding the direction of monetary policy, sending equity markets higher. Powell's speech this morning was like a parent telling the waiting children "The wait is over; you will be able to open your presents come Christmas morning." However, although the timing of the beginning of monetary easing now appears more certain, questions remain regarding the magnitude and pace of the easing. Economists surveyed earlier in the month showed expectations of faster cooling in the labor market and a need for steeper cuts, pricing in 75 basis points -or bps- of cuts in 2024 up from 50 in July. After Powell's speech, and as of the time of this writing, the markets are now pricing in 100 basis points of cuts for the current year, down from 150 in July, with the first cut of 25bps starting in September. However, the math between a 25bp cut next month and 100bps spread over the next three months does not add up. The math is implying that investors are pricing in at least 25bps in each of the last three months of the year, with the possibility of a 50bp cut in one of these months if the labor market proves weaker than expected. In fact, markets appear to be expecting a cut at every Fed meeting over the next five meetings. This pace and magnitude of monetary easing currently expected by the markets could prove to be true in the end but are far from certain.

Although Chairman Powell told the markets today when it will be able to open its presents, what is inside the boxes remains uncertain…will it be toys, or will it be clothes? Clothes are not a bad present, but they are not the toys that most children expect to find under the tree.

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