The Weekly Snapshot

5 August 2024

ANZ Investments brings you a brief snapshot of the week in markets

It was a risk-off week, with major US indices finishing sharply lower. It followed a much weaker-than-expected jobs report on Friday, which some took to suggest the US economy was heading for a recession. It also came on the back of some disappointing quarterly earnings results from some of the mega-cap names. The declines came despite some encouraging news on the interest rate front, with central banks in both the US and UK meeting during the week.

The S&P 500 Index and the Dow Jones Industrial Average fell 2.1%, although it was the tech names that saw the biggest losses. The Nasdaq Composite Index was down 3.4%, pushing it into 'correction' territory – down over 10% from its recent high on 10 July. We also saw a reversal of the recent rotation from large cap to small call, with the Russell 2000 Index down 6.7%.

Indices elsewhere took their direction from the US. The Euro Stox 50 Index was down 4.6%, although the UK's FTSE 100 Index delivered a more modest fall of 1.3%, helped partly by a Bank of England rate cut. Asian markets were also down, with the Nikkei 225 Index in Japan one of the worst performers, down 4.7%. Local equity markets held up much better, with the ASX 200 Index in Australia up 0.3% and the NZX 50 Index up 0.8%.

Unsurprisingly, bond yields were sharply lower (when bond yields fall, their prices rise), helped by the prospect of rate cuts in the US, and actual cuts in the UK. The yield on the US 10-year bond fell by 40 basis points to 3.79%, with most of that move coming on Friday following the jobs report. Yields on the equivalent UK and New Zealand bonds fell by 26 basis points to 3.84%, and 14 basis points to 4.24%, respectively.

What's happening in markets?

Last week saw key central bank meetings in both the US and the UK, as well as a major employment report in the US.

The Federal Reserve (the Fed) kept interest rates unchanged for the eighth consecutive time, as anticipated. However, its accompanying statement and remarks from its Chair, Jerome Powell, signalled a potential shift towards rate cuts, with a reduction possibly coming as early as September. Although the Fed has not committed to a specific pace of rate cuts, Powell indicated that while a 50 basis point cut is not currently considered, the bar for a 25 basis point cut in September is low. Markets have moved to price in four such cuts through the rest of the year.

Underscoring the probability of four cuts this year was a series of weak labour market data. The July ISM Manufacturing report revealed a deeper contraction in manufacturing activity, with the Employment Index falling to its lowest level since June 2020. This also followed weaker-than-expected ADP employment data – a measure of employment in the private sector.

Rounding out the week however was the much-watched non-farm payroll numbers. This showed the US economy created only 114,000 jobs in July, a slowing from the 179,000 added in June, and well below the 175,000 expected. Meanwhile the unemployment rate rose to 4.3%, its highest level since October 2021. The report was a big worry for markets, as investors feared the Fed may have made a mistake by leaving interest rates unchanged, and that its economy could be headed for a recession.

Meanwhile, in the UK, the Bank of England cut interest rates by a quarter of a percent, to 5%. It's the central bank's first reduction in four and a half years. Its Committee voted five votes to four in favour of a cut – as its Governor, Andrew Bailey, said that inflation pressures had *"eased enough"* to enable it to cut interest rates. However, he said that savers and borrowers should not expect large reductions in the coming months, amid concerns about lingering risks to the economy. *"We need to make sure inflation stays low, and be careful not to cut interest rates too quickly or by too much"* he said.

Closer to home we had Australian inflation data for the second quarter, which came in line with economist's forecasts. The Consumer Price Index rose 3.8% from a year earlier, which was up slightly on the previous reading of 3.6%. While the headline CPI rate was up, core inflation was lower for the sixth consecutive time. The numbers come ahead of the Reserve Bank of Australia's (RBA) meeting early this week, where they'll decide on whether interest rates need to go higher or not.

Finally, quarterly earnings for the mega cap names remained in focus. Following big falls in the previous week for Tesla and Alphabet, the attention shifted to ecommerce giant Amazon. Its shares ended the week 8% lower, as it missed revenue estimates and announced weak forward guidance and job cuts. Meanwhile, Apple and Meta both beat expectations, and their shares were up by almost 1% and 5%.

What's on the calendar?

In the US, the focus will be on US Services PMI (Purchasing Manager Index) data, as the Fed has previously said it is looking for further easing of inflationary pressures within this sector if it's to go ahead and cut interest rates.

Closer to home, in Australia, we have the RBA meeting on Monday and Tuesday. Last week's inflation data seems to suggest markets no longer believe a rate hike is on the cards, with most expecting no change this week.

The attention in New Zealand will be on second quarter employment data. The labour market has shown signs of softening since last year's dip into recession, and unemployment is expected to have climbed. This will be a key data release ahead of the RBNZ's August meeting.

Chart of the week

As expected, the Fed left rates unchanged last week, but Jerome Powell hinted at a possible rate cut in September. Neither the Fed's statement nor Powell's comments were particularly dovish, but the US central bank is increasingly focusing on the loosening of the labour market.

While not a chart, the following is interesting in terms of being able to see what's changed in terms of the Fed's language since its previous meeting in June.

> Recent indicators suggest that economic activity has continued to expand at a solid pace. Job gains have ~~remained strong~~moderated, and the unemployment rate has ~~remained~~moved up but remains low. Inflation has eased over the past year but remains somewhat elevated. In recent months, there has been ~~modest~~some further progress toward the Committee's 2 percent inflation objective.
>
> The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee judges that the risks to achieving its employment and inflation goals ~~have moved toward~~continue to move into better balance ~~over the past year.~~. The economic outlook is uncertain, and the Committee ~~remains highly~~is attentive to ~~inflation~~the risks to both sides of its dual mandate.

Here's what we're reading

Barry Ritholtz: See you in September. Click here.

Alliance Bernstein: Scanning the US consumer – Conservatism, not collapse. Click here.