

When doves yell: Fed loudly signals a September rate cut

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Kristina Hooper
Chief Global Market Strategist



Dovish meeting minutes

The minutes from the July Federal Open Market Committee (FOMC) meeting were surprisingly dovish.

Powell signals a shift

At the Jackson Hole symposium, Federal Reserve Chair Jay Powell signaled a policy shift is imminent.

Watching the data

I expect a soft landing for the US economy, but recession risks continue to rise every day that monetary policy is this restrictive.

Last week saw an abundance of dovishness from the US Federal Reserve (Fed), which only increased expectations for a September interest rate cut. First, we got the minutes from July's Federal Open Market Committee (FOMC) meeting, which were surprisingly dovish. And then, during his long-awaited speech at Jackson Hole, Fed Chair Jay Powell indicated that a policy shift is imminent. Given these developments, I can't help but think about a certain song about doves, but in my version, they're yelling instead of crying (if you'd like to get the same song stuck in your head also, I'll share my lyrics at the end.)

The FOMC says a September rate cut is likely appropriate

The minutes from the July FOMC meeting were surprisingly dovish;¹ participants recognized that the US has made more compelling disinflationary progress. More importantly, there was a focus on downside risks, especially a weakening labor market and fears of a more serious deterioration – and July's meeting of course came well before the August release of the preliminary annual review of jobs, which showed a serious downward revision to jobs created.

While “several” participants noted that easing monetary policy too soon could risk a resurgence in inflation, “many” participants noted that easing policy too little or too late “could risk unduly weakening economic activity or employment.”

It seems clear the Fed no longer sees risks as balanced: “A majority of participants remarked that the risks to the employment goal had increased, and many participants noted that the risks to the inflation goal had decreased...Some participants noted the risk that a further gradual easing in labor market conditions could transition to a more serious deterioration.”

It's also important to note that the staff's economic forecast for the July FOMC meeting was “marked down largely in response to weaker-than-expected labor market indicators.” Most importantly, we learned that a “vast majority” of participants said “it would likely be appropriate to ease policy at the next meeting” if the economy evolved as the Committee expected.

Powell says now's the time for Fed policy to adjust

Then came Powell's long-awaited speech from the Kansas City Fed's Symposium at Jackson Hole. Powell was more dovish than I expected, even after reading the July FOMC meeting minutes. In my view, Powell said all the right things and signaled a policy shift is imminent: “The time has come for policy to adjust. The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks.” He also shared the powerful statement, “We do not seek or welcome further cooling in labor market conditions.”

Powell didn't even use the term "gradual" to describe his expectations around rate cuts. Not surprisingly, markets reacted positively, with small caps and cyclicals outperforming.²

The last time the Fed hiked rates was July 26, 2023. If a September rate cut comes to fruition, that means there will be about 14 months between the last rate hike and the first rate cut, which is significantly longer than the average time frame between the end of tightening and the start of easing (the average time from last rate hike to first rate cut in the last four policy cycles was 9 months).³

Markets are closely watching the economic data

Stocks have been waiting a long time for this moment. We have had several periods in the last year in which small caps and cyclicals briefly outperformed, but they were never sustainable. However, this time I believe such outperformance could be sustainable – as long as new economic data doesn't reignite concerns about recession.

A soft landing is still my base case scenario for the US economy, but recession risks continue to rise every day that monetary policy is this restrictive. From now until the September FOMC meeting, we should be watching economic data closely for signs of further weakening since the risk of recession is the biggest risk facing the economy right now. In past months, bad news about the economy was seen as good news for stocks, as it upped the chances for a Fed rate cut. But now, it's likely that bad news would simply be seen as bad news. Worse-than-expected economic data could especially derail any small cap or cyclical rally.

And that brings me back to singing about doves:

"Dig if you will the picture
Of a US soft landing bliss
Target inflation is near
Can you my darling
can you picture this?

The threat of recession worries me
Job losses at risk
Makes me lose sleep
Can we my darling
Can we avoid this?

How can we just leave the economy standing
With monetary policy that's so cold? (So cold)
Maybe this Fed's just too demanding
Maybe they're just like Paul Volcker, too bold

In September they'll start easing
Rates are too high
It's time to shift policy
They don't want to hear what it sounds like
When doves cry"

Apologies to those who are wincing right now – there is a reason I never became a songwriter.

Looking ahead

This week, the focus will be on Nvidia earnings and the Personal Consumption Expenditures (PCE) print for the US. I would caution against placing too much emphasis on Nvidia earnings since we are seeing contributions to earnings growth coming from more companies in the S&P 500, which means Nvidia's earnings are becoming less important. The PCE print will be most important, although I can't imagine a print that would derail the Fed's intent to cut in September.

Dates to watch

Date	Event	What it tells us
August 26	US Durable Goods Orders	Measures current industrial activity.
	Germany Ifo Business Climate Index	Assesses the current German business climate and measures expectations for the next six months.
August 27	Germany Gross Domestic Product	Measures a region's economic activity.
	GfK Germany Consumer Climate Index	Measures the level of consumer confidence in economic activity.
	S&P/Case Shiller US Home Price Index	Indicates the health of the housing market.
	Conference Board US Consumer Confidence	Details consumer attitudes and expectations for inflation, stock prices, and interest rates.
August 28	Japan Leading Index	Tracks economic indicators to assess the future direction of the economy.
	Crude Oil Inventories	Indicates the health of the energy sector.
	Australia and New Zealand Business Confidence	Measures current business conditions.
August 29	Eurozone Consumer Confidence	Tracks sentiment among eurozone consumers.
	Eurozone Consumer Inflation Expectations	Assesses eurozone consumers' expectations for the path of inflation.
	Germany Consumer Price Index	Tracks the path of inflation.
	US Gross Domestic Product	Measures a region's economic activity
	Japan Consumer Price Index	Tracks the path of inflation.
August 30	Germany Retail Sales	Indicates the health of the retail sector.
	Germany Unemployment	Indicates the health of the job market.
	Eurozone Consumer Price Index	Tracks the path of inflation.
	US Personal Consumption Expenditures	Measures price changes in consumer goods and services.
	Canada Gross Domestic Product	Measures a region's economic activity

Date	Event	What it tells us
August 30	University of Michigan US Consumer Sentiment	Assesses US consumer expectations for the economy and their personal spending.
	University of Michigan US Inflation Expectations	Assesses US consumers' expectations for the path of inflation.
	China Manufacturing Purchasing Managers' Index	Indicates the economic health of the manufacturing sector.
	China Services Purchasing Managers' Index	Indicates the economic health of the services sector.

Notes

¹Source for all FOMC information and quotes: Federal Reserve as of Aug. 21, 2024

²Source: Bloomberg, L.P., based on the performance of the Russell 2000 Index (3.2%) versus the S&P 500 Index (1.15%) on the day of Powell's speech, Aug. 23, 2024. Past performance is not a guarantee of future results. An investment cannot be made directly in an index.

³Source: Board of Governors of the Federal Reserve System. Feb. 1994 – Feb. 1995 hike cycle: 5 months to first cut. June 1999 – May 2000 hike cycle: 8 months to first cut. June 2004 – June 2006 hike cycle: 15 months to first cut. Dec. 2015 – Dec. 2018 hike cycle: 8 months to first cut.

Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

An investment cannot be made directly in an index.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Stocks of small and mid-sized companies tend to be more vulnerable to adverse developments, may be more volatile, and may be illiquid or restricted as to resale.

A cyclical stock is an equity security whose price is affected by ups and downs in the overall economy.

The Federal Open Market Committee (FOMC) is a committee of the Federal Reserve Board that meets regularly to set monetary policy, including the interest rates that are charged to banks.

Tightening monetary policy includes actions by a central bank to curb inflation.

Dovish refers to an economic outlook that generally supports low interest rates as a means of encouraging growth within the economy.

Disinflation, a slowing in the rate of price inflation, describes instances when the inflation rate has reduced marginally over the short term.

Personal consumption expenditures (PCE), or the PCE Index, measures price changes in consumer goods and services. Expenditures included in the index are actual US household expenditures.

The S&P 500® Index is an unmanaged index considered representative of the US stock market.

The Russell 2000® Index measures the performance of approximately 2,000 small-cap US equities.

The opinions referenced above are those of the author as of **August 26, 2024**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.