

CERTUITY®

What is the Fed Focusing On?

August 2024

Scott Welch, CIMA®



We have passed the midway point of the third quarter, and the Fed (as expected) did not raise rates at its FOMC July meeting.

The markets clearly want – and are pricing in – a rate cut in September of at least 25-50 bps, and some analysts still expect as many as three before year-end. One senior economist whom we greatly respect suggested the Fed should cut 75 bps *today* and another 75 bps in September. With complete respect to him, we just don't see it.

In his post-meeting press conference last month, Fed Chair Jerome Powell, while emphasizing “data dependency” regarding future policy changes, signaled more strongly than he has previously that the Fed is open to a rate cut in September should the data “continue to cooperate.” The market reacted positively and is now fully expecting that cut to take place.

A wild card is that this is a national election year. The Fed is supposed to be independent and non-partisan, but it will be under increasing political pressure as we approach the September meeting.

If it decides to cut or not cut, it will be criticized by one side or the other. In addition, the market is now so convinced of a September cut that it will most likely react very negatively if there is *not* one.

Remember, however, that this is the same “market” that priced in *six* rate cuts at the beginning of the year – a belief we never bought into.

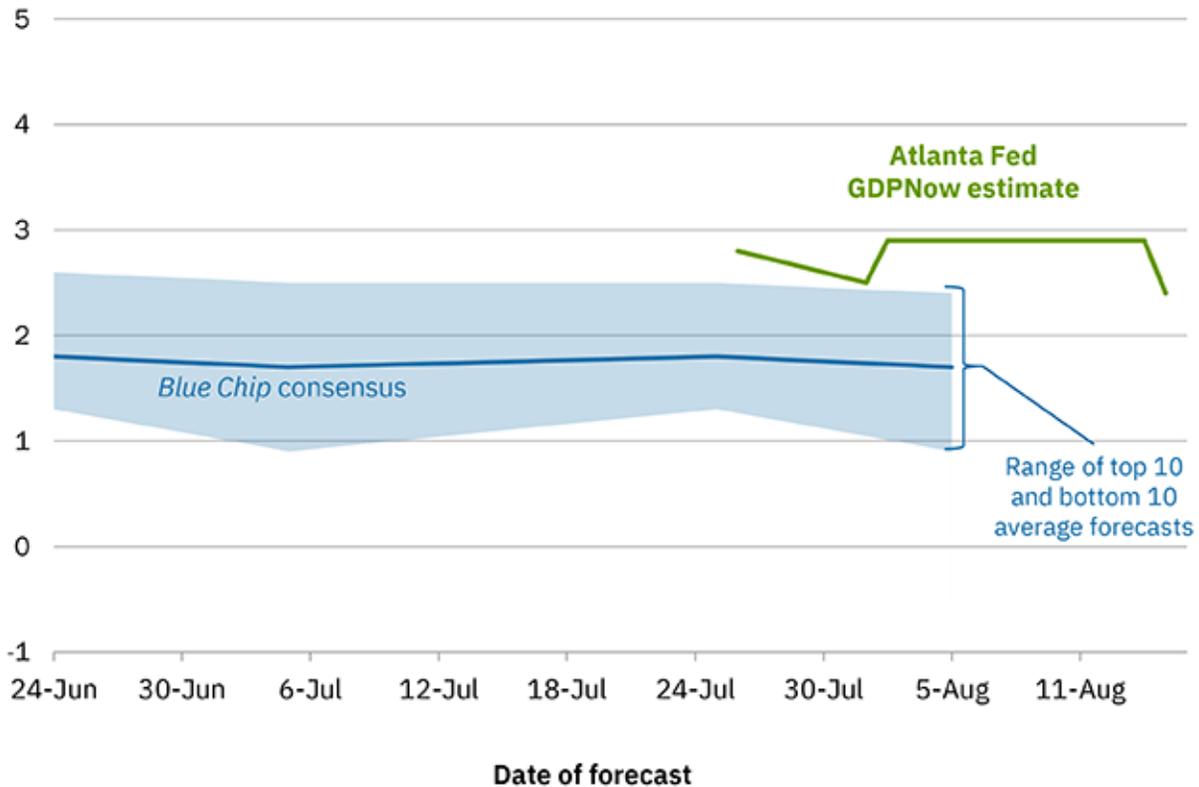
In this posting, we will focus on the three things the Fed, in accordance with its mandate, watches most closely – the economy, inflation, and the labor markets, and see which signals might suggest a Fed rate in September – and which might not. Let's dive in.

The Economy

US economic growth remains positive. The Bureau of Labor Statistics estimates a Q2 growth rate of 2.8%, following a 1.4% increase in Q1.

The Atlanta Fed's “GDPNow” indicator estimates a reasonable Q3 growth rate of 2.4%, suggesting the economy continues to prove more resilient than many analysts forecasted. Note, however, that the “blue chip consensus estimate” is much lower, coming in at under 2.0%.

Evolution of Atlanta Fed GDPNow real GDP estimate for 2024: Q3
 Quarterly percent change (SAAR)

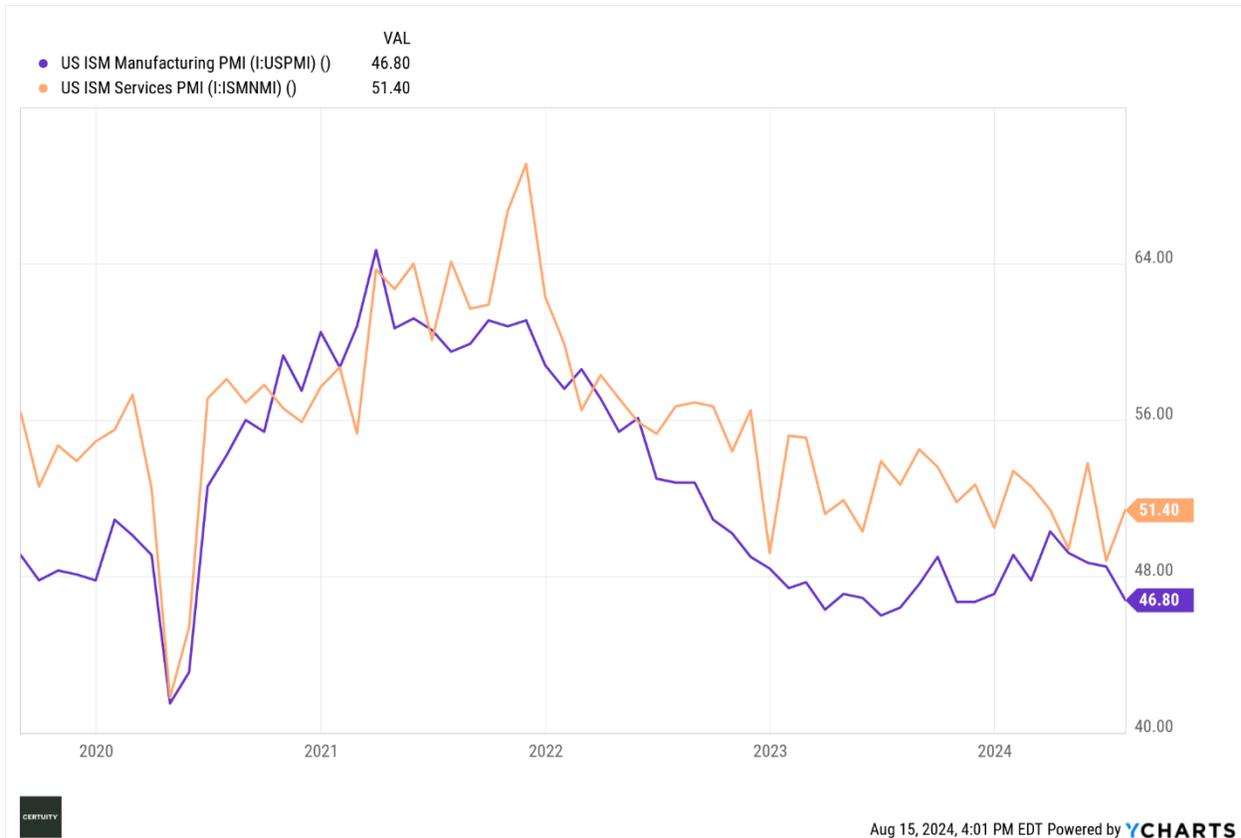


Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

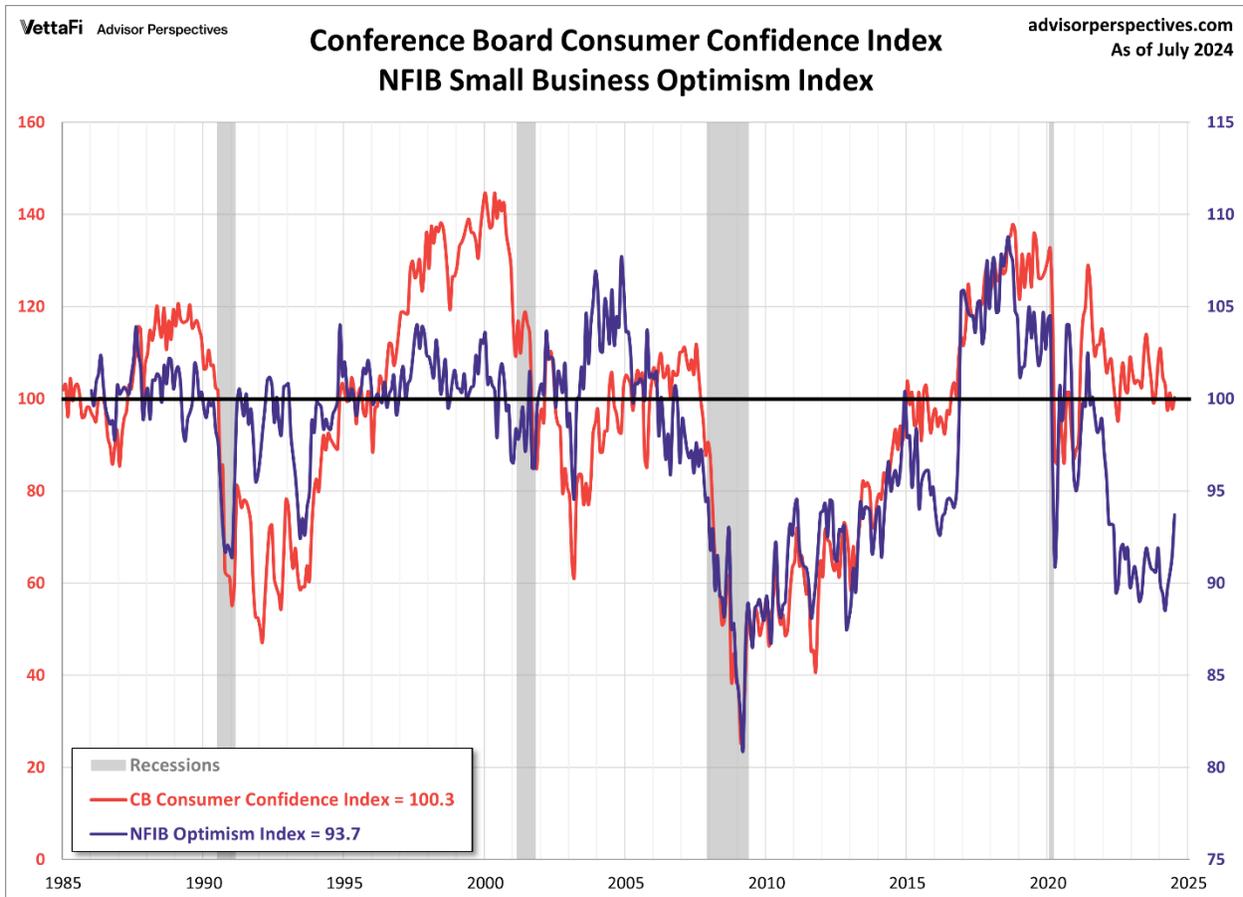
Source: The Atlanta Fed "GDPNow" Forecast, as of August 15, 2024. This is a forecast and will change as additional data are reported through the quarter.

There may be some signs of economic weakening. Through the end of July, the manufacturing sector was in a contractionary environment (i.e., a reading below 50), while the services sector inched back into expansionary mode (i.e., a reading above 50).



Source: Ycharts, 5-year data through July 2024. Readings above 50 indicate expansion; readings below 50 indicate contraction. The ISM Manufacturing and Services metrics are monthly survey-based economic indicators published by the Institute for Supply Management (ISM).

In addition, both consumer and small business owner sentiments are trending in the wrong direction (though the small business owner optimism index jumped in July), which may result in reduced consumption and hiring in the months ahead.

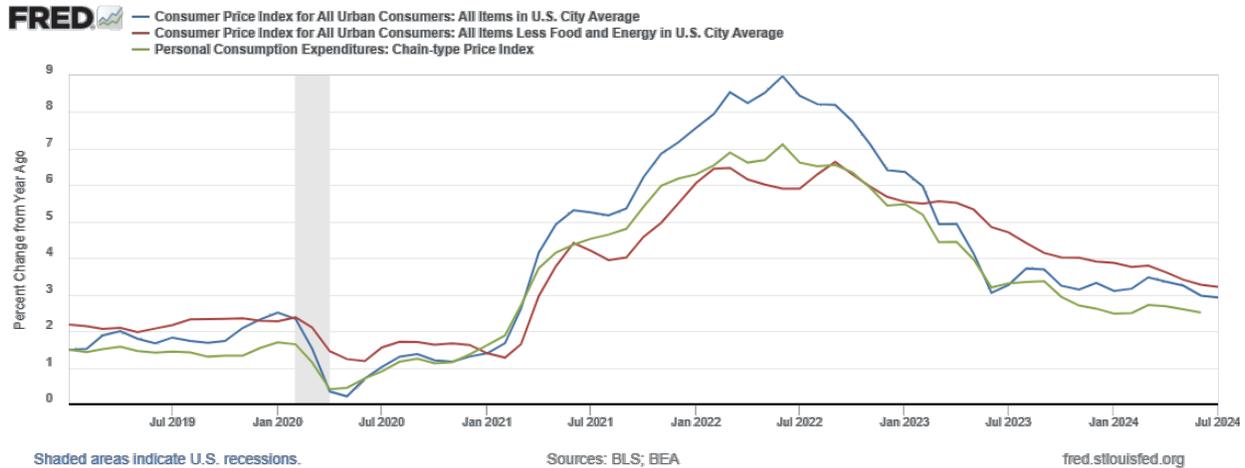


Source: *d.Short.com*, through July 2024. The Conference Board Consumer Confidence Index measures the consumers' attitudes and confidence in the economy, business conditions, and labor market, with higher readings indicating higher optimism. The National Federation of Independent Businesses (NFIB) Optimism Index is a monthly compilation of member surveys regarding optimism toward various aspects of their business. Both indicators are survey based and therefore can be volatile as perceptions and attitudes change.

In summary, the economy is maintaining a slow but steady expansion, with some signs of weakening, suggesting the Fed needs to be neither “dovish” or “hawkish” in its policy decisions until additional data come in.

Inflation

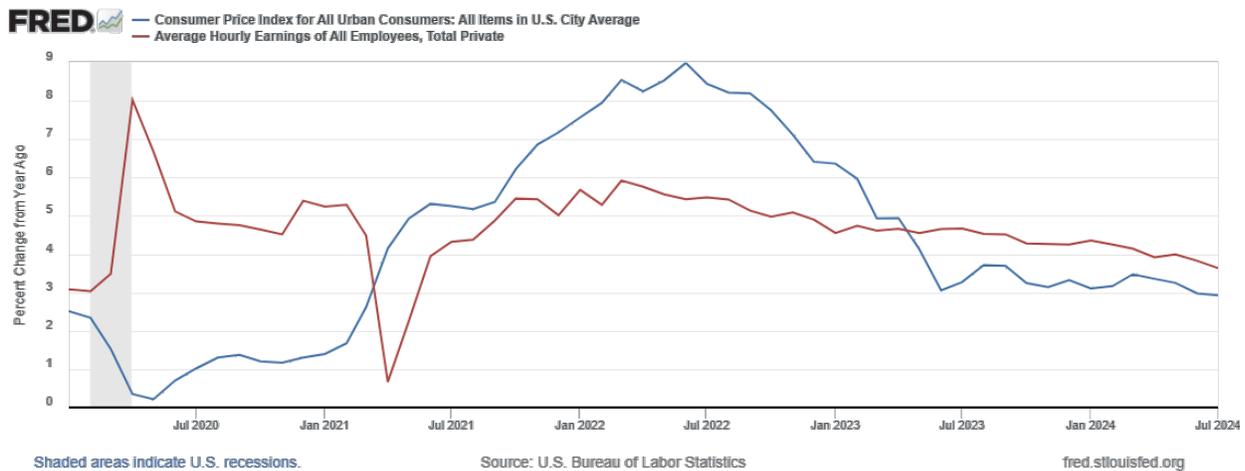
In general, inflation has moved in the right direction but remains above the Fed's target of 2% annualized. An unexpected upturn in Q1 frightened the markets into thinking we may see a reacceleration of inflation moving forward, but there are no recurring signs of that now.



Source: St. Louis Fed (FRED), through July 2024.

Next, we look at wages in comparison to inflation. After a steady increase in wages post-Covid, we see them now leveling off and trending downward.

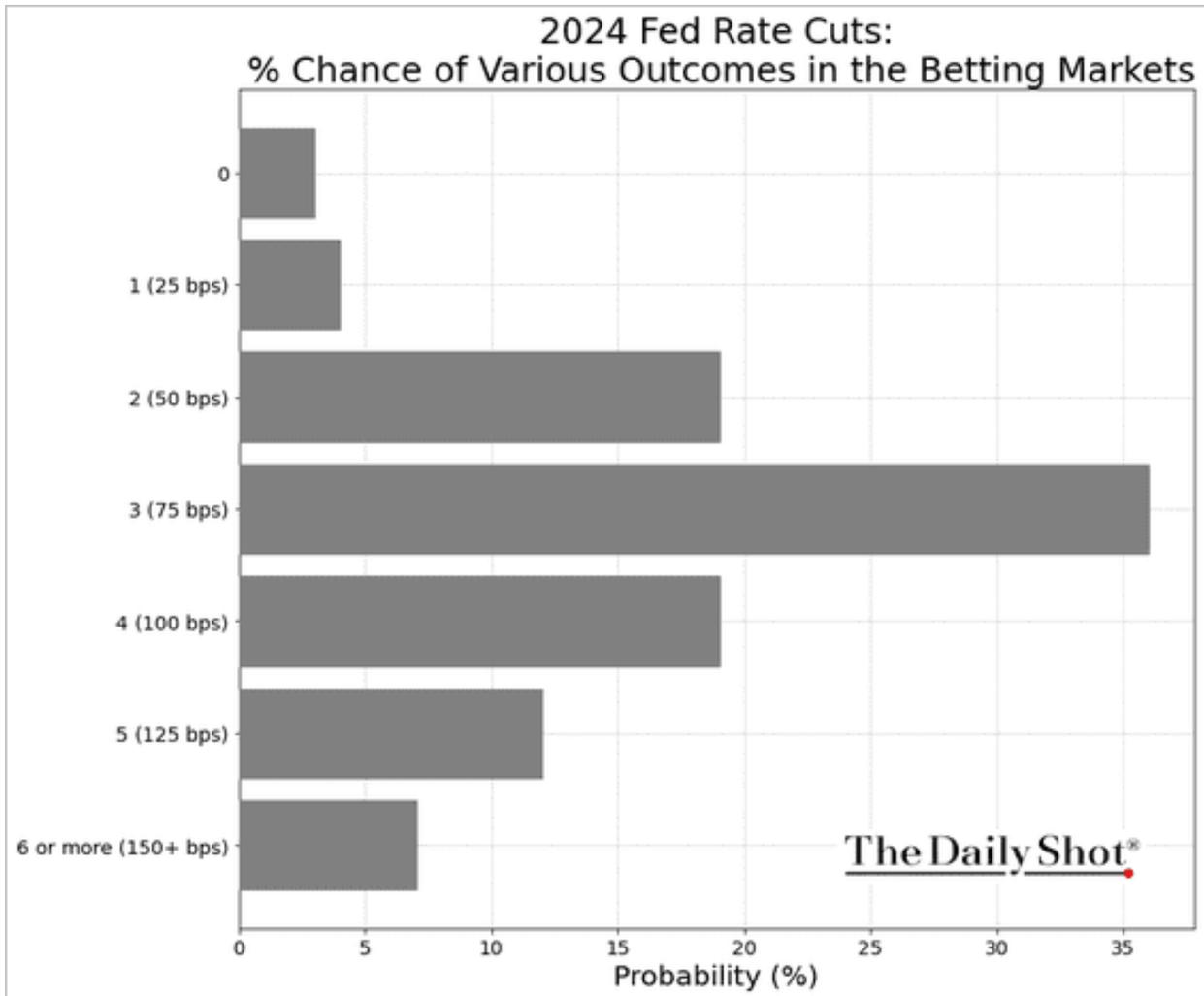
While the year-over-year rate of wage increases remains higher than that of inflation (which would tend to have an inflationary effect), we see the trend lines converging, suggesting wage pressures may not contribute significantly to inflation moving forward.



Source: St. Louis Fed (FRED), data as of July 2024.

Inflation remains probably the most uncertain aspect of the current economic landscape. The upturn in Q1 caused some analysts to fear not only the Fed not easing going forward, but perhaps even tightening if the inflationary rise continued.

More recent data, however, indicates a “cooling” in inflation from previous months. This calmed the market, and it is now once again pricing in 2-3 rate cuts over the remainder of 2024.

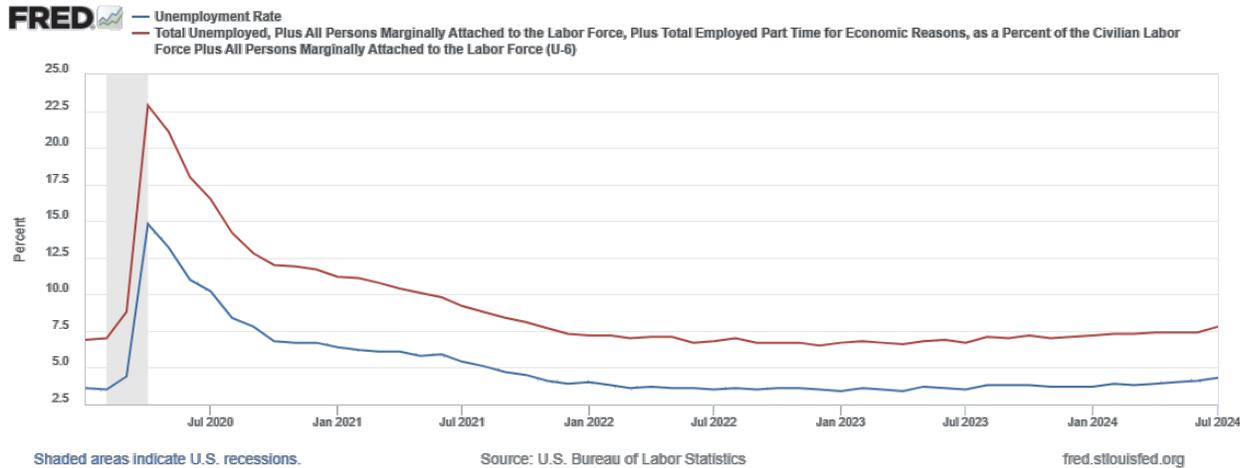


Source: The Daily Shot, as of August 15, 2024.

In summary, while inflation is trending downward, it remains above the target rate of 2% annualized. As with the economy, there is nothing here to suggest the Fed needs to move aggressively toward a rate cut unless further data indicate a continued “cooling.”

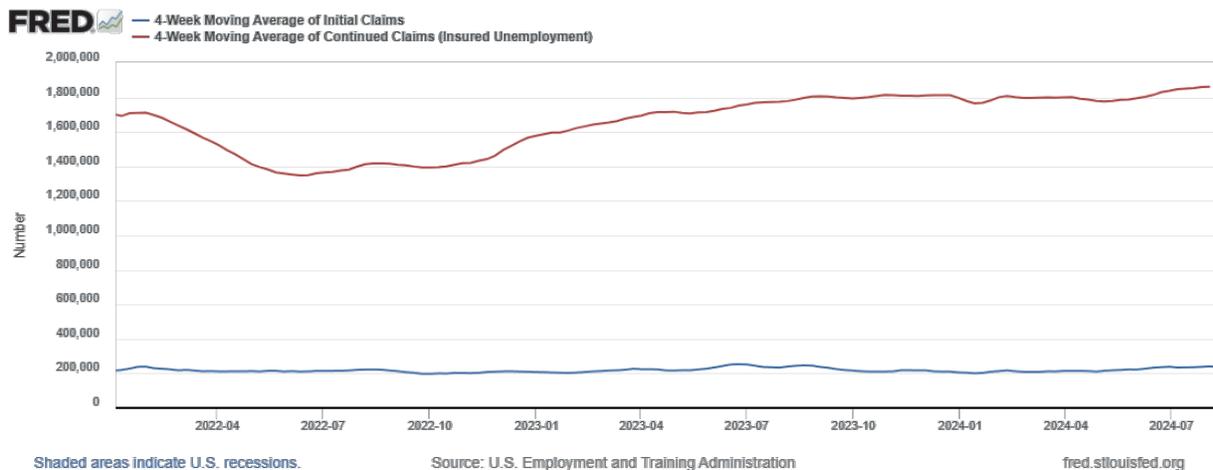
The Labor Markets

We'll start with the headline “U-3” (unemployment) and “U-6” (partial employment) rates. Overall unemployment remains low but, as with inflation, we may be seeing signs of an upward trend, which is what the Fed would prefer if it wanted to initiate rate cuts.



Source: St. Louis Fed (FRED), as of July 2024.

Let's now review jobless claims, both initial and continuing. These weekly reports can be volatile but provide a "real time" snapshot of what's happening in the labor market. Using the 4-week moving average helps to smooth out the volatility in the weekly numbers, and what we see is a continuance of the stability of the labor market over the past 2-3 years, with a slow rise in continuing claims.



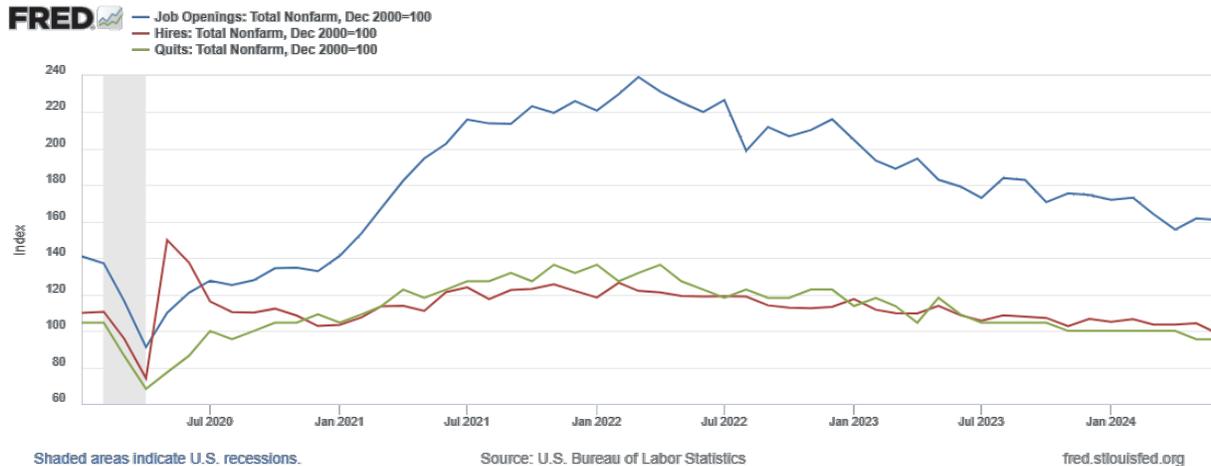
Source: St. Louis Fed (FRED), as of August 10, 2024.

Finally, let's review some "behind the headlines" numbers, in this case job openings, the "hires" rate, and the "quits" rate. Job openings and the hires rate are self-explanatory, but the "quits" rate requires some additional explanation.

Definitionally, it is exactly what it sounds like – how many employees are quitting their current jobs. But the informational value of the number is that it indicates employee confidence – the higher the quits rate the more confident workers are they can find other employment, and vice versa.

What we see is a slow but steady decline in both job openings and hires, as well as a steady decline in the quits rate – suggesting workers are becoming less confident of finding work

elsewhere and so are remaining in the jobs they have. These trends certainly signal at least a potential softening of the labor market.



Source: St. Louis Fed (FRED), data through June 2024.

This potential “softening” of the labor market is perhaps the most compelling signal for a Fed rate cut.

Summary and Interpretation

No single metric, index, or survey provides a perfect forecast of future economic conditions, and we’ve only illustrated a handful of the more well-known and followed.

All things will change as more data come in, and we’ve chosen to not dive into the “known unknowns” that may affect the economic environment over the remainder of this year – a chaotic presidential election cycle and continuing geopolitical upheaval in Ukraine, Israel, Iran and the broader Middle East, Russia, and China.

But, regarding future Fed policy, we’ve been consistent in our belief that the market was engaging in wishful thinking regarding rate cuts and, so far, that has played out.

We currently don’t see anything in the numbers that proclaim with certainty it is time for the Fed to cut rates. The economy continues to be resilient and inflation, while moving in the right direction, remains above the Fed’s target rate.

The most compelling metric for a rate cut is the softening of the labor market, and Fed Chair Powell signaled this in his post-FOMC remarks that the Fed will remain focused on *both* of its mandates – stable prices *and* employment.

It would be against its supposed independence for the Fed to make a move due to political and market pressure. But that pressure will mount as we approach the September FOMC meeting and the November election.

So, while the data do not seem to support the notion that the Fed *must* act in September, we now strongly suspect that it will.

Scott Welch, CIMA®
Chief Investment Officer
Certuity

Legal Disclaimer

Certuity, LLC, a Delaware limited liability company ("Certuity"), is an investment adviser registered with the U.S. Securities and Exchange Commission ("SEC"). Registration of an investment adviser does not imply any specific level of skill or training and does not constitute an endorsement of the firm by the SEC. Certuity® is a registered trademark of Certuity Holdings, LLC.

This presentation is intended solely for the person to whom it is delivered by Certuity. This presentation is confidential and may not be reproduced, in whole or in part, or redistributed to any party in any form, without the prior written consent of Certuity. The information enclosed in this presentation is confidential. By accepting it, you agree to treat it as such and any unauthorized use, reproduction, distribution or disclosure of this presentation or the information enclosed herein, in whole or in part, without the prior written consent of Certuity is strictly prohibited.

The information contained herein is for informational purposes only to describe certain of our investment strategies and related market commentary. The attached should not be construed to provide any specific investment advice to you or to recommend the purchase of any securities or other assets described herein, and should not be relied upon for purposes of making any investment decision. This presentation does not constitute, and should not be construed to constitute, an offer to sell, or a solicitation of any offer to buy, interests in any investment or private investment fund advised and administered by Certuity. Investors wishing to pursue any of the investment strategies described herein must obtain and review offering documents and other materials describing the investment or investment strategy. In addition, this presentation is not intended to serve as the basis for any contract to purchase or sell any security, or other instrument, or to enter into or arrange any type of transaction as a consequence of any information contained herein.

Certain information contained herein has been obtained or derived from unaffiliated third-party sources believed by Certuity to be reliable. Neither Certuity nor any of its affiliates or representatives makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein and nothing contained herein may be relied upon as an indicator or representation as to prior or future performance.

Some of the materials contained herein may be characterized as "forward-looking statements", which can be identified by the use of forward-looking terminology such as "may", "will", "should", "expect", "anticipate", "target", "project", "estimate", "intend", "continue" or "believe" or the negatives thereof or other variations thereon or comparable terminology, and which may include, among other things, projections of future performance, estimates, forecasts, scenario analysis, or pro forma information. These forward-looking statements reflect Certuity's views with respect to future events. Actual returns and results could differ materially from those in the forward-looking statements as a result of changes in assumptions, market conditions, and other factors beyond Certuity's control. Investors are cautioned not to place undue reliance on such information. No representation or warranty, express or implied, is made or can be given with respect to the accuracy, completeness, fairness, reliability or suitability of any information included herein. Furthermore, no representation or warranty is made that the information presented, including the views expressed, will be realized as a result of implementing the investment strategy and proposed fund structure. Additionally, there is no obligation to update, modify or amend this report or to otherwise notify the recipient in the event that any matter stated herein changes or subsequently becomes inaccurate.

Products and/or services offered by Certuity are not deposits or other obligations of Certuity, are not endorsed or guaranteed in any way by Certuity or any banking entity, and are not insured by the Federal Deposit Insurance Corporation or any other government agency. Certain products and services may have restrictions on their transfer or sale. There can be no assurance that actual returns and results will not be materially lower than those presented. Any prior investment results or returns are presented for illustrative purposes only and are not indicative of the future returns of the issuers of the securities described herein. An investment in any Certuity product or investment service involves a high degree of risk and could result in the loss of your entire investment.

All analyses and projections depicted herein are for illustration only and are not intended to be representations of performance or expected results. The results achieved by individual clients will vary and will depend on a number of factors including prevailing dividend yields, market liquidity, interest rate levels, market volatilities, and the client's expressed return and risk parameters at the time the service is initiated and during the term. Past performance is not a guarantee of future results.

Stock values fluctuate in response to the activities of individual companies and general market and economic conditions. Bond values fluctuate in response to the financial condition of individual issuers, general market and economic conditions, and changes in interest rates. In general, when interest rates rise, bond values fall and investors may lose principal value. Certain investment strategies tend to increase the total risk of an investment (relative to the broader market). Alternative investments, such as commodities, real estate, and short strategies, are speculative and entail a high degree of risk. Foreign investments are especially volatile and can rise or fall dramatically due to differences in the political and economic conditions of the host country. Certain investment strategies tend to increase the total risk of an investment (relative to the broader market).

This presentation is not intended to provide legal, accounting or tax advice. Because investment products and services often have tax consequences, you should consult your own attorney or tax adviser to fully understand the tax consequences of any product or services mentioned in this presentation. You should seek financial advice regarding the appropriateness of investing in any securities or investment strategies discussed in this presentation. Information regarding Certuity's fee schedules are described in its Form ADV Part 2A. Any additional information regarding this presentation is available upon request.