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Why So Sensitive?

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For some months the performance of public markets, both fixed income and equities, brooked few doubters. As one strategist put it, “Stocks have become a buy high, sell higher asset class.”

All that changed last week. July’s labor report showed the US economy added only 114k jobs, down sharply from June’s level of 179k. Unemployment rose to 4.3% from 4.1%. Markets (as they say) swooned on the news. Confidence in the economy was replaced by worries that the Fed had waited too long and would now be forced to cut rates quickly to avoid a recession.

As so often happens in these situations, cooler heads took the time to read the details of the jobs data. Turns out the numbers of unemployed increased in part because the numbers of jobseekers increased. In fact, the participation rate of 84% was the highest in twenty-three years! And over 70% of job losses were temporary, mainly weather-related, layoffs.

Accordingly, markets snapped back. Only to slump again on Japanese yen trade weakness. Finally the week ended on more good labor news. Initial jobless claims shrank to 233k from the prior recent high of 250k. And the S&P 500 had its best day in two years, up 2.3%, with the 10-year Treasury yield back up to 4%.

Market participants, as one analyst remarked, “had been puzzled to a degree by the amount of sensitivity the market was showing.” Timing is a factor. The Fed’s likely rate hike meeting is upon us, so incoming data between now and then receives greater scrutiny. Everyone is also alert to a recession scenario and how quickly rates must drop to offset that risk.

Volatility, of course, is one of the reasons institutional investors view alternatives with such favor today. Its return last week reminded many of alts’ virtues. Not the least of which is that prices are decided by fundamentals, not technical whipsawed with every new piece of economic news.

As we head to our end of summer break, let’s reflect on three things that will *not* change. First, rate expectations are headed lower, beginning next month; likely to include at least one more cut before the end of the year. It’s also clear that pattern will continue into 2025.

Second, the economy will continue to grow, albeit slowly. Business services will lead the way, along with other defensive sectors such as healthcare, technology, and software. The consumer is still spending, though sentiment remains cautious.

Finally, availability of private capital solutions for issuers and investors is still plentiful. Second half deal flow should benefit from transactions looking to close before volatility roils markets at year-end. And investors will deploy cash to take advantage of higher yields, tighter structures, and stable valuations with less sensitivity to market whims.

? From the Editor: The Lead Left will be on its annual August break and will return the week of Sept 2.