



6 August 2024

FLASH CRASH?

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Howard Marks, the respected investor, made one of the most insightful comments on the relationship between markets and economies or the “real world”. He said, markets go from flawless to hopeless, while the real world goes from not so good to not too bad.



The last month has illustrated that with vengeance. What has actually happened? Earnings results are coming in pretty well in the main; not every company will do well, but in the main the results are good, some very good. The finance sector is not having major issues with loan books, always a good thing.

The Fed seems to be getting what it wants – the extreme tightness in the labour markets is diminishing, wider inflationary pressures have dropped sharply and are now close to their target level. So much so that they have signalled a rate cut in September. The yield curve has gone normal (that is yields are higher with increasing length of maturity) which is often cited as an indication of

economic growth not recession. Interestingly, the Fed has some firepower this time. During the post GFC period the Fed had no further capacity to reduce interest rates – they were effectively at zero. At this point they are at over 5%! The Fed presently has its most powerful tool available to increase economic growth. Critically, the shortage of housing in the US (and many developed economies) is very high. Current demand has softened as a result of mortgage rates more than doubling, but it is likely to return once they are lowered, and that, we have been told is going to happen in September. With housing comes demand in a raft of other areas. That is, it has a big multiplier effect. This would not seem a time to feel overly pessimistic.

Prices, as we recently commented are high in the tech sector, but nowhere near the extent they were in earlier tech bubbles in 2000 and September 2021. The exception being in those extraordinary companies Nvidia (chip designer) and, for instance, ASML (the maker of chip making machines). There are quite a few more but it is not endemic by any means. Outside the tech sector there are plenty of sectors where the pricing of good quality stocks is attractive.

Our view is that markets have done the switch from flawless to hopeless while the real world is about to improve from currently being a bit below average. What would the US economy look like if the Fed reduced interest rates 1% or 2%?