Tactical Market Update. Powell Encourages Investor Confidence
Week Ahead

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Several Federal Reserve representatives are slated to speak, potentially providing insights into the rationale and underlying logic behind the recent decision to reduce the interest rate by 50 basis points (bps). Investors will also be keen to understand the interpretation of the ambiguous inflation and retail sales data released prior to the Fed meeting.

The forthcoming macroeconomic calendar features an array of compelling releases. The S&P Global PMI business sentiment assessment is poised to garner significant attention. As we progress towards the end of the week, the spotlight will pivot to a crucial set of data that provides insights into the “health” of the consumer. This includes the University of Michigan’s sentiment index (UMich), consumer expenditures, and the PCE deflator.

Investors will continue to analyze the implications of the Fed's recent decision, with the easing of option positioning following the substantial September expiration (which occurred on Friday), expected to sustain increased market volatility. It is worth noting that the second half of September historically poses challenges for equities, particularly during the pre-election period. This seasonal trend advises caution, even though the market appears robust from a technical standpoint, currently hovering near historical highs. The S&P 500 is projected to fluctuate within the 5,600-5,800 points range. Upcoming quarterly earnings to watch include those from Costco (COST), Accenture (ACN), and Micron Technology (MU).

Monday – September 23

S&P Global PMI (preliminary). The manufacturing index may improve – the consensus forecast predicts an increase from 47.9 to 48.6 points. Regional indices from New York and Philadelphia Feds have unexpectedly moved into growth territory in September.

Tuesday – September 24

Conference Board Consumer Confidence Index. The consensus forecast suggests the index will remain nearly unchanged. We’re closely monitoring the “labor market differential,” which has notably declined in recent months, closely correlating with the rise in the unemployment rate. Stabilization of the differential would be a positive signal.

Wednesday – September 25

No significant events are scheduled.

Thursday – September 26
Pending Home Sales Index. Mortgage rate cuts have not yet revitalized sales. We expect a near-zero change following July's 5.5% month-over-month drop.
Weekly Jobless Claims. Initial jobless claims are expected to rise from last week's 219,000 – the lowest level since May – due to the effect of the shortened business week.

Friday – September 27
PCE Price Index. The Core PCE price index, taking into account inputs like CPI and PPI, may increase by about 0.15% m/m, aligning with the regulator's annualized target. Such statistics would confirm there are favorable disinflationary forces in the economy.
Concurrently, data on personal income and spending should underscore the high probability of a soft landing scenario for the economy.
University of Michigan Consumer Sentiment Index. We anticipate a slight improvement compared to the initial estimate of 69 points published on September 13. The positive impact of the Fed's actions may be reflected in the forthcoming releases of this index.

Highlights of the Week
Stock indices rallied last week. The S&P 500 reached a new all-time high, climbing by 1.4%. The equal-weight S&P 500 mirrored this performance, while the Russell 2000 index rose by 2.1%. The results of the highly anticipated Fed meeting proved favorable. The regulator demonstrated what the market most wanted to see: the Fed is prepared to take decisive actions to support economic growth in a timely manner.
Fed officials have decided to lower the rate by 50 bps at once. It's worth noting that the probability of this event was estimated at about 60% prior to the meeting, indicating that investors were not unanimous on the Fed's forthcoming actions. **According to Jerome Powell, the aggressive rate cut was influenced by "risk management" considerations: inflation risks have declined while the risks of a deterioration in employment have risen.**
However, Powell emphasized the strength of the labor market, which is only cooling relative to a very overheated condition. Fed Chair also expressed confidence that proper policy easing would preserve the strength of the labor market, thus the 50-bps cut did not trigger investor panic.
The regulator anticipates the unemployment rate to slightly increase until the end of the year, and then stabilize at 4.4%. The forecast for GDP growth in 2025-2026 remains unchanged at 2% per year, while the inflation forecast has been downgraded by one or two tenths of a percentage point.

The new rate forecast anticipates a 25-bps cut in both November and December, followed by an additional 100 bps reduction in 2025, bringing the rate to within the 3.25-3.5% range. This outlook suggests a transition to a quarterly decline rate beginning in early 2025. It's worth highlighting that this path is markedly different from the more aggressive expectations held by market participants. According to rate futures, the decline to the 3.25-3.5% range could occur as early as March or May 2025. This discrepancy likely stems from the market's more pessimistic outlook on employment dynamics and economic growth. Should the unemployment rate rise above 4.4%, the Federal Reserve may be compelled to reassess the projected pace of monetary policy normalization. Additionally, the neutral rate estimate has been adjusted upward from 2.8% to 2.9%, while still assuming a range of 2.75-3%.

The retail sales statistics for August largely met market expectations. Overall volume experienced a modest growth of 0.1% m/m. As anticipated, the negative contributions stemmed primarily from the gasoline and vehicle sales sectors. Conversely, sales within the control group showed a healthier increase, rising by 0.3% m/m.

We maintain a positive outlook for the S&P 500 through the year's end. One compelling argument for a sustained rally is the possibility that the significant lag in semiconductor stocks observed during the third quarter (the SMH ETF has experienced a 9% decline since early July) may be supplanted by outperformance in the final three months of the year. This potential for rotation and leadership change appears considerable. Additionally, the robust AI trend is anticipated to bolster the market in the medium to long term. Highlighting sector performance, the Utilities sector (XLU ETF) has demonstrated an impressive rally, largely driven by the energy demands of data centers. Notably, this sector has emerged as the top-performer both since the beginning of the third quarter and continuing into 2024.

Technical Analysis

Last week, the S&P 500 soared to a new historical high, driven by robust bullish momentum. Notably, the RSI indicator has not yet entered the overbought territory, suggesting that the upward movement may have further room to run. Analysts identify the next key targets for buyers as the 5,750 and 5,800 levels. Meanwhile, the 5,600 points mark is expected to serve as a significant support zone.

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