August 8, 2024

| Dow Jones | S&P 500 | NASDAQ | Russell 2000 | 10 yr Treas | Bitcoin | Gold | Crude Oil |
|---|---|---|---|---|---|---|---|
| 39,446 | 5,319 | 16,660 | 2,084 | 4.00% | 59,662 | $2,467 | $76.09 |

# *Investment Strategy Report*

## *Double Whammy Causes Stock Sell-Off, Bond Rally*

Things got a little spooky this past Monday morning (8/5) for investors. Stocks plunged to begin the day, and at their lows at the beginning of trading, the stock indexes were down a substantial 4.3% for the S&P 500 and a scary 6.4% for the Nasdaq. The yield on the 10 year Treasury note, which had been 4.36% a month ago, nose-dived to a low of 3.67%, as investors ran to the safety of government securities. The panic didn't last very long. By mid morning, the panic had subsided and stocks pared their losses. What caused the sell-off and what helped to allay investor fears?

Stocks got hit by a double whammy. The first "hit" was the weak jobs report that was released last Friday morning (8/2). The Federal Reserve had met 2 days prior (7/31) and left interest rates unchanged, citing that their restrictive monetary policy was still necessary to rein in inflation. However, the weak jobs report turned that thinking on its head, causing investors to fear that the economy was indeed weakening and that the Fed had fallen behind in their mission to engineer a soft landing. Another Fed policy mistake, this time, too slow to cut rates, would lead to a recession.

However, the second "hit", caused even more damage to stocks. This was the unwinding of the Japanese Yen carry trade. To understand this, you need to know that the yen has been weakening vs. the dollar for all of 2024 (and for 3 years prior as well). Japanese traders had been taking advantage of this by converting their yen into dollars and buying US large cap tech stocks. This strategy benefited them in 2 ways: 1) they made money on the appreciating stocks and 2) as long as the yen continued to depreciate, the dollars they were holding appreciated in value. This worked well for them until the Bank of Japan put an end to this by raising interest rates last week. This caused the yen to appreciate in value vs. the dollar, causing huge losses for these traders. They then had to sell their stocks causing the stock market decline.

The selling stopped mid morning on Monday because a strong ISM services report, suggesting that the economy might not be as weak as some thought, allayed recessions fears. Stocks got another boost today (8/8) when the weekly jobless claims number was less than expected, again adding positive sentiments for the economy. A third reason that stocks had a big up day today (S&P up 2.3%), was due to reports that the unwinding of the yen carry trade was almost done, reducing the selling pressure.

The question now is whether this approximately 10%, very quick, correction was just a normal pull back in the midst of an ongoing bull market, and has thus presented us with a buying opportunity? Or has this 19 month stock market rally, led by huge gains in the mega-cap tech stocks, been too much, with stock prices needing to get knocked down further to more reasonable levels?

My feeling, and the consensus among my analysts, is that there are reasons to be optimistic. 1) The Fed now sees that it needs to get serious about rate cuts. A 50 basis point cut is priced in for September and further cuts are seen for Nov., Dec., and January. These actions will help to prop up equities. 2) The analysts at Sentimentrader.com are in agreement that their indicators are favorable for stocks. a) Jay Kaeppel wrote on Tuesday (8/6) "Two Indicators arguing for "buy the dip". He looked at stock relative strength and the Nasdaq McClellan Oscillator and concluded that it "suggests that the current pullback is normal and that the historical probabilities favor a rebound in the months ahead". b) Dean Christians wrote yesterday about Bollinger Band parameters and concluded that they indicate "an oversold condition within a long term uptrend", suggesting that stocks can bounce back quickly, especially the S&P 500. c) Dean also wrote yesterday that the "stock/bond ratio plunged to a historically low level as traders abandoned stocks in favor of bonds. Following similar periods of panic-driven fear, S&P 500 returns and consistency were excellent, especially over the following month. A year later, the S&P 500 rose 92% of the time". He also added that the 10 year Treasury yield fell 77% of the time, creating a favorable environment for bonds as well.
*Jeff Feldman*