Weathering Market Storms

August 12, 2024

Charleston went through a tough summer tropical storm last week, and much of the East Coast has suffered from excessive rainfall and flooding. Financial markets also encountered a summer storm last week as bond and stock markets experienced unusual volatility. Various reasons have been given for the dramatic swings in stock prices, but one significant event was the trigger that surprised investors. On Monday, the Japanese stock market (Nikkei-225 index) dropped over 12% and flowed into U.S. markets on the open. Speculators have been using the recent strength of the Japanese yen to purchase other assets, most notably the Mexican peso and cryptocurrencies. Moreover, in a surprising and aggressive move, the Bank of Japan voted in late July 2024 to increase its short-term policy rate target to 0.25% from 0% to 0.1%. This interest rate hike marked the first in the country since 2007, signaling a clear shift in monetary policy. Once the speculators were chastised, the Nikkei rallied 10% on Tuesday, and other financial markets followed suit.

Market observers gave various reasons why stocks and interest rates initially declined but then rallied by the end of the week. Daily releases of economic statistics allowed traders to buy and sell securities based on the market's interpretation of whether there would be a soft landing or a recession on the horizon. These price swings had little to do with the overall corporate profit picture as companies continued to report earnings that were generally better than expected by Wall Street analysts. As we said earlier this year, there would be some periods of increased market volatility, especially among the high-flying large-growth stocks, simply because the wave of enthusiasm that characterized their first-half performance could not continue. As the second half began, most of these stocks fell into correction territory, giving back some of this year's gains.

This week is important from an economic perspective because inflation data will be reported, as will data on unemployment and consumer confidence. These data could swing the markets again if one or more reports fall out of the expected range, resulting in additional market storms. However, current data suggests that the economy is slowing, and inflation is in a downtrend. Professional investors expect one or more Federal Reserve rate cuts beginning in September, and markets generally like an environment of falling interest rates. And as we head into November, the outcome of national elections may result in another disturbance in financial markets. History tells us that such market storms are short, whether a Democrat or Republican is elected.

Equity markets tend to rely on rising corporate profits to keep an uptrend intact. Remember that even though the underlying company fundamentals look favorable for the stock market in general, outside events, such as the one markets experienced last week, can temporarily offset a long-term favorable trend. Thankfully, there is no rain in sight in Charleston today!

109 East Bay Street, #1E, Charleston, SC 29401
843-342-3044 www.vcm.us.com