August 2024

From the front page of this weekend's WSJ:

Volatile Month In Stocks Ends on High Note

Encouraging data override concerns about labor market; indexes surge late

BY SAM GOLDFARB

Major U.S. stock indexes closed the books on a tumultuous August with monthly gains, riding a string of encouraging economic data to overcome concerns about the health of the labor market.

For all the intervening volatility, stocks rallied Friday to finish the month not far from where they started. The S& P 500 climbed 2.3% from the end of July, leaving it just shy of its record close. The Dow Jones Industrial Average rose 1.8% for the month, and the tech-heavy Nasdaq Composite ticked up 0.6%.

Knocked off kilter by a disappointing July jobs report in early August, stocks at one point appeared to be in a major tailspin as worries about the economy triggered an unwinding of popular trades, including bets on large technology companies.

But markets quickly regained their footing and were eventually buoyed by a run of better data. Not long after the July jobs data was released, reports showed continued easing in inflation and a jump in retail sales.

Weekly unemployment claims also remained steady— a sign that, while a cooling labor market might be leading to a hiring slowdown, it is still not causing any big increase in layoffs.

Markets remain in a delicate balance .... Despite encouraging signs in recent weeks, the labor market remains a source of anxiety, putting a huge amount of weight on the August jobs report, which will be released next Friday.

While Federal Reserve Chair Jerome Powell has strongly signaled that the central bank plans to cut interest rates at its next meeting on Sept. 17-18, other officials have sent conflicting messages about how rapidly they want to cut rates beyond that point. ...

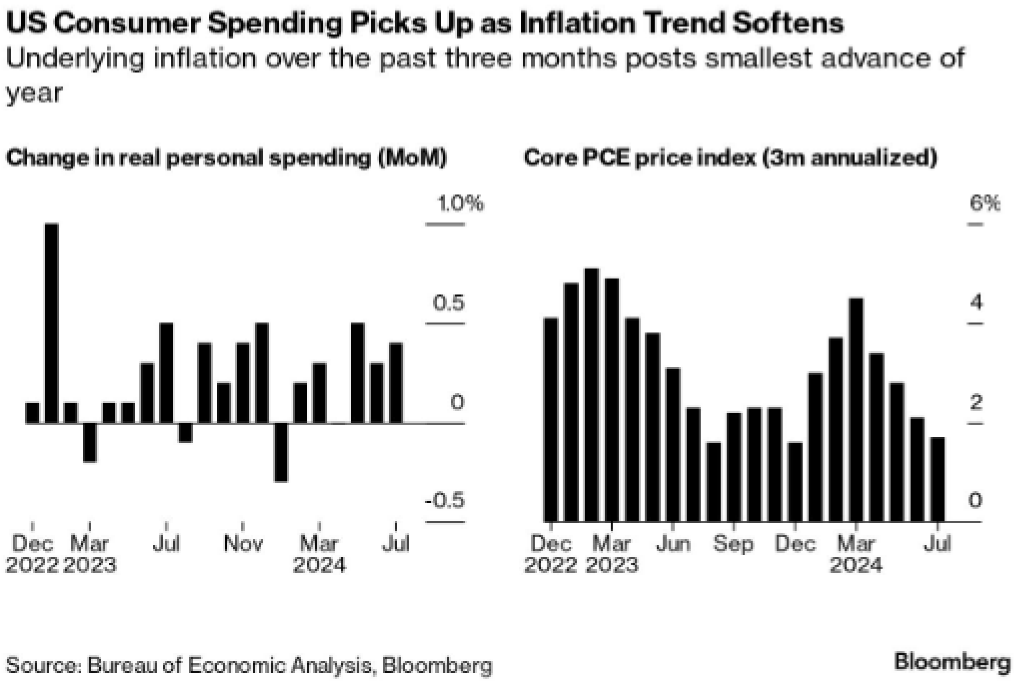
Friday’s moves came after the release of broadly positive economic data. ... personal spending rose 0.5% in July from the previous month, up from 0.3% in June. Personal income exceeded expectations, while the Fed’s preferred inflation gauge held steady at 2.5% on an annual basis. ...

By the end of the session, the yield on the benchmark 10-year U.S. Treasury note had settled at 3.910% ... down from 4.107% at the end of July. ...

Interest rate futures suggested Friday that investors thought there is a roughly 31% chance the Fed will cut rates by a larger-than-normal half percentage point at its next meeting, according to CME Group. That was down from 85% earlier in the month but still up from 12% at the end of July.

From Bloomberg's Weekend Reading:

If there's one truism about the US economy these last few years, it's that the consumer—perhaps America's biggest economic engine—keeps on spending. As the pandemic recession gave way to a labor market roaring back to life, and then half-century records, it's been Americans clicking "purchase" or swiping credit cards that's [kept growth solid](). Now, with a Federal Reserve interest-rate cut in the cards for next month, recent economic data shows inflation continued to [slow]() in July and spending stayed robust despite higher borrowing costs—all the makings of Fed Chair Jerome Powell's soft landing. Still (and there's always a still), income growth is much more sluggish, the [job market softer]() and the savings rate slower. These points arguably raise questions about the durability of consumer spending, but it's been a rough three years for Team Recession and their fellow travelers. The numbers right now look more favorable to Powell declaring final victory.



Another piece of this puzzle is arriving soon in the form of the monthly jobs report, the final comprehensive look at the US labor market before the Fed's policy meeting. Over in Europe, which is already ahead of the Fed as far as lowering rates is concerned, another European Central Bank cut [got fresh reinforcement]() as euro-area inflation in August plunged to the lowest level since mid-2021. ...

However, BCA Research's Global Investment Strategy is stilling predicting a recession. From Friday:

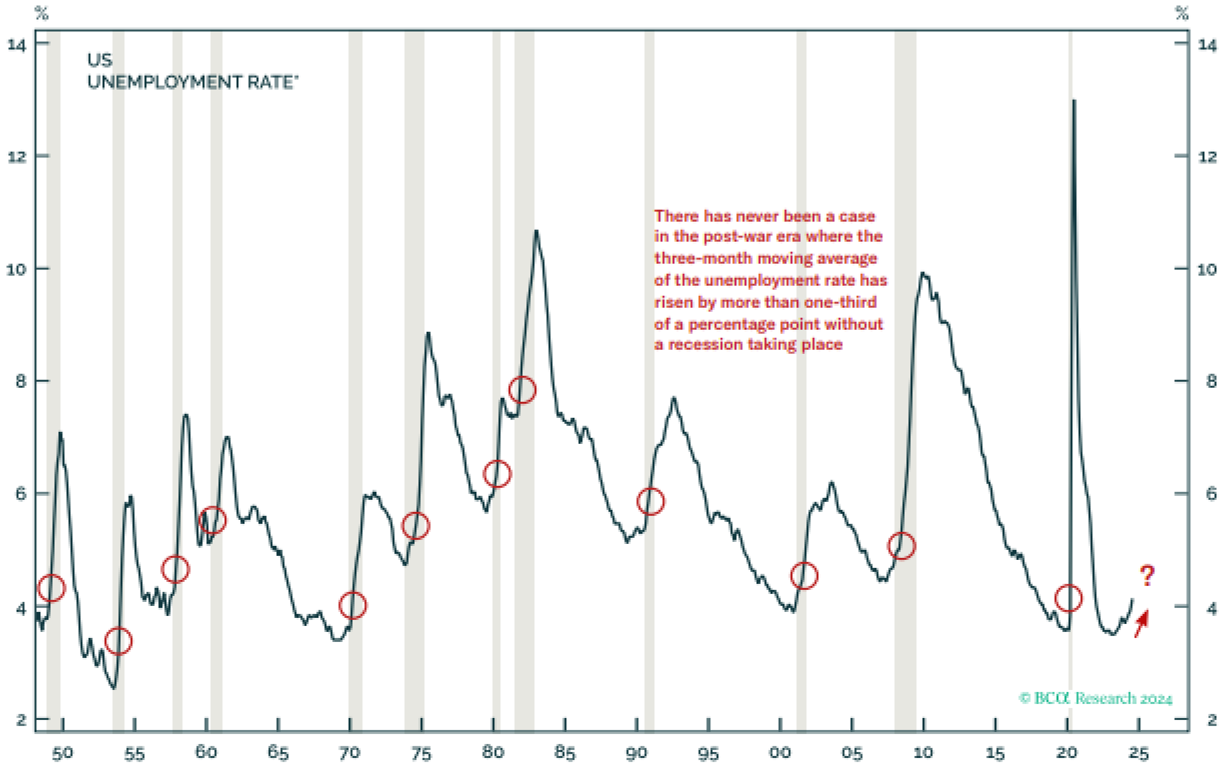
... Based on past data, the current assortment of macro data has coincided with negative returns on stocks and positive returns on bonds.

That this is the case is not particularly surprising. For example, consider a chart of the US unemployment rate (**Chart 1**). Notice how incredibly mean-reverting the series is: It is usually either going up or down. And when the unemployment rate starts rising, this almost always coincides with a recession.

Of course, just because a certain relationship has worked in the past does not guarantee that it will work in the future. Structural breaks happen. Many people have remarked that rising labor supply has inflated the US unemployment rate. There is some truth to that: About two-fifths of the increase in the unemployment rate from

CHART 1

The Unemployment Rate Is A Highly Mean-Reverting Series

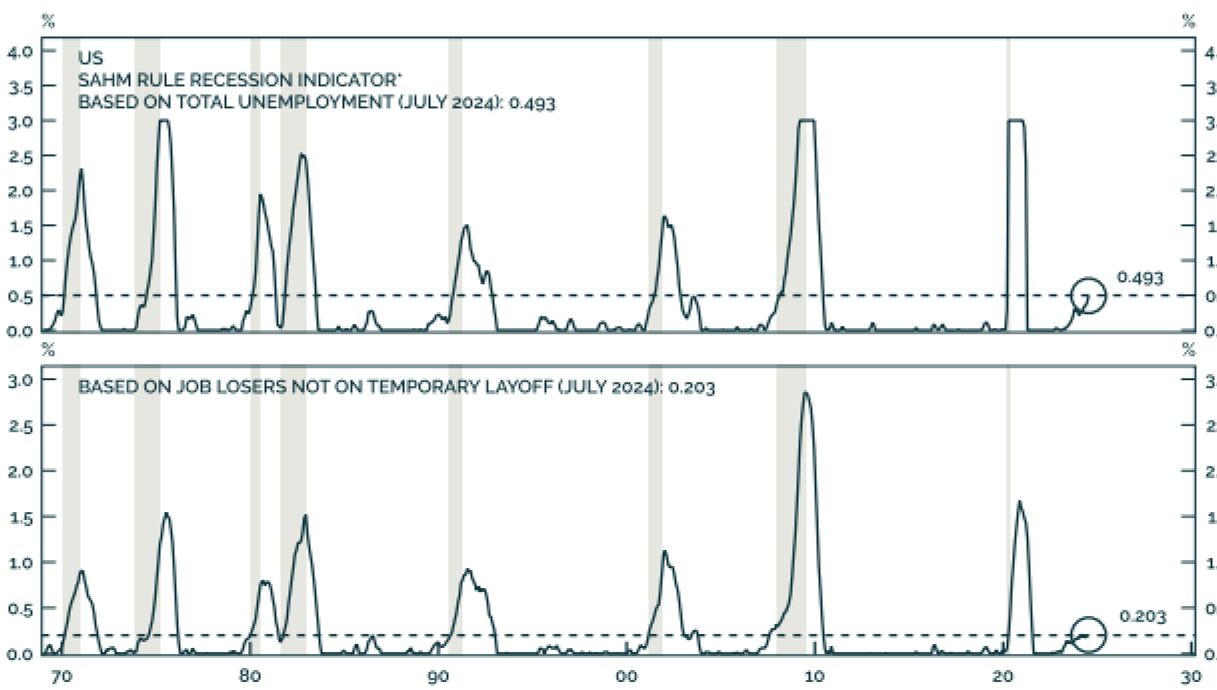


* SHOWN AS A 3-MONTH MOVING AVERAGE.
NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS; CIRCLES IN THE CHART DENOTE THE TIMES WHEN THE 3-MONTH MOVING AVERAGE OF THE UNEMPLOYMENT RATE INCREASED BY MORE THAN ONE-THIRD OF A PERCENTAGE POINT FROM PRIOR LOWS.

its 2023 lows is due to new entrants and re-entrants returning to the labor market in search of work. This is twice as much, on average, as seen in past cycles when the Sahm rule was triggered.

CHART 3

The Upward Trend In Permanent Job Losers Is Worrying



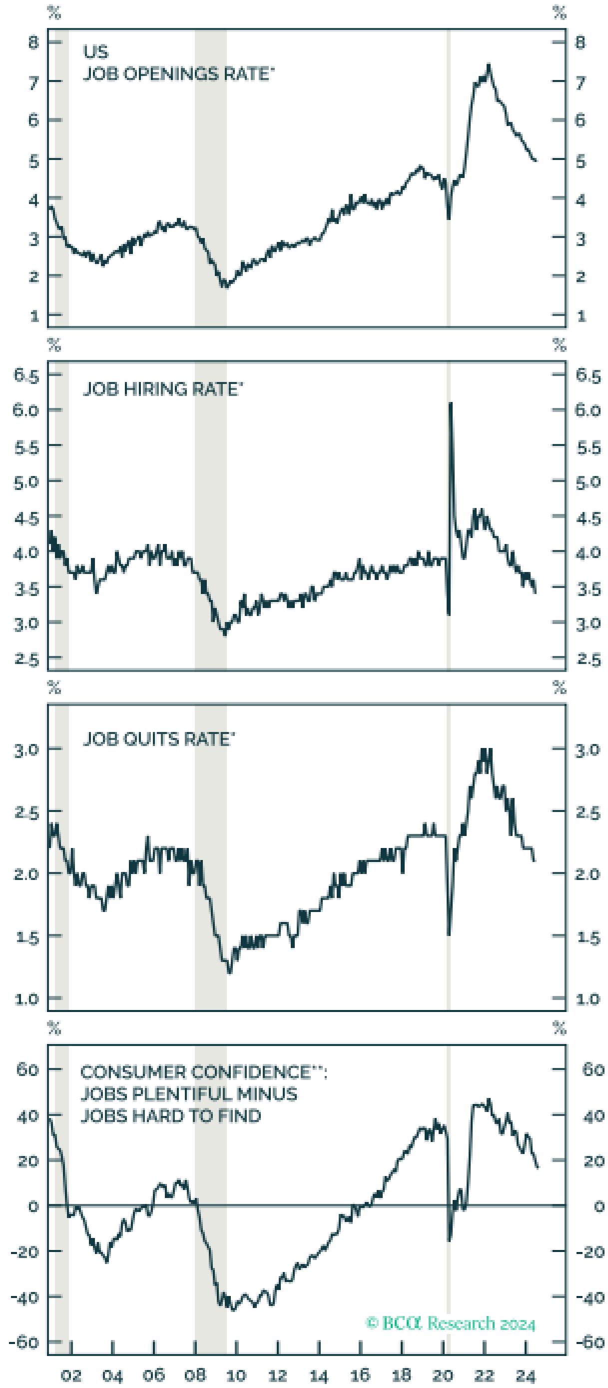
* SAHM RULE RECESSION INDICATORS ARE TRIGGERED WHEN THE 3-MONTH MOVING AVERAGE OF AN UNEMPLOYMENT METRIC RISES A CERTAIN LEVEL ABOVE THE LOWEST 3-MONTH MOVING AVERAGE OVER THE PREVIOUS 12 MONTHS OF THE SAME METRIC. SERIES SHOWN TRUNCATED AT 3%. DOTTED LINES REPRESENT TRIGGER THRESHOLDS.
NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.
© BCA Research 2024

Still, around one-half of the increase in the unemployment rate this time around is due to job loss. As a share of the labor force, the number of so-called "permanent job losers who are not on temporary layoff" has risen by around 0.2 percentage points relative to its 12-month low. Although there have been a few close calls, this category of unemployed workers has never increased by that much without a recession occurring (**Chart 3**).

Other metrics such as the job openings rate, the hiring rate, the quits rate, and household perceptions of job availability tell a similar story: The US economy is approaching a recession (**Chart 4**). ...

CHART 4

The Labor Market Looks "Pre-Recessionary"



* SOURCE: JOB OPENINGS AND LABOR TURNOVER SURVEY (JOLTS), BLS.
** SOURCE: THE CONFERENCE BOARD.
NOTE: JOB OPENINGS SINCE JUNE 2022 ARE BASED ON BLS JOLTS JOB OPENINGS, AND ESTIMATES USING LINKUP AND INDEED JOB POSTINGS INDEX. SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.

Some other leading sectors of the economy also look worrisome. Housing activity is weak, as evidenced by falling homebuilder confidence, pending home sales, building starts and permits, and units under construction (**Chart 6**). Capex intentions are downbeat (**Chart 7**). The manufacturing PMIs have relapsed (**Chart 8**). Outside the US, business activity has faltered, with German GDP contracting in the second quarter. The Chinese credit/fiscal impulse – an excellent leading indicator for Chinese growth – remains depressed.

There are some bright spots, however. Most notably, inflation is coming down. ...

Will the Fed's forthcoming rate cuts preclude a recession? They did not in 2000 and 2007. In both cases, the recession began just a few months after the Fed started cutting rates (**Chart 10**). ...

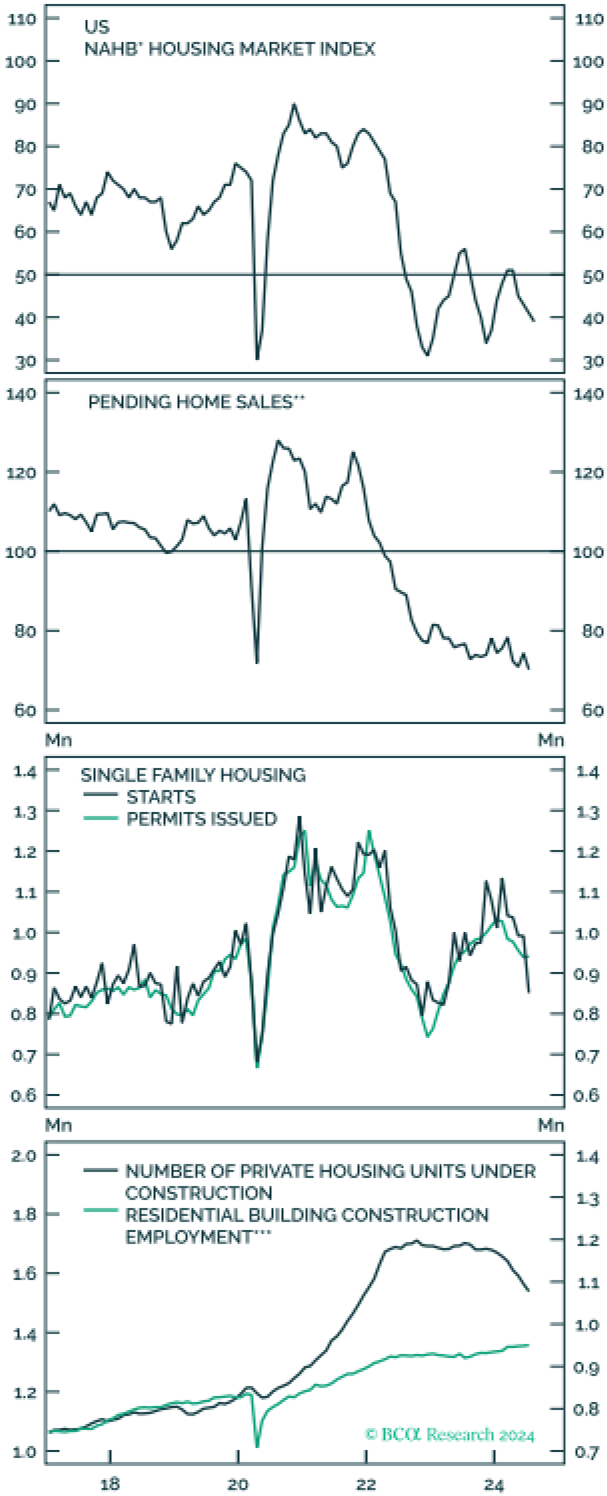
Meanwhile, valuations remain stretched. ... the S&P 500 is currently trading 46% above its net present value, the same level of overvaluation reached in September 2000. Equities have only been this richly valued 4% of the time over the past 60 years.

One of my favorite quotes bears repeating: **"I'm neither smart enough nor dumb enough to forecast the future."** - Mike Nash

Despite our doubts about anyone's ability to successfully time the markets, we remain cautious.

CHART 6

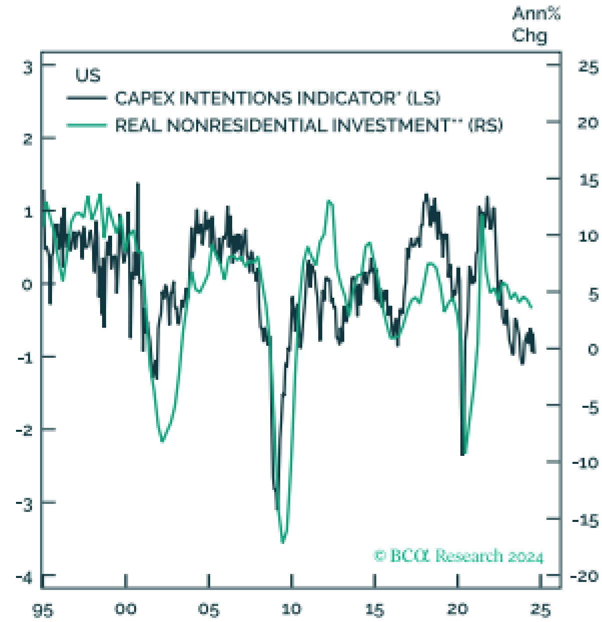
Housing, A Leading Sector Of The US Economy, Is Faltering



* NATIONAL ASSOCIATION OF HOME BUILDERS.
** VOLUME INDEX (2001 = 100). SOURCE: NATIONAL ASSOCIATION OF REALTORS.
*** SOURCE: BUREAU OF LABOR STATISTICS (BLS).

CHART 7

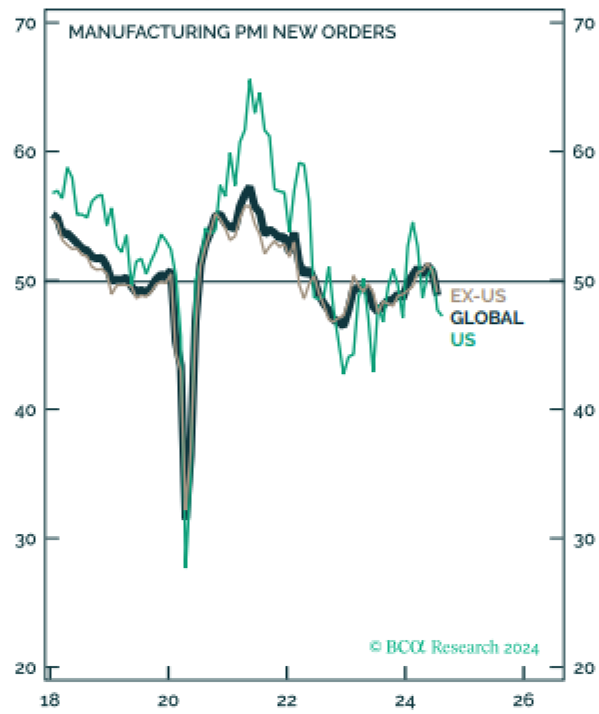
Capex Intentions Are Downbeat



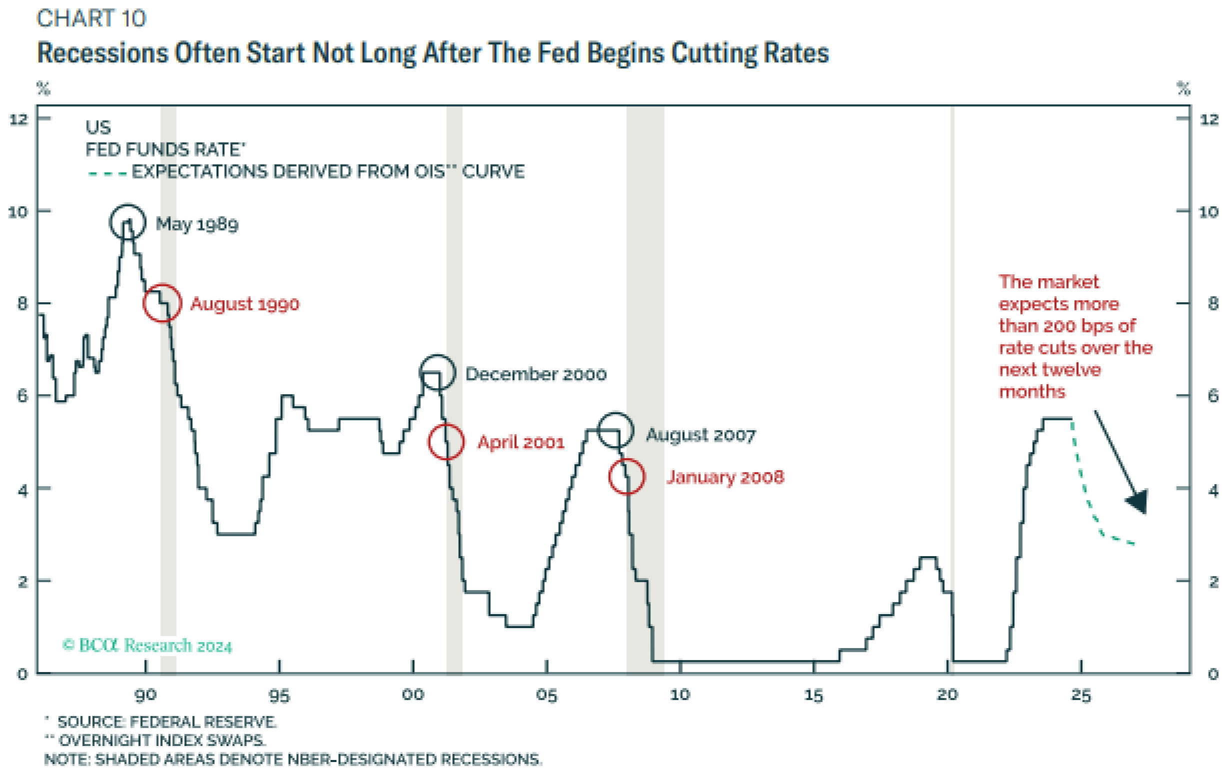
* AVERAGE OF STANDARDIZED CAPITAL EXPENDITURE EXPECTATIONS FOR THE NFIB SURVEY (3-TO-6 MONTHS), DALLAS, KANSAS CITY, NEW YORK EMPIRE, PHILADELPHIA, AND RICHMOND FED REGIONAL SURVEYS (6 MONTHS). LATEST DATA POINT IS AN ESTIMATE.
** REAL GROSS PRIVATE NONRESIDENTIAL FIXED INVESTMENT. SOURCE: BUREAU OF ECONOMIC ANALYSIS (BEA).

CHART 8

Manufacturing PMIs Have Slipped Again



SOURCE: S&P GLOBAL.



Positions

While we continue to allow cash to accumulate in client accounts, one opportunity arose in August that was compelling:

HTGC - is the premiere Venture Capital BDC. Internally managed, it typically takes an equity kicker when making a loan. On 8/13 we purchased 2% positions for 3 clients @ 17.91.

Insider Buying:

Trade Date	No. Part	Participants	Net Sell (Shares)	Net Buy (Shares)
08/06/2024	6	Aguirre DeAnne, Loo Wade, ...		27,324

From BDC Buzz:

The following table shows the changes in NAV per share and dividends paid between December 31, 2017, and June 30, 2024. **...** most BDCs with higher ROEs have historically held higher amounts of equity investments, especially HTGC, MAIN, GLAD, CSWC, ARCC, FDUS, and GAIN.

ROE Analysis - Since 2017

BDCBUZZ
www.BDCBuzz.com

	NAV/Book Value				Dividends Paid				NAV			Price-to	
	Dec-17	Jun-24	Change		(2018 - Q2 2024)		Return		Dec-17		ROE	NAV	
HTGC	9.96	11.43	1.47	+	10.35	=	11.82	/	9.96	=	119%	1.57	
MAIN	23.53	29.80	6.27	+	19.47	=	25.74	/	23.53	=	109%	1.62	
GAIN	10.37	13.01	2.64	+	8.11	=	10.75	/	10.37	=	104%	0.99	
TSLX	16.09	17.19	1.10	+	14.48	=	15.58	/	16.09	=	98%	1.20	**AVG**
FDUS	16.05	19.50	3.45	+	12.25	=	15.70	/	16.05	=	98%	0.99	**1.26**
ARCC	16.65	19.61	2.96	+	11.19	=	14.15	/	16.65	=	85%	1.05	
GLAD	16.96	20.18	3.22	+	11.08	=	14.30	/	16.96	=	84%	1.11	
CSWC	18.44	16.60	(1.84)	+	15.25	=	13.41	/	18.44	=	73%	1.44	
OCSL	17.43	18.19	0.76	+	10.93	=	11.69	/	17.43	=	67%	0.90	
OBDC	15.03	15.36	0.33	+	8.75	=	9.08	/	15.03	=	60%	0.93	
NMFC	13.63	12.74	(0.89)	+	8.57	=	7.68	/	13.63	=	56%	0.95	
CGBD	18.12	16.95	(1.17)	+	10.74	=	9.57	/	18.12	=	53%	0.95	
GBDC	16.04	15.32	(0.72)	+	8.89	=	8.17	/	16.04	=	51%	0.94	
GSBD	18.09	13.67	(4.42)	+	11.85	=	7.43	/	18.09	=	41%	1.00	
TPVG	13.25	8.83	(4.42)	+	9.91	=	5.49	/	13.25	=	41%	0.80	
PFLT	13.86	11.34	(2.53)	+	7.52	=	5.00	/	13.86	=	36%	0.97	
PNNT	9.10	7.52	(1.58)	+	4.30	=	2.72	/	9.10	=	32%	0.93	
SLRC	21.81	18.20	(3.61)	+	10.66	=	7.05	/	21.81	=	31%	0.83	
TCPC	14.80	10.20	(4.60)	+	9.04	=	4.44	/	14.80	=	30%	0.85	
MFIC	19.81	15.38	(4.43)	+	10.35	=	5.92	/	19.81	=	30%	0.85	
MRCC	13.77	9.20	(4.57)	+	7.40	=	2.83	/	13.77	=	21%	0.82	
BBDC	13.43	11.36	(2.07)	+	4.93	=	2.86	/	13.43	=	21%	0.87	**AVG**
FSK	37.20	23.95	(13.25)	+	18.58	=	5.33	/	37.20	=	14%	0.81	
PTMN	48.70	21.21	(27.49)	+	25.41	=	-2.08	/	48.70	=	-4%	0.88	**0.83**
OXSQ	7.55	2.43	(5.12)	+	3.81	=	-1.32	/	7.55	=	-17%	1.25	
LRFC	83.46	33.13	(50.33)	+	15.10	=	-35.23	/	83.46	=	-42%	0.65	
PFX	154.20	76.35	(77.85)	+	10.32	=	-67.53	/	154.20	=	-44%	0.62	
									Average		46%	0.99	
									Median		41%		

Note that some of our clients hold positions in ARCC, CSWC (Internally managed, and Venture Capital focused), MAIN (Internally managed), and NMFC.