RESEARCH UPDATE

August 5, 2024

CAPITAL ADVISORS

Thoughts on the Stock Market Pull-Back

The two tables below reflect a steady decline in the riskiness of economic life over the past nine decades that we believe is relevant to forecasting the economy and financial markets. This data shows it has become increasingly difficult to topple the U.S. economy, and we believe it should frame investors' expectations whenever there is an outbreak of fear about a pending downturn, like now.

Decade-by-Decade Volatility of GDP[1] and Consumption
01-01-1930 to 12-31-2019

Standard Deviation by Decade*

	GDP	Personal consumption
1930-1939	8.52	5.91
1940-1949	9.45	3.73
1950-1959	3.26	2.08
1960-1969	1.59	1.44
1970-1979	2.38	1.93
1980-1989	2.41	1.87
1990-1999	1.41	1.43
2000-2009	1.93	1.71
2010-2019	0.44	0.59

*Standard deviation of annual % change

Source: SED, Inc.

Time Spent in Recession
01-01-1870 to 12-31-2023

Time Period	% of Time Spent in Recession
1870 – 1945	40%
1945 – 1980	20%
1980 – 2023	10%

Source: Rockefeller International; Financial Times

Importantly, there are structural reasons for the improving resilience of economic life, including a steady rise of the service sector as a percentage of total employment, a rise of two-income households, and increasingly active fiscal and monetary interventions to help offset stress when it arises. Another important factor has been a structural decline in the *correlation* among subsectors within the economy – think of the rolling recessions that impact a few sectors at any given time while the overall economy keeps chugging along (travel and leisure collapsed during covid then came roaring back, while construction and goods boomed during covid then rolled over more recently).

When it comes to forecasting the economy, it is usually wise to avoid overreacting to either side of the emotional pendulum whenever the prevailing narrative becomes unusually dark or euphoric. We do not believe the U.S. economy is headed for a recession, and our forecast is supported by strong empirical evidence (above) that is driven by enduring structural forces.

[1] "GDP" refers to Gross Domestic Product, a broad measure of economic activity

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This is not to suggest financial markets are "wrong" today. There are myriad reasons the stock market does what it does, many of which have nothing to do with the economy. According to numerous reports[2], the current downturn is being exacerbated by the unwinding of a massive carry trade involving money borrowed at ultra-low interest rates in Japan to fund the purchase of investments elsewhere, including the U.S. stock market. This trade works as long as the Japanese interest rate and exchange rate remain stable, but it falls apart when Japanese rates turn higher and the currency appreciates, both of which have happened abruptly in recent weeks.

There are other factors at work today, no doubt, but to the extent it is internally generated feedback loops driving volatility on "Wall Street," rather than economic factors driving a downturn on "Main Street," we suspect corporate America can ride out the current conflagration without a debilitating hit to forward earnings expectations.

We hope to take appropriate actions *within* our investment strategies to manage risk as market conditions evolve. We do *not* believe it is necessary to change the asset allocation of a well-designed portfolio in response to the recent volatility.

[2] Source: CNBC.com; Bloomberg; ERIC; Marketwatch.com

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