State of Play

Making waves

12 September 2024

In recent months there has been an increase in market volatility, as investors started to question the outlook for economic growth in the US. Until now, the US has posted solid enough numbers, however, there's growing concern that the recently released labour market data could point towards a downturn in growth. With employment being such an important driver for economic growth, questions have been raised on the possibility of a future recession. Santander Asset Management digs deeper in this week's State of Play.

The numbers behind the volatility

It is important to remember that sudden drops in stock market prices are not uncommon. Since October 2023, global shares have been performing well and a drop or modest reset in prices is normal and healthy for markets.

US jobs data

The decision of the US Federal Reserve (Fed) to leave interest rates unchanged at its July meeting was followed by weak US jobs data in early August. The non-farm payrolls report showed that 114,000 jobs were added in July, well below the consensus expectation of 175,000, while the unemployment rate rose to 4.3%[1].

The August employment data showed a lower-than-expected increase in non-farm payrolls, with the actual figure of 142,000 being less than the predicted 165,000.[1] Additionally, there were downward revisions to the previous two months' employment numbers, indicating a consistent pattern of correction. Furthermore, the recent provisional benchmark revisions revealed that the Bureau of Labor Statistics had overestimated the payroll growth by an average of 78,000 per month in the 12 months leading up to March 2024.[1] This trend of downward revisions is evident in the changes to the June and July employment figures, which were initially reported higher and then subsequently revised lower.

Non-farm payroll employment is a compiled name for goods, construction and manufacturing companies in the US. Approximately 80% of the workforce is accounted for non-farm payrolls and it excludes farm workers, private household employees, actively serving military or non-profit organization employees.

Sahm Rule

As mentioned in our previous State of Play, the jobs data triggered what is known as the Sahm Rule. Global investors reacted to the news with fears that the US economy could be heading for a recession, leading to a sell-off in global stock markets.

Nvidia and AI

Also covered in a previous State of Play was Nvidia's recent earnings. Since the announcement, Nvidia's stock has been particularly volatile. Less than a week after Nvidia's quarterly financial results and forecasts disappointed investors, and despite its sales doubling and beating forecasted projections, $279bn was wiped off the value of Nvidia, as its shares dropped by 9.50%.[2] Nvidia makes up around 5.55% of the S&P 500 index, meaning that its performance can have a meaningful impact to those invested in the index.[3] Nvidia's financial results are closely monitored by investors, as they can provide insights into whether the surge in AI is expected to persist or level off. If Nvidia's stock price declines due to concerns about its earnings growth, it often leads to a similar impact on the stocks of other companies that specialise in AI.

Manufacturing data

Also adding to market volatility was the latest manufacturing data from the Institute for Supply Management (ISM). It shows persistent difficulties in the industry, which has been shrinking for 21 out of the previous 22 months.

Is a recession a real possibility?

According to the current numbers, the US is still far from entering a recession in the foreseeable future. However, it could be a distant possibility if US economic data continues its downward trend and continues to be below expectations. The US economy showed signs of strengthening in the second quarter of 2024, with the country's overall GDP growing at an annual rate of 3.0%. This was a significant increase from the 1.4% growth recorded in the previous quarter.[4]

Our outlook

The market consensus would suggest that the Fed could lower interest rates by as much as 0.50% in September. However, we believe this is too optimistic and they are more likely to lower rates by 0.25%. The US economy remains strong, as people are spending, income levels are stable, and company earnings are robust. If the situation worsens significantly or more abruptly than anticipated, a smaller cut now, leaves more capacity for the Fed to take further action in the coming months.

Stock markets have been performing well so far this year, with the S&P 500 index increasing around 18% (in dollar terms) to the end of August.[5] However, history has taught us that September and October are typically more volatile and there's the added pressure of the US election in November. Given the uncertainty in the economic and political environment, there is a possibility of a market correction in the weeks ahead. Nevertheless, the underlying fundamentals still support the ongoing market expansion, as inflation is moderating, the Fed is expected to cut interest rates, and economic growth, although slowing, does not yet show signs of a recession.

The power of long-term investing

Although there is some short-term volatility in the market, it is important to remember why you invested and the power of investing over the long-term.

Investing in an appropriate portfolio is often recommended as a minimum 5-year investment commitment due to the volatile nature of investment returns and values. Investing is often about being rewarded for the time you invest and the patience you must allow your portfolio to grow.

Disregarding short-term market volatility and maintaining a long-term outlook on returns could mean you take on less risk overall. This is because the ups and downs of markets tend to level out over time, meaning the longer you invest, the lower the historical risk of losing money. However, all investing carries some level of risk, and the value of your investments can decline.

History has shown that your risk of losing money decreases when you invest over longer periods. Had you invested in the global stock market on a random day between 1971 and 2022 and held that investment for two years, the probability of losing money would be around 20%. If you held onto the investment for a fifteen year period, you would significantly reduce the risk of losses, almost eliminating it. Even if you're tempted to withdraw due to short-term market fluctuations, keeping your money invested could provide the best chance for it to grow over time.

The value of seeking guidance and advice

It is important to seek advice and guidance from a professional financial adviser who can help to explain how to build an appropriate financial plan to match your time horizons, financial ambitions and risk comfort. If you already have a plan in place or have already invested, it is important to allocate time to review this to ensure this remains on track and appropriate for your needs.

Learn more!

Investing can feel complex and overwhelming, but our educational insights can help you cut through the noise. Learn more about the Principles of Investing here.

Note: Data as at 10 September 2024

[1]US Bureau of Labor Statistics, 6 September 2024
[2]The Telegraph, 3 September 2024
[3]Slick Charts, 10 September 2024
[4]US Bank, 4 September 2024
[5]Edward Jones, 7 September 2024
[6]Nutmeg, 18 August 2022