EFFICIENT GROUP

ECONOMIC COMMENTARY

- Dr. Francois Stofberg, with specialist input from Renier van Zyl

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Main Street vs. Wall Street: The strange relationship between stock markets and economies

American stockbroker, Peter Schiff, delivered a timeless reminder: "The stock market is not the economy, and the economy is not the stock market". What Schiff was trying to say is that the stock market, often referred to as Wall Street, is not always an accurate reflection of what occurs on Main Street, that is, the real economy. Schiff's statement has never rung truer than in the ever-fluctuating landscape of today's financial world.

The United States (US) economy grew at a 4.9% annual rate in the third quarter, marking a steep acceleration from the second quarter's 2.1% growth rate. Nearly every component of the gross domestic product contributed positively to what was the strongest growth quarter since late 2021. This growth reminded us just how strong the economy remained throughout September; even as financial conditions tightened further. The data even placed a future recession into question, given the size of the economic surge.

One might assume that this economic surge would be mirrored in the stock market but that is where the disparity emerges. Big Tech, which had played a significant role in propelling the market's positive performance since the beginning of the year, collectively suffered a decline of more than a tenth of its value since 31 July. This decline was more pronounced than that of the other sectors comprising the S&P 500, which was down by approximately 10% from its summer peak. A contributing factor was the recent uptick in bond yields, as higher long-dated bond yields curtailed the present value of future profits.

However, the stock market is not just influenced by immediate circumstances: It is known for its forward-looking nature, often gazing at least 6 to 12 months into the future. Meta's recent earnings guidance served as a testament to this. While the company's sales and earnings exceeded estimates, it also voiced concerns about a potential slowdown in advertising spending. This expectation was not unexpected, given that brands might start trimming marketing budgets owing to the pressure on consumers because of inflation and higher interest rates.

Consumer spending will exert immense influence over the health of the stock market going forward. Until now, earnings reports from companies have been praising the financial might of the American consumer. The looming spectres of high inflation and rising interest rates are, however, already showing up in consumer data. A sizeable portion of spend is not discretionary anymore; rather it is a necessity for many households, driven by the need to keep up rather than to indulge in luxury. This predicament is glaringly evident in the personal savings rate, which plummeted in the third quarter to 3.8%, down from 5.2% in the second quarter, and a far cry from the pandemic-induced peak of 32%.

An increase in economic headwinds in the US should see a period of slower growth and reduced inflation in the coming quarters. Consequently, the US Federal Reserve (Fed) may find itself contemplating a pause, or even a cut, in interest rates in 2024. Investors are already pricing in a more than 98% chance that the Fed will keep the federal funds rate steady at the next meeting.

In the aftermath of recent market corrections and the forward-looking nature of the stock market, a wealth of high-quality global companies are now undervalued, patiently waiting for astute, long-term investors to recognise their potential. This serves as a testament to the enduring truth that, while the stock market and the economy are intertwined, their trajectories can diverge significantly, creating opportunities for investors.

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81 Dely Road, Hazelwood, Pretoria, 0081 087 944 7999 info@efgroup.co.za www.efgroup.co.za