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Macro Market Insights

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A Goldilocks Moment

Who would of figured that in a week when the US economy reported initial estimates of second quarter GDP growth of 4 per cent, that the Dow Jones Industrial Average would simultaneously erase its gains for the year. Investors are grappling with the notion of whether this economy is ready to break out or revert back to the moderate 2 per cent growth levels we've witnessed on average since escaping recession. Similar to the jobs report early Friday morning, gains were strong despite missing expectations, but it's the troubling 2 per cent wage growth barely matching inflation that leads investors to pause and question the economic outlook, particularly as viewed from the lens of the US Federal Reserve, and what corresponding policy could potentially be.

The headline print for US GDP growth is certainly one that appears strong on paper. No question following a dismal start to the year that the three month period ending in June made up for some of the weakness from the winter freeze. But it was the fact that consumption, which attributes for approximately seven tenths of the US economy's output only advanced at two and a half per cent. This is what leads to questions or uncertainty surrounding whether growth in inventory building by US businesses will be matched by a pickup from the American consumer, or whether the expenditure is simply a trade-off for business spending later in the year. Currently, it seems the latter, that the economy will simply revert back to trend, that seems to resonate with investors as the equity markets seem exhausted at current levels.

Friday's job numbers added credence to this theme as the number of jobs created no longer seems to be the focal point of the Federal Reserve. As renowned PIMCO economist Paul McCulley suggests, we know longer have a US federal reserve that is satisfied with just lowering the jobless rate. The Fed, under Janet Yellen is making clear their mandate that wage growth and other structural problems in the labour market is of particular importance. So while the broader theme around the US market is strength in full time employment on a monthly basis and encouraged workers rejoining the workforce, the issue and focus for the Fed stays with the measure of long term unemployed, which did tick higher in July, and the need for an increase in wage growth to keep pace with inflation and productivity gains.

This cautiously strong economic environment is congruent with the fashion in which the US dollar is trading. Wednesday of this week, the US dollar index rose to a 10 month high following the GDP numbers, and the way in which the dollar gained fits with this goldilocks economy-not too hot, and not too cold. We are seeing resounding strength in the dollar and the potential for upside, but still the uncertainties of the Fed ending QE, shifting consensus on when the Fed will be able to raise the Federal Funds Rate, and even whether the weakness in the euro will follow through.

The puzzle for the markets in a week when the Dow lost close to 400 points (2.40%) and the S&P close to 50 points (2.46%) was that there was no clear safe haven. Gold floundered, government bonds found modest bids, and the US dollar, albeit, gathering some momentum, stayed relatively quiet. As the markets and the economy recouple into a period of perhaps more normalcy, the question becomes is the inevitable equity correction looming, or is this another buy the dip as markets climb at a not too hot, but not too cold pace.