Q2 2024

Market View Quarterly

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The second quarter of 2024 started poorly, with the S&P 500 and NASDAQ indices experiencing their worst month since September 2023, and the Dow its worst month since September 2022.[1] April's sell-off was driven largely by various geopolitical concerns, notably Iran's missile attack on Israel. Despite a Q1 GDP downward revision to 1.3% from 1.6%, markets recovered in May, supported by robust earnings and a resilient labor market.[2] The S&P 500's estimated earnings growth for Q2 is 9.0%, the highest since Q1 2022.[3] The economy added 165,000 jobs in April and 272,000 in May, with the unemployment rate rising to 4% (breaking a 28-month streak below 4%), but primarily affecting younger and older workers. The closely watched prime-age participation (24-55 years of age) rose to 83.6%, the highest since 2002 and there are still 8.1 million job openings compared to 6.6 million unemployed individuals.[2] A strong jobs market may delay the start of rate cuts but continues to be the primary support for consumers and economic activity.

Domestic Equities

"Sell in May and Go Away" advises investors to exit the market in May and reinvest in November to sidestep summer downturns. However, this year, investors following this strategy missed a significant market rebound. In May, the S&P 500 rose 4.11%, followed by a 3.59% gain in June, driven by mega-cap tech stocks, especially those with artificial intelligence (AI) exposure. For instance, Nvidia shares surged, briefly making it the world's most valuable company, returning 149% this year and accounting for nearly 35% of the S&P 500's gains. The S&P 500 index is up 15.29% year-to-date. The top five S&P 500 holdings now constitute 27% of the index, the highest concentration since 1980. This dominance by large-cap stocks has widened the gap between the S&P 500 and small-cap (Russell 2000) stocks to levels not seen since November 1999. Historically, such extremes have led to small caps outperforming large caps significantly in subsequent years. For example, from 1999 to 2006, the Russell 2000 gained 90%, compared to just an 11% gain for the S&P 500.[4] This pattern suggests a potential shift on the horizon, emphasizing the importance of diversification and a long-term strategy.

International Equities

In the second quarter of 2024, international equities underperformed U.S. equities, with the S&P 500 returning 4.28%[1] while the MSCI EAFE Index returned -0.42%.[1] Recently, the Eurozone and Canada made their first interest rate cuts in five and four years, respectively. Historically, European equity markets have risen 20% on average within 12 months after the first rate cut, occurring in 9 of the last 11 instances.[5] However, this depends on a weaker dollar, which has increased by 4.47% this year. A strong dollar indicates more foreign money flowing into the U.S., driven by higher rates that attract investors. As the Federal Reserve delays rate cuts, the dollar is likely to remain strong, potentially causing international stocks to underperform compared to domestic stocks.

The MSCI Emerging Markets (EM) Index returned 5.03%[1] in the second quarter, outpacing both internationally developed and U.S. markets. EM gained some momentum in the second quarter driven by optimistic growth prospects. Earnings growth expectations for EM have risen for 2024 and 2025, outpacing developed markets (DM), economists' forecast EM earnings growth at nearly 19% in 2024 and 15% in 2025, compared to less than 11% and 13% in the U.S. However, China makes up a large portion of the EM index and it is important to note that new U.S. tariffs on Chinese exports have raised concerns about potential trade frictions ahead of upcoming elections, which could add volatility to the market.

Fixed Income

The Federal Reserve (Fed) and the bond market finally seem to agree that the rate tightening cycle that began in 2022 is likely to end and should switch to easing sometime in the second half of 2024. Comments by Fed Chairman Jerome Powell suggest that the Fed has actively discussed a timeline for lowering interest rates and recent inflation data supports this possibility, as the Consumer Price Index (CPI) continued to moderate this quarter with core inflation, which excludes food and energy, falling from 3.6% in April to 3.4% in May. This resulted in the 10-year Treasury yield dropping significantly from 4.62% at the start of June to 4.39% at the end of June. This decline in bond yields benefits fixed-income investments, offering better expected total returns. Lower interest rates also ease financial burdens for consumers by reducing costs on credit cards, home equity loans, and other debts. For instance, mortgage rates, which were at 6.99% for a 30-year loan in early June, are expected to decrease as bond yields fall, aiding potential homeowners.[2] Ultimately, we anticipate this cutting cycle will look very different from previous cycles when the Fed cut all the way down to zero. In a more typical cycle, with a higher longer-term neutral rate, absolute fixed income yields across the curve should remain attractive.

Alternatives and Real Estate

Gold posted a fourth consecutive monthly gain in June, rising by 5.26% for the second quarter to $2,326/oz. Despite the more moderate gain compared to previous months, gold hit a new all-time high of $2,450/oz in May before pulling back, likely reflecting some profit-taking.[2]

In Q2, oil market volatility increased due to the Israel-Hamas conflict, with predictions of $150 per barrel of oil and a $1 trillion cut in global output.[6] West Texas Intermediate (WTI) oil prices peaked at $86 per barrel in April, up from $71 at the year's start. Gas prices remained stable, with the national average at $3.45 per gallon, down from $3.57 a year ago.[7]

In May, existing home sales fell for the third month, and the median price hit a record $419,000, widening the gap for first-time buyers. New home construction dropped 5.5% to an annualized rate of 1.28 million, the lowest since June 2020, due to higher interest rates and decreased demand. Mortgage payments for typical homes have more than doubled since 2020.

Conclusion

Artificial Intelligence is set for rapid growth over the next decade, offering significant potential. Initially, gains have been concentrated in companies developing AI infrastructure, but future benefits will likely extend to those applying AI for productivity. Despite the outsized gains of technology stocks, diversification remains crucial for investing in growth equities along with cyclical and value investments. The labor market resilience continues to reduce stagflation concerns and support stable Fed policies. As central banks shift toward rate cuts, bond yields are expected to decline. Investors should consider diversifying fixed-income allocations into intermediate and long-term bonds, mitigating reinvestment risk for investors heavily allocated to CDs and cash investments. For equities, the period from May to October during presidential election years has historically seen an average return of +2.3% with the market rising 78% of the time and often with a summer rally ahead of November. Therefore, while gains in the second half of 2024 may be more moderate than they've been so far this year, we believe the bull market in equities will persist.

Economic Definitions

CPI (headline and core): Consumer prices (CPI) are a measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate.

Existing Home Sales: This concept tracks the sales of previously owned homes during the reference period. Total existing home sales include single-family homes, townhomes, condominiums and co-ops. All sales are based on closings from Multiple Listing Services. Foreclosed homes are only counted in the inventory if the bank is working with a realtor. Foreclosed homes that sell via auction (or other closings outside of the Multiple Listing Services) are not included.

Federal Reserve (Fed): The Federal Reserve System is the central banking system of the United States of America.

GDP: Gross domestic product (GDP) measures the final market value of all goods and services produced within a country. It is the most frequently used indicator of economic activity. The GDP by expenditure approach measures total final expenditures (at purchasers' prices), including exports less imports. This concept is adjusted for inflation.

West Texas Intermediate (WTI): West Texas Intermediate (WTI) is crude stream produced in Texas and southern Oklahoma which serves as a reference or "marker" for pricing a number of other crude streams and which is traded in the domestic spot market at Cushing, Oklahoma.

Unemployment Rate: The unemployment rate tracks the number of unemployed persons as a percentage of the labor force (the total number of employed plus unemployed). These figures generally come from a household labor force survey.

Labor Force Participation Rate: The labor force participation rates is calculated as the labor force divided by the total working-age population. The working age population refers to people aged 15 to 64. This indicator is broken down by age group and it is measured as a percentage of each age group

Mortgage Rate: A mortgage rate, or mortgage interest rate or interest rate, is part of what it costs to borrow money from a lender. Instead of paying your mortgage lender a lump sum, the interest is paid as part of your monthly payment for your home loan.

US Dollar: The U.S. Dollar Index is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies. The Index goes up when the U.S. dollar gains "strength" when compared to other currencies.

Index Definitions

S&P 500®: The S&P 500 is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

NASDAQ: The NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

Dow Jones Industrial Average: The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Russell 2000: The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization. The real-time value is calculated with a base value of 135.00 as of December 31, 1986. The end-of-day value is calculated with a base value of 100.00 as of December 29, 1978.

MSCI EAFE: The MSCI EAFE Index is a free-float weighted equity index. The index was developed with a base value of 100 as of December 31, 1969. The MSCI EAFE region covers DM countries in Europe, Australasia, Israel, and the Far East.

MSCI EM: The MSCI EM (Emerging Markets) Index is a free-float weighted equity index that captures large and mid-cap representation across Emerging Markets (EM) countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

Bloomberg Barclays US Agg Bond: The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

Disclosures

Index performance does not reflect the deduction of any fees and expenses, and if deducted, performance would be reduced. Indexes are unmanaged and investors are not able to invest directly into any index. Past performance cannot guarantee future results.

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1 Data Obtained from Morningstar as of 6/30/2024.

2 Data Obtained from Bloomberg as of 6/30/2024.

3 https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_061424A.pdf.

4 https://bilello.blog/2024/us-large-cap-domination-chart-of-the-day-6-20-24.

5 https://www.morningstar.co.uk/uk/news/250081/what-ecb-rate-cuts-mean-for-european-equities.aspx.

6 https://www.bloomberg.com/company/press/escalated-conflict-in-the-middle-east-could-result-in-150-barrel-oil-price-and-a-cut-in-global-output-by-1-trillion-finds-new-analysis-by-bloomberg-intelligence-and-bloomberg-economics/#:~:text=Share-,Escalated%20conflict%20in%20the%20Middle%20East%20could%20result%20in%20%24150,Bloomberg%20Intelligence%20and%20Bloomberg%20Economics.

7 https://gasprices.aaa.com/.

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