June 2024

MONTHLY MARKET INSIGHTS

Key takeaways:

- The S&P 500 swiftly recovered all of April's losses and made a new all-time high in May before pulling back late in the month.
- The Federal Reserve ("Fed") remains predisposed to rate cuts despite this year's disappointing inflation readings.
- The narrative around artificial intelligence ("AI") is becoming more nuanced, posing a risk to many technology stocks and the broader market.

US equities bounced back sharply in May from April's selloff, with the S&P 500 and other major indices making new all-time highs during the month before pulling back in the last week. In May, the S&P 500, the Nasdaq, and the Russell 2000 index gained 4.80%, 6.88%, and 4.87%, respectively.[1] May's equity rally was sparked by the Fed meeting, which concluded on May 1. While the Fed left interest rates unchanged, it announced plans to start tapering its quantitative tightening program. The Fed plans to reduce the monthly quantity of Treasuries it will allow to roll off its balance sheet from $60 billion to $25 billion starting June 1. Additionally, in his post-meeting press conference, Chairman Powell reassured investors that rate hikes were not on the table despite a string of disappointing inflation data. Investors came into the month concerned that the Fed would shift to a tightening bias, but Chairman Powell confirmed that he and Fed officials are predisposed to lowering rates, even if they have to wait a few months to begin.

The Fed's tapering announcement and Powell's press conference comments set in motion a bond market rally that swiftly lowered yields. The 10-year yield dropped from 4.68% to 4.34% during the first two weeks of May.[2] Lower yields and a better-than-expected earnings season helped bolster sentiment and spurred an equity rally as investors looked to take advantage of lower equity prices created by April's selloff. The rally during the first two weeks of the month was sharp, with the S&P 500 making a new all-time high around the same time the 10-year bond yield bottomed. The back half of the month saw mixed price action in both bonds and equities, culminating in a down week for equities to end the month. Yields reversed course during the latter half of the month on the back of several Treasury auctions that exhibited weak demand. At one point late in the month, the 10-year yield traded back above 4.60% before settling back down to end the month at 4.50%.[3]

May's equity advance had a different feel than the first quarter's rally. The recovery was relatively narrow in scope, with NVDA +26.8%, AAPL +12.9%, MSFT +6.8%, and GOOGL +6% accounting for most of the S&P's gain.[4] According to FactSet, only about 36% of S&P constituents remained above their 50-day moving average at month's end, showing little improvement from the end of April.[5] The market's deteriorating breadth can be somewhat attributed to the uneven performance of S&P companies. While first quarter earnings growth has come in better than expected at +5.9%, the earnings growth falls to -1.80% after stripping out the Magnificent 7 names.[6] Another potential harbinger of concern was the resurgence of meme stocks after one of the main instigators of the original meme stock rally, Keith Gill, also known as "Roaring Kitty," reappeared on social media. The meme stock rally has been short-lived so far, but the renewed interest and frothy price action during the month undermines any argument that monetary policy is currently too tight.

1. FactSet, return indicates index's price return.
2. FactSet.
3. Id.
4. FactSet, return indicates price return.
5. FactSet Alerts. StreetAccount Summary - US Monthly Recap (May 2024), 31 May 2024.
6. Id.

AI continues to garner much investor attention, but the narrative coming out of this earnings season is becoming more nuanced. Undoubtedly, AI initiatives are driving capital expenditures and technology spending across a wide swath of the economy. "In recent weeks, four tech giants – Alphabet, Amazon, Meta, and Microsoft – have pledged to spend close to a total of $200bn this year, mostly on data centres, chips and other gear for building, training and deploying generative-AI models."[7] That total is 45% higher than last year's already elevated figure. Nvidia's earnings report in May confirmed its status as the primary beneficiary of this massive spend, and the company appears likely to overtake Microsoft in the coming year as the most valuable company in the world.

While the amount of investment dollars going towards AI is extraordinary, the list of companies benefitting from this spending is narrowing. Advanced Micro Devices ("AMD") and Intel ("INTC") responded poorly to their earnings reports on concerns they are falling too far behind Nvidia on advanced GPU technology. Other AI beneficiaries, such as Dell ("DELL") and Super Micro Computer ("SMCI"), saw big post-earnings declines due to disappointing margin guidance. During recent earnings calls, some leading software companies, like Salesforce ("CRM"), Workday ("WDAY"), and MongoDB ("MDB"), have pointed to a shift in enterprise software spending patterns. The main message coming from these companies is that deals are being downsized and taking longer to close as companies shift their tech budgets to AI at the expense of other areas.

AI continues to be a focal point for investors, and its ability to transform many industries remains unquestioned. That said, there is growing debate about the rate of meaningful AI adoption and whether much of today's AI spending will generate an attractive return on investment. Some investors are starting to call the massive investments in large language models ("LLMs") a bubble reminiscent of the internet-driven fiber optic boom and subsequent bust of the late 1990s. That view may be too extreme, but investors are clearly becoming more discerning when assessing the impact of AI on capital markets. With expectations already elevated, any disappointments pose a risk to technology stocks and the broader market.

Overall, the equity market is in a similar position to where it was before April's selloff. Valuations are stretched, and positioning and sentiment are elevated again. Investors seem to have a high degree of confidence that inflation and yields have peaked and that a multi-year period of earnings growth has begun. With the job market still strong and consumer spending resilient, we believe inflation will stay firm absent significant economic weakness. All considered, the Fed will likely remain on hold, disappointing investors and pressuring yields higher. Higher-for-longer interest rates serve as a headwind for earnings growth, and they raise the probability of an adverse economic outcome. Thus, we remain cautious on equities given an unfavorable risk/reward set up.

7. "A Trillion-Dollar Arms Race." The Economist, 18 May 2024, p. 12.

Important Disclosures

This publication is provided by Element Pointe Family Office ("Element Pointe") for general information and educational purposes only. Any discussion of securities or investment strategies should not be construed as research or investment advice. This material should not be construed as an offer to sell or a solicitation of an offer to buy any security.

This publication contains certain forward-looking statements that indicate future possibilities. Due to known and unknown risks, other uncertainties and factors, actual results may differ materially from the expectations portrayed in such forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of their dates.

Element Pointe does not make any representations as to the accuracy, timeliness, suitability, completeness, or relevance of any information prepared by any unaffiliated third party incorporated herein, and takes no responsibility therefore. All such information is provided solely for convenience purposes only and all users thereof should be guided accordingly.

Nothing herein should be construed to limit or otherwise restrict Element Pointe's investment decisions. Element Pointe customizes the portfolios it manages to suit the needs of each client. Investment advisory services are only provided to investors who become Element Pointe clients pursuant to a written account agreement, which investors are urged to read and carefully consider in determining whether such agreement is suitable for their individual facts and circumstances.

Investing in fixed income products is subject to certain risks, including interest rate, credit, inflation, call, prepayment, and reinvestment risk. Investments in alternative investment strategies is speculative, often involves a greater degree of risk than traditional investments including limited liquidity and limited transparency, among other factors and should only be considered by sophisticated investors with the financial capability to accept the loss of all or part of the assets devoted to such strategies. Investing in the stock market involves gains and losses and may not be suitable for all investors. The indexes mentioned are unmanaged and an investment cannot be made directly into them and do not include fees and charges, which would reduce an investor's return. Past performance is no guarantee of future results.

All expressions of opinion reflect the judgment of the authors as of the date of publication and are subject to change without prior notice. There is no guarantee that the views and opinions expressed herein will come to pass.

The Firm, the Adviser and its affiliates and employees may hold positions in the securities discussed. You may access the Adviser's regulatory filings on the SEC's website for additional information about certain of the securities that the Adviser and its principals may hold. It is important that you do not base your investment decisions on our discussion of certain individual securities as one's overall investment portfolio and individual objectives should be considered when making such a decision.