July 2024

MONTHLY MARKET INSIGHTS

Key takeaways:

- The Artificial Intelligence ("AI") trend continues to bolster markets, but also creates concentration risk.
- A robust labor market underpins services inflation, despite broad disinflationary trends.
- Diverging global monetary policy and political uncertainty will likely heighten volatility in the second half of the year.

US large-cap stocks posted strong returns in June, culminating in robust gains for the first half of the year. The S&P 500 returned 3.45% for the month, while the tech-laden Nasdaq returned 5.96%. The S&P 500 and Nasdaq have returned 14.48% and 18.13% year-to-date, respectively. US stock market returns continue to be bolstered by the Magnificent 7, which returned 9.64% in June, bringing its year-to-date return to 36.78%. By contrast, the US large-cap market excluding the Magnificent 7 returned 0.82% during the month and only 7.15% year-to-date. While large-cap stocks flourished in June, small-cap stocks were challenged. Slowing economic fundamentals and weakening sentiment weighed on small-cap stocks with the Russell 2000 declining by -1.08%.[1]

Artificial Intelligence ("AI") continues to be the dominant theme propelling markets forward. Apple shares soared after the iPhone maker announced a partnership with OpenAI at its Worldwide Developers Conference on June 10. Similarly, Nvidia ("NVDA") rose 3.5% on June 18 to close at a record-high of $135.58 per share, briefly becoming the world's most valuable company by market capitalization.[2] High demand for NVDA's AI chips caused the company's revenue to triple over the last year, as of its latest earnings report. On the other hand, glimpses of vulnerability are emerging across the AI landscape as companies struggle to meet investors' lofty expectations after months of unprecedented growth. After reporting earnings that beat sell-side expectations, Micron shares tumbled late in the month due to underwhelming revenue and elevated capital expenditure guidance. The selloff led to contagion across the AI landscape, causing NVDA to endure its worst three-day rout since December 2022, losing $430 billion in market capitalization.[3] We remain long-term bullish on the AI trend, but we recognize that the industry may be vulnerable to mean-reversion. Given the S&P 500's concentration towards AI, any short-term volatility in AI stocks presents a significant risk to the overall market.

Treasury yields fell during the month as receding inflation numbers spawned optimism for Fed rate cuts in the back half of the year. Two-year yields dropped 13 basis points ("bps") to end the month at 4.75%, while ten-year yields fell 10 bps to end the month at 4.40%, after hitting an intra-month low of 4.22%.[4] The May Core Consumer Price Index ("CPI") rose 0.16% month-over-month, 14 bps below consensus expectations, marking the slowest pace since August 2021.[5] Under the surface, surprising airfare and auto insurance declines contributed to the downside. Consumer goods inflation broadly declined, indicating normalizing supply chains and consumer pushback on prices. Meanwhile, shelter inflation marginally reaccelerated while labor-reliant services generally rose across the board. The May Core Personal Consumption Expenditure ("PCE") price index rose 0.08% month-over-month, taking the year-over-year rate to 2.57%.[6] Similar to the CPI, the Core Services

1. Bloomberg, return indicates index price return.
2. Fitch, Asa. "Nvidia Tops Microsoft to Become Largest U.S. Company." Wall Street Journal, 18 June 2024, www.wsj.com/livecoverage/stock-market-today-dow-sp500-nasdaq-live-06-18-2024/card/nvidia-moves-into-the-top-spot-for-market-cap-4i1SFFzMdA4HO4OwnWSk?page=1&mod=article_inline.
3. Koenig, Kimberley. "Nvidia Stock Dips as AI Bubble Fears Surface; Is the Stock a Buy Now?" Investor's Business Daily, 2 July 2024, www.investors.com/research/nvda-stock-is-nvidia-a-buy-now/.
4. Bloomberg
5. Hatzius, Jan, et al. "USA: Monthly Core CPI Inflation Slows to 33-Month Low." Goldman Sachs, 12 June 2024, publishing.gs.com/content/research/en/reports/2024/06/12/696a2c5a-702c-4b32-99f9-1dc52cad5dfc.html.
6. Hatzius, Jan, et al. "USA: Core PCE Inflation Somewhat Below Expectations; Saving Rate Edges Up to 3.9%." Goldman Sachs, 28 June 2024, publishing.gs.com/content/research/en/reports/2024/06/28/f3f91d14-a237-4d96-a41d-5b94f5233393.html.

PCE increased month-over-month, implying that sticky services inflation will continue to challenge the Fed to meet its 2% inflation target. While inflation is trending in the right direction, the Fed will still need to maintain restrictive policy to weaken labor demand before reaching its target.

A resilient US labor market continues to make the Fed's fight against inflation difficult. The US economy added 272,000 jobs in May, exceeding economists' expectations of 190,000 new jobs. The unemployment rate ticked higher to 4.0%, but remains historically low, while US wage growth of 4.1% continues to backstop services inflation.[7] The labor market has now fully rebalanced with the jobs-workers gap[8] returning to its February 2020 level.[9] The normalization is mainly attributed to a sharp decline in job openings with a minimal increase in unemployment; however, further softening in labor demand will likely lead to increased unemployment at this juncture. We anticipate that labor market weakness will hinder consumer spending, which, along with heightened fiscal stimulus, has supported the economy over the past few years. Increased credit card delinquencies and declining savings rates imply that US consumers are struggling to maintain their spending. An increase in the unemployment rate would likely curb consumer spending and, in turn, impact economic growth. The federal government will likely use all the tools in its arsenal to support the economy through the election, but the risk of a 2025 US recession is rising.

Overseas, varying economic and inflation outlooks have led to diverging monetary policy across central banks. In June, the European Central Bank and the Bank of Canada cut rates, with additional cuts expected in the second half of the year. Meanwhile, the Bank of Japan ("BoJ") is moving in the opposite direction, with the expectation of further rate hikes by year-end. The Yen declined to historically weak levels against the US dollar, negatively impacting returns in Japanese equities for unhedged US investors. Nonetheless, diverging monetary policy between the BoJ and the Fed should eventually lead to a rebound in the Yen. Further, a resurgence in Japanese inflation after decades of zero to negative inflation creates a solid fundamental backdrop that leads us to continue to find Japanese markets attractive. Historically, varying policy actions have led to volatility across economies and markets, which behooves investors who diversify geographically in their portfolios.

2024 is proving to be the year of elections, as nearly half of the world's population hits the polls this calendar year. We have already witnessed global elections create investor anxiety in international markets. Claudia Sheinbaum's landslide victory in Mexico and the BJP party's failure to win a clear majority in India led to steep selloffs in both countries' respective equity markets. In France, a devasting loss to the far-right National Rally party in the European parliament elections led President Macron to call a snap election where his party currently trails. French equities have been under pressure from the uncertainty created by this unforeseen election. In the US, June ended with the first presidential debate between former-President Trump and President Biden. President Biden's lackluster performance during the first debate has called into question his candidacy, with many outspokenly calling for his resignation. The implied probability in the prediction markets that President Trump will win rose roughly 6% during the debate and has risen further since.[10] While much can happen between now and November, election uncertainty is increasing, and we anticipate a heightened level of volatility as we move through the election season. Philosophically, we do not make draconian changes to our long-term market views on account of perceived election results as, historically, they have not materially influenced returns. However, regardless of who wins in November, neither administration is likely to show fiscal restraint, and instead, we expect federal spending to continue to increase in either scenario. In turn, this should create upward pressure on US treasury yields, as the government is forced to issue more debt to support its spending.

Market concentration, diverging global monetary policy, and political uncertainty lead us to maintain a cautious stance toward risk assets. We believe investors would be prudent to adequately diversify and maintain a quality bias in portfolios to navigate what appears to be a more volatile second half of the year.

7. Duggan, Wayne. "June Fed Meeting: Fed Continues to Walk the Inflation Tightrope and Holds Rates Steady." Forbes, Forbes Magazine, 12 June 2024, www.forbes.com/advisor/investing/fomc-meeting-federal-reserve/.

8. The Job-workers gaps is the difference between job openings and unemployed workers.

9. Hussey, Chris, et al. "End of Month Market Intelligence: Inflection?" Goldman Sachs, 28 June 2024, publishing.gs.com/content/research/en/reports/2024/06/28/a6679f39-3c45-4164-9033-e6eb211548c0.html.

10. Phillips, Alec, and Tim Krupa. "Election 2024: Even More Uncertain." Goldman Sachs, 1 July 2024, publishing.gs.com/content/research/en/reports/2024/07/01/9d8c63b2-f423-4fa3-8ef0-dff159da5f58.html.

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