Weekly Investment Insights

July 8, 2024

VERDENCE CAPITAL ADVISORS

Key Takeaways:

- Manufacturing and services sectors both contract.
- Job openings unexpectedly increase.
- U.S. economy adds more jobs than expected; wage growth cools.
- Large-cap growth continues to drive U.S. equities higher.
- Yields plummet on prospect of Fed rate cuts.
- Commodities rally driven by crude oil and gold prices.

Weekly Economic Recap –

Labor Market in Focus as Unemployment Rate Climbs Again

U.S. manufacturing activity according to the ISM Manufacturing Index remained in contraction territory in June (a reading below 50) for the third straight month. The production component of the index slipped into contraction territory for the first time since February, and employment also fell into contraction territory.

The service sector in the U.S., according to the ISM Services Index contracted at the fastest pace since December 2022 and fell to the lowest level since May 2020. Every segment of the index fell except inventory sentiment and imports. Prices paid, an inflation indicator dipped modestly but has been in expansion territory since 2017.

Job openings as tracked by the JOLTS report unexpectedly increased in May. Available positions increased to ~8.14 million, up from a downwardly revised 7.92 million in the prior month, which was the lowest in three years. The number of vacancies per unemployed person held steady at ~1.2, matching the lowest since June 2021.

The U.S. economy added slighly more jobs than expected in June (206k vs. 189.5k est.). However, the unemployment rate unexpectedly increased to 4.1% (from 4.0% in May) as the labor force participation rate increased to 62.6%. The prime age-rate (those 25-54 years old) increased to 83.7%, the highest in over 22 years.

Weekly Market Recap –

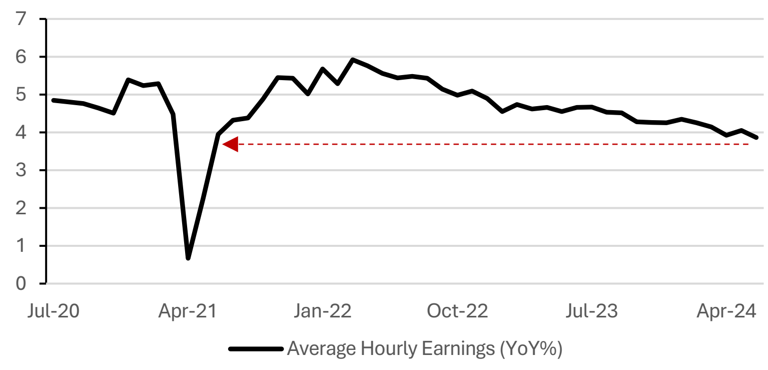
Large-Cap Growth Continues Higher on Prospect of Fed Rate Cuts

Equities: The MSCI AC World Index was higher for the fifth straight week as U.S. employment and wage data suggested the Fed may be able to cut rates later this year. Large-cap growth remained the key driver of U.S. equity markets last week as the Nasdaq and S&P 500 both closed at record highs. Small-caps failed to catch the rally as the Russell 2000 was the only major average lower in the U.S., falling for the first time in three weeks.

Fixed Income: The Bloomberg Barclays Aggregate Index was higher for the first time in three weeks as bond yields fell sharply on the prospect of Fed rate cuts. All areas of fixed income markets were higher for the week with investment grade and emerging market bonds leading the increases.

Commodities/FX: The Bloomberg Commodity Index was higher for the first time in three weeks. Crude oil prices were higher for the fourth straight week amid declining U.S. stockpiles and increasing demand. Gold prices ended the week at a one-month high after the U.S. employment report showed signs of a softening labor market.

Wage Growth Increases at Slowest Since May 2021



Footnotes: Data is as of June 2024.
Source: Bloomberg Finance LP, Verdence Capital Advisors.

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Past performance is not indicative of future returns.

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Key Takeaways:

- Double digit back-to-back first halves are rare.
- Historically, second half returns less than first half.
- Pullbacks and corrections are common in second half of year.
- Presidential election years show a similar pattern.
- History is one thing to analyze, fundamentals and valuations hold more weight.

As Goes the First Half so Goes the Year?

The S&P 500 has posted its second consecutive year of double digit gains to start the calendar year (+15% through 2Q of each year). This is the first time the Index has posted double digit gains through the second quarter for two consecutive years, since the years of 1998-1999 (price return only). This year the returns have been concentrated in the technology sector as the artifical intelligence craze intensifies. In fact, through 2Q24, the top 10 companies in the S&P 500 made up 108% of the return. In this weekly we used history as a guide to analyze what an impressive start to a year may mean for returns for the remainer of the year. In addition, we looked at Presidential election years to see what history tells us about returns for the rest of the year.

- **Returns good after double digit start but less than first half:** Going back to 1945, if the S&P 500 was up more than 10% in the first half of the year (through 6/30 and price return only), on average, the S&P 500 has rallied ~8.0% more through the remainder of the year. In addition, the Index was positive ~80% of the time.

- **It is not often a smooth ride to the end of the year:** Going back to 1945, the average pullback in the S&P 500 in the second half of each calendar year is ~10%. Of all the years since 1945, most of these pullbacks are more than 5%. In fact, only 16% of the years since 1945 experienced a pullback less than 5% in the second half of the year. For the remaining 84% of the years, the average correction in the second half of the year was ~12%.

- **Looking at Presidential election years:** Going back to 1945, the average return in the first half of an election year is ~3.0% and it has been positive 68% of the time. The average return in the second half of the year is ~ 4% and it has been positive 79% of the time. However, in the event the first half of a Presidential election year is up more than 10% (like this year), the average return in the second half is much more muted (up ~2%). Like all the other years, election years do not come without volatility in the second half. The average correction in the S&P 500 in the second half of an election year has been 10%.

The Bottom Line:

History can be a useful tool to look at patterns in performance of asset classes. However, it is only one metric that we use when making investment decisions. Underlying fundamentals and valuations in asset classes hold more weight in our investment decisions. At this point, the equity market returns have been highly concentrated in a select few names which is why this bull market does not feel like a true bull market. In addition, a large portion of the U.S. equity market cap has not been participating in this rally. For example, small cap stocks (Russell 2000) are underperforming large cap stocks (Russell 1000) on a rolling 12 month basis by the most since the pandemic. This year there has only been one modest pullback (~5%). This rally has continued despite growing concerns about the economy, political uncertainty, sticky inflation and lack of clarity about timing of first rate cut. Therefore, we would not rule out at least a 10% correction in the S&P 500 in the second half of the year. Especially when we see future earnings expectations get more realistic.

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Global Equities Higher on Hopes for Central Bank Rate Cuts

		Current	1WK	1MO	3MO	1YR	YTD
U.S. Equities	Dow Jones Industrial Average	39,376	0.7%	1.6%	1.7%	17.2%	5.5%
	S&P 500	5,567	2.0%	4.1%	7.3%	27.1%	17.6%
	Russell 1000 Growth	3,806	3.7%	7.8%	13.1%	38.4%	25.2%
	Russell 1000 Value	1,711	-0.4%	-0.9%	-1.2%	12.7%	6.2%
	Russell Midcap	3,222	-0.6%	-0.9%	-2.3%	12.5%	4.4%
	Russell 2000	2,027	-1.0%	-1.6%	-1.4%	9.8%	0.7%
	Nasdaq	18,353	3.5%	6.9%	13.2%	34.2%	22.7%

		Current	1WK	1MO	3MO	1YR	YTD
International Equities	MSCI AC World (USD)	818	2.0%	3.1%	5.8%	21.8%	13.5%
	MSCI EAFE (USD)	2,364	2.2%	0.0%	3.1%	14.5%	7.6%
	MSCI Europe ex UK (USD)	2,656	2.0%	-1.5%	2.8%	15.0%	7.6%
	MSCI Japan (USD)	4,015	3.1%	2.6%	1.4%	15.7%	9.6%
	MSCI UK (USD)	1,250	1.8%	0.1%	6.1%	15.8%	8.8%
	MSCI EM (USD)	1,105	1.9%	4.5%	6.7%	13.3%	9.6%
	MSCI Asia ex Japan (USD)	709	2.0%	4.5%	9.2%	13.7%	11.9%

		Current Yield	1WK	1MO	3MO	1YR	YTD
Fixed Income	U.S. Aggregate	4.9%	0.7%	0.4%	1.9%	4.0%	0.0%
	U.S. Govt/Credit	4.8%	0.7%	0.4%	1.9%	4.1%	0.0%
	U.S. 10 Year Treasury	4.3%	0.8%	0.4%	2.0%	1.1%	-1.3%
	U.S. TIPS (1-10YR)	4.6%	0.5%	0.6%	2.0%	5.1%	1.8%
	U.S. High Yield	7.9%	0.3%	0.6%	1.9%	10.9%	2.9%
	EM Bonds (USD)	7.1%	0.5%	0.6%	1.6%	8.6%	2.7%
	Municipal Bonds	3.7%	0.1%	0.7%	0.7%	3.3%	-0.3%

		Current	1WK	1MO	3MO	1YR	YTD
Commodities	Bloomberg Commodity Index	242	1.6%	1.1%	1.0%	6.0%	6.8%
	Crude Oil (USD/bbl)	$82.6	1.3%	7.1%	-3.8%	8.8%	11.0%
	Gold ($/oz)	$2,392.2	1.8%	3.5%	1.5%	23.4%	15.1%
	Copper	$465.9	6.0%	3.8%	8.9%	23.6%	19.6%
	Wheat	$590.5	0.9%	-10.9%	-3.2%	-17.4%	-11.8%
	U.S. Dollar	105	-1.0%	-0.1%	0.6%	2.5%	3.4%
	VIX Index	12.5	0.3%	-1.2%	-22.1%	-12.0%	0.2%

Footnotes: Data is as of July 5, 2024.

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