Convergence Commentary

May 2024 Market Recap

Quick Hits:

- The market rally resumes.
- GDP growth came in below expectations.
- Inflation data was better than expected.
- US Consumers are being tested.

Market-Moving Highlights

May featured the end of the first quarter's earnings results, with 98% of the S&P 500 reported. Overall, results have beat sales by 0.8% and beat earnings by 7.9%. The biggest positive surprises came from communication services, consumer discretionary, and health care. In the sector highlights and commentary section, you will notice that consumer discretionary was one of the worst performers. There are worries that consumers spending will slow down soon, with negative catalysts such as high interest rates and rent prices playing their part. These worries caused a downward revision in consumer spending. The story, however, is yet to be written. The first quarter marked a positive earnings season with a diverse set of sectors showing strength.

After 4 months of higher-than-expected inflation readings, the reading in May provided relief. CPI came in at 3.4% year-over-year and 0.3% month-over-month. The expectations were for 3.5% and 0.3%. Core CPI decreased to 3.6% and 0.3% monthly, better than expectations of 3.7% and 0.3%. In our last commentary we mentioned how the goldilocks scenario of strong growth and slowing inflation is loosening its grip. This still seems to be the case, as the Q1 GDP estimate came in at 1.3%, below estimates of 1.6%. The difference came mostly from the revision of consumer spending. However, most of the time goldilocks scenarios do not happen, and the market has been coming to terms with that fact. The slower growth should help battle inflation, while profit margins are expanding during a period of growth.

Index Performance

Index	1 Month	YTD	1 Year	5 Year
S&P 500	4.96%	11.30%	28.19%	15.80%
Nasdaq Composite	6.98%	11.82%	30.37%	18.54%
Russell 2000	5.02%	2.68%	20.12%	8.61%
MSCI ACWI ex US	3.00%	6.10%	17.33%	7.32%
Bloomberg US Aggregate Bond	1.70%	-1.64%	1.31%	-0.17%

In our last market commentary, we mentioned that the global economic strength provides hope that the tough month of April was just a healthy pullback. The performance in May provides support to this theory, as all major indices ended in positive territory. Treasury yields, while still high, decreased from 4.68% to 4.51% after encouraging inflation data along with a weaker-than-expected quarterly GDP report. This development is especially important for the Russell 2000 small-cap space, which showed some relative strength as it beat the S&P 500 for the month. The Nasdaq Composite was the best performer, as the technology sector gained after earning reports from major chipmakers. The internationals also performed solidly, with little news to note in May.

S&P 500 Sector Highlights & Commentary

Best-Performing Sectors		Worst-Performing Sectors	
Utilities	8.96%	Energy	-0.34%
Technology	7.08%	Consumer Discretionary	0.20%
Communication Services	6.94%	Industrials	1.64%

10 out of 11 S&P 500 sectors landed in positive territory in May, with mostly cyclical sectors leading. Utilities are an exception, as they continue gaining traction due to data centers' energy needs. Technology, after a sluggish first couple of months of the year in comparison to 2023, gained from strong demand for AI chips. Communication Services benefited from a continuously strong demand for entertainment.

On the worst-performing front, the energy sector took a breather after gas prices stabilized. High interest rates and decreased saving rates are making it unclear whether or not US consumers can continue their pace of discretionary spending, which pressured the consumer discretionary sector. PMI (purchasing manager indices) came in lower than expected for the month, pressuring industrials, albeit they still had a decent performance. Overall, it was a great month for the S&P 500 sectors, indicating further signs of broadening of the rally beyond the tech sector, which is currently the 5th performer year-to-date.

What to Watch in June

Click here to read our reference guide for economic indicators.

06/03 – Manufacturing PMI
After the first expansion in 16 months in the March reading, the manufacturing sector fell to contraction territory at 49.2, below market expectations of a stall at 50. Lower demand for textile mills, food, beverage, and machinery played a part. On the bright side, production is still at an expansionary level of 51.3.

06/05 – ISM SERVICES PMI
The Services PMI has dropped sharply to 49.4 from 51.4 in the earlier month, marking the first contraction in services since December of 2022. The market expectations were for a 52 reading. The services and manufacturing readings suggest that higher borrowing costs from the Fed are starting to have a larger impact on business conditions.

06/07 – Non-Farm Payrolls, Unemployment Rate
The first Friday in June will offer a snapshot of the labor market. The US economy is expected to add 150,000 jobs and the unemployment rate is expected to remain at 3.9%. As a reminder, the US economy added 175,000 jobs in April, below expectations of 315,000. While healthcare job gains remain strong, the labor market is expected to weaken significantly from the strength we have seen in the first quarter.

06/12 – CPI and Core CPI, Fed Interest Rate Decision and Conference
Both CPI and Core CPI came in line with expectations at 3.4% and 3.6%, respectively. Inflation remains the most important economic reading.

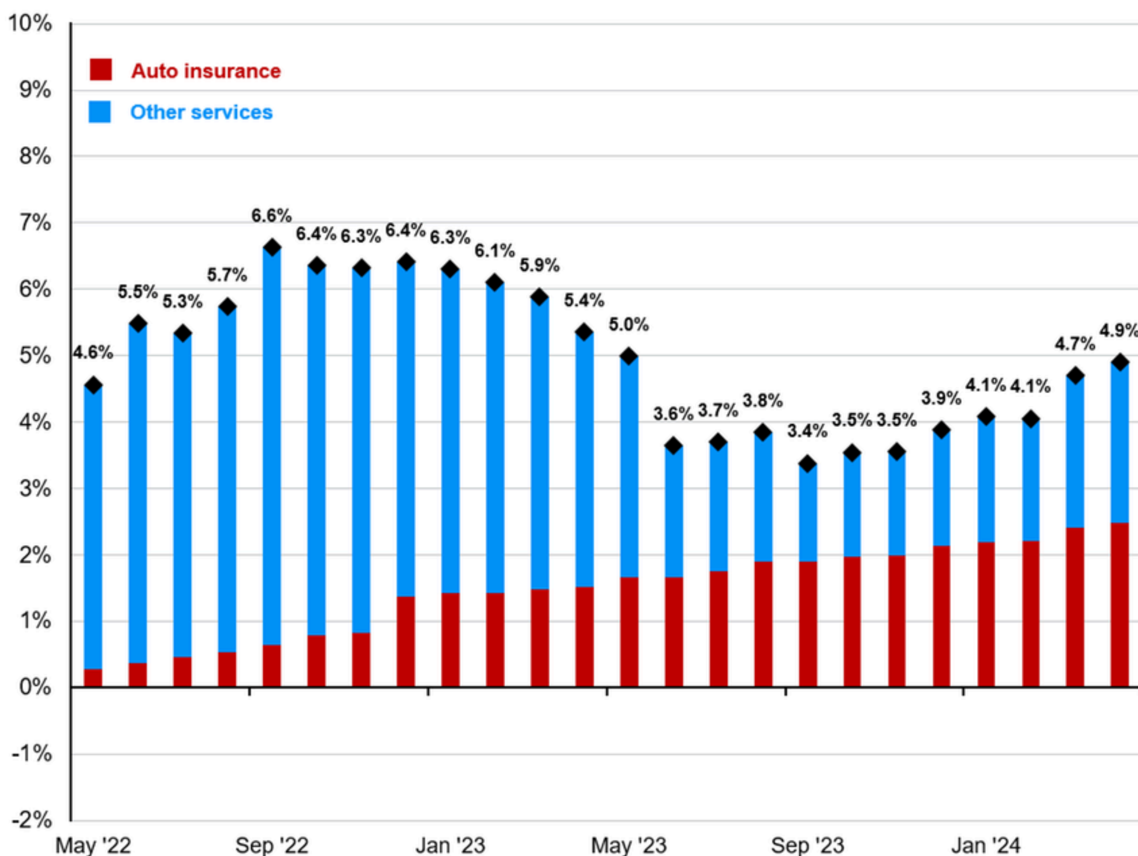
06/14 – Michigan Consumer Sentiment Preliminary
The last reading was 69.1, which was the lowest in six months. The reading is also lower than 84% of the readings since 1978. Consumers were less optimistic about the unemployment rate and income growth. The high interest rates and geopolitical tensions are pressuring consumer views. The forecast expects a slight improvement to 70.

Market Wrap

May was a successful month for the equity markets, with a better-than-expected inflation reading, and worse-than expected GDP growth and strong earnings. It was a quiet month on the market highlights front, with not many events that caused outsized moves. While there are worries that US consumers will be slowing down, there are also signs that inflation/growth/profit margins are coming to a healthy balance.

Still, CPI inflation remains uncomfortably high for the Federal Reserve. The major culprit is service inflation, which has its own version of a CPI, called "super core" inflation. The latest read of 4.9% is much higher than the headline CPI print. Within that super core index, auto insurance accounts for 3% of the increase. Auto insurance rising not only affects consumer wallets, but it also makes consumers think that inflation is worse than it is. Increased vehicle costs, higher claims, more uninsured drivers, and regulatory delays in rate adjustments are some of the factors. According to JPMorgan, all of these factors are improving.

The graph below shows visually the contribution of auto insurance (red line) to services inflation. It is a good reminder that headline data does not often show the full picture, but also gives hope of how much inflation could fall once auto insurance moderates.



Sources

What's going on with auto insurance costs? | J.P. Morgan Asset Management (jpmorgan.com)

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