Convergence Commentary

June 2024 Market Recap

Quick Hits:

- Inflation had a big slowdown.
- Signs emerge that indicate the US economy could be slowing.
- Tech names lead while the broader market is muted.

Market-Moving Highlights

June provided relief on the inflation-data front, as both CPI and Core CPI readings showed better-than-expected progress. CPI came in at 3.3% year-over-year and 0% month-over-month. This is the lowest CPI reading in three months, and expectations were for 3.4% and 0.1%, respectively. On the Core CPI front, the reading eased to 3.4% year-over-year and 0.2% month-over-month, the lowest in three years. The expectations were for 3.6% and 0.3%, respectively. This is great news for the battle on inflation.

Despite this news, a broader market rally has failed to materialize in June. There were some signs of the slowing economy, such as retail sales coming in softer than expected, unemployment ticking up slightly to 4% (3.9% was expected), producer price index coming in much lower than expected -0.2% vs 0.2%, and consumer sentiment coming in much lower than expected (65.6 vs 72). The signs of weakness in the economy, albeit welcome for the inflation fight, gave way for fear to creep in. It is now questioned whether the economy can handle the interest rates, or whether the Federal Reserve is going to act too slow. That might explain the muted reaction. It is possible that for the next readings, the market will want either more in-line readings, or stronger-than-expected, which is a shift over wanting the economy to slow down. It is important to remember that one month of data can be misleading. For example, the slowdown could be exaggerated. It will be interesting to see what will happen in July.

Index Performance

Index	1 Month	YTD	1 Year	5 Year
S&P 500	3.05%	15.29%	26.67%	15.05%
Nasdaq Composite	4.27%	18.57%	31.49%	18.21%
Russell 2000	-0.75%	1.73%	11.90%	6.94%
MSCI ACWI ex US	-1.29%	6.04%	12.95%	6.05%
Bloomberg US Aggregate Bond	1.35%	-0.71%	2.13%	-0.23%

June brought a mixed market performance with technology having a great month (as evidenced by the Nasdaq and S&P 500 performance), while the broader market stagnated. 10-year Treasury Yields declined further to 4.34% from 4.51%, as inflation showed signs of cooling. However, there was an increasing attention on the health of the consumer given weak retail sales reports, as well as numerous corporate updates about more "value-conscious" customers. On the positive side, ongoing AI optimism and potential for a soft-landing are still fueling the market. Overall, it was a good, but mixed month for the markets, as further broadening of the market is needed to provide more confidence.

S&P 500 Sector Highlights & Commentary

Best-Performing Sectors		Worst-Performing Sectors	
Technology	7.84%	Utilities	-5.55%
Consumer Discretionary	3.88%	Materials	-3.06%
Communication Services	3.15%	Energy	-1.43%

Cyclical sectors stole all the glory in June, with 6 out of 11 S&P 500 sectors landing in negative territory. Technology continues to benefit from tailwinds, as Apple announced a deal with ChatGPT maker, Open AI, to better iPhone AI capabilities. It is a surprise to see consumer discretionary being the second-best performing sector, as concerns over a weaker consumer arise. For example, Nike had the worst day in its history, wiping around 26B of value in one day. However, Amazon and Tesla are the two biggest components of the Index (around 40% of the total consumer discretionary index), and both of those had some positive catalysts in June. Communication services benefited from companies like Google teasing innovation.

On the worst-performing front, utilities were taking a breather after being the best performer in May. Despite many positive factors, such as energy storage being needed for innovation purposes, and supporting valuations as the sector was mostly ignored in the current market rally, there are uncertainties whether utilities will have to raise more capital by the time the Federal Reserve starts cutting rates. While there was no notable news for materials and energy, the broader market outside of cyclical sectors was slightly negative. Overall, the positive is that the leadership was cyclical, and the negative is the lack of broadening of the rally.

What to Watch in July

Click here to read our reference guide for economic indicators.

07/01 – Manufacturing PMI
The Manufacturing sector continues its slump with a 48.7 reading in May, down from 49.2 and below forecasts of 49.6. A big decline was seen in orders, but interestingly, employment rebounded strongly.

07/03 – ISM SERVICES PMI, FOMC Minutes
The Services sector beat all expectations (50.8) with a reading of 53.8 in May. Business activity boomed, including export orders. As mentioned in our previous commentary, the last reading was the first contraction since December 2022. It is good to see a sharp rebound following the contractionary reading.

07/05 – Non-Farm Payrolls, Unemployment Rate
The US economy added 272,000 jobs in May 2024, well beyond the 185,000 expected. Health care continues to be a leader in added jobs with 68,000 jobs added in May. With the Federal Reserve wanting a slowdown in job openings to have conviction for a rate cut, it remains to be seen when the labor market will show persuasive signs of cooling. The unemployment rate is expected to remain at 4%, while 160,000 jobs are forecasted to be added.

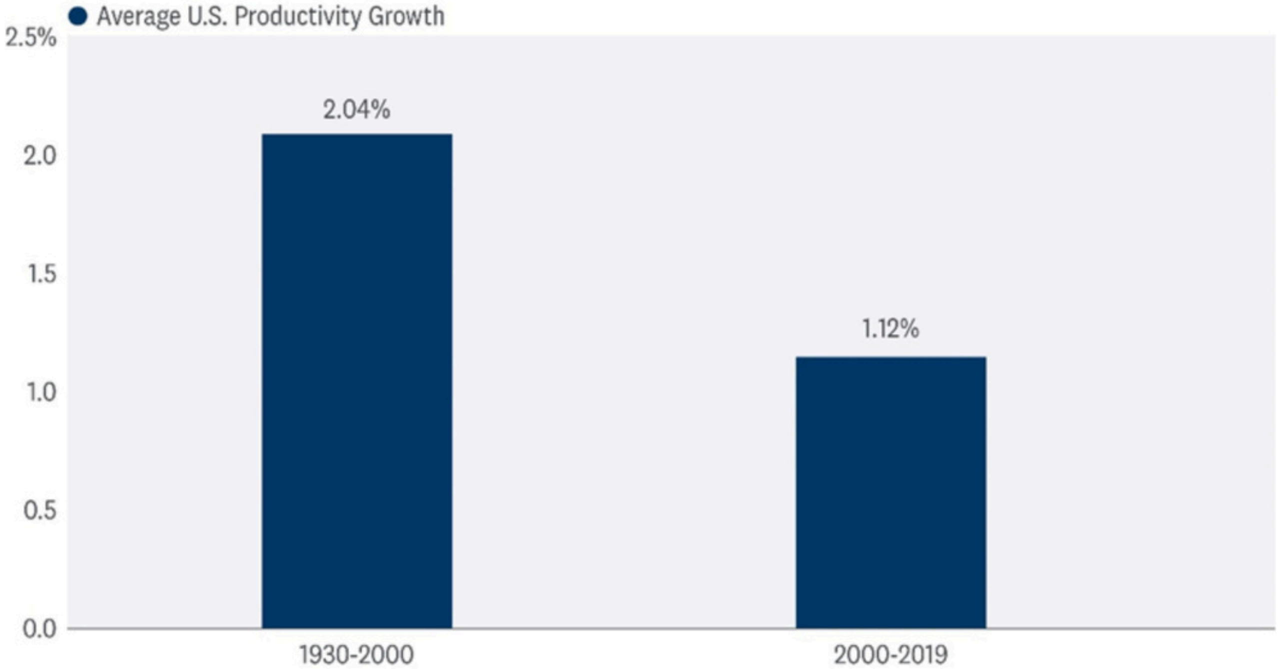
07/11 – CPI and Core CPI
Both CPI and Core CPI were better than expected this month. Inflation remains the most important economic reading.

07/12 – Michigan Consumer Sentiment Preliminary
The last reading was 68.2, which was the lowest in 7 months. Inflation expectations of consumers are positive, but consumers are less optimistic about income growth (similar to the last reading).

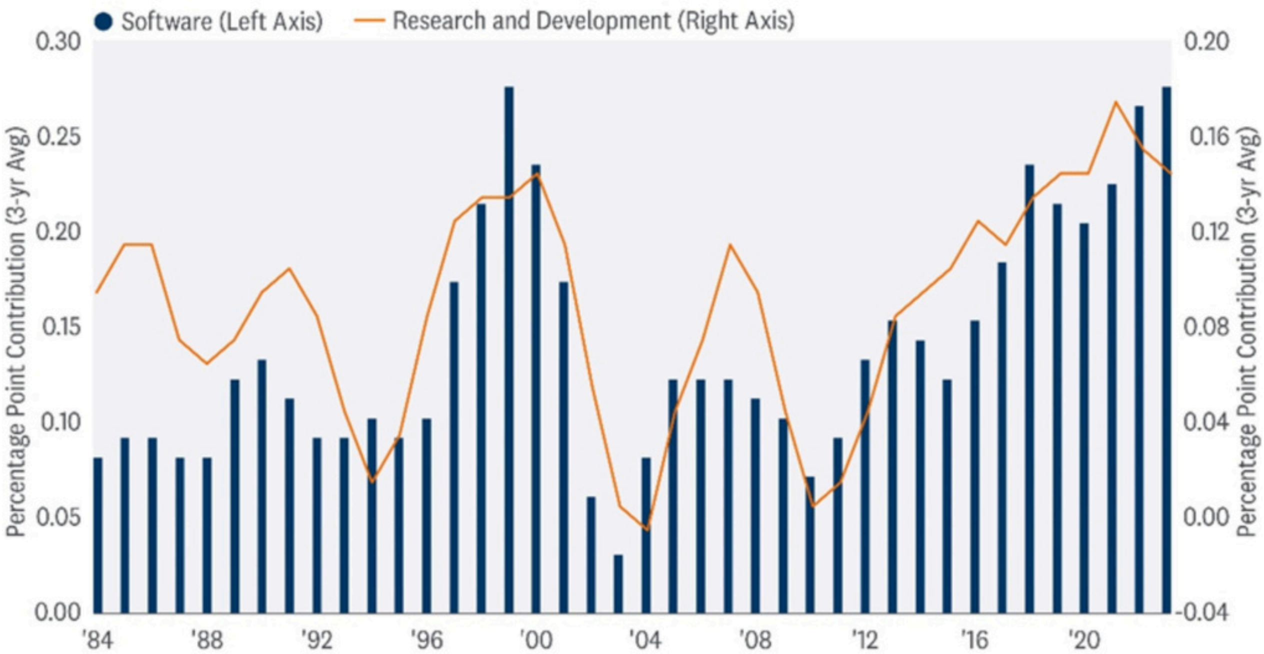
07/16 – Retail Sales
With a lot of market chatter about the US consumer cooling off, retail sales are especially important. Expectations are for a 0.3% month-to-month increase.

Market Wrap

June has been a mixed month for equities as Large Caps rallied while the broader market remained muted, causing investors to question the legitimacy of the current rally. Let's take a look at some potential reasons why Large Caps are currently leading the market, and what it means for the broader market from a long-term perspective. Productivity growth is one of the strongest forces in dealing with demographic and inflation headwinds. Until the recent emergence of hardware and software improvements, we have suffered a slump historically, as indicated by the graph below.



However, a big re-emergence in software and R&D development spending, indicated by the graph below, should serve as a productivity booster in the years ahead. According to Nicholas Bloom of Stanford University, most of the disruptive technologies are concentrated in a few places initially (like Silicon Valley), but eventually the technology disperses into the broader economy. If the theory holds true, both the technology dispersing and productivity growth potentially growing thanks to an increase in R&D spending would mean the current environment should be celebrated by long-term investors.



Sources

[Artificial Intelligence: Is AI the Antidote to Fed Policy? (lpl.com)]

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