Convergence Commentary
July 2024 Market Recap

Quick Hits:

- Data supports continued disinflation
- Sector rotation out of technology
- Headwinds for home sales

Market-Moving Highlights

On July 31, the Federal Reserve surprised no one when it voted to maintain its interest rate target at 5.25% - 5.50%. Rather than focusing on the results of the meeting itself, investors instead were paying attention to what Federal Reserve Chair Jerome Powell had to say at his post-meeting press conference, hoping for clues on what lies ahead. Powell didn't disappoint. Citing continued progress on inflation and growing risks to the labor market, he opened the door for an interest rate cut at the FOMC's next meeting. Any potential move by the Fed wouldn't be done in isolation – more than half of developed market central banks around the world have already started cutting rates, including a reduction by the Bank of England at the start of August.

Data released over the past few weeks certainly hasn't hurt the case for a cut later this year. In June, the year-over-year change in the Consumer Price Index fell to its lowest level since 2021, while the 3-month annualized change dropped to just 1.1%. That's the best mark in 4 years. Falling inflation isn't coming at the expense of slower growth, either. Last week, the US Bureau of Economic Analysis reported that US real GDP grew at a 2.8% annual rate in the second quarter, up from just 1.4% in Q1. And despite signs of a softening labor market (declines in job openings and a rising unemployment rate) consumer spending remained a large contributor to growth during the quarter.

Today, futures markets imply 100% odds of a rate cut at the Fed's next meeting in mid-September. There's a lot of data to sift through between now and then, though, so we aren't taking anything for granted. Friday's payrolls report is the first thing on the docket.

Index Performance

Index	1 Month	YTD	1 Year	5 Year
S&P 500	1.22%	16.70%	22.15%	15.00%
Nasdaq Composite	-0.73%	17.71%	23.62%	17.53%
Russell 2000	10.16%	12.07%	14.25%	8.91%
MSCI ACWI ex US	2.35%	8.53%	10.28%	6.80%
Bloomberg US Aggregate Bond	2.34%	1.61%	5.10%	0.19%

In June we talked about technology having a great month while the broader market stagnated. July strongly reversed the trend, with the tech sector being the only major weak part of the market. This can be seen in the Nasdaq Composite having a negative month, while the S&P 500 was roughly flat. The Russell 2000 small cap index was the main winner this month, as investors anticipate a disproportionate impact on small caps from any perceived change in Federal Reserve policy. However, slowing economic activity usually has a greater negative impact on small caps as well, and it will be interesting to see how the dynamic plays out. On the international front, it was a quiet, slightly positive month with investors awaiting results from elections, timing of rate cuts, and updates from the tensions in the Middle East.

S&P 500 Sector Highlights & Commentary

Best-Performing Sectors		Worst-Performing Sectors	
Real Estate	7.24%	Technology	-3.28%
Utilities	6.82%	Communication Services	0.15%
Financials	6.4%	Consumer Staples	1.66%

Sectors that typically benefit the most from rate cuts were the leaders for July, with 10 out of 11 S&P 500 sectors showing gains. Real estate, for the first time all year, will end a month in positive territory. Financials and Utilities celebrated the slowly clearing skies over high interest rates as well.

On the worst-performing front, information technology and communication services suffered from a rotation away from growth-oriented areas into areas that have not received as much attention lately. Firms like Microsoft and Google that play an outsized role in those indices found it hard to fill the lofty expectations during their earnings calls. Additionally, a world-wide outage caused by a cybersecurity firm update has placed some scrutiny on the sector. While the size, existence, and severity of the consumer slowdown is unclear, the fact is that the consumer discretionary sector has now landed the last place based on year-to-date performance. Overall, a great month for the S&P 500 sectors, with only technology having a negative performance.

What to Watch in August

Click here to read our reference guide for economic indicators.

08/01 – Manufacturing PMI
The Manufacturing sector continues its slump with a 48.5 reading in June, down from 48.7 and below forecasts of 49.1. Production and employment contracted, while new orders, price pressures, and supplier deliveries improved.

08/03 – Non-Farm Payrolls, Unemployment Rate
The US economy added 206,000 jobs in June, above forecasts of 190,000. However, there were some revisions to April and May employment, which resulted in April and May readings to be 111,000 lower than previously reported. June figures have been taken as a positive for the market, as they point to a strong, but cooling labor market. Forecasts call for a 190,000 July reading. The unemployment rate is expected to stay steady at 4.1%.

08/05 – ISM Services PMI
The Services PMI surprised to the downside in their June reading at 48.8, which is the worst reading since April 2020. The lower PMI readings sparked some worry that the economy is slowing down faster-than-expected. Remember, the May reading surprised to the upside at 53.8. Therefore, a single reading often paints a skewed picture, and next readings should be more indicative.

08/14 – CPI and Core CPI
Both CPI and Core CPI were better than expected this month. Inflation remains the most important economic reading.

08/15 – Retail Sales
Retail sales stalled in June, amplifying fears over a consumer slowdown. However, looking deeper and excluding a big drop in auto sales due to a CDK attack (a software provider for auto dealers), retail sales were stronger than expected. From that perspective, it is possible that the extent of a consumer slowdown is overstated. It will be interesting to see how the next readings unfold.

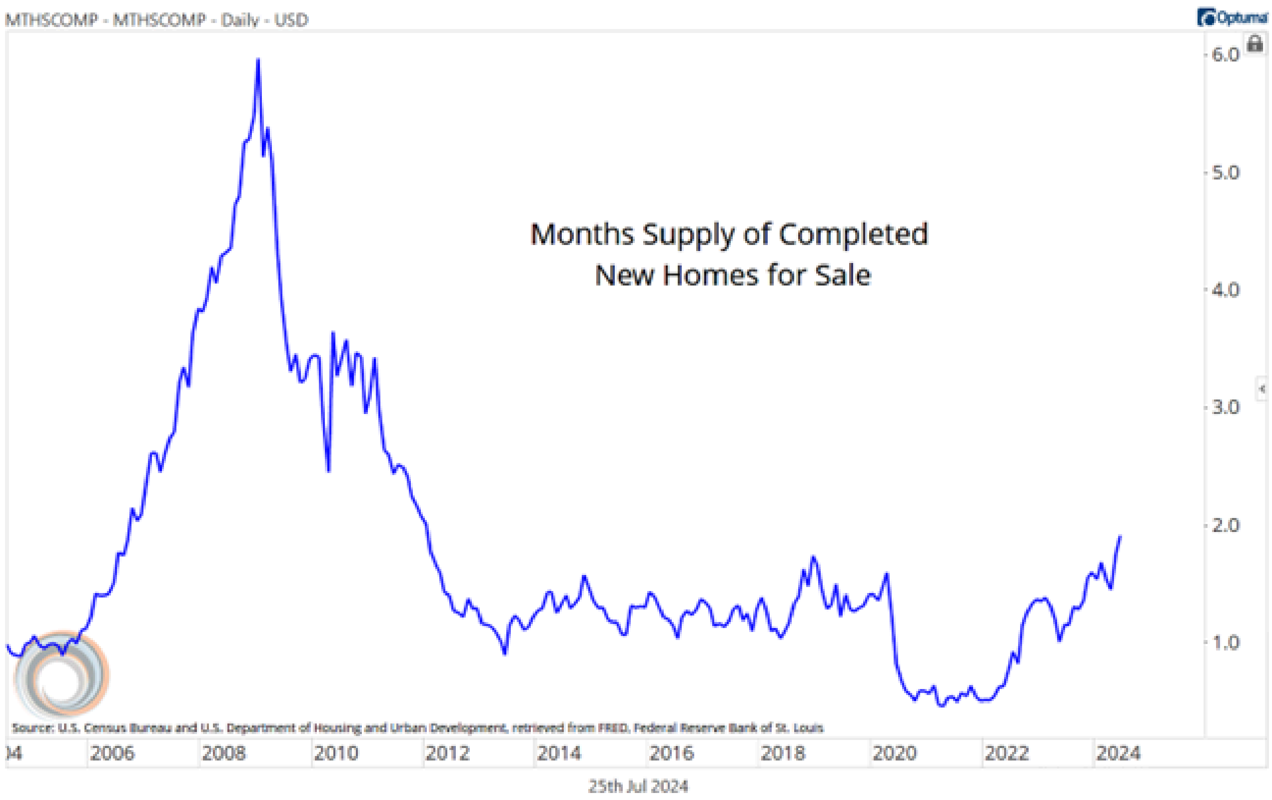
08/16 – Michigan Consumer Sentiment Prel
Consumer sentiment fell for the fourth straight month to 66 in July. Concerns around high prices, and uncertainty about the upcoming election have put downside pressure on the index. However, inflation expectations fell to 2.9% from 3%.

Market Wrap

The Federal Reserve's efforts to bring inflation under control haven't resulted in a broad-based economic downturn, but one area has certainly felt the impact: the housing market.

In June, existing home sales declined 5.4% versus the prior year, and new home sales dropped 7.4%. To be fair, low home sales volume isn't new a story - it's been a theme since mortgage rates doubled to more than 6% in 2022. That surge in rates had the dual impact of crimping demand (by reducing affordability for buyers) and reducing supply (by causing potential sellers to stay put and hang on to their lower mortgage rate).

The story is starting to change. Thanks to stubbornly high home prices, buyers are largely in the same position as they were before, so demand remains at a low level. But supply (inventory of homes for sale) is on the rise. One of our favorite ways to measure the supply/demand dynamics within the housing market is to look at how long it would take for buyers to absorb all the homes currently for sale. The 'months supply' of homes is on the rise. For existing homes, there are now 4.1 months of inventory available, which is double what was available at the post-pandemic lows, and in-line with historical averages. The months supply of completed new homes for sale, however, just hit its highest level in more than a decade.



Sources

FedWatch: Stay up-to-date with the latest probabilities of FOMC rate moves

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