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QUARTERLY

MARKET INSIGHTS

2Q 2024

THE ECONOMY CHUGS ALONG AND FIVE STOCKS PUSH THE S&P 500 TO NEW RECORD HIGHS.

SUMMARY

- US Economic strength in Q2 was buoyed by easing financial conditions and tight labor conditions.
- The momentum in US large cap equity markets from Q1 largely continued into Q2, but the breadth of equity leadership narrowed to the “Fab Five.”
- Meanwhile, US interest rates rose modestly, and bond market returns were mixed for the quarter.
- Looking forward, geopolitical risks may rise to the forefront in Q3, and, while seasonality is generally favorable in the summer months, equities could be vulnerable to a pull-back in the late Summer or early Fall.

ECONOMY

Employment, growth, and inflation

The US economy continued its resilient pace of growth in Q2 following a slower, albeit still expanding, pace of growth from Q1. The current consensus estimate for real GDP growth for Q2 is tracking around +2.9%, compared to Q1 growth of +1.4%.[1] Employment trends remained favorable, with the unemployment rate of 4.1% only modestly higher than one year ago (3.7%).[1] The uptick in unemployment has largely been attributed to increases in labor force participation rather than job losses, with the US economy adding an average of 230,000 jobs per month since this time last year.[1] Economic conditions continue to resemble that of a soft landing, though with a less certain path for inflation.

	GDP	Unemploy-ment	Core-PCE	Probability	Rate Implications	Equities	US$
No Landing	>3% *Above trend growth*	≈ 3.5%	4% to 6%	<5%	Fed Funds ↑ US 10Yr ↑	↓	↑
Soft Landing & Sticky Inflation	1.5% to 3% *At trend growth*	3.5% to 3.9%	3% to 4%	40%	Fed Funds ↔ US 10Yr ↔	↔	↔
Soft Landing & Disinflation	1.5% to 3% *At trend growth*	3.5% to 3.9%	2% to 3%	40%	Fed Funds ↓ US 10Yr ↓	↑	↔
Stagflation	0% to 1.5% *Low growth*	4.0% to 5.5%	3% to 4%	<5%	Fed Funds ↔ US 10Yr ↑	↓	↔
Mild Recession	-0.1% to -1.0% *Moderate contraction*	4.5% to 6.0%	2% to 3%	5%	Fed Funds ↓ US 10Yr ↓	↓	↔
Hard Landing	< -1% *Significant contraction*	> 6%	1% to 2%	<5%	Fed Funds ↓ US 10Yr ↓	↓	↑

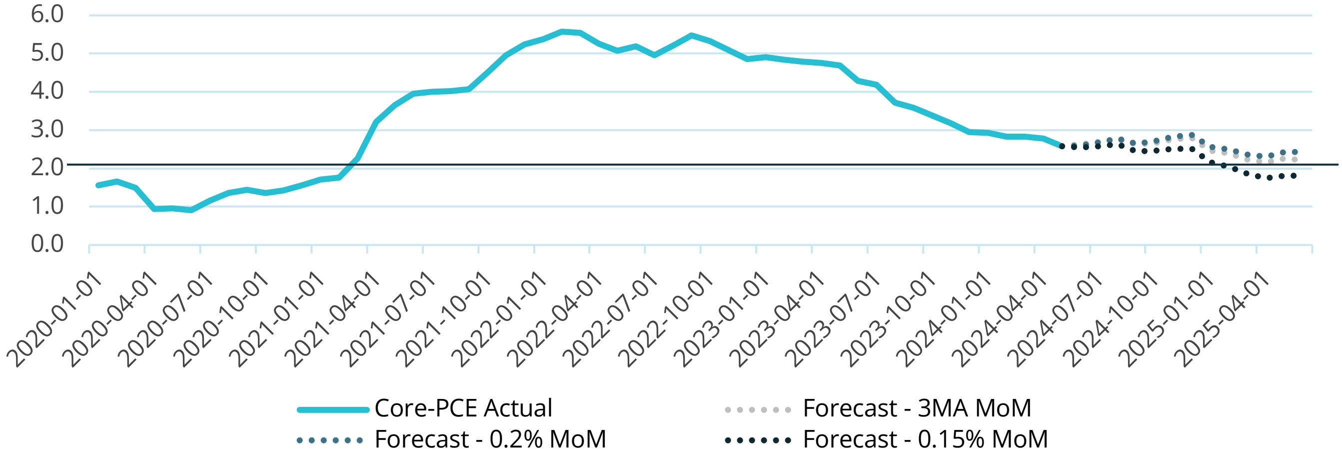
Source: Clearstead, Payden & Rygel as 6/25/2024

Both the services and manufacturing sectors of the economy stumbled in Q2, but overall, the service sector fared better. The ISM Services PMI has averaged 51.6 *(Readings above 50 generally indicate expanding activity)* during the first half of the year despite falling to 48.8 in June.[1] June's decline marked just the 3rd time in 49 months in which the services sector contracted, and the Services PMI still averaged above 50 for the quarter. Meanwhile, in the manufacturing sector, growth continued to be less than stellar during Q2—the manufacturing ISM averaged 48.8 during the quarter, and it has registered only one reading above 50 (March at 50.3) in the past year. However, it is important to note that ISM Manufacturing index readings above 42.5—which the index has been and is comfortably above—have generally been associated with positive overall growth in the broader US economy.[1]

Inflation continues to move towards the Fed's 2.0% target, with the central bank's preferred inflation gauge—Core Personal Consumption Expenditures (PCE)—declining from 2.9% year-over-year (YoY) at the beginning of 2024 to 2.6% YoY in the most recent data for May.[1] While generally positive news, potential inflation pressures, such as housing, persist, and the path for further declines in inflation might be challenged in coming months.

[1] Bloomberg LP

Outlook Scenarios
Core PCE YoY %



Source: Clearstead, Bloomberg LP, as of 6/26/2024

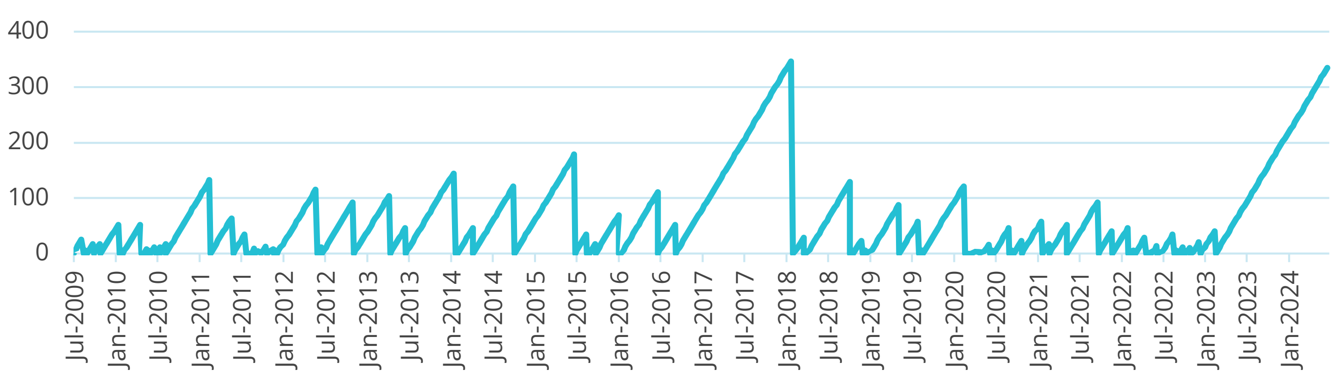
As a result, during Q2, markets pushed out the timing of expectations for the Fed's first 25bps rate cut from July to November, with approximately two 25bps rate cuts expected for 2024. Interesting to note, the November Federal Reserve meeting is scheduled for November 6-7, the day(s) after the US presidential elections.[1]

EQUITY MARKETS

New all-time highs for the S&P 500, not so much for everything else

A familiar theme reemerged in equity markets during the second quarter, with just a few stocks pushing markets higher. While the theme of a broadening rally played out in Q1, Q2 was quite the opposite. During the quarter, the median stock in the S&P 500 index declined -3.1%, yet the S&P 500 gained +4.3% thanks to the likes of Nvidia, Apple, Microsoft, Alphabet *(parent company to Google)*, and Amazon, aka the Fabulous Five, which collectively accounted for 100% of the index's quarterly gains (the "Fab Five" contributed to about one-third of the index's returns in Q1-2024).[1] Of note, as of the end of the second quarter, the S&P 500 had not experienced a -2.0% daily decline in over 339 trading days, the longest such stretch since 2016-2017.[1]

Number of Trading Days Since -2% Decline - S&P 500



Source: Clearstead, Bloomberg LP, data for S&P 500 as of 6/26/2024

The momentum of the Fab 5 helped push large cap stocks to outperform their small cap counterparts by a significant margin, and overall small cap suffered negative returns, with the Russell 2000 Index declining -3.3% in the quarter and largely reversing gains experienced in Q1.[1]

Growth stocks beat value stocks in the quarter by more than 10 percentage points (Russell 1000 Growth +8.3%, Russell 1000 Value -2.2%), with growth again buoyed by the Fab 5. The quarterly outperformance of growth ranks as the second largest since Q2 2020.[1]

In overseas markets, emerging markets (MSCI Emerging Markets Index +5.0%) bested developed international markets (MSCI EAFE Index -0.4%) thanks to strong performance from China (MSCI China Index) and India (MSCI India Index) which gained +7.2% and +10.3%, respectively during Q2.[1] Despite this quarter's relative outperformance, the two markets have been on very different paths as China continues to battle property sector woes while India's economy has generally performed well. The MSCI China Index is still down -52.2% since it peaked in mid-February-2021, while India (MSCI India Index) is up +53.8% over that same period.[1]

As we look forward, markets will have to contend with new governments in the UK and France, US elections in the Fall, and ongoing wars in Ukraine and the Middle East. The headlines around these events may be market moving as trading volume generally thins in July and August, and market analysts begin to shift their focus from 2024 earnings to the outlook for 2025 given the November election.

FIXED INCOME MARKETS

Coupon drives returns, financial conditions remain favorable

Benchmark interest rates remained volatile in the quarter, with the yield on the 10-Yr US Treasury moving from 4.2% to start the quarter to an intra-quarter high of 4.7% before closing out the month of June at 4.4%.[1] Generally speaking, the yield curve was higher in the quarter, with most tenors from 2 years to 30 years rising by 10-20bps.[1] The uptick in rates weighed on most bond market indexes, though coupon return helped mitigate losses—the broad US Bloomberg Aggregate Bond Market Index gained +0.1% in the quarter.[1]

Tenor	6/30/2024	3/31/2024	Change
1M	5.32%	5.36%	-0.03%
2M	5.36%	5.37%	-0.02%
3M	5.36%	5.37%	-0.01%
4M	5.38%	5.38%	0.00%
6M	5.33%	5.32%	0.00%
1Y	5.12%	5.03%	0.09%
2Y	4.76%	4.62%	0.13%
3Y	4.55%	4.41%	0.14%
5Y	4.38%	4.21%	0.16%
7Y	4.37%	4.21%	0.16%
10Y	4.40%	4.20%	0.20%
20Y	4.66%	4.45%	0.21%
30Y	4.56%	4.34%	0.21%

Source: Clearstead, Bloomberg LP, 6/28/2024

Credit spreads for both investment grade and high yield bonds ticked marginally higher, with the former (Bloomberg US Aggregate Corporate Index) losing -0.1% amidst rising interest rates and the latter (Bloomberg High Yield Bond Index) posting gains of +1.1% during the quarter thanks in part to lower interest rate sensitivity and higher coupon income.[1] In absolute terms, credit spreads for both high yield and investment grade remain remarkably tight as financial conditions and economic backdrop remain hospitable to corporate America. As of Q2, high yield credit spreads (Bloomberg High Yield Bond Index) stand at 308bps, well below the 25-year average of 520bps and in the top 10% of all observations (i.e., 90% of all daily observations of high yield spreads over the last 25 years are higher than today).[1] Investment grade spreads (Bloomberg US Aggregate Corporate Index) currently stand at 94bps below the 25-year average of 149bps, ranking in the top 15% of daily data over that period.[1] The relative tightness in these spreads reflects the current strength of the US economy and the low, near-term likelihood of any type of recession.

SUMMARY

The economy continues to grind ahead despite the continued headwinds of higher interest rates. While pockets of stress have emerged in the riskiest segments of the economy (both consumer and corporate) the broad economy remains healthy with a labor market at full employment, declining inflation (at least by some measures), and eased financial conditions.

Presidential election years have produced, on average, positive returns to stock market investors and this year has been no exception to that observation. With a remarkable first half of the year now behind us—this has been the third best start to the year since 1999—we look to the back half of the year with a bit more skepticism. Volatility in equity markets is likely to increase as elections, both domestically and abroad, continue to add to macro uncertainty. Given the run-up, and likely increase in macro uncertainty, it would not be surprising to see equity markets face a modest decline on the order of -3% to -5%. That said, we would not see that as the beginning of a larger drawdown (all else equal), as strong fundamentals, stable interest rates, and falling inflation have tended to be supportive of risk assets, such as equities. Despite the potential for near-term challenges, it remains prudent to stay invested, rebalance your portfolios, and remain focused on one's long-term investment goals.

	MTD	QTD	YTD	1 YEAR
DOMESTIC EQUITY				
Russell				
All Cap	3.10%	3.22%	13.56%	25.14%
Large	3.31%	3.57%	14.23%	25.90%
Large Growth	6.74%	8.33%	20.70%	35.65%
Large Value	-0.94%	-2.17%	6.62%	14.93%
Mid	-0.66%	-3.35%	4.96%	14.76%
Mid Growth	1.67%	-3.21%	5.98%	16.96%
Mid Value	-1.60%	-3.40%	4.54%	13.85%
Small	-0.93%	-3.28%	1.73%	11.87%
Small Growth	-0.17%	-2.92%	4.43%	11.17%
Small Value	-1.69%	-3.65%	-0.86%	12.48%
Micro	-2.25%	-5.28%	-0.86%	7.30%
S&P				
500	3.59%	4.28%	15.29%	26.65%
400	-1.58%	-3.45%	6.15%	15.70%
600	-2.28%	-3.11%	-0.74%	10.56%
Other				
DJIA	1.23%	-1.27%	4.79%	17.92%
NASDAQ	6.03%	8.47%	18.57%	31.55%
INTERNATIONAL EQUITY				
MSCI				
EAFE	-1.61%	-0.42%	5.34%	12.53%
ACWI ex USA	-0.10%	0.96%	5.69%	12.38%
ACWI ex USA Growth	0.93%	0.72%	6.67%	10.66%
ACWI ex USA Value	-1.51%	1.07%	5.58%	14.15%
ACWI ex USA Small Cap	-1.06%	0.66%	2.78%	12.22%
EAFE Small Cap	-3.04%	-1.84%	0.51%	8.54%
World ex US Small Cap	-2.88%	-1.56%	0.98%	8.77%
Emerging	3.94%	5.00%	7.49%	12.40%
ALTERNATIVES				
NAREIT Developed	0.51%	-2.15%	-3.17%	6.92%
FTSE Global Infrastructure 50/50	-2.56%	1.00%	2.77%	6.23%
GS Commodity	1.43%	0.65%	11.08%	16.13%
Alerian MLP Index	4.45%	3.28%	17.56%	36.83%
SPDR Gold Shares	-0.13%	4.52%	12.47%	21.28%
FIXED INCOME				
Bloomberg US Agg	0.95%	0.07%	-0.71%	2.13%
Bloomberg Global Agg	0.14%	-1.10%	-3.16%	0.63%
Bloomberg US Corporate High Yield	0.94%	1.09%	2.58%	10.72%
Bloomberg Long G/C	1.09%	-1.73%	-4.10%	-1.97%
Credit Suisse Leveraged Loan	0.27%	1.86%	4.44%	11.35%
J. P. Morgan Emerging Markets Bond	0.66%	0.44%	1.84%	8.21%
Bloomberg Municipal Bond	1.53%	-0.02%	-0.40%	3.06%
Bloomberg 1-3 Year Gov/Credit	0.56%	0.95%	1.38%	4.65%

Source: Clearstead, Bloomberg LP, as of 6/30/2024

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