# Market Watch

July 15, 2024

## Primary Market Drivers

### Inflation

Last week, June CPI came in softer than expected at -0.1% m/m vs expectations for +0.2%. The y/y rate declined to 3%, its lowest level in over three years. Equity markets surged on the news, particularly the relatively depressed small- and mid-caps, as investors eye a September rate cut as a suddenly firm possibility. June PPI was not as rosy, missing expectations at +0.2% m/m vs +0.1%. The y/y firgure was +2.6% vs expectations for +2.3%. While PPI tempered the excitement driven by the CPI data, investors tend to give more weight to the CPI. June's final inflation data point will arrive on 6/26 with June Core PCE.

### Fed Policy

Following last week's soft CPI report, the market is convinced the Fed will cut rates in September, assigning a nearly certain 94.4% probability per CME's FedWatch Tool. Soft inflation, labor, and general economic data over the last month have only firmed up this expectation. Barring a surprising uptick in July's inflation data or unusually hot economic data, the September cut is looking very likely at the current juncture. The Fed's next meeting will be held on July 31st, though no change is expected (93.3% probability of no change). All eyes are firmly set on the Fed's subsequent meeting on September 18th.

### Economic Data & Earnings

Last week's lower-than-expected CPI data finally gave small- and mid-caps the jolt they needed, leading to a broad surge in equities. This week brings a bevy of important data points spanning all segments. We will get Retail Sales (7/16), Imports & Exports (7/16), NAHB Housing Market Index (7/16), Housing Starts & Building Permits (7/17), Industrial Production (7/17), Philadelphia Fed Index (7/18), and Leading Economic Indicators (7/18). Earnings season also officially kicks into gear this week with significant announcements from Bank of America, Morgan Stanley, UnitedHealth Group, Johnson & Johnson, US Bancorp, Discover Financial, Kinder Morgan, Steel Dynamics, United Airlines, Abbot Labs, Progressive, Netflix, PPG Industries, American Express, Haliburton, SLB, and Travelers Cos, among many others. Expect some volatility as the market digests the data and earnings throughout the week.

*All referenced market information, statistics, and economic data were gathered from StreetAccount, a paid subscription data service provided by FactSet Research Systems Inc.*

## Market Returns — 7/12/2024

| *Category* | *Ticker* | *YTD%* |
|---|---|---|
| **Domestic Equity** | | |
| S&P 500 | SPY | 18.52% |
| Dow Jones | DIA | 7.13% |
| Large-Cap Growth | QQQ | 21.15% |
| Large-Cap Value | IVE | 7.95% |
| Mid Caps | MDY | 9.43% |
| Small Caps | IWM | 6.73% |
| **International Equity** | | |
| Developed Intl | EFA | 10.17% |
| Emerging Markets | EEM | 11.41% |
| **Fixed Income** | | |
| Core Bonds | AGG | 0.91% |
| Corporate Bonds | LQD | 0.81% |
| High Yield Bonds | HYG | 3.83% |
| ST Treasuries | IEI | 1.05% |
| LT Treasuries | TLT | -3.15% |
| International Bonds | BNDX | 0.33% |

*Performance data and stock chart were gathered from eSignal, a paid market screening application provided by Intercontinental Exchange, Inc.*

## Current Environment Summary

| What's Working | What's Not | What's Next |
|---|---|---|
| Inflation Subdued | Economic Slowdown | **Retail Sales (7/16), LEIs (7/18)** |
| Fed Pause / QT Taper | Core Inflation Stubborn | **First Major Earnings Season Week** |
| Recession Remains Unlikely | Yield Curve Inversions Persist | **Earnings: BAC, UNH, JNJ, UAL, NFLX, ABT** |
| Strong Earnings Growth | Interest Rates Remain Elevated | Significant Amount of Economic Data |
| Short-Term SMid Rally Signals Broadening | The State of US Politics | Watching SMid-Cap Rally |
| Tech Bull & New All-Time Highs | | RNC, Fallout from Assassination Attempt |

## Portfolio Manager Commentary

### Ken Hartley, CFA

It would be hard to think of a more impactful seven-day period than July 9th to July 15th. The US economy appears to be slowing at a rate that brings down inflation but not at a pace that can be construed as “recessionary”. A major party candidate for President is grazed by a would-be assassin’s bullet and the current President is being abandoned by his own party.

The stock market continues its march higher with some much-needed broadening out of the rally to include small and mid-cap stocks. The reversion to the mean trade is underway with many advisors asking: “How long will it last”? The high-flying tech stocks seem to be providing some of the liquidity. Some of the “magnificent seven” are plateauing or even falling from the lofty valuations seen recently. How long and how far are the questions being asked most often by money managers and clients.

The US government bond market has seen yields fall in the face of record new issuance and record sales of the holdings at the Bank of Japan. It seems the BOJ is fighting the hangover from the policy of zero rates, maybe for too long. Over the last week the BOJ has been actively intervening in the currency markets to stop the fall of the yen against the US Dollar. The favored method of the Japanese Central Bank is to sell US treasury holdings. Historically this strategy has had limited effects outside of the short term, usually about 30 days.

Finally, the attempt on the life of former President and current presidential candidate Trump was thankfully unsuccessful. As Don Moenning mentions so well in his commentary, I too will not stray into the political morass to offer an opinion. I guess the thing that concerns me is that the equity markets seem unfazed by it. With earnings season upon us, it is best that the market stays focused on outcomes for the second quarter.

As the market begins to broaden (a short period so far), it should be a sign of a better environment for investors going forward. The remaining days until the election promise to present opportunities for increased volatility. I pray the election can be decided honestly, peacefully and without excessive legal challenges. This is the greatest country on Earth. We need to return to acting like we deserve it.

### Don Moenning

The attempted assassination of Donald Trump at a Pennsylvania rally this weekend brought a sobering reminder of just how dangerous the current political environment in the United States is. Personally, I was shocked, horrified, and heartbroken for the families of those killed and injured. Americans were left with more questions than answers, which I won't get into here. While I try to avoid political discourse in my role at Clarus, I did want to acknowledge how deeply saddening the day was, and hope we can use it as a unifying factor in this country moving forward.

Turning to equity markets, the events of this weekend have acted as a tailwind in early trading as investors begin to price in another Trump presidency and a Republican-controlled Congress. This comes after last week's CPI data gave a swift kick in the rear to small-and mid-caps, which have been trading sideways for the majority of the year. We suddenly find ourselves with a broad-based rally on extremely positive breadth, quelling the cries of the "market leadership is too narrow!" in just a few sessions.

The big question on investors' minds after small-caps have blasted higher for three straight sessions is "will it last?" Is this time different? Perhaps, though I'm not convinced in these early innings. What's working for the trade is the expectation that a Fed cut in September will cause general interest rates to finally turn a corner and start to moderate long-term. This fundamentally helps small-caps as it reduces the cost of borrowing, which is critical for a segment that relies heavily on financing to facilitate growth. Second is the fact that before Thursday's CPI report, small-caps were negative on the year. Mean reversion is a powerful source of thrust when called upon, and traders are taking full advantage. Could a falling rate environment and a relatively underpriced segment turn the tide long-term?

There is a "but" here, though: 1) Interest rates falling and the Fed cutting are fundamentally rooted in the assumption that the economy will continue its trend of weakening. The Fed wouldn't be cutting rates, even if inflation continues to moderate, if it wasn't very worried that its long-held restrictive policy was doing significant damage to the economy. We see soft pockets cropping up across the board, and while things are "not bad, but not good" at the current time, small-caps need a strong economy a lot more than they need low interest rates in order to sustain a long-term bull. While rates look like they could head lower through 2H, nobody is arguing that the economy is going to start expanding at a healthy clip. I just don't see the macro lining up for this to become a truly broad-based rally unless the Fed starts cutting and we start seeing strong results towards the end of the year. I believe we need the Fed to masterfully thread the needle here, which is a big ask. 2) We've seen this story so many times before, and recently. Small-caps get a jolt on good news, traders rotate for a few weeks, and then it's right back to business as usual once that trade gets overcrowded and the reality sets in. Perhaps this time is different, though I'm not holding my breath.

In the meantime, can we have both? A broad based rally in SMid- and Large-Caps? I don't see why not. Big tech and mega-caps, though still an extremely crowded area, have earnings on tap starting next week. The rally to this point has been so concentrated and so significant for a reason, as it's been fundamentally driven by earnings growth since October 2022. If Microsoft, Google, Meta, Apple, Nvidia, and Amazon put up another strong showing this quarter, the market won't ignore it and I don't see why we couldn't enjoy a broad-based bull in the intermediate-term. It almost feels odd that we haven't had one in so long.

***Equity Market Risk*** *: Economic, market, political, and issuer-specific conditions and events will cause the value of equity securities to rise or fall. Stock markets tend to move in cycles, with periods of rising prices and periods of falling prices.*

***Value Investment Risk*** *: Value stocks may perform differently from the market as a whole and following a value-oriented investment strategy may cause a portfolio to underperform equity funds that use other investment strategies.*

***Small Company Risk*** *: Securities of small companies are often less liquid than those of large companies and this could make it difficult to sell a small company security at a desired time or price. As a result, small company stocks may fluctuate relatively more in price. In general, smaller capitalization companies are also more vulnerable than larger companies to adverse business or economic developments and they may have more limited resources.*

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