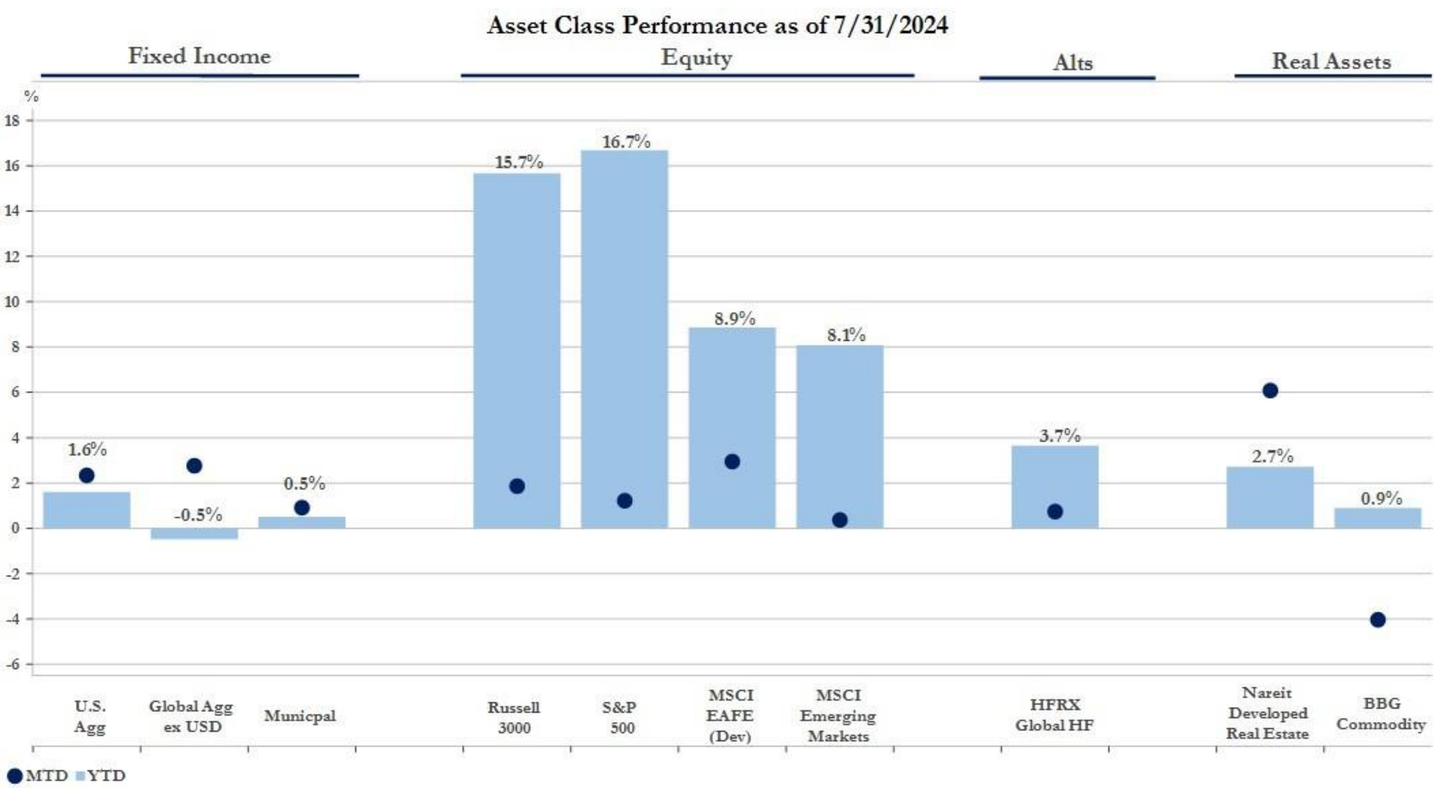
Investment Newsletter July 2024

Key Takeaways

- After slowing to 1.4% in Q1, the initial reading of U.S. economic growth for Q2 surprised to the upside and came in at 2.8%, beating the consensus estimate of 2.0%.
- The labor market continues to demonstrate signs of weakening as the July unemployment rate climbed to 4.3%, up from 4.1% in June, marking its fourth consecutive increase. Job growth also disappointed as the economy added 114,000 jobs, well below the expected 175,000.
- Inflation, as measured by the consumer price index, continues to moderate after briefly spiking in Q1, providing some relief to households as consumers have also shown signs of weakness in recent months.
- Markets are now pricing in a 100% chance of a September rate cut, with focus turning to whether it will be 25 or 50 basis points. Confidence in a cut was boosted after the July FOMC meeting when Fed Chair Powell finally turned dovish by stating a September cut is now "on the table".
- Equity markets finished mixed in July, but the biggest story of the month was the 10.5% surge in the Russell 2000 as money started to rotate out of richly-valued tech stocks and into small-caps, which had been out of favor for several years.
- The beginning of August, however, was marked with heightened global volatility and a sharp selloff as U.S. recession concerns were ignited by the underwhelming July employment data and the Bank of Japan raising its policy rate from effectively zero spooked investors and unwound a popular carry trade used by hedge funds.
- Many economists, on the other hand, feel that fear of an impending recession is premature and point to persistent GDP growth and unemployment remaining below its historical average to support their argument.
- With election and geopolitical uncertainty on the rise, and talk of a coming U.S. recession dominating headlines, volatility may persist throughout the back half of the year. One of the best defenses for investors remains diversification and ensuring investment portfolios are properly aligned to long-term financial goals.

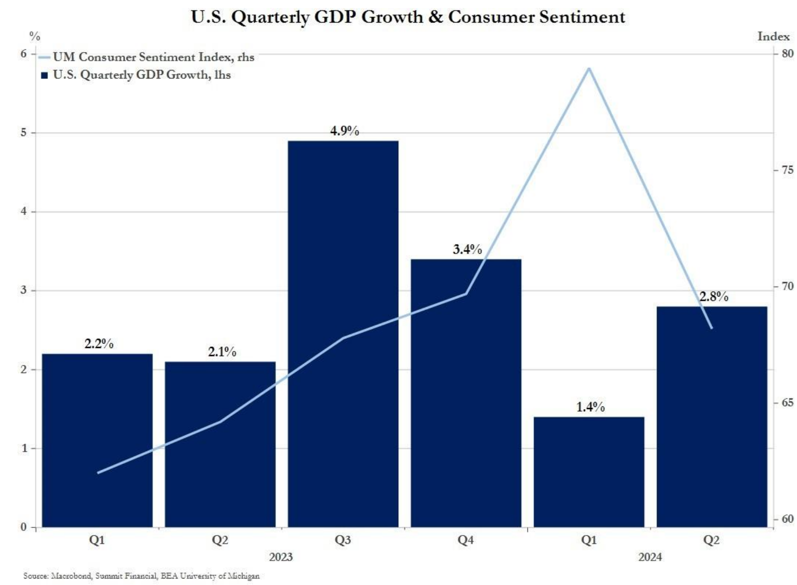


Source: Macrobond, Summit Financial, Bloomberg, MSCI, FTSE Russell Investment Group, S&P Global, HFR

Economy

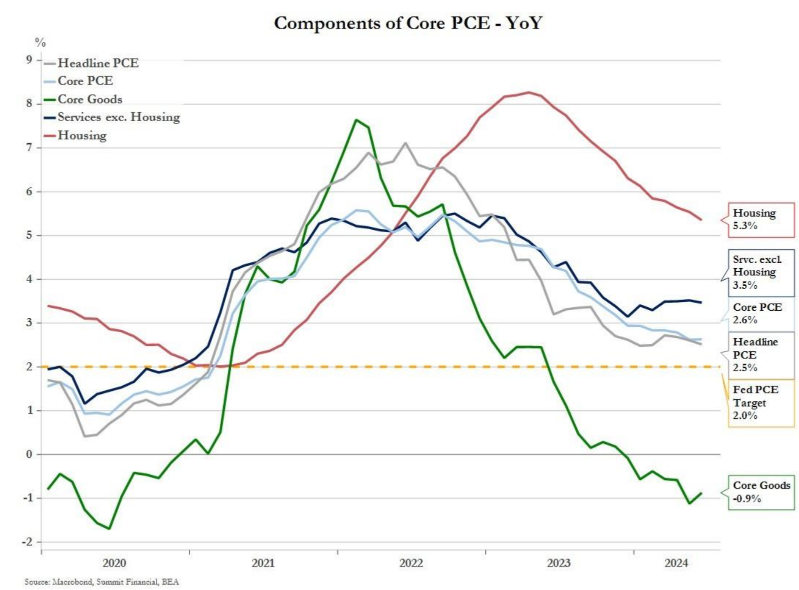
Despite Warning Signs Emerging, U.S. Economic Growth Surged in Q2

- The U.S. GDP grew 2.8% in Q2, beating the 2.0% forecast by a wide margin and marking a meaningful acceleration from the 1.4% it posted in Q1.
- The 2.8% rate is close to a full percentage point above it's long-term trend and was driven by robust consumer and business spending.
- While a positive surprise is rarely a bad thing, leading indicators have been sending warning signals in prior months, causing some economists to question whether conditions are as good as the most recent data suggests.
- A cooling labor market and rising jobless rate, slowing home sales, and stagnant personal incomes have led to a meaningful gap between apparently solid growth and deteriorating consumer sentiment which now sits at an eight-month low.



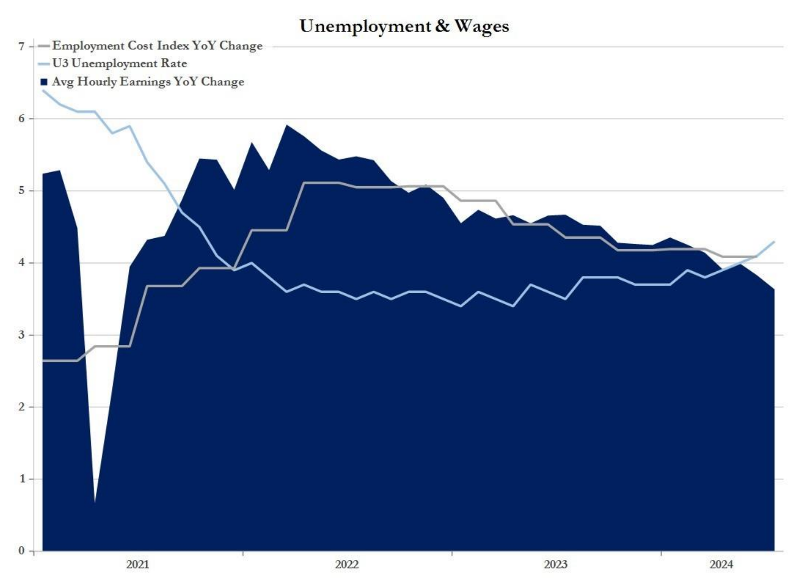
Inflation Tracks Sideways in June

- Core PCE, the Fed's preferred measure of underlying inflation, increased a moderate 0.2% in June as a decline in cost of goods tempered a rise in the cost of services.
- The YoY figure advanced 2.6%, matching May's rise but was slightly above the 2.5% forecast.
- Headline PCE inflation, which includes food and energy, increased 2.5% YOY, down slightly from 2.6% in May and was helped by softening energy prices.
- While the Fed would ultimately like to see further progress towards its 2% target, recent readings have been promising and welcome after the flare up in Q1.



Labor Market Shows More Signs of Cooling

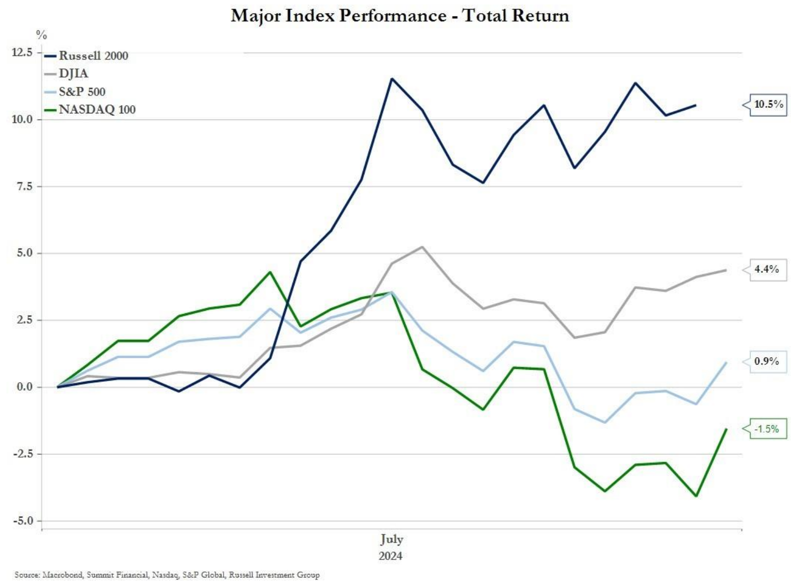
- The July unemployment rate jumped to 4.3%, increasing for the fourth consecutive month.
- The jobs report also showed that 114,00 nonfarm payroll jobs were added in the month, well below the 175,000 consensus estimate.
- The Employment Cost Index, one of the Fed's preferred measures of total compensation growth, edged down to 4.1% on a YoY basis, its slowest pace since Q4 2021.
- Being a consumer driven economy, a continued rise in unemployment coupled with a sustained slowing in wage growth would put U.S. GDP growth in jeopardy, something that could push the Fed to cut rates before inflation drops to its target level.



Markets

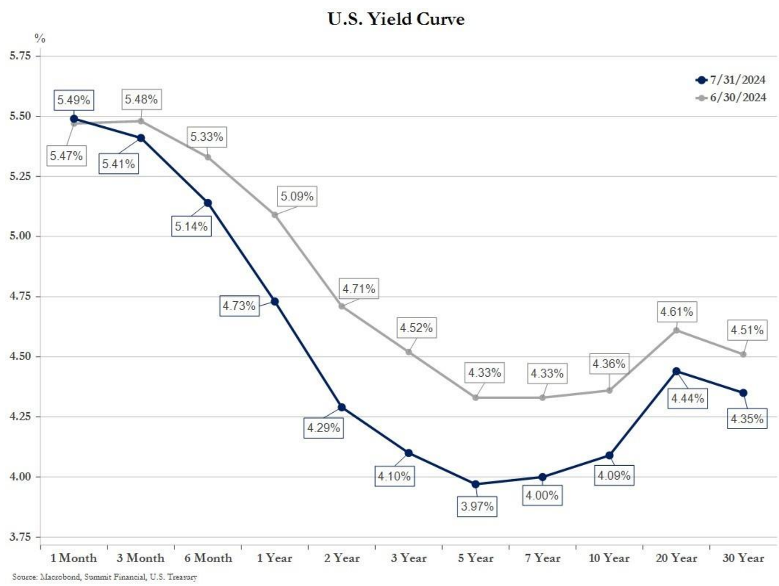
Stocks Mixed in July, Volatile to Start August

- Results for major U.S. indices were mixed in July with the DJIA advancing 4.4%, the S&P 500 finishing with a 0.9% gain, and the Nasdaq dropping 1.5% but the biggest story of the month was the 10.5% surge in the Russell 2000 as money began rotating out of tech and into small-caps.
- To start August, however, volatility spiked throughout global markets as heightened U.S. recession concerns mounted from underwhelming July employment data and Japanese equity markets dropped sharply following the Bank of Japan's decision to raise its policy rate to 10 bps from effectively zero.
- Although painful, the S&P 500 Index has had average intra-year drawdowns of ~14% since 1980 so this type of market movement is common and investors are typically best served maintaining a long-term focus.



Treasury Yields Drop to Four-Month Low

- U.S. 10-year Treasury yields ended July at a four-month low after falling 27 basis points to 4.09%, while rates at the short and longer ends of the curve ticked down more moderately.
- The yield curve has now remained inverted for a record 25-months and the magnitude of inversion, measured as the 10-year Treasury yield minus the 3-month Treasury yield, widened from –1.12% to –1.32% by month end.
- The yield curve is expected to normalize with short rates falling as Fed rate cuts occur, but the shape of the curve going forward will have broad implications for investment markets.



Markets: 100% Chance of September Cut

- Fed Funds futures have been volatile over recent weeks as the market now predicts a 100% chance of a rate cut during the September Fed meeting and a 74% chance that it will be a 50bp cut.
- Looking farther out, the market is suggesting there will be five 25bp cuts by the end of 2024, a sharp increase from the one cut that was expected earlier in the month.
- The shift has been driven by moderating inflation and a solid GDP report despite a slower labor market, conditions that are supportive of a soft landing or Goldilocks scenario for the U.S. economy.
- The market has been wrong in the recent past as the higher-for-longer environment played out, but comments from Fed Chair Powell are finally turning dovish and starting to align with market hopes.

Fed Funds: Futures Implied Probabilities

Meeting	Implied FFR	2.5-2.75	2.75-3	3-3.25	3.25-3.5	3.5-3.75	3.75-4	4-4.25	4.25-4.5	4.5-4.75	4.75-5	5-5.25
2024-09-18	5.30 %										74.0 %	26.0 %
2024-11-07	5.11 %								49.8 %	41.7 %	8.5 %	
2024-12-18	4.86 %						12.7 %	47.8 %	33.2 %	6.3 %		
2025-01-29	4.31 %					12.1 %	46.1 %	33.9 %	7.6 %	0.3 %		
2025-03-19	3.90 %			0.7 %	14.0 %	45.4 %	32.4 %	7.2 %	0.3 %			
2025-04-30	3.79 %		0.5 %	10.0 %	36.1 %	36.3 %	14.7 %	2.3 %	0.1 %			
2025-06-18	3.63 %	0.3 %	6.9 %	27.6 %	36.2 %	21.7 %	6.4 %	0.8 %				
2025-07-30	3.28 %	3.0 %	15.3 %	31.1 %	30.3 %	15.5 %	4.1 %	0.5 %				

Source: Macrobond, Summit Financial, CME Group as of 2-Aug-24

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Label	Index	Index Description
U.S. Agg	Bloomberg U.S. Aggregate Bond Index	The Bloomberg U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS, and CMBS (agency and non-agency).
Global Agg ex USD	Bloomberg Global Aggregate Index	The Bloomberg Global Aggregate Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes Treasury, government-related, corporate, and securitized fixed-rate bonds from both developed and emerging markets issuers.
Municipal	Bloomberg Municipal Bond Index	The Bloomberg Municipal Bond Index covers the U.S. dollar-denominated long-term tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.
Russell 3000	Russell 3000 Index	The Russell 3000 Index measures the performance of the largest 3,000 U.S. companies representing approximately 98% of the investable U.S. equity market. It is constructed to provide a comprehensive, unbiased, and stable barometer of the broad market and is completely reconstituted annually to ensure new and growing equities are included.
S&P 500	S&P 500 Index	The S&P 500 Index is a market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market. It measures the movement of the largest issues. Standard and Poor's chooses the member companies for the 500 based on market size, liquidity, and industry group representation. Included are the stocks of eleven different sectors.
MSCI EAFE (Dev)	MSCI EAFE Index	The MSCI EAFE Index (Europe, Australasia, Far East) captures large- and mid-cap representation across developed markets countries around the world, excluding the U.S. and Canada. The index covers approximately 85% of the free float-adjusted market capitalization in each country.
MSCI Emerging Markets	MSCI Emerging Markets Index	The MSCI Emerging Markets Index captures large- and mid-cap representation across emerging markets countries across the world. The index covers approximately 85% of the free float-adjusted market capitalization in each country.
HFRX Global HF	HFRX Global Hedge Fund Index	The HFRX Global Hedge Fund Index is comprised of funds representing the overall hedge fund universe. Constituent funds include but are not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event-driven, macro, merger arbitrage, and relative value arbitrage. The underlying strategies are asset-weighted based on the distribution of assets in the hedge fund industry.
Nareit Developed Real Estate	FTSE EPRA/NAREIT Developed Index	The FTSE EPRA/NAREIT Developed Index is designed to track the performance of listed real estate companies and REITS worldwide. Index constituents are free float-adjusted, subject to liquidity, size, and revenue screening for inclusion.
BBG Commodity	Bloomberg Commodity Index	The Bloomberg Commodity Index reflects commodity futures price movements and is calculated on an excess return basis. The index rebalances annually weighted 2/3 by trading volume and 1/3 by world production, and weight-caps are applied at the commodity, sector, and group level for diversification. The roll period typically occurs from the 6th-10th business day based on the roll schedule.
PCE - Personal Consumption Expenditures	PCE Price Index	Personal consumption expenditures (PCE), also known as consumer spending, is a measure of the spending on goods and services by consumers in the United States . The PCE Price Index measures the prices consumers pay for goods and services and changes in those prices. It is considered a gauge of inflation in the U.S. economy. Headline PCE includes all spending categories, while Core PCE strips out food and energy prices as they are more volatile and can make an underlying inflation trend less visible.