Week in Review

Equity Markets:

The markets experienced their deepest weekly declines in more than a year last week. The S&P 500 finished the week down 4.22% as concerns rose regarding an economic slowdown. Large-cap value fared better than their growth peers as investors sold technology heavily. The Russell 1000 Value Index still ended the week down 3.06% but far less than the Growth Index which closed down by 5.4%[1].

The second quarter earnings season is essentially complete for the S&P 500 with 99% of companies having already reported. The results came in better than expected. Year-over-year earnings growth for the S&P 500 was 11.3%, much better than the 8.3% that was expected on July 1[2]. 79% of companies beat earnings expectations and 60% of companies exceeded revenue expectations[2].

Fixed Income Markets:

The Treasury market rallied last week as the negative correlation benefits from high-quality fixed income amidst the equity market weakness. The yield curve steepened as longer-maturity bonds were favored. The 10-year Treasury yield finished the week at 3.72% and the 2-year Treasury yield closed at 3.66%. This portion of the yield un-inverted for the first time since the inversion in July 2022.

The Fund Fund's Futures Market is pricing in a 100% probability of a rate cut at the September meeting[3]. The question is to whether it will be a 25 basis point or 50 basis point cut. The probability of a 25 basis point cut was 70% and a 50 basis point cut was 30% at close last week.

Economic:

A slew of labor market reports occurred during the holiday-shortened week. The first report was the ADP Private Payrolls which was softer than the previous month. The report showed that the private sector jobs increased by 99,000 in August, down from the 122,000 in July. The highlight for the week was the Non-Farm Payroll Report on Friday. This report also disappointed and showed that the economy added 142,000 jobs in August which was below the 160,000 expected by economists. The lone labor market report that strengthened was weekly initial jobless claims which was 227,000, notching a drop of 5,000 from the previous week.

Looking Ahead

Equity Markets:

As we get closer to the last quarter of the year concerns have risen regarding an economic slowdown or potential recession. The yield curve un-inverted last week and headlines recently have pointed out that that when this occurs, it is a recession signal. We believe it is important to point out this does not point to a recession in the immediate future and it does not signal a complete market breakdown. Since 1970 all recessions have been accompanied by the yield curve un-inverting but not all un-inversions have been immediately followed by a recession[4]. The average intra-year drawdown in the S&P 500 is 13%[5] and during a recession is 31% since 1950[6].

We do believe a slowdown is imminent due to the restrictive economic policy over the last two plus years but we see the probability is low for a severe slowdown. Much of this is due to the healthy stance of consumers, corporations, and banks heading into the most recent rate hiking cycle. Economic cycles are naturally occurring and necessary for an economy to continue to grow and develop. Public companies are still expecting strong profits through the end of the year and anticipate strength moving into 2025. Expected third-quarter earnings growth for the S&P 500 currently sits at 5.8% with a significant boost in the fourth quarter of 13.5%[7]. Our expectation is for volatility to remain elevated due to the seasonal period, upcoming election, and sensitive economic footing. During bouts of volatility can be an opportunity to dynamically rebalance into asset classes that may indiscriminately be sold off and acquire them at lower prices while keeping your target allocations in line to achieve your long-term investment objectives.

Fixed Income Market

We believe the path for rates over the intermediate to long term is lower. The 5% level on the 10-year treasury is very unlikely to be seen again and we are comfortable with saying that peak rates for the current cycle are behind us. There could still be choppiness around important economic reports but we anticipate the yield on the 10-year to remain below 4.25% until it works into a long-term range of 2.75-3.5% over the next cycle.

Economic:

Fresh inflation numbers will be released this week. The Consumer Price Index will be released on Wednesday and the Producer Price Index will follow on Thursday. Economists expect core CPI to increase by 0.2% in August and 3.2% annually[8]. A check-in on small businesses will occur on Tuesday with the Small Business Optimism Index. The weekly unemployment report will be in focus as recent labor market reports have come in soft. The University of Michigan Consumer Sentiment Index will close the week out on Friday.

**** *See Important Disclosures on the following page*

Sources:

1) JP Morgan Asset Management
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2) FactSet Research Inc.
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4) Reuters
https://www.reuters.com/markets/us/yield-curve-disinversion-is-recession-signal-watch-2024-06-04/

5) AES International
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6) NASDAQ Inc.
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8) Trading Economics
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Important Disclosures: