Beacon Trust
INNOVATING WEALTH STRATEGY

Market Outlook 2Q 2024 Review | July 5, 2024

Second Quarter Summary

The S&P 500 reached an all-time high during the second quarter of 2024, although performance was more subdued across most other stock and bond indexes. Specifically, over the second quarter the S&P 500 increased 4.3%, the Russell 1000 Growth increased 8.3%, the Russell 1000 Value decreased 2.2%, the Russell 2000 (small cap index) decreased 3.3%, and the Bloomberg Barclays Aggregate Bond Index increased 0.1%. The disparity between the performance of growth equities and most other asset classes was largely driven by continued enthusiasm surrounding artificial intelligence (AI) stocks. NIVDIA, the poster child for AI stocks, increased more than 150% year-to-date (YTD) and briefly passed Apple and Microsoft to become the most valuable company in the world. Each of these three tech titans still have a valuation in excess of $3 trillion. This year is shaping up to be the 5th most concentrated year of performance since 1952. The top 5 performing stocks (NVIDIA, Alphabet, Microsoft, Meta, and Amazon) account for 60% of the S&P 500's total return and NVIDIA alone represents an astounding 30% of S&P 500 performance.

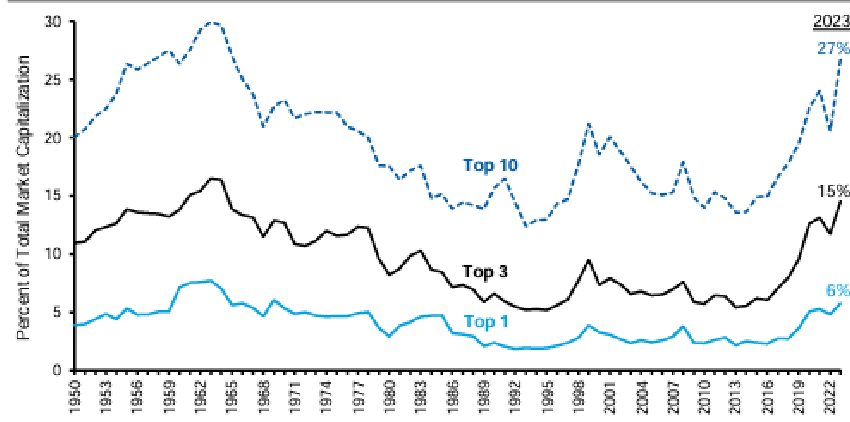
The Federal Reserve continued to hold short-term interest steady since inflation has not yet approached their 2% target and the unemployment rate remains near historic lows, despite its recent uptick to 4%. The Consumer Price Index (CPI) most recently expanded at a 3.3% annual rate while the Personal Consumption Expenditure Index (PCE), the Fed's preferred inflation metric, increased at a 2.6% annual rate. While these numbers are down substantially from a year ago, they remain well above the Fed's 2% target. Accordingly, the date of the Fed's first rate cut since the pandemic continues to be pushed back. Futures markets currently point to a roughly 65% chance of a 0.25% cut in September.

The economy has showed some signs of slowing, although we do not see a near term recession as imminent. GDP growth from Q1 was revised downward to a modest 1.3%. Second quarter GDP growth estimates are for roughly 2%. Part of the reason for the downshift in the economy is the dissipation of the $2.1 trillion in excess savings that accumulated over the course of the pandemic. With further stimulus limited, consumers, especially those at the lower end of the economic spectrum, are tightening their belts in an effort to grapple with elevated inflation. Persistent inflation is likely the primary reason why consumer sentiment remains less than cheerful, despite a good job market and record stock and real estate prices. Consumer sentiment may have been further impacted by a spate of recent political developments and uncertainty, such as former President Trump's conviction on 34 counts of falsifying business records and a controversial first presidential debate.

Market Outlook

We remain modestly optimistic on stocks since earnings have been growing and the Fed's next move is likely to lower interest rates, although the timing remains uncertain. We are not super bullish on equities due to heightened valuation levels, strong performance since 2023, and a sense of complacency that seems to permeate the market, exemplified by a Volatility Index (VIX) near the lower end of its historical range. In fact, we expect volatility to increase as the election approaches since some investors may wish to take some risk off the table after a good run in stock prices and in the face of an uncertain election. As we have written in the past, election uncertainty usually resolves itself within a few days to weeks after the election, regardless of the outcome(s). The private markets and economic fundamentals tend to drive asset prices more than politics.

Although overall valuations for the S&P 500 are higher than their long-term averages, on a relative basis it may be possible for the gaps between growth and value and large cap and small cap to narrow, especially if the Fed cuts interest rates in September. A rate cut tends to be incrementally more beneficial to firms with higher borrowing costs. Another way to note the divergence in performance among equities is to compare the performance of the (value weighted) S&P 500 (+15% YTD) to the equal weighted S&P 500 (+5% YTD). The divergences between the biggest firms in the stock market and the rest are the highest since the early 1960s, as shown in the graph below. In the early 1960s, firms such as IBM, General Motors, and Exxon led the S&P 500, while today the index is dominated by the aforementioned technology stocks. Historically, the gaps eventually narrowed, providing a ray of hope for those investors exposed to the underperforming equity segments.



Source: Morgan Stanley

We expect bonds to continue to clip their coupons and play a diversifying role in portfolios. It is worth noting that the yield on many bond portfolios is now firmly higher than inflation rates, providing a real yield net of inflation, in contrast to most years since the Great Recession. We do not foresee a material decline in intermediate to long-term interest rates, unless the economy substantially weakens. Given the large federal budget deficit, we expect long-term interest rates to either remain stable or drift upward, since the growing federal debt must be financed and the Fed's prior zero interest rate policy is likely a vestige of the past.

As usual, our last paragraph focuses on current market-related risks. The previously noted economic, political, and interest rate risks are in addition to the ever-present geopolitical risks. Wars continue to rage in Ukraine and Israel and the highly important relationship between the U.S. and China remains frosty. North Korea continues its status as a "rogue state" by testing ballistic missiles prohibited by international law and by supplying Russia with arms in its fight against Ukraine. The U.S. banking sector seems to have rebounded from yet another bout of volatility, but concerns about the commercial real estate sector persist. With many asset prices near all-time highs, the market has been climbing its proverbial wall of worry. All of us at Beacon wish you an enjoyable summer season and beyond.

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