Monthly Commentary

August 2nd 2024

Signs of Life | Steve Henderly, CFA

Ever feel confused by highway signs? "Slow Children at Play", or "Caution Pedestrians Slippery When Wet." A traffic sign in England says, "Right Lane Must Turn Left." Or how about "Entrance Only. Do Not Enter". And if you see a large sign announcing, "Welcome to Accident," you're probably entering the town of Accident, Maryland. I'm sure you can think of similar perplexing signs in your travels. The world is giving us a lot of confusing signs right now, and sometimes we hardly know where we're headed or what we're doing. The same is often true with investing; for example, good economic news is sometimes viewed as bad by the markets. Or in the case of the last several years when inflation was running too hot, weak economic news is often viewed favorably.

Style	July	YTD
Small-Cap Stocks	+8.8%	+11.2%
Mid-Cap Stocks	+5.4%	+11.3%
Avg US Stock Fund	+4.8%	+13.6%
Foreign Stocks	+2.9%	+8.4%
Bloomberg Bond Idx	+2.3%	+1.6%
Large-Cap Stocks	+1.7%	+14.6%
S&P 500	*+1.2%*	*+16.7%*

July was a dynamic month – both in financial markets and world events. The seemingly invincible Magnificent Seven (tech-titans), which left most every other sector and stock in the dust over the last two years and on their own lifted the S&P500 index to record heights, surrendered leadership in recent weeks. Mid- and smaller-size companies, as well as more cyclically sensitive sectors such as industrials, financials, and homebuilders (each tending to be more sensitive to the level of interest rates) showed encouraging signs of life!

Evidence of the dynamics in July are seen via small- and mid-cap funds, which leapt nearly 9% and 5.5%, respectively, during the month while the S&P500 was up just 1.2%. Amazing how dramatic rotations from big divergences can occur. As we highlighted in last month's commentary, large divergences (tech-titans advancing while other market areas flat or opposite) ultimately lead to the alligator jaws snapping shut.

IT'S BEEN A WHILE…

Equal-Weight S&P 500 Sectors

Sector	Trading Days Since Last All-Time High
Energy	2542
Communications	848
C. Discretionary	677
Healthcare	647
Real Estate	644
Financials	638
Materials	571
C. Staples	570
Utilities	481
Industrials	10
Tech	10
Equal-Weight S&P 600	683
Russell 2000	683

Bond funds also jumped in recent weeks as market rates adjust lower ahead of any changes from the Fed. Since early-July, a dramatic rotation toward laggard market areas occurred as investors appear to also be attempting to posture on the interplay between shocking political developments and evolving economic conditions that increasingly suggest inflation is calming without economic recession. Market participants also hope the Fed will begin cutting interest rates in September.

Inflation and interest rates are central to the investor's dashboard over the last several years. The economic and investment landscape has often been as confusing as some road signs, with the S&P 500 and Nasdaq performing well while most of the market lags behind. Despite the S&P 500 hitting "near-record highs" and gaining 1.2% in July, many sectors outside of technology and industrials have not reached new highs since January 2022. From July 11 through month-end (20 days), more than 70% of S&P 500 companies outperformed the index, the *highest rate since 2001(!)*. Mega-size tech companies, which positively distorted performance for 2023 and most of 2024, lagged the rest of the market in July.

A few weeks does not make for a trend (and market action in early August creates new doubt), but this is something we hope continues. It better aligns with our philosophy to own assets that are fairly priced relative to earnings and balance sheet strength, thus poised for long-term appreciation. Conversely, the Magnificent 7 are priced as if the current rate of growth will continue at a feverish pace for many years to come, which means they could be punished more harshly for any setbacks or missed earnings.

In July, we received encouraging economic news with the first month over month drop in consumer price index (CPI) since 2021. But some small (not big… yet) cracks are appearing in unemployment and consumer confidence readings. A year after the Fed paused rate-hikes, the market now expects the first cut in September with almost 100% certainty. Fed Chair Powell stopped short of explicitly promising a cut in recent days, but he hinted the market's anticipated timing is basically correct assuming data between here and September confirms recent trends. Lower interest rates generally help both consumers and businesses by reducing borrowing costs.

Smaller companies, which tend to carry more and higher interest debt, should benefit more from cuts. This could help explain the shift in July from tech giants to mid- and smaller-size companies. But for these companies to lead, it takes more than rate cuts. Smaller companies perform best when the economy is stable and if it weakens too much their recent advance could be short lived.

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The Fed's goal with rate cuts is to orchestrate a smooth economic transition - a "soft landing". Keeping rates too high for too long increases the chance of economic recession, while cutting too soon could reboot inflation. With cuts anticipated but not guaranteed, it is important for new inflation data to confirm easing price pressures and a stable economy in August and early September. Softer than expected economic data in these first days of August is renewing worry that the Fed is already late, or staying high too long.

Market performance in the short to intermediate term is also influenced by …politics. We are always reluctant to discuss politics in investment decisions; however, there now remain less than 100 days until the November election, and with the earthquake-type surprises we witnessed last month, it seems stubborn to pretend the topic is not on investors' minds. Election years tend to be overall positive but more volatile because markets dislike uncertainty. Historically, the strongest performance occurs in Q4 of an election year as the outcome becomes clear.

After a weak debate performance by Biden and assassination attempt on Trump, markets began to rotate toward sectors thought to benefit most from specific outcomes in November. But President Biden's decision to not seek re-election seemed to reset the dynamics of the race as evidenced by polls and market performance being more sideways/indecisive since. Remarkably, the financial markets did not seem as impacted by the events in July as one might anticipate. More political surprises are likely between now and November, and with those surprises, increased market volatility. The next few months carry a reputation for seasonal weakness and lower trading volume (which can amplify daily moves), but it is rare for the market to peak in July. Taken together, while the path may be bumpy, history suggests the market is likely to end the year higher than it is now.

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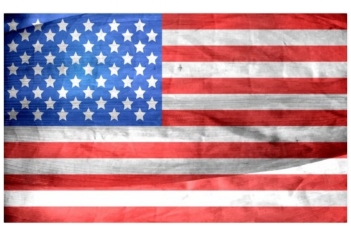
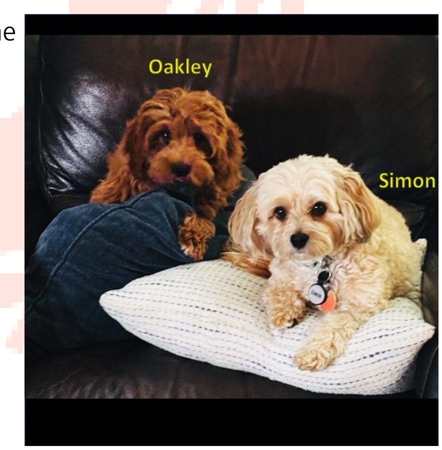
As we conclude this month's update, "Signs of Life" as a title could be used in multiple ways. Like signs appearing near our roads, highways, and cities, the investment backdrop creates confusion when considering interest rates, economic data, and political surprises. Alternatively, in July we observed "signs of life" in sectors of the market that almost appeared dead relative to the Magnificent Seven. Broadening participation is encouraging because it implies investors are either awakening to the idea that many tech-titans are priced for perfection and may be seeking to harvest some profits and redeploy proceeds in cheaper areas; and/or they are beginning to anticipate that the worst of inflation is behind us, the Fed will soon ease interest rates, and earnings growth is about to broaden to a larger swath of the economy and market.

Nvest Engagement:

Delivering financial peace of mind is our ultimate goal. A quick summary below of the content our team shared over the past month via LinkedIn and Facebook. We hope you find these updates useful and informative. Please take a moment to follow us to receive on-going updates:
Like us on Facebook | Follow us on LinkedIn



- July is a time to commemorate the birth of our nation's freedom. Take these steps to attain your own financial independence. LINK
- We're hiring! Seeking to fill the position of Client Advisor. Please share our position profile with anyone you believe might be a good fit at Nvest as we seek to deliver financial peace of mind to our wonderful clients. LINK
- Oakley (Henderly) and Simon (Ranly) enjoying a little quiet time at the office.



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