


Weekly Market Commentary

JULY 22, 2024


MARKET UPDATES

July 19, 2024: Recorded Leadership Discussion Featuring: Regions Chief Economist, Chief Investment Officer, and Chief Market Strategist.
 July 26,, 2024: Join the upcoming live Regions Market Update.


KEY OBSERVATIONS



U.S. large caps (S&P 500) fell on the week as semiconductor and artificial intelligence (AI)-related names dragged down the information technology sector. Market participation remained encouraging as capital flowing out of information technology names found a home in energy, financial services, industrial, and real estate stocks, among others.




Small cap stocks (S&P 600) continued to perform well on an absolute and relative basis over the balance of the week with economically sensitive sectors such as energy and financial services leading the way.




Riskier, higher yielding corporate bonds have been beneficiaries of the rally and improved sentiment surrounding smaller capitalization stocks. High yield corporate bonds could offer investors the best of both worlds with the potential to rally alongside small cap stocks should gains be sustained, while also potentially holding up better should small caps or equities broadly sell off.


WHAT WE'RE WATCHING



U.S. Purchasing Managers Index (PMI) for July is released Wednesday. The PMI Composite came in at 54.8 in June, with a Manufacturing reading of 51.6 and a Services reading of 55.3. A reading above 50 indicates expansion



Preliminary 2nd quarter U.S. GDP is released Thursday with 1.9% quarter over quarter and 2.9% year over year growth expected.



June Personal Consumption Expenditure (PCE), the FOMC's preferred inflation gauge, is released Friday. Headline PCE Deflator is expected to rise 2.5% year over year, down from 2.6% year over year the prior month. Core PCE Deflator, which is more closely watched by

	Price/Yield			Total Return (%)			
	7/19/2024	1 Week Ago	1 Month Ago	Year to Date	1 Year	3 Years	5 Years
S&P 500	5505.00	-1.95	0.42	16.30	23.22	10.09	14.95
NASDAQ	17726.94	-3.65	-0.73	18.55	24.42	7.78	17.79
S&P Mid Cap 400	3015.30	-0.17	3.03	9.30	12.44	6.19	10.99
S&P Small Cap 600	1380.44	2.23	7.59	5.73	10.69	3.48	9.71
MSCI World ex US	334.65	-2.12	0.83	12.61	17.44	6.15	10.84
MSCI EM	1089.61	-2.96	0.01	8.24	9.61	-3.41	3.11
Bloomberg U.S. Aggregate	4.81	-0.33	0.38	0.49	3.13	-2.98	0.01
Bloomberg Corporate	5.30	-0.44	0.40	0.85	5.15	-2.97	0.88
Bloomberg U.S.High Yield	7.67	0.30	1.47	4.01	10.56	2.13	4.19
Bloomberg EM USD Aggregate	7.02	-0.39	0.53	3.22	7.83	-2.07	0.57
Bloomberg Global Aggregate	3.77	-0.16	0.75	-1.62	0.81	-5.23	-1.68
Bloomberg Municipal Bond	3.60	0.16	0.49	0.34	3.28	-0.93	1.21

Source: Bloomberg (3- and 5-Year Returns Annualized)

Price/Yield

	7/19/2024	1 Week Ago	1 Month Ago	12/31/2023	1 Year Ago	3 Years Ago	5 Years Ago
SOFR (yield)	5.34	5.34	5.33	5.38	5.05	0.05	2.41
30 Year Mortgage (average rate)	7.16	7.19	7.30	6.99	7.15	2.98	3.84
2 Year Treasury (yield)	4.51	4.45	4.71	4.25	4.77	0.22	1.82
10 Year Treasury (yield)	4.24	4.18	4.22	3.88	3.75	1.19	2.06
30 Year Treasury (yield)	4.45	4.40	4.36	4.03	3.84	1.82	2.58
WTI Crude (closing price)	80.13	82.21	81.57	71.65	75.35	66.42	55.63
Gold (NYM \$/oz)	2399.10	2420.70	2330.40	2071.80	1980.80	1809.20	1426.70

Source: Bloomberg (3- and 5-Year Returns Annualized)

WHAT HAPPENED LAST WEEK?

Stocks:

S&P 500 Falls But Holds Up Relatively Well Due To Improved Breadth, Participation; Summer Surge For Small Caps Continues; Emerging Markets Swoon On Rising Geopolitical Risk.

• **U.S. Large Cap Indices Hold Up Relatively Well Despite Another Rough Week For Information Technology Stocks.**

The S&P 500 information technology sector, still the best performer year-to-date, fell 5.1% as semiconductor stocks and artificial intelligence-related plays experienced profit taking for the second consecutive week. Last week's semiconductor swoon was largely a byproduct of political rhetoric and geopolitics weighing on the industry. President Biden talked up the prospect of additional export controls on semiconductor shipments to China, while Donald Trump noted that Taiwan shouldn't expect the U.S. to come to its aid or defense for free. Trump's remarks led to a rush for the exit in some of this year's highfliers tied to the AI theme due to the crucial role Taiwan Semiconductor (TSM) plays and its importance to the U.S. semiconductor industry, calling into question the industry's AI-related growth outlook should supply chain disruptions occur. The Van Eck Semiconductor ETF (SMH) fell 9.5% on the week, pulled lower by Nvidia, Taiwan Semiconductor, Advanced Micro Devices, and ASML, among others, but the prospect of disruption to the semiconductor supply chain and potential negative ramifications for the growth of AI weighed on the 'Magnificent 7' as well with Amazon, Apple, and Meta Platforms all falling between 4% and 13% on the week. Given the size of the drawdowns in many of the 'Mag 7' and semiconductor names last week, we were encouraged that the broader S&P 500 only fell by 1.9% on the week. A pullback in many of this year's best performing stocks was long past due and, while painful, is likely healthy and with broader participation of late, should support additional upside for the S&P 500 into year-end.

• **Offsides Positioning Driving Summer Gains For Small Caps.** The S&P 600 Small Cap index built on gains from the prior week by generating a 2.2% return as capital continued to flow away from mega-cap information technology leaders and into underperforming small cap stocks. While far from a smooth ride, the recent performance surge out of smaller cap stocks has been a function of market participants ratcheting rate cut expectations higher, but the rally has been magnified by short covering and firms repositioning and increasing exposure from

underweight to neutral on the asset class. Odds of a September rate cut now sit at 95% according to Fed funds futures and have provided a tailwind for bullish small-cap sentiment, but investors may just be renting smaller company stocks and with the index now well into overbought territory, it will be interesting to see if traders begin to trim positions or ride the momentum wave into late summer. Recent outperformance of the Russell 2000 relative to the S&P 600 is notable as the latter index carries superior fundamentals from an earnings and free cash flow perspective, while the former doesn't have a profitability filter and some 40% of index constituents remain unprofitable. With unprofitable, highly levered small caps leading the charge up to this point, we see ample reason for caution and there is no need to chase the move and increase exposure to small caps, specifically. Instead, we view the rally in small caps as a feather in the cap for diversified investors that were rewarded for maintaining exposure through some trying times.

• **Factor Performance Shift Poses Problems For Large Cap Growth Stocks.** In taking a magnifying glass to recent areas of outperformance across equities last week, it stands out to us that the best performing stocks tended to be those with high levels of short interest and those most highly levered, i.e. indebted. Equities with those attributes are often favored in market melting up in which higher beta stocks are favored by investors chasing the hot-dot or latest and greatest trade before the window closes. We've highlighted the broadening out trend in markets and expect that to persist in the near-term, caution is typically warranted when what we view as lower quality stocks are rallying without significant fundamental improvement underpinning the move. Momentum and quality factors underperformed last week as powerful uptrends in cash-rich mega cap growth stocks reversed, and at the start of July quality and dividend growth were among the most expensive factors based on long-term valuations, with information technology well represented in many dividend growth benchmarks. Fading quality in the face of rising economic, geopolitical, and political uncertainty could prove detrimental to returns over the intermediate term, but we're also aware that cheaper areas include value and smaller cap companies, which could provide a downside buffer through more diversified sector exposures.

• **China, South Korea, And Taiwan Weigh On Emerging Market Indices.** The MSCI Emerging Markets (EM) index fell 2.9% last week and it could have easily been much worse given that country indices tied to China, South Korea, and Taiwan all fell at least 4.5% on the week. Most Asian markets appeared to sell off in unison on the heels of comments made by both U.S. presidential candidates noted above mid-week, as well as on rumors that China's President Xi Jinping had suffered a

stroke, a combination of events that contributed to elevated geopolitical uncertainty and reduced investor risk appetite. India, and its 18% weight within the MSCI EM index, provided a bit of a ballast by falling just 1.5% on the week, but there were few places in which to hide over the balance of last week in the developing world.

Bonds:

Corporate Bonds Benefitting From Linkage To Smaller Capitalization Companies; ECB Stands Pat But A September Rate Cut Remains Likely.

• **Ties To Small Cap Stocks A Tailwind For Riskier Corporate Bonds.** High yield bonds again benefited from improved sentiment surrounding small cap stocks with the Bloomberg High Yield index rising 0.3% on the week, with virtually all of that gain materializing on last Tuesday alone. The run up early in the week was the product of tighter credit spreads which ultimately narrowed just 4-basis points as riskier assets pulled back into the weekend. Spread narrowing stems from the recent uptick in the odds of multiple FOMC rate cuts this calendar year, and the perception that future refinance rates will be lower, thereby boosting the creditworthiness of below investment grade debt issuers. It's common to see a meaningful correlation between the performance of high yield corporate bonds and small cap stocks as they both fit into the higher risk segments of portfolios, but they are also intertwined as smaller companies often receive below investment-grade credit ratings. Sector exposures within the High Yield index are closely aligned with small-cap equity benchmarks as industrials and other cyclical segments are prevalent in both. The investment thesis for these two areas overlaps with exposure to both areas justified by improved fundamentals, and both should benefit from higher economic growth and/or lower rates, but we maintain a neutral allocation to both as rich valuations (high yield) and elevated volatility (small caps) must be considerations.

• **European Central Bank (ECB) Leaves Rates Unchanged After Cutting In June.** Following a 25-basis point rate cut in June, the ECB met last week and as expected left key policy rates unchanged, citing the central bank's expectation that inflation remains above its 2% target "well into next year." President Lagarde hinted that a pause in July would likely be warranted after last month's cut, and with recent inflation data out of the euro area continuing to point toward upward pressure on prices, the governing council believed it prudent to stand pat. However, the futures market currently places the odds of a rate cut out of the ECB in September at 80% and is pricing in a total of two 25-basis point cuts between now and year-end. Less restrictive monetary policy out of the ECB should provide a boost for the euro area economy, but with inflationary pressures persisting, upward pressure on euro area sovereign bonds could also be sustained in the quarters to come.



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