

Moving Forward from Inflation

Even as the major indices keep hitting new all-time highs, the motivating factor – that the Fed is preparing to pivot to accommodative monetary policy – is proving ever more tenuous. The May inflation data released in mid-June was either in line with or slightly better than expected. Yet the response from the Federal Open Market Committee (FOMC) was to suggest that not two but one rate cut would be appropriate in the current year.

The stock market is in good shape as the end of the first-half looms. History has shown that markets carrying double-digit appreciation into mid-year tend to finish the year with above-average gains. Yet the advance seems oddly fragile, predicated as it seems to be on the perception that the Fed will soon begin cutting rates for the first time since early pandemic days.

The Usual Mixed Bag from Inflation, and the Fed

The May inflation numbers released in the second week of June generally were seen as positive, enabling the stock market to rise to fresh new highs four times in one week. Yet the data also showed several components remaining stubbornly elevated.

The May all-items consumer price index (CPI) was unchanged on a month-over-month basis from April; the prior month reading was a higher-than-expected 0.3% gain. The consensus of economists expected all-items CPI to be up 0.1%. On an annual basis, May all-items CPI at 3.3% was 0.1% better than expected and a tick better than in April.

Economists focus on core CPI, which excludes food and energy. Given withering inflation in those two categories, consumers are much less likely to disregard the two components that are contributing to their pricing misery. Still, core CPI also showed moderate progress. On a month-over-month basis, May core CPI was up 0.2%, down from 0.3% in April (which was also the consensus call) and the lowest level since June 2023. The annual change in core CPI was 3.4%, beating both the 3.5% consensus call and the 3.6% level from April.

The producer price index also contained good news from further up the pricing pipeline. The all-items PPI unexpectedly fell 0.2% from April levels, much better than expectations for a 0.1% increase. The year-over-year change in all-items PPI was 2.2%, again much better than the 2.5% consensus. Excluding food & energy, the monthly change in PPI was 0.0% (vs. 0.3% consensus); and the annual change was 2.3% (vs. 2.4% consensus).

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ECONOMIC & MARKET COMMENTARY (CONT.)

On June 12, the day of the CPI release and a day ahead of the PPI release, the Fed concluded its two-day FOMC event and released minutes from that meeting. To no one's surprise, the committee voted to hold the fed funds rate steady at the 5.25%-5.50% tendency, as it has done for seven straight meetings since July 2023. The subsequent FOMC statement had both positive and negative elements and as usual left the Fed plenty of wiggle room.

In May, the FOMC statement noted "a lack of further progress toward the Committee's 2 percent inflation objective." The language in the June FOMC report, by contrast, noted "modest further progress toward the Committee's 2 percent inflation objective." On the downside, the Fed issued a new dot-plot that appeared to signal the likelihood of just one rate cut in 2024. Of the 16 voting members, eight projected two rate cuts for the year, seven favored one rate cut, and four projected zero rate cuts in 2024.

Despite the Fed shifting from two projected cuts to possibly just one, Argus Fixed Income Strategist Kevin Heal believes the Fed is trying to balance the positive effects of restrictive policy on reducing overall inflation, with the negative effects of prolonged high prices on the low- to moderate-income population. Middle-class to lower-middle-class earners have been compelled to reduce goods purchases, and that may be contributing to actual price declines in categories including used cars.

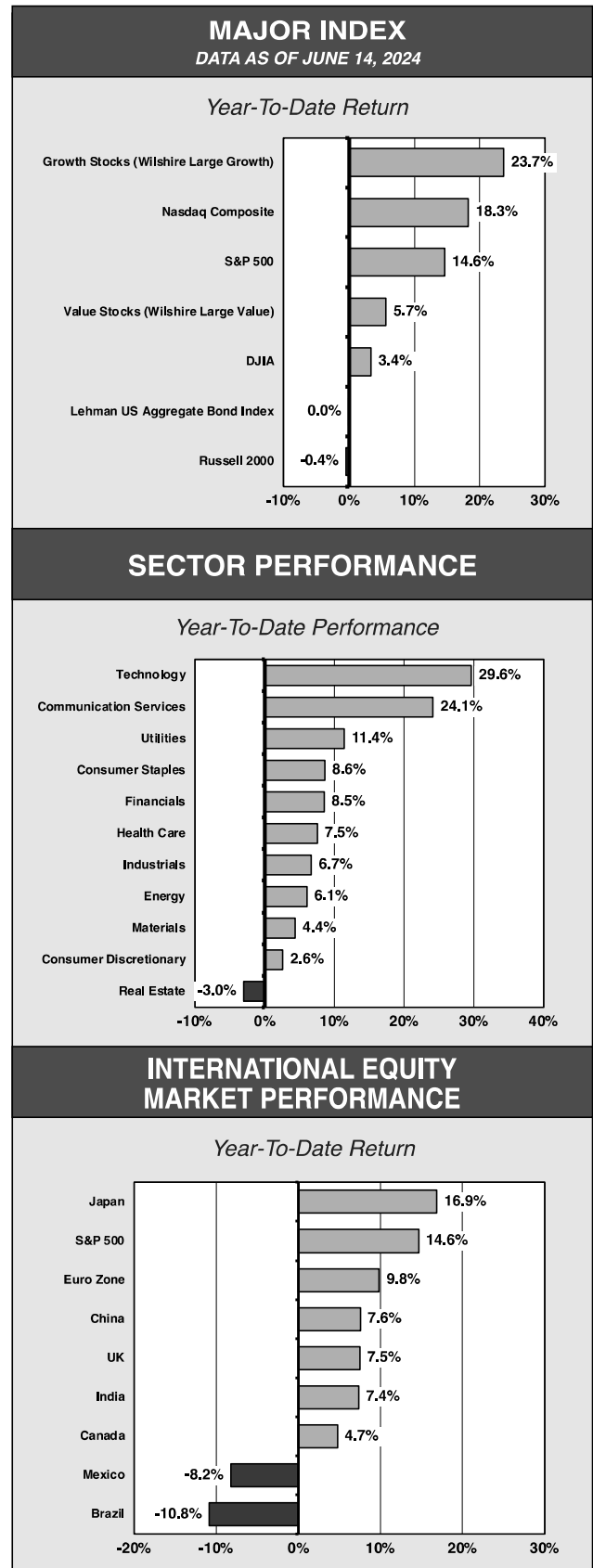
Everyone is being hit by skyrocketing inflation in services categories such as car insurance – unavoidable for most people trying to get to work. Shelter costs are also persistently running ahead of the general inflation trend, rising 5.4% annually in the May CPI. If you take the current annual change in CPI and subtract the shelter component, the current inflation rate would be right at the Fed's 2% target.

Argus still expects the Federal Reserve to cut the fed funds and discount rates two times in 2024: once at the September meeting prior to the election, and again at the December meeting post-election. Each cut is expected to be 25 basis points, bringing the Fed's central tendency to the 4.75%-5.00% level by year-end. Despite packing in two rate cuts in the final four months of 2024, the Fed is expected to proceed cautiously next year, according to Income Strategist Heal, with just two additional quarter-point rate cuts in 2025.

Stocks Log New All-Time Highs, Again

As of the 6/14/24 close, the S&P 500 had delivered 2024 total return of 14.6%. Capital appreciation excluding dividends was a few ticks less, at 13.9%. As of the mid-June mark, the S&P 500 had hit new all-time highs about 30 times. Also at mid-June, the S&P 500 had ended higher in 25 of the preceding 32 weeks, for its best weeks-winning record since 1989.

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Source: Dow Jones, Argus Research

ECONOMIC & MARKET COMMENTARY (CONT.)

The Nasdaq has pulled away from SP5 in the past month and a half, after tracking the blue chip index through April. Total return for the Nasdaq Composite as of 6/14/24 was 18.3%. Wilshire Large-Cap Growth has done best, with 23.7% total return. The gap from Large-Cap Growth to Large-Cap Value (up 5.7%) continues to widen, and now stands at 18 percentage points. The DJIA continues to lag, hurt by laggards such as Boeing and legacy technology names that are being outshone by new tech giants.

Sector-wise, Information Technology and Communication Services continue to lead, both with 20%-plus year-to-date gains. Utilities are the only other double-digit year-to-date gainer, but are now lagging the overall market. Seven sectors are up 3%-9%, while Real Estate remains the only losing sector in 2024.

The stock market is still showing better breadth this year than in 2023. But growth sectors are now pulling away from the broad market, in an echo of last year. Every time Nvidia reports quarterly results, as it did in mid-May, the market responds with another round of AI-driven frenzy. We would like to see better sector breadth across the remainder of the trading year, but companies in non-growth sectors need to show stronger earnings trends.

Conclusion

We noted in our introduction that market strength through mid-year is a positive indicator for the full year. Yet there

are some caveats. Since 1980, most years with double-digit gains as of mid-year occurred before the millennial turn. And presidential election years rarely deliver double-digit gains, at mid-year or for the full year.

From 1980 through 2023, the S&P 500 has averaged an annual capital gain of 10.0%. That of course includes lots of good years, such as 1997, 2013, and 2019 – all up 28.9%-31.0% – and several bad years, such as 2002, 2008, and 2022 – all in the down 19.4% to down 38.5% range.

Also since 1980, the S&P 500 has appreciated in double-digits as of the end of June a total of 16 times. Eleven of those 16 double-digit mid-year gains were concentrated in the years prior to the millennial turn, including six times in the 1983-1989 period. Also since 1980, the S&P 500 has never been up in double-digit percentages as of end-of-June in a presidential election year. Barring a market collapse by June-end, 2024 will represent the first double-digit mid-year gain in any presidential election year since 1980.

That said, a double-digit win as of mid-year has predicted a much better-than-average full-year gain for stocks. For the 16 years between 1980 and 2023 in which the S&P 500 has been up more than 10% at mid-year, the average gain as of June 30 has been 15.8%. And for those same 16 years, the average full-year gain has been 23.3%, or more than twice the market's 10% average gain.

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TECHNICAL TRENDS COMMENTARY

If June finishes higher for the major indices, it will mark seven out of the last eight months with gains (since October) as well as the third consecutive quarter on the green side. On June 17, the S&P 500 (SPX) tacked on 0.8%, the Nasdaq rose 1%, and the Nasdaq 100 (QQQ) was up 1.2% -- all closing at all-time highs. Since the last low on May 30, the SPX had jumped 4.5% in 12 days. Since the May 31 low, the Nasdaq had popped 6.7%. The QQQ had soared 7.6% in 11 days.

The three indices have cycled into extreme daily-overbought territory, with the 14-day Relative Strength Index (RSI) at 77 on the SPX, at 81 on the Nasdaq, and at 82 for the QQQ. The 14-week RSI has pushed over 70 for all three. So far, weekly momentum on the SPX and the QQQ have not confirmed price, creating a potential bearish divergence. That's something to watch -- but not a sell signal, just a warning.

There was a character change in the SPX sectors as well as industries on June 17. Discretionary (+1.8%) led, with Technology (+1.5%) second and followed by Industrials (+1.1%), Staples (+1%), and Financials and Materials (both +0.8%). Discretionary was led by autos, as TSLA jumped over 5%. TSLA has traced out a bullish ABC reversal and is working on a small inverse head-and-shoulders formation -- but has a lot of work to do in order to turn its chart bullish.

In Technology, hardware led, with big gains in Super Micro (SMCI) and Dell Technologies (DELL), followed by electronic equipment, telecom equipment, and software. Semiconductors rose, but were in sixth position for the day (not their usual first). Yes, it was only one day -- but leadership changes have to start somewhere.

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