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ARGUS ECONOMIC COMMENTARY

July 15, 2024

Solid Second Quarter Amid Signs of Slowing Activity

History will record a good start to 2024, with the S&P 500 up 15% in the first six months. However, it was not all sunshine and roses. After generally rising across the first quarter, stocks fell in April. Heading into May, the gain in the S&P 500 had been cut to 7%.

From May 1 to mid-June, the Nasdaq soared 17%; and the S&P 500 rose 13%. If you annualize those returns, the Nasdaq was on track for a 110% annual gain and the S&P 500 for a 70% annual gain. After consolidating those gains in the final two weeks of June, the stock market took off again to open July – normally a good market month. Plainly, the mood has shifted to anticipating the Fed beginning to cut rates this year as inflation continues to decline.

Environment: Second-Quarter 2024

The U.S. stock market extended its first-quarter 2024 momentum into the second quarter, but gains were muted by an April stumble and some narrowing in sector breadth compared with 1Q24. After advancing 10.6% on a total-return basis (with dividends) in 1Q24, the S&P 500 posted 2Q24 total return of 4.1%, while rising from 5,254 at the end of March 2024 to 5,460 at the end of June.

The quarter started with a "cruel" April, in which the S&P 500 slid 3%. Interest rates spiked in the fourth month, as March data suggested that the fight against inflation had bogged down. The index posted identical 3.5% gains in May and June, as improving inflation trends rekindled rate-cut optimism.

The Fed held rates steady at its June 2024 meeting, as it has done at every FOMC meeting since July 2023. Following the May FOMC meeting, the Fed noted "a lack of further progress" toward the Committee's 2% inflation objective. The language in the June FOMC report, by contrast, noted "modest further progress" toward the Committee's target.

The Fed started to hike rates more than two years ago based on the perception that pricing pressures were mainly tied to the supply-chain crisis and could be quickly subdued. Stubbornly high costs for shelter and service components, including vehicle insurance, have underscored that inflation is about far more than the supply chain.

The Fed's preferred inflation gauge, the core PCE price index, rose 0.1% in May and was up 2.6% year over year. That was the lowest annual rate of change in the core PCE price index since March 2021, which was also the first time in the current economic cycle that inflation topped the Fed's 2% target. The core PCE data confirmed inflation inputs from May CPI and PPI reported earlier in June. May core CPI was up 0.2% month over month, the lowest since June 2023. Overall improvement in inflation is allowing market rates of interest to move down from spring peaks, even though they remain above optimistically low levels at the beginning of 2024.

The 10-year Treasury yield was 4.29% at the end of June, down from 4.41% at the end of May and peak levels of 4.63% as of the end of April. The two-year Treasury yield was 4.70% as of end of June, down 4.82% at the end of May and the peak level of 4.96% as of end of April.

After showing signs of moderation for much of 2023, the jobs economy sustained year-end 2023 strength across the first half of 2024. The U.S. economy delivered 206,000 new jobs in June, above the consensus of 190,000. June's increase in payrolls and revisions lower to results from May and April took the three-month average to 177,000, below the 12-month average of 220,000. The unemployment rate rose to 4.1% for June, and is now at the level the Fed would prefer to see before beginning its rate-cutting campaign. Average

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hourly earnings increased 10 cents month to month and are 3.9% higher year over year (compared to 4.1% in May). Annual wage growth continues to run above inflation, but the premium has narrowed.

The industrial economy continues to send mixed signals. Industrial Production for May rose 0.9% month-over-month, much better than the 0.3% consensus forecast and up from no growth in April. May capacity utilization was still below the long-run average, but was up half a point from April. Supply-chain executives in the manufacturing sector expressed cautious optimism in spring 2024, but it did not last. For June 2024, the ISM manufacturing PMI index came in at 48.5%, down from 48.7% in May and 50.3% in April. ISM's manufacturing PMI has been below 50% for 19 of the past 20 months. After several years of adding workers as fast as they could, manufacturers are now engaging in targeted layoffs. Order growth has slowed in areas including metal fabrication and transportation equipment, while rising in areas such as computers & electronic products. The ISM services PMI unexpectedly dipped to 48.8% for June from 53.8% in May. While this was just the third time the services sector contracted in the past 49 month, it was also the second sub-50 reading in just the past three months. That is of concern, given that the services economy is several time the size of the manufacturing economy.

Signals from the consumer economy also remain mixed. Retail sales in May edged up just 0.1% from April, when sales declined 0.2%. On a year-over-year basis, retail sales in May 2024 were up 2.3%; that is down from consistent mid- to high-single-digit annual growth across 2023.

Straddling the commercial and consumer economies is housing. Both existing home sales and new home sales as of spring 2024 were running at about 62% of peak pandemic-infused levels from 2020-2022. Housing likely is frozen in place until mortgage rates begin coming down.

First-quarter GDP grew at a disappointing 1.4% annual rate. Personal consumption expenditures (PCE) for 1Q24 increased 1.5% while non-residential fixed investment (a proxy for corporate capital spending) rose 4.4%. Together, these two components make up over 80% of GDP.

S&P 500 earnings for 1Q24 (reported from mid-April to mid-May) rose in high-single-digit year-over-year percentages, marking a third consecutive quarter of annual EPS growth. Around 80% of companies exceeded consensus expectations for 1Q24 EPS versus 70%-75% on average. The magnitude of the beat was at the high end of the 5%-8% historical range. As of the end of 1Q24, the S&P 500 was a few ticks ahead of the Nasdaq Composite. That changed in 2Q24, as Nasdaq raced ahead for an 18.6% total return as of mid-year, versus 15.3% for the S&P 500.

Information Technology was the fourth-place sector for 1Q24 and lagged the S&P 500. That too changed in the second quarter. Information Technology led the market with a 28% gain at mid-year, just ahead of 27% for Communication Services. While only those two sectors were ahead of the S&P 500 at mid-year 2024, multiple sectors – including Energy, Financial, Utilities, Consumer Staples, and Healthcare – were beating or just below the S&P 500's average annual appreciation, which has been right around 10% since 1980. The Consumer Discretionary sector, one of the top-three performers in 2023, was ninth among 11 sectors in the 2024 first half. The reality of weak consumer goods spending was evident in the 1Q24 GDP report as well as in April and May retail spending. After a worrisome level of AI-driven sector concentration in 2023, the market experienced much-better breadth in 1Q24. A refocus on growth sectors and AI led to a narrowing in the advance in 2Q24. But breadth at mid-year 2024 was still better than it was at mid-year 2023.

Conclusion

In broad terms, the nearly two-year rally in stocks is a good thing. Investors are in the green; with fewer losers, they do not need to sell underwater positions and thus weaken rallies. Also in broad terms, the nearly two-year rally in stocks is too narrow. The risk of investor concentration has been amplified by AI mania. In 2023, three sectors – Communication Services, Technology, and Consumer Discretionary – accounted for most of the year to date advance. This year, we are down to two sectors – Communication Services and Technology.

In addition to sector concentration, this rallying market is characterized by individual stock concentration. As AI mania gripped the stock market, the "Magnificent Seven" of assumed AI beneficiaries dominated the rally. These seven stocks are Nvidia, Microsoft, Alphabet, Meta Platforms, Amazon, Apple, and Tesla. As of May 2024, these stocks represented 29% of total S&P 500 market capitalization.

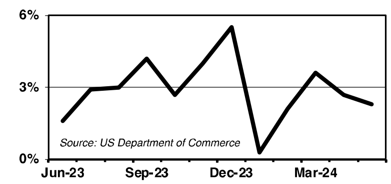
When a single sector or a single cluster of stocks is dominant, it usually does not end well. Past examples include Energy, which is now one-quarter its peak market weight; and Apple, which was unstoppable in the early days of iPhones but has stumbled multiple times since.

The Street is divided as to how long the seven can remain magnificent. Given that the age of generative AI has only just begun, Argus believes these names and other perceived AI winners could lead the market over the next several years.

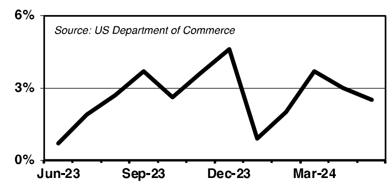
Jim Kelleher, CFA,
Director of Research

ECONOMIC TRADING CALENDAR

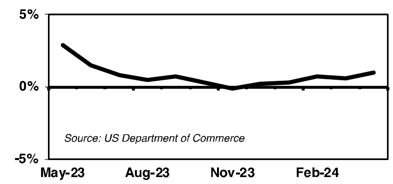
Release: **Retail Sales**
Date: 7/16/2024
Month: June
Previous Report: 2.3%
Argus Estimate: 1.8%
Street Estimate: NA



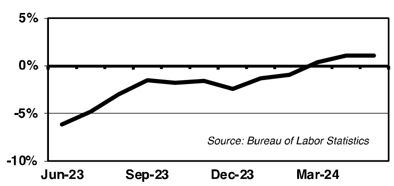
Release: **Retail Sales ex-autos**
Date: 7/16/2024
Month: June
Previous Report: 2.5%
Argus Estimate: 2.2%
Street Estimate: NA



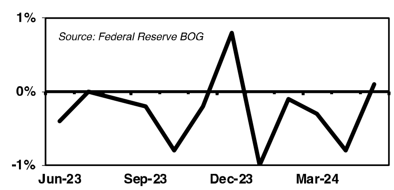
Release: **Business Inventories**
Date: 7/16/2024
Month: May
Previous Report: 1.0%
Argus Estimate: 1.1%
Street Estimate: NA



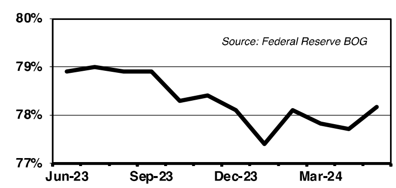
Release: **Import Price Index**
Date: 7/16/2024
Month: June
Previous Report: 1.1%
Argus Estimate: 1.6%
Street Estimate: NA



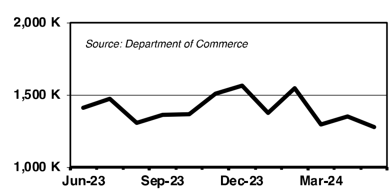
Release: **Industrial Production**
Date: 7/17/2024
Month: June
Previous Report: 0.1%
Argus Estimate: 0.8%
Street Estimate: NA



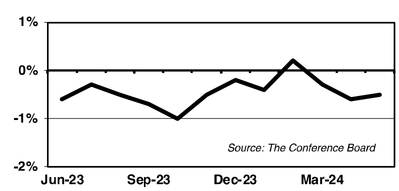
Release: **Capacity Utilization**
Date: 7/17/24
Month: June
Previous Report: 78.2%
Argus Estimate: 78.4%
Street Estimate: 78.6%



Release: **Housing Starts**
Date: 7/17/2024
Month: June
Previous Report: 1,277 K
Argus Estimate: 1,250 K
Street Estimate: 1,290 K



Release: **Leading Index**
Date: 7/18/2024
Month: June
Previous Report: -0.5%
Argus Estimate: -0.4%
Street Estimate: NA



Previous Week's Releases and Next Week's Releases on next page.

ECONOMIC TRADING CALENDAR (CONT.)

Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
9-Jul	Total Vehicle Sales	June	**15.93 mln.**	15.90 mln.	NA	**15.29 mln.**
10-Jul	Wholesale Inventories	May	-1.7%	-0.5%	NA	NA
11-Jul	Consumer Price Index	June	3.3%	3.1%	NA	NA
	CPI ex-Food & Energy	June	3.4%	3.5%	NA	NA
12-Jul	PPI Final Demand	June	2.2%	2.0%	NA	0.0
	PPI ex-Food & Energy	June	2.3%	2.2%	NA	0.0
	U. of Michigan Sentiment	July	68.2	67.0	NA	NA

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
23-Jul	Existing Home Sales	June	4.11 Mln.	NA	NA	NA
24-Jul	New Home Sales	June	619 K	NA	NA	NA
25-Jul	GDP Annualized QoQ	2Q "1st est."	1.4%	NA	NA	NA
	GDP Price Index	2Q "1st est."	3.1%	NA	NA	NA
	Durable Goods Orders	June	-1.3%	NA	NA	NA
26-Jul	PCE Deflator	June	2.6%	NA	NA	NA
	PCE Core Deflator	June	2.6%	NA	NA	NA
	Personal Income	June	4.6%	NA	NA	NA
	Personal Spending	June	5.1%	NA	NA	NA

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