Monday, July 22, 2024

SUMMARY-

I. Relief rally fades as tech stocks lead growth stocks lower last week.

II. Sector rotation continues to support value and small-cap names.

III. Republicans rally behind Trump while Democrats force Biden to end campaign.

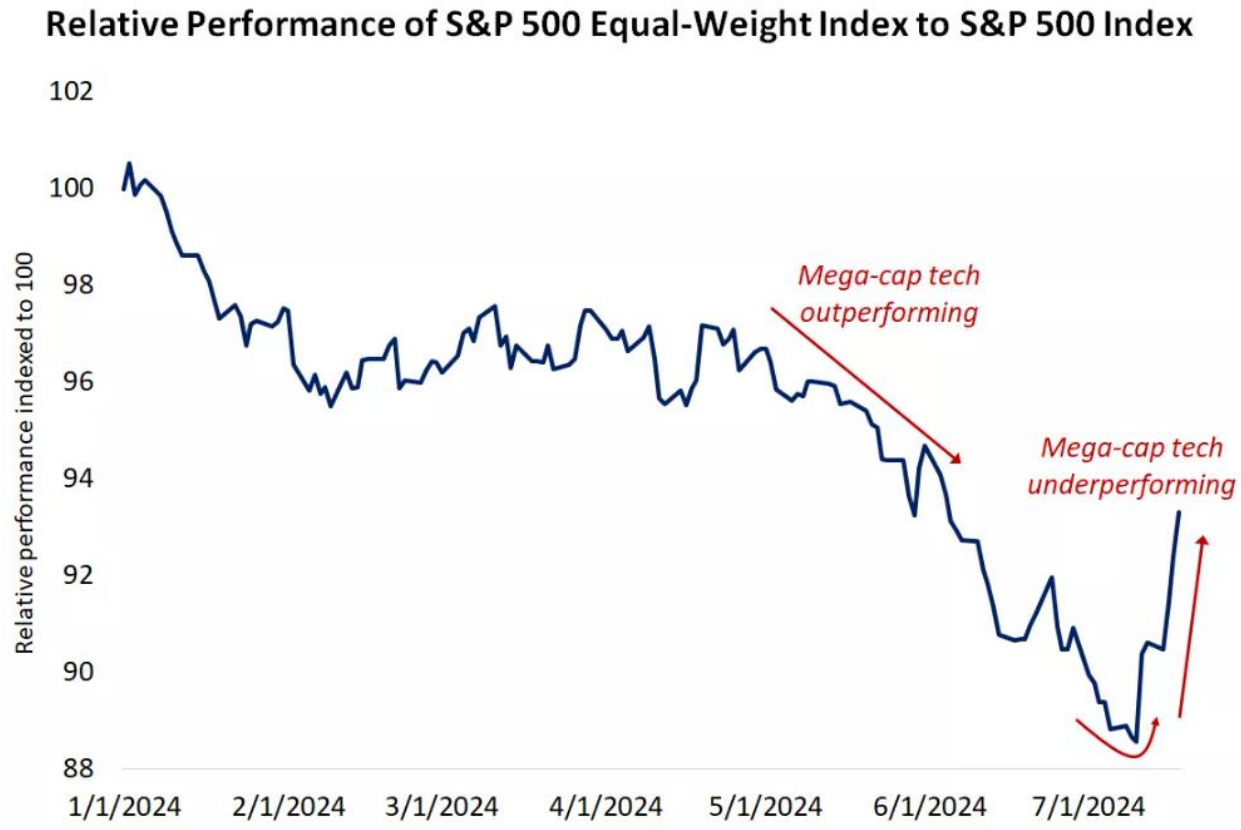
IV. Despite political turmoil, impending rate cuts, improving profits, and widening breadth support bull market.

Good morning:

Markets began last week with a relief rally that the assassination attempt on former President Trump nine days ago was unsuccessful, as the alternative would have likely led to untold social and political turmoil for the nation. However, as the week progressed, the notable sector rotation seen the week prior again drove market action. After major averages hit new highs early in the week, many of the tech sector's prior winning names led the NASDAQ and S&P 500 lower. By Friday's close, the NASDAQ posted a decline of 3.6% and the S&P 500 lost 2.0%. As much of this capital shifted to value and small-cap issues, the Dow ended the week with a gain of 0.7% while the Russell 2000 added 1.0%. Oil prices also declined 4.2% for the week as promises of dramatically increased domestic energy production were made at the Republican convention should they win.

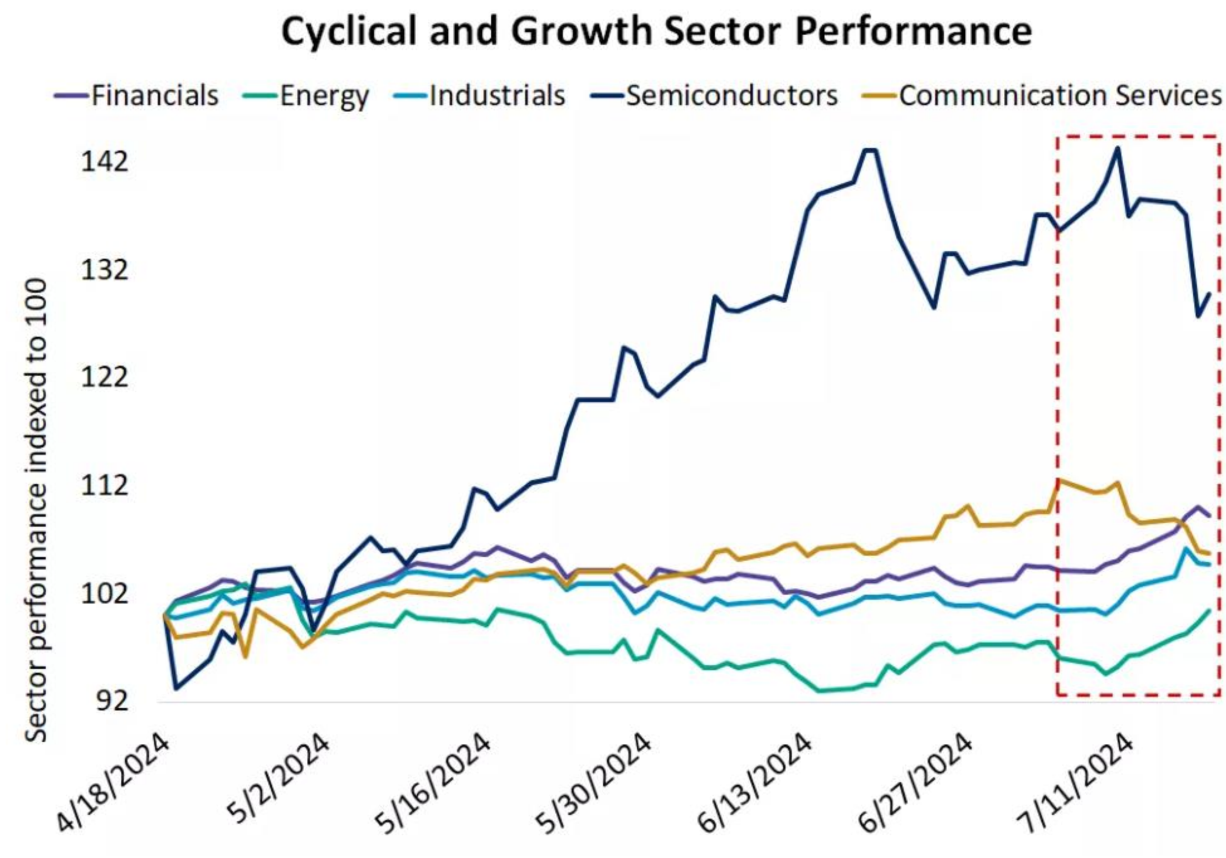
Meanwhile, the week saw mounting calls from key members of the Democratic party for President Biden to end his reelection campaign in the face of declining poll numbers and increasingly apparent heath issues. When major party donors echoed these concerns and refused to continue funding the campaign, the President's fate was all but sealed. With the Republican nominee nearly stopped by an assassin's bullet only days earlier, the Democrat nominee finally succumbed to tremendous intraparty pressure and ended his reelection campaign early yesterday. With only one month until the Democratic convention in Chicago, markets will be watching closely to see how events unfold as the party ultimately chooses its candidate. Regardless of how things turn out, we are clearly living through unique and historic times for our country.

Against the backdrop of the evolving political landscape currently underway, several key things will likely remain as fundamental support for the financial markets. Chief among them is the expected shift in monetary policy in the near future after inflation's significant decline over the past two years. A falling interest rate environment is historically very bullish for both stocks and bonds and could be this time as well. Next is the large number of highly profitable and growing companies that represent the core of the U.S. equity market. And third is the improving breadth in market participation which we hope continues in the weeks and months ahead. Additionally, recent excitement surrounding A.I. and its possibilities for both key tech companies, as well as the broader economy is a theme that is not likely ending any time soon. The massive profitability of most of the Magnificent Seven companies could result in their recent weakness turning out to be a very short-lived buying opportunity. As the chart below shows, the significant weighting of the Mag 7 in the S&P 500 Index has resulted in an *equally weighted* index outperforming the standard market-cap-weighted average over the past two weeks for the first time this year.   We continue to view this as a healthy development for the bull market.



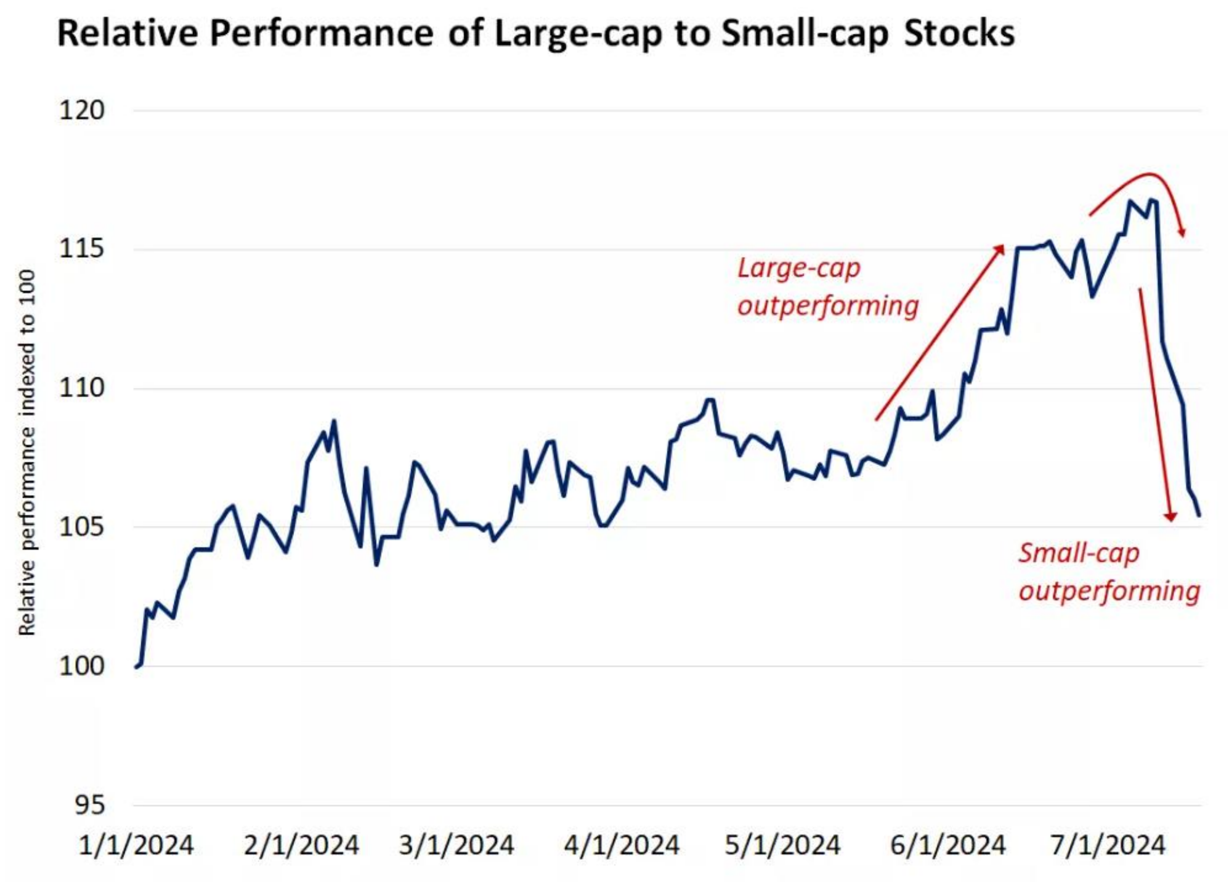
Source: FactSet

The second week of the quarterly earnings season produced an uptick in expectations. Based on initial results and forecasts for upcoming reports, analysts on Friday were expecting S&P 500 companies to post an average second-quarter earnings increase of 9.7% compared with the same quarter a year earlier. Just a week earlier, the projected growth rate was 9.1%. This week will see another round of earnings from important financial, healthcare, and industrial firms. Positive results and guidance from these names could propel the value sector rotation trade even further by week's end. The chart below illustrates how sector leadership has started to shift towards cyclical sectors.



Source: FactSet, S&P 500 sector indexes.

Similarly, the recent awakening of small-caps after several years of underperformance is another example of improving market participation in the current rally. As higher borrowing costs have a greater impact on smaller companies, many of which are highly leveraged, lower rates have a disproportionately positive effect on small firms and their profitability. However, small-caps also are economically more sensitive than large companies and generally perform better during periods of GDP growth and expansion. Therefore, the recent surge and interest in small-caps is based on the anticipation of both declining rates *and* continued economic growth and resilience. We continue to believe in the inclusion of small and mid-caps in a diversified portfolio to attempt to both reduce long-term volatility, as well as to participate in periods of shifting sector leadership as we are currently witnessing.



Source: FactSet, relative performance of S&P 500 Index to Russell 2000 Index.

In addition to a steady stream of earnings reports and political media coverage, this week will also feature a few key economic reports later in the week. Thursday will see an advance estimate of Q2 GDP, durable goods orders, and weekly unemployment claims. Friday will be highlighted by the latest Personal Consumption Expenditures Price Index (the Fed's preferred measure of inflation), as well as the latest University of Michigan's Index of Consumer Sentiment. Both reports could spark a reaction from investors attempting to handicap the timing of the Fed's easing campaign.

Have a great week and stay calm!

Mark and Jeff

Mark S. Loftus, CFP®
Managing Partner & Founder, LPWP
Registered Principal, RJFS

Jeffrey C. Preusser, CFP®
Senior Partner, LPWP
Registered Principal, RJFS

O: 630.566.9200 // T: 844.890.8750 // F: 630.566.9292
1901 Butterfield Road, Suite 100, Downers Grove, IL 60515
www.loftus-preusser.com