Tuesday, May 28, 2024

SUMMARY-

I. Dow pulls back while NASDAQ continues to march higher.

II. Growth and A.I. sectors back up leadership with strong profits.

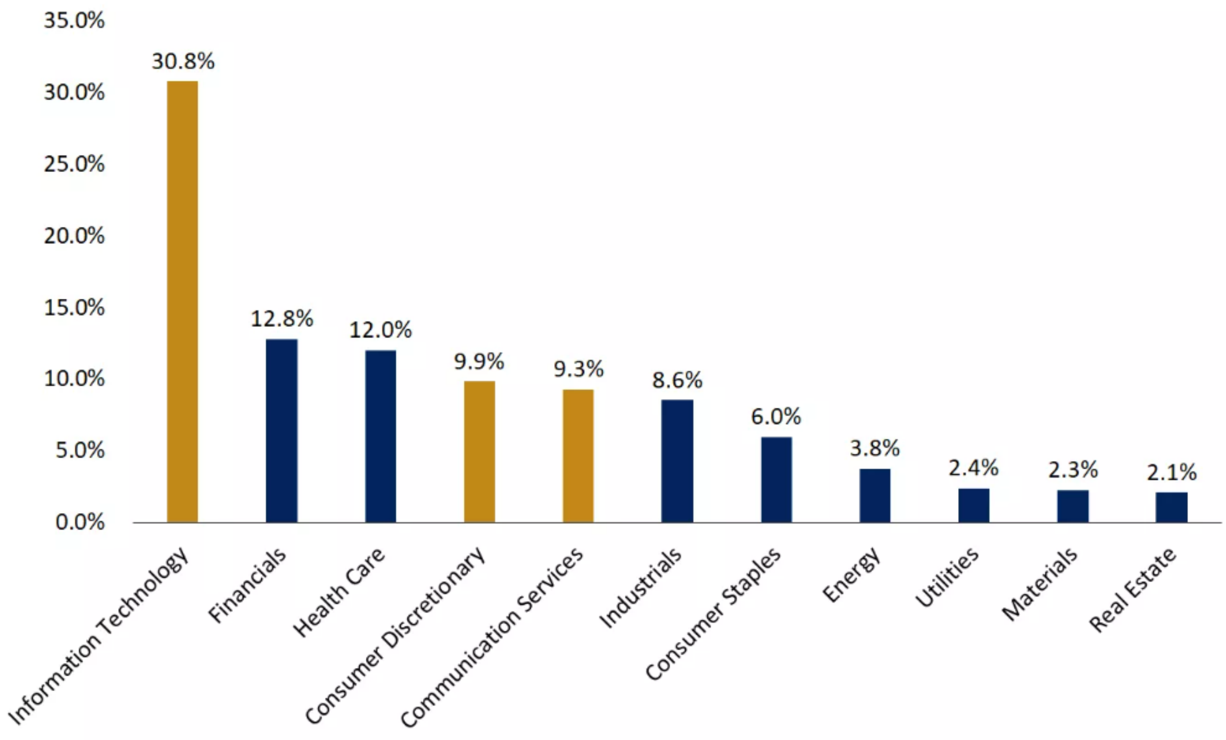
III. Over time, productivity gains from A.I. could help market performance broaden beyond tech sector.

IV. Rate cuts, lower inflation, earnings growth, and improved participation could extend bull market towards historical norms.

Good morning:

Last week saw starkly different results for the major U.S. stock indexes, with the Dow down 2.3%, the NASDAQ up 1.4%, and the S&P 500 posting a tiny gain. The Dow snapped a string of five positive weeks in a row and fell more than 900 points below the record-high 40,000-point threshold that it had breached the previous week. Magnificent Seven and A.I. leader Nvidia capped off a strong earnings season with stellar results helping the NASDAQ and keeping the momentum behind the large-cap technology sector. In fact, three growth sectors that claim the Mag Seven – Communication Services, Consumer Discretionary, and Technology – make up about 50% of the S&P 500 index's weighting. Over the past 18 months, U.S. markets have benefited tremendously from technology companies, as the enthusiasm around artificial intelligence and its growth prospects helped push stock markets higher. For example, in 2023, the S&P 500 was up about 24%, but the three growth sectors were up a lofty 40%-55%.

The three growth sectors have about a 50% weight in the S&P 500 index

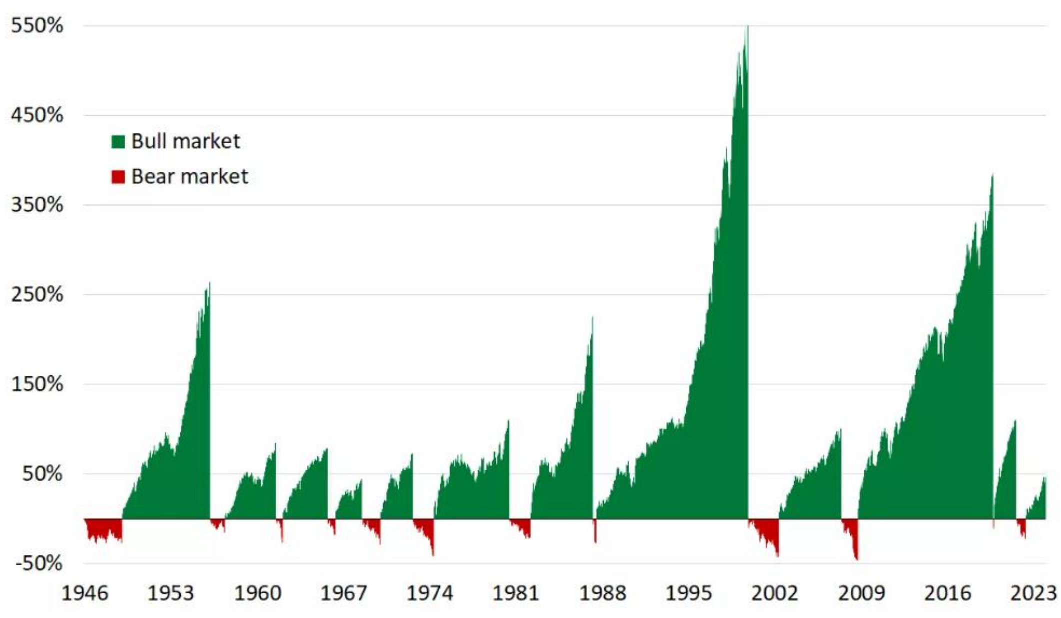


Source: Bloomberg as of May 2024.

Fortunately, unlike other tech-driven market surges in the past, like the internet bubble of the late 1990's, the current mega-cap technology rally has been driven by actual growth of revenues and profits. While we would expect bouts of volatility in the growth and technology sectors that tend to fluctuate more than other areas of the market, we also believe that we are in the early innings of a longer-term growth phase in artificial intelligence. Along with us, many have been expecting a broadening of industry participation in the bull market, which may accelerate if tech valuations start to show signs of being extended. However, it appears investors and portfolio managers will continue to return to mega-cap technology and growth as a core holding because 1) we will likely continue to see announcements of new and innovative A.I.-driven advancements in the years ahead, and 2) these companies have used their large cash positions to reinvest in their businesses, as well as return value to shareholders through share repurchases and increased dividends. Remember, P/E ratios that measure a stock's value can remain attractive if the "E" (Earnings) continues to rise along with the "P" (Price).

The early winners in the A.I. space have been the enablers of artificial intelligence (the mega-cap technology and semiconductor companies), but over time the beneficiaries of A.I. could also include the sectors that will benefit from the productivity gains. Industries beyond tech, like financial services, health care, automotive, and manufacturing should benefit, as A.I. helps these companies realize productivity and efficiency gains. This makes the case for portfolio diversification more compelling over the long run rather than simply overconcentrating in the areas that are hot in the moment.

With core inflation and wage gains both cooling, markets are back in anticipation-mode for rate cuts in the coming months. Underlying corporate profits continue to rise with over 80% of S&P 500 companies beating recent earnings expectations and most providing improved guidance for the coming quarter. Overall GDP growth may be slightly cooling but is certainly not heading towards the recession that so many predicted for most of last year. Therefore, the bull market that began in October 2022 may have legs to extend even higher. Over time, bull markets are longer and stronger than bear markets. Since 1946, the average bear market in the S&P 500 lasted 16 months and declined 34%, while the average bull market lasted more than 5½ years and gained 192%. With only a year and a half into this run, and a gain of about 48% on the S&P 500, history suggests we could certainly see equities continue to perform for quite some time before running out of steam.



Source: FactSet, S&P 500 Index

As we start this holiday-shortened trading week, markets will again be looking at several key economic reports that may support or refute the current thinking on inflation and Fed rate cuts. Pending home sale and price data may reveal whether the stickier dwelling components of CPI will ease. First quarter GDP estimates and Consumer Confidence Index will likely show modest declines, thus helping the inflationary picture. And finally, U.S. Bureau of Economic Analysis on Friday will release their latest Personal Consumption Expenditure Price Index data, the Fed's preferred measure of inflation.

Source: Investopedia

Have a great week!

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Market return and statistical data obtained from: https://am.jpmorgan.com/blob-gim/1383452890099/83456/weekly_market_recap.pdf?segment=AMERICAS_US_ADV&locale=en_US

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