OBSERVATIONS

- Markets were mixed last week with the S&P 500 gaining +2.0% while small cap stocks (Russell 2000 Index) fell -1.0%. The yield on a 10-year Treasury moved down -12 basis points to end the week at 4.28%.[1]
- The US manufacturing economy struggled in June with the Institute for Supply Management (ISM) Manufacturing index registering 48.5. While a reading below 50 is generally associated with manufacturing contraction, the ISM notes that index readings above 42.5 generally still indicate expansion for the overall economy—the index has been above 42.5 for 50 consecutive months.[2]
- The ISM Services Index also underwhelmed in June declining from 53.8 in May to 48.8. This is only the third reading below 50 for the services sector PMI since mid-2020.[1]
- Initial unemployment claims rose 4k to 238k last week, just slightly above consensus expectations. Unemployment claims from mid-June through early August can be volatile as large portions of the manufacturing sector shutdown operations for annual maintenance and the auto industry transitions to its new model year production.[1]
- The Job Openings and Labor Turnover Survey (JOLTS) showed that the total number of job openings increased in May to 8.1 million up from April's 7.9 million openings, while the quit rate—typically a good indicator of confidence in the labor market—remained steady at 2.2%.[1]
- The US economy created 206k jobs in June, but there were large downward revisions to both April (-57k to 108k) and May (-54k to 218k). Labor force participation increased slightly to 62.5% and the unemployment also ticked up to 4.1%, while average hourly wages fell to +3.9% YoY down from May's +4.1% YoY figure.[1]

EXPECTATIONS

- The minutes from the early June Fed meeting show that most participants noted modest progress in recent months towards the Fed's 2% inflation goal and that there was some evidence that wage growth was also slowing and the labor market was moving into better balance. Nonetheless, Fed officials "emphasized the importance of conditioning future policy decisions on incoming data, the evolving economic outlook, and the balance of risks" to the US economy and progress towards their inflation goal.[3]
- The UK (on July 4th) and the French (on July 7th) elected new governments. For the UK, there was little surprise as the Labor Party—which had been leading in the polls—won a landslide victory and set the stage for Keir Starmer to take over as Prime Minister. In contrast, the results in France were a surprise as well as more indecisive. The far-left New Popular Front (NFP), despite polling in third place, won an historic number of seats in the French Parliament, but fell short of being able to form a government on their own. Several weeks of negotiations may be needed to determine the next French Prime Minister. Meanwhile, French President Macron's party faced a real setback in the recent election losing over 85 seats.[4]

ONE MORE THOUGHT: Initial Thoughts on H2-2024[1]

As we head into the back-half of 2024, it is worth noting that the US economy, thus far, remains on solid footing. Economic growth is set to improve upon Q1's +1.4% (annualized rated) as financial conditions eased in Q2, the US remains near full-employment, and inflation moves (slowly) towards the Fed's target of 2%. The momentum in US

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[1] *Bloomberg LP*
[2] *https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/pmi/june/, 7/2/2024*
[3] *https://www.federalreserve.gov/monetarypolicy/fomcminutes20240612.htm*
[4] *https://www.ft.com/content/9ddccaa8-4b63-4a7a-8192-c65b7318c16e; https://www.ft.com/content/cea94bca-2ae5-4279-8b67-5c7c021324af*

large cap equity markets from Q1 largely continued into Q2, but the breadth of equity leadership narrowed substantially in Q2—from the Magnificent Seven to the 'Fab Five'—as Nvidia, Apple, Microsoft, Alphabet (parent company to Google), and Amazon powered much of the gains. Outside of US large cap stocks (S&P 500 +4.3%), mid-caps (Russell Midcap Index -3.4%) and small caps (Russell 2000 Index -3.3%) declined during the quarter. As we look forward, markets will have to contend with new governments in the UK and France, US elections in the Fall, and ongoing wars in Ukraine and the Middle East. The headlines around these events may be market moving as trading volumes generally thin in July and August and market analysts begin to shift their focus from 2024 earnings to the outlook for 2025 given the November election. Meanwhile, benchmark interest rates remained volatile in Q2, with the yield on the 10-Yr US Treasury moving from 4.2% to start the quarter to an intra-quarter high of 4.7% before closing out the month of June at 4.4%. In absolute terms, credit spreads for both high yield and investment grade remain remarkably tight as financial conditions and the economic backdrop remain hospitable to corporate America. So far, the market has priced in a soft-landing type scenario—which is broadly consistent with most current macroeconomic data—along with further progress towards inflation declining towards the Fed's inflation goal (see Chart of the Week). As long as incoming data over the course of the Summer is consistent with that narrative, risk assets should see sunny days ahead. However, should the data fail to show inflation declining, then the Fed's "higher for longer" mantra may weigh on risk assets and may put a cap on equity gains for the year around their present level—bearing in mind we have already gained over 15% this year in the S&P 500.

CHART OF THE WEEK

	GDP	Unemployment	Core- PCE	Probability	Rate Implications	Equities	US$
No Landing	>3% *Above trend growth*	≈ 3.5%	4% to 6%	<5%	Fed Funds ↑ US 10Yr ↑	↓	↑
Soft Landing & Sticky Inflation	1.5% to 3% *At trend growth*	3.5% to 3.9%	3% to 4%	40%	Fed Funds ↔ US 10Yr ↔	↔	↔
Soft Landing & Disinflation	1.5% to 3% *At trend growth*	3.5% to 3.9%	2% to 3%	40%	Fed Funds ↓ US 10Yr ↓	↑	↔
Stagflation	0% to 1.5% *Low growth*	4.0% to 5.5%	3% to 4%	<5%	Fed Funds ↔ US 10Yr ↑	↓	↔
Mild Recession	-0.1% to -1.0% *Moderate contraction*	4.5% to 6.0%	2% to 3%	5%	Fed Funds ↓ US 10Yr ↓	↓	↔
Hard Landing	< -1% *Significant contraction*	> 6%	1% to 2%	<5%	Fed Funds ↓ US 10Yr ↓	↓	↑

Source: Clearstead, Payden & Rygel as 7/1/2024

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