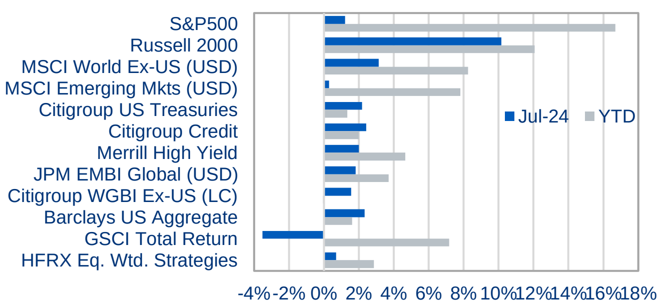
Strategic Investment Group®

Global Market Review

Moderating inflation and the prospect of less restrictive central bank policies sent global equity markets higher in July. In the U.S., the rally by small cap and value stocks was especially striking. Global bond markets also rose across the credit spectrum, with longer maturity bonds enjoying the largest gains. The Bank of England reduced its policy rate on August 1, joining Bank of Canada and the ECB in adopting a less restrictive monetary stance. The FOMC, for its part, took the opportunity of its July meeting to all but commit to a September rate cut. The Bank of Japan, in contrast, raised its policy rate to 25 basis points and announced a slower pace of asset purchases. Hopes that a decades-long deflation was finally over and a desire to end the steep slide of the yen spurred the BoJ to action. The yen responded favorably, gaining nearly 7% against the dollar. Reduced demand from a slowing Chinese economy sent oil and other commodity prices lower. The drop in copper prices was especially steep.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



Global equities rise. Small cap and value stocks soar.

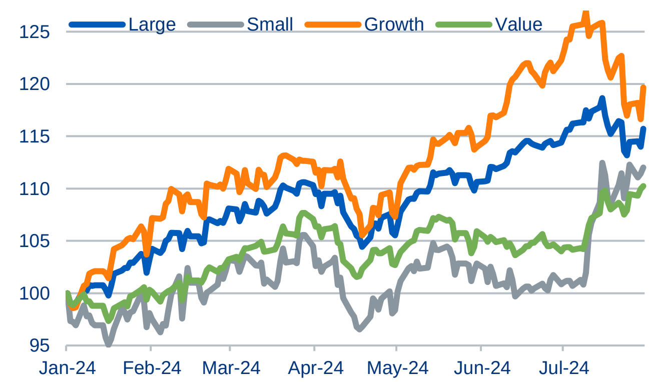
Value and Small Shine in Broad U.S. Equity Rally

The S&P 500 index gained 1.2% in July. It is up 16.7% so far this year. Unlike previous months, however, the gains were not led by large growth stocks in the tech sector. Less-than-stellar earnings announcements from Tesla and Alphabet appear to have raised doubts about the lofty earnings expectations underpinning the current valuations of other large tech firms, especially those thought to benefit from an AI revolution. Reflecting these concerns, tech and telecom stocks lost 2.1% and 4.3%, respectively, in July. Despite these declines, they remain up 23.8% and 19.8%, respectively, so far this year.

Small cap stocks soared in July, rising 10.2% (Exhibit 1). Value stocks also enjoyed strong gains of 5.5%. So far in 2024, small cap and value stocks are both up about 12%, reflecting the breadth of the U.S. market's gains across market segments and capitalizations. Although the market has been dominated by an obsession with AI for much of the year, the breadth of the market's gain is attributable to a common factor – the widespread belief that the largest and most rapid Fed tightening in over 40 years will succeed in reducing inflation without also pushing the economy into recession.

Exhibit 1. Small Is Beautiful, at Least in July

Source: Bloomberg. Index January 1, 2024 = 100.



The resilience of the U.S. economy reflects two main factors. First, rapidly rising stock and house prices have boosted household net worth to near record levels relative to disposable income. This, combined with rising real wages, has helped sustain household consumption despite sharply higher interest rates. Second, the impact of the Fed's tightening has

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been blunted by a boom in household and corporate debt refinancing during the period of ultra-low rates following the pandemic. Many households locked in low, fixed-rate mortgages. About 14 million households participated in the boom, extracting $430 billion in home equity and generating a $24 billion reduction in annual interest payments. Corporations also took advantage of low rates to refinance and extend the maturity of their borrowing. As a result, non-financial corporate interest expenditure has fallen despite the increase in rates.

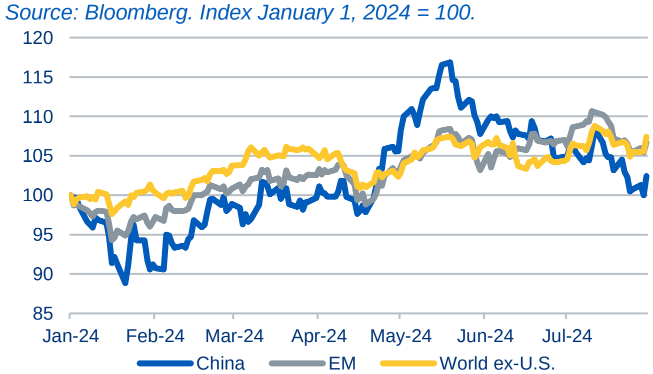
To be sure, these gains are uneven. Households at the lower end of the income spectrum are feeling the pinch of higher prices, many are locked out of the housing market due to high prices and high mortgage rates, and credit card and auto loan defaults are rising. Similarly, some corporations are buckling under the weight of higher borrowing costs. U.S. corporate bankruptcy filings in the first six months of the year were at the highest level since the COVID-related spike in 2020. Moreover, recent survey data points to an accelerating decline in manufacturing output and slowing service sector activity. The long and variable lags of monetary policy may yet manifest themselves in a generalized downturn.

Japanese Equities Enjoy Strong Gains in July

Equity markets outside of the U.S. also rose in July. The MSCI World ex-U.S. index of advanced economy stocks rose 3.1% to bring its gain for the year to 8.2% (Exhibit 2). Japanese equities, which jumped 5.8% in July, led other advanced economy bourses in the first seven months of the year. These gains in U.S. dollar terms were achieved notwithstanding a sharp slide in the yen, which touched a 38-year low in July (Exhibit 3). The decision of the Bank of Japan to tighten monetary policy to stop the slide of the yen was not welcomed by the Japanese equity market. The TOPIX index, which had reached an all-time high in July, fell 6% on August 1 the day after the BoJ's move on fears that a rising yen would hurt the competitiveness of Japanese exporters.

Exhibit 2. Chinese Stocks Lag Other Equity Markets

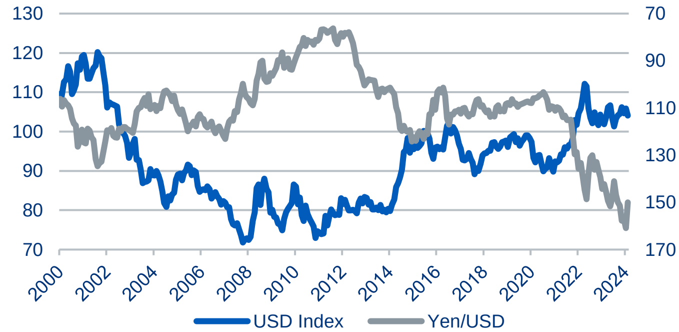
Source: Bloomberg. Index January 1, 2024 = 100.



Emerging market equities managed a small gain in July, notwithstanding the continued lackluster performance of the Chinese market (see Exhibit 2). The broad MSCI EM index is up 7.8% so far in 2024. Sluggish Chinese economic growth, an overbuilt and overleveraged property market, and a fragile financial sector are discouraging household spending and corporate investment. Fears of deflation have sent the yield on Chinese bonds to record lows. Measures by the Chinese authorities to stimulate the economy and restore confidence, including unexpected interbank rate cuts by the Bank of China, have not yet had their desired result.

Exhibit 3. Yen Falls to Four Decade Low in July

Source: Bloomberg. Broad U.S. dollar index and Yen/US$ inverted.

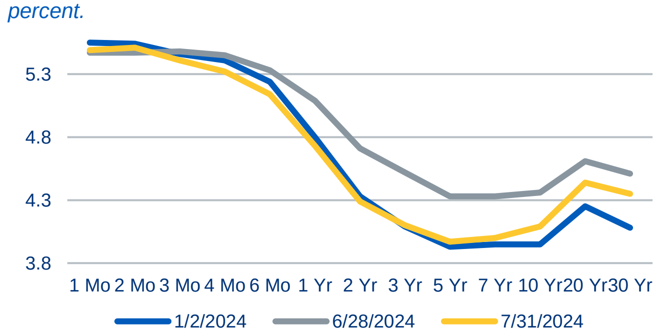


U.S. Treasury Yield Curve Retraces its Position

Expectations for declining inflation and easing Fed policies sent U.S. Treasury yields lower across the maturity spectrum in July (Exhibit 4). The slope and level of the yield curve have returned more or less to their positions at the beginning of the year when hopes were high that the Fed would cut rates early and often in 2024. Reflecting this move, U.S. Treasuries gained 2.2% in July, pushing their return through July to a modest 1.3%. Investment grade and high yield bonds also rose in July. They are up 1.6% and 4.8%, respectively, so far in 2024.

Exhibit 4. U.S. Treasury Yield Curve Shifts Lower

Source: Bloomberg. U.S. Treasury yields at different maturities in percent.



Performance of Major Market Indices through 07-31-2024

Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	1.2%	1.2%	16.7%	22.1%	9.6%	15.0%
Russell 2000	10.2%	10.2%	12.1%	14.3%	1.9%	8.9%
MSCI World Ex-US (USD)	3.1%	3.1%	8.2%	11.1%	3.7%	7.5%
MSCI Emerging Mkts (USD)	0.3%	0.3%	7.8%	6.3%	-2.7%	3.4%
Citigroup US Treasuries	2.2%	2.2%	1.3%	4.1%	-3.0%	-0.2%
Citigroup Credit	2.4%	2.4%	2.0%	6.8%	-2.7%	1.0%
Merrill High Yield	2.0%	2.0%	4.6%	11.0%	2.2%	4.0%
JPM EMBI Global (USD)	1.8%	1.8%	3.7%	8.6%	-1.8%	0.4%
Citigroup WGBI Ex-US (LC)	1.6%	1.6%	-0.1%	3.0%	-4.2%	-2.1%
Barclays US Aggregate	2.3%	2.3%	1.6%	5.1%	-2.6%	0.2%
GSCI Total Return	-3.5%	-3.5%	7.2%	0.2%	10.8%	7.6%
HFRX Eq. Wtd. Strategies	0.7%	0.7%	2.9%	5.5%	0.9%	2.7%