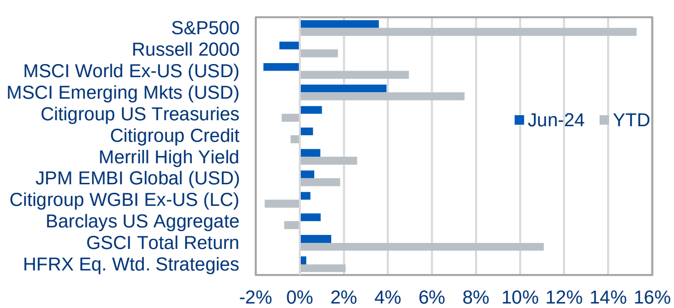
Global Market Review

Concentrated, overvalued, and AI-obsessed, the U.S. equity market extended its gains in June. NVIDIA, the chief object of the market's obsession, roared further ahead, briefly capturing the crown of most highly capitalized U.S. company. In addition to the AI frenzy, U.S. equities were supported by declining U.S. bond yields. The Bank of Canada cut its policy rate by 25 basis points in June, becoming the first G-7 central bank to do so. The ECB soon followed, also cutting its policy rate by 25 basis points. Nevertheless, European equity markets fell after the call for a snap election in France. Emerging equities rose despite declines in the Chinese market as well as in Latin American bourses. Yields across the credit spectrum declined in June. Together with rising equity prices, falling yields and spreads have eased financial conditions, dampening the impact of the Fed's tight policy stance. Oil prices rose strongly in June. The U.S. dollar's gain was more muted.

Performance of Major Market Indices

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



AI-related shares propel the U.S. equity market higher.

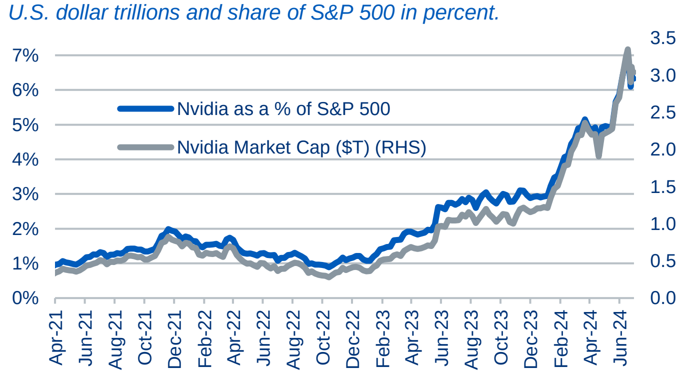
U.S. Market's AI Obsession

The S&P 500 index gained 3.6% in June. Growth stocks dominated the rally, rising 6.4%, while value stocks fell 1.0%. In the first half of 2024, the S&P 500 index rose 15.3% as growth stocks outpaced value by a wide margin, rising 19.9% versus a gain of 6.1% by value.

While the U.S. equity market's performance in the first half of the year has been strong, NVIDIA's gains have been stratospheric, rising 149.5%. NVIDIA is now valued at over $3 trillion, up from $144.5 billion at the beginning of 2020 (Exhibit 1). It joins Microsoft and Apple as one of three U.S. companies with market capitalizations of over $3 trillion.

Exhibit 1. NVIDIA Shares Soar

Sources: Bloomberg and Strategic estimates. NVIDIA's market cap in U.S. dollar trillions and share of S&P 500 in percent.



Although highly speculative, NVIDIA's vertiginous ascent is not baseless. Its earnings growth has also been spectacular, fueled by high operating margins and a seemingly insatiable demand for its chips which form the nucleus of AI platforms. As a result, NVIDIA's forward P/E ratio (39 times 1-year forward EPS, compared to 33 and 30 for Apple and Microsoft, respectively), seems high, but not outlandish, and certainly nowhere near the levels seen in the case of tech stocks at the height of the 2000 dot com bubble. However, the extraordinary rise of AI-related stocks has contributed to the concentration of the U.S. equity market. The top 10 firms in the S&P 500 now account for over 35% of its total market capitalization, exceeding past peaks including that of the 2000 tech bubble (Exhibit 2). The growing legions of passive investors seeking low-cost exposure to the S&P 500 index are consequently, and

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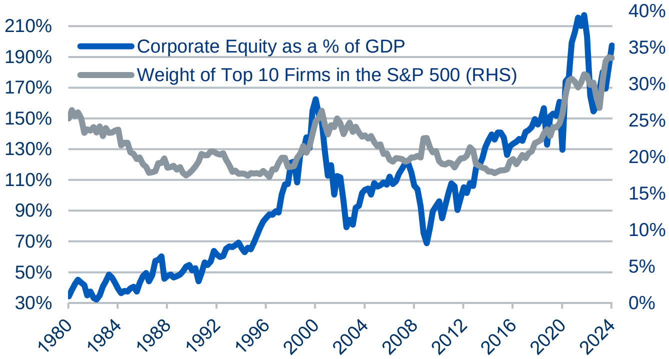
probably inadvertently, also tying their fortunes to a continued AI boom.

Exhibit 2. U.S. Equity Concentration at 40+ Year High

Sources: Bloomberg. Percent share of the top 10 stocks in the S&P 500.

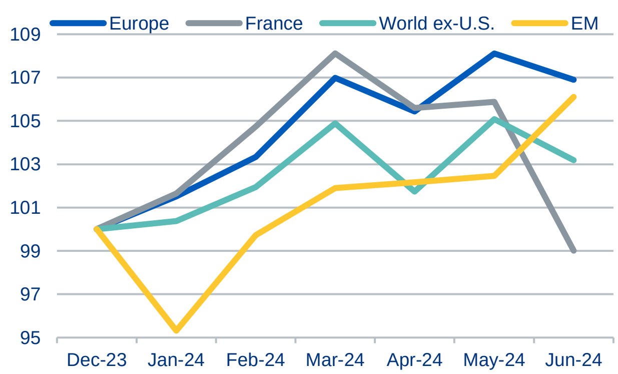


French Election Roils Market Despite Easing ECB

The uncertainty unleashed by French President Macron's decision to call a snap election roiled European equity markets in June, negating the supportive impact of the ECB's pivot to easier policies. What makes this election particularly unsettling is the dominant positions of parties at the extreme poles of the political spectrum, heightening uncertainty over the future direction of policies and stability in the European Union. European equity markets fell 2.3% in June, led by the 5.8% decline of the French market, and contributing to the 1.7% decline of the MSCI World ex-U.S. index. Emerging equity markets, in contrast, rose 3.9% in June notwithstanding the Chinese market's 1.9% decline (Exhibit 3).

Exhibit 3. French Election Roils Non-U.S. Equity Markets

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



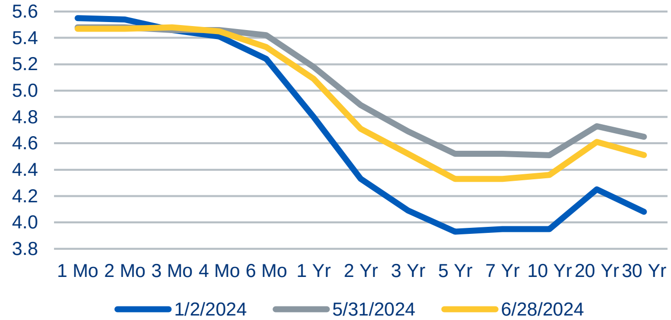
U.S. Bond Prices Rise Across Credit Spectrum

At the beginning of the year, many feared that the U.S. economy would fall into recession following the jolt of a sharp increase in interest rates by the Fed. Interest rate futures markets were pricing in six or more rate cuts in the course of 2024. Reflecting these expectations, the U.S. Treasury yield curve was steeply inverted (Exhibit 4).

Expectations that Fed rate cuts would come early and often were soon dashed, however, and markets now expect at most one rate cut this year. Continued inflation, a robust and resilient U.S. economy, and tight labor market have combined to stay the Fed's hand, while other central banks like the Bank of Canada and the ECB cut rates in the face of slowing growth and in anticipation of a return to price stability.

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

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



Double-Edged Sword of Easy Financial Conditions

Many factors have contributed to the U.S. economy's surprising resilience. Pandemic-fueled excess savings and pent-up demand, massive fiscal stimulus, and easier financial conditions have all helped sustain a strong recovery.

Of these factors, easier financial conditions are particularly noteworthy because of their current role in sustaining growth and as an indicator of potential future fault lines. A long period of ultra-low interest rates following the GFC has increased the size of the financial sector in the U.S. economy as well as household net worth. Although shy of its 2021 peak, the size of the U.S. equity market relative to GDP is well above long-term averages pointing to the growing financialization of the economy (see blue line in Exhibit 2). The increase in the relative size of the market combined with its high concentration raises concerns over the prospects for financial stability. Their immediate consequence has been to sustain household consumption. Buoyed by higher equity and home prices, household net worth is now hovering around 8-times disposable income, just below its all-time high in 2022. While currently sustaining a strong recovery, the equity market's size, overvaluation, and concentration raise concerns over future financial stability.

Performance of Major Market Indices through 06-30-2024

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	3.6%	4.3%	15.3%	24.6%	10.0%	15.0%
Russell 2000	-0.9%	-3.3%	1.7%	10.1%	-2.6%	6.9%
MSCI World Ex-US (USD)	-1.7%	-0.6%	5.0%	11.2%	2.8%	6.6%
MSCI Emerging Mkts (USD)	3.9%	5.0%	7.5%	12.5%	-5.1%	3.1%
Citigroup US Treasuries	1.0%	0.2%	-0.8%	1.6%	-3.2%	-0.6%
Citigroup Credit	0.6%	0.1%	-0.4%	4.7%	-3.0%	0.6%
Merrill High Yield	0.9%	1.1%	2.6%	10.4%	1.6%	3.7%
JPM EMBI Global (USD)	0.7%	0.4%	1.8%	8.4%	-2.2%	0.3%
Citigroup WGBI Ex-US (LC)	0.5%	-1.2%	-1.6%	1.0%	-4.2%	-2.2%
Barclays US Aggregate	0.9%	0.1%	-0.7%	2.6%	-3.0%	-0.2%
GSCI Total Return	1.4%	0.7%	11.1%	15.0%	12.7%	8.3%
HFRX Eq. Wtd. Strategies	0.3%	-0.1%	2.1%	5.2%	0.5%	2.7%