

The Stock Market Experienced a Big Rotation in July

Services

Investment Management

August 1, 2024

Monthly Market Summary

- The S&P 500 Index returned +1.2% in July, underperforming the Russell 2000 Index's +10.3% return. Ten of the eleven S&P 500 sectors traded higher, led by Real Estate, Utilities, and Financials. Technology was the only sector to trade lower, reversing a portion of its rise in the first half of 2024.
- Corporate investment-grade bonds produced a +2.6% total return as Treasury yields declined. Corporate high-yield bonds gained +2.3% as credit spreads tightened.
- International stock performance was mixed. The MSCI EAFE developed market stock index returned +2.6%, while the MSCI Emerging Market Index returned +0.8%.

Stocks & Bonds End the Month Slightly Higher

The S&P 500 ended July slightly higher, its third consecutive monthly gain. The index initially traded higher and briefly surpassed 5,600 for the first time before it traded lower in late July and gave back some of the gains. The tech-heavy Nasdaq 100, which led markets higher in 1H 2024, returned -1.7% as Nvidia, Microsoft, Google, and Facebook-parent Meta traded down after their strong 2024 start. In contrast, the Russell 2000 Index of small-cap stocks posted its highest monthly return since December 2023. In the bond market, Treasury yields fell. The U.S. Bond Aggregate Index, which tracks a wide array of investment-grade bonds, traded higher for a third consecutive month, the longest win streak since 2021. Despite the muted headline returns, the stock market experienced a seismic shift as expectations increased for a September interest rate cut.

Investors Rotate into Small Cap Stocks as Rate Cuts Come into View

Large-cap stocks dominated in the first half of 2024, with the S&P 500 outperforming the Russell 2000 by over +13%. The S&P 500's first-half return was influenced by two factors: (1) investor concerns about the impact of high interest rates on smaller companies and (2) large-cap stock indices' exposure to the artificial intelligence (AI) industry. This combination of interest rate concerns and AI dominance led to crowded positioning as investors focused on a narrow group of large-cap stocks. The investment narrative changed in July after the CPI inflation report showed continued progress. The better-than-expected inflation report raised expectations for a September interest rate cut, leading to a significant rotation within equity markets. Investors moved from large-cap stocks into small-caps, with the Russell 2000 outperforming the S&P 500 by over +9%.

Dropping the Baton (sorry - we had to do it!)

As the Russell 2000 rallied last month, large-caps stumbled. Mega-caps bore the brunt of the sell-off as investors questioned when billions of dollars in AI investments would pay off. As investors rotated, the year-to-date return gap between the Nasdaq 100 and Russell 2000 shrank from nearly +16% at the end of June to only +3.3%. It's a healthy reminder that markets do not rise in a straight line.

August tends to be seasonally choppy as investors return from their summer vacations to assess their portfolios for the remainder of the year. The past week's volatility has left many to speculate on the cause(s). Over the week, we heard many plausible explanations: jobs data, inflation data, interest rates, U.S. politics, geopolitics, and 2nd quarter earnings. This volatility may be the culmination of those factors above. Still, many of them were known and thus, should have been priced in by the markets. More likely, given the viciousness of the sell-off, is a broader deleveraging event (i.e., forced liquidations) as the Japanese Yen (stronger) has rallied over 13% against the U.S. Dollar (weaker). This phenomenon is known as a "Carry Trade," while they're rare, they can catch the market flat-footed. A carry trade involves borrowing from a country with low interest rates and a weak currency (Japan) and reinvesting the money in assets of another country with a higher return, such as U.S. equities. Investors can be forced to liquidate the trade when the stability of that foreign-exchange rate (YEN/USD) disappears, and the borrowing currency increases rapidly.

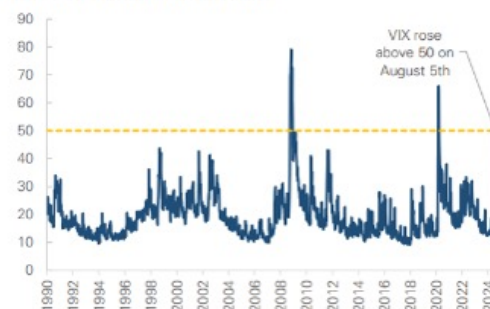
When traders choose to liquidate quickly, they sell the most liquid assets with the highest prior returns. The bottom line is that global stock markets are very interconnected in today's world. Stock market moves are no longer localized; an event halfway around the world can impact U.S. stock markets.

Moving Forward and Hopefully, Higher

The U.S. economy is estimated to have grown at a +2.8% pace in Q2 2024, and initial jobless claims are very low by historical standards. The Fed's real-time Weekly Economic Index signals that the economy is still growing around 2%, and it uses high-frequency data to measure growth in real-time.

The equity market's path forward is uncertain, and our focus will be on whether investors buy the dip (section 7 in the August Roundup). Market dynamics, particularly the VIX, suggest the market may be near a significant turning point. The VIX briefly traded above 50, a level not seen since March 2020. Statistically, a rise above 50 is very bullish for forward returns. Since 1990, the CBOE VIX has only risen above 50 seventy-five times. Over the next 12 months, the S&P 500 traded higher 74 of those 75 times, a 98%-win rate. Continue to expect elevated volatility in the near term as the "known unknowns" remain top of mind for the market.

FIGURE 1 – CBOE VIX Since 1990



Source: MarketDesk, CBOE (January 1990 to August 2024).

FIGURE 2 – Historical Forward Win Rate with VIX at 50 is 99%



Source: MarketDesk. Based on daily S&P 500 data since 1990.

Annual returns and intra-year declines



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2023, over which time period the average annual return was 10.3%.

Guide to the Markets – U.S. Data are as of July 31, 2024.

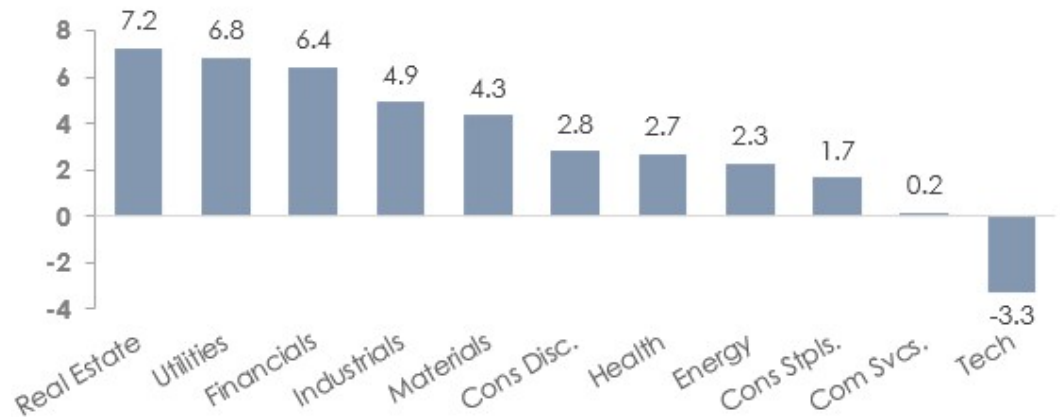
This Month in Numbers

FIGURE 1

U.S. Style Returns (July in %)

	Value	Blend	Growth
Large	5.1	1.2	-1.7
Mid	6.0	4.8	0.6
Small	12.4	10.3	8.2

Data Reflects Most Recently Available As of 7/31/2024

FIGURE 2
U.S. Sector Returns (July in %)


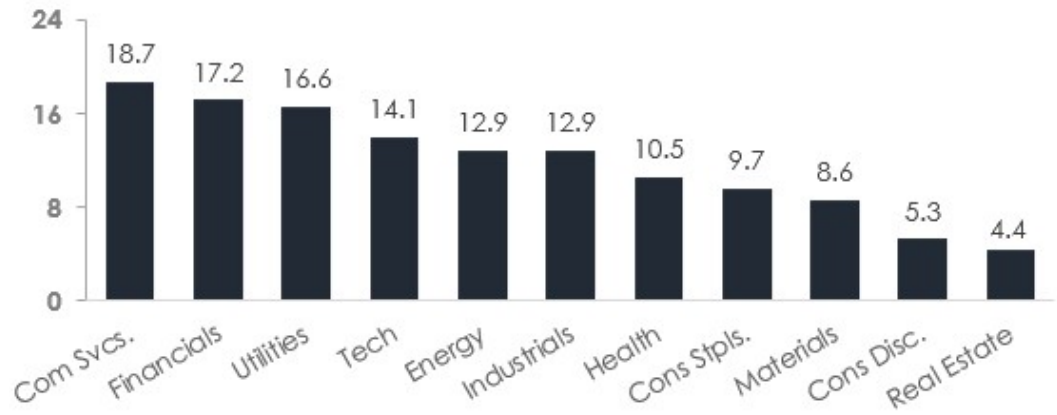
Data Reflects Most Recently Available As of 7/31/2024

FIGURE 3
U.S. Style Returns (YTD in %)

	Value	Blend	Growth
Large	11.9	16.6	18.4
Mid	10.7	9.8	6.5
Small	11.0	12.1	12.9

Data Reflects Most Recently Available As of 7/31/2024

FIGURE 4
U.S. Sector Returns (YTD in %)



Data Reflects Most Recently Available As of 7/31/2024

FIGURE 5
Market Data Center

Stocks	1 month	3 months	6 months	YTD	1 year	3 years	Dividend Yield	NTM P/E	P/B
S&P 500	1.2%	10.1%	14.8%	16.6%	21.8%	30.0%	1.26%	20.8x	4.6x
Dow Jones	4.5%	8.5%	8.0%	9.4%	16.8%	22.5%	1.66%	18.4x	4.9x
Russell 2000	10.3%	14.6%	16.6%	12.1%	14.0%	4.8%	1.19%	24.9x	1.9x
Russell 1000 Growth	-1.7%	11.1%	15.6%	18.4%	26.5%	29.7%	0.52%	27.8x	11.7x
Russell 1000 Value	5.1%	7.3%	11.8%	11.9%	14.3%	20.6%	1.87%	16.2x	2.6x
MSCI EAFE	2.6%	5.8%	9.0%	8.5%	11.0%	9.8%	2.93%	13.8x	1.8x
MSCI EM	0.8%	5.5%	12.6%	7.5%	4.9%	-10.9%	2.47%	12.0x	1.6x
NASDAQ 100	-1.7%	11.1%	13.3%	15.4%	23.5%	31.1%	0.59%	25.3x	7.3x

Fixed Income	Yield	1 month	3 months	YTD	1 year	3 years
U.S. Aggregate	4.64%	2.4%	5.0%	1.6%	4.9%	-7.9%
U.S. Corporates	5.29%	2.6%	5.5%	1.2%	5.9%	-10.8%
Municipal Bonds	3.96%	1.3%	2.0%	0.8%	4.0%	-1.9%
High Yield Bonds	7.79%	2.3%	4.5%	4.6%	10.1%	3.6%

Key Rates	7/31/2024	6/30/2024	4/30/2024	1/31/2024	7/31/2023	7/31/2021
2 yr Treasury	4.26%	4.72%	5.03%	4.22%	4.86%	0.18%
10 yr Treasury	4.05%	4.37%	4.68%	3.95%	3.95%	1.23%
30 yr Treasury	4.34%	4.54%	4.79%	4.19%	4.02%	1.89%
30 yr Mortgage	7.14%	7.26%	7.55%	6.96%	7.26%	2.98%
Prime Rate	8.50%	8.50%	8.50%	8.50%	8.50%	3.25%

Commodities	Level	1 month	YTD
Oil (WTI)	78.53	-3.7%	9.6%
Gasoline	2.33	-0.6%	13.2%
Natural Gas	2.04	-21.3%	-12.2%
Propane	0.78	-8.5%	15.3%
Ethanol	1.74	-11.7%	7.7%
Gold	2,491	6.5%	20.2%
Silver	29.20	-1.2%	21.3%
Copper	4.06	-7.5%	4.7%
Steel	704	4.5%	-38.0%
Corn	4.00	-4.9%	-15.1%
Soybeans	10.47	-9.6%	-18.7%

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