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Major economic upgrades into summer

Market Digest, June 2024

Editors: Owen Haffey, Technical Writer and Amy Lubas, CFA, VP, Investment Solutions

Executive Summary

In Q1, real GDP growth underwent a downward revision to 1.3% from the initial estimate of 1.6%, albeit slightly better than the consensus projection of 1.2%. We revised our 2024 real GDP growth projection upward by 50 basis points to 1.5%-2.0% due to a somewhat firmer demand than previously anticipated. Additionally, we increased our forecast for 2024 CPI inflation by 25 basis points to 2.75%-3.25%, reflecting a slower path to the Fed's inflation target and indicating the importance of monitoring inflationary pressures.

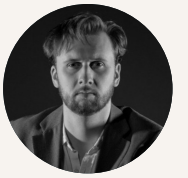
Last month, the global economy maintained its robust pace, with the composite PMI (services and manufacturing) surging by 1.3 points to 53.7, reaching its highest level in a year. This acceleration in economic momentum historically correlates with strong performance in equity markets globally. The positive trend in the composite PMI is also supported by various global macroeconomic indicators.

Speculation about potential policy changes under a Trump 2.0 administration, including currency devaluation and tariff imposition, raises concerns among bond investors, but obstacles like congressional control and confirmation processes may limit significant shifts. Meanwhile, ongoing debates among policymakers and analysts regarding monetary policy's restrictiveness, alongside evidence from the banking sector, contribute to market uncertainty about economic conditions.

We have been bullish on U.S. stocks all year, both absolutely and relative to bonds and cash. However, in April, we shifted 5% from stocks to cash due to some deterioration in our U.S. asset allocation model, retaining a 10% equity overweight. As the model rebounded in May, we recently moved 5% back into stocks (max overweight), this time taking it from bonds.

In May, the S&P 500 surged by 4.8%, the highest return for the month since 2009, driven by robust performance by the Technology and Communication Services sectors, which contributed 3.5% points to the index's gain. Apart from Energy, all sectors experienced gains, highlighting broad market strength. Notably, Utilities saw the second-best performance, rising by 8.5% and prompting an upgrade to overweight status.

"We revised our 2024 real GDP growth projection upward by 50 basis points to 1.5%-2.0% due to a somewhat firmer demand than previously anticipated. Additionally, we increased our forecast for 2024 CPI inflation by 25 basis points to 2.75%-3.25%, reflecting a slower path to the Fed's inflation target."



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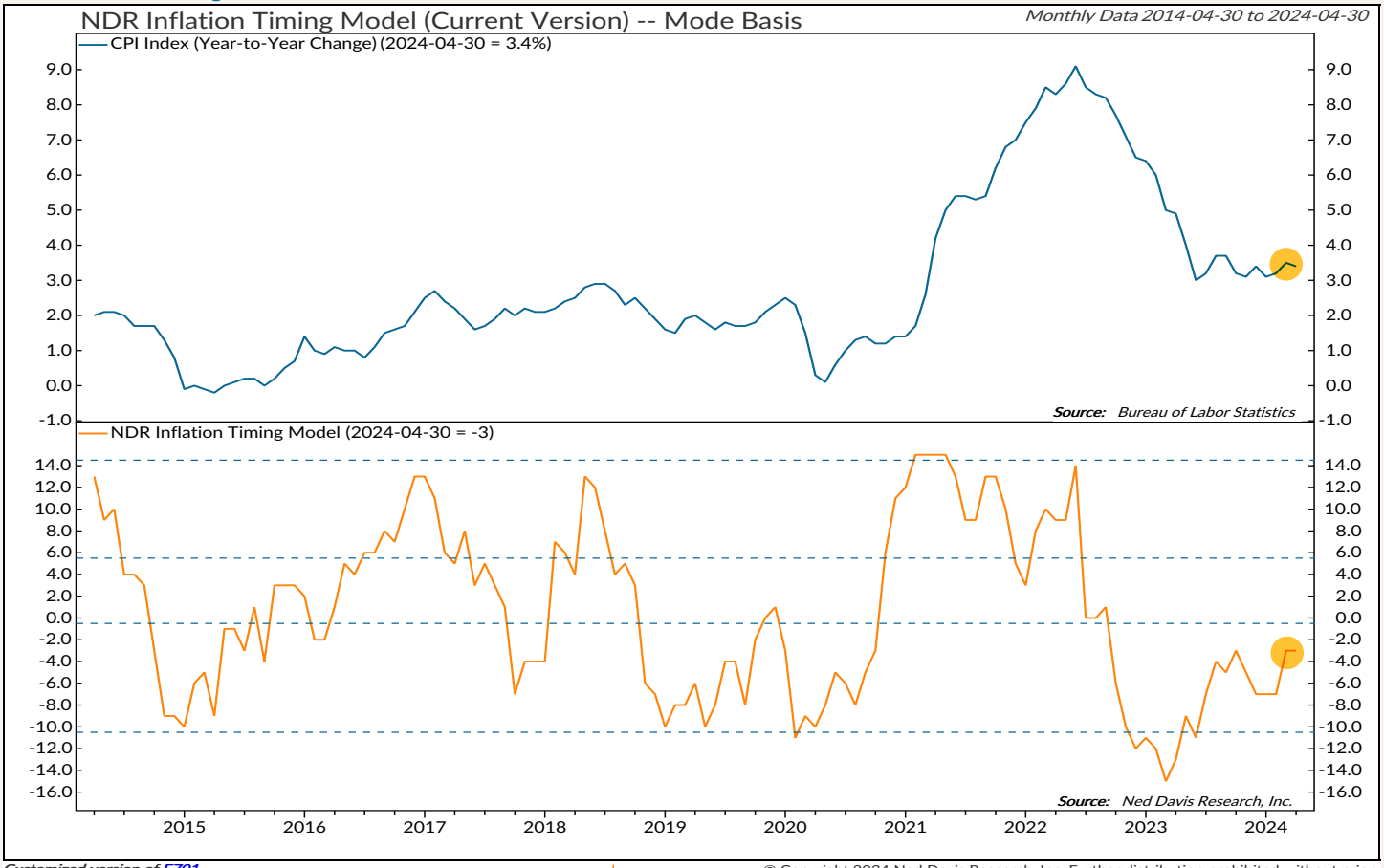
U.S. economy: Upgrades to growth & inflation

In Q1, real GDP growth underwent a downward revision to 1.3% from the initial estimate of 1.6%, albeit slightly better than the consensus projection of 1.2%. This downward adjustment was primarily driven by softer consumer spending, particularly on durable goods, and a more significant decline in inventory investment. Despite the slowdown, final sales to domestic purchasers, which exclude inventories and net exports, maintained a steady pace, rising at a 2.5% annualized rate. This indicates a resilient underlying domestic demand, essential for sustaining economic expansion, albeit at a slower pace compared to the previous year. As a result, we upgraded our projection for 2024 real GDP growth by 50 basis points to 1.5%-2.0%.

Moving further into 2024, we anticipated a significant moderation in economic growth due to several factors, including the lagged impact of Federal Reserve tightening, slower consumer spending amid labor market rebalancing, signs of financial stress, and diminishing excess savings. Although the economy is still on a slowing growth trajectory, a somewhat firmer demand than previously projected feeds into slightly firmer inflation, as well. Therefore, we revised our forecast for 2024 CPI inflation upward by 25 basis points to 2.75%-3.25%, reflecting a slower path to the Fed's inflation target. While our Inflation Timing Model suggests continued disinflation (chart below), elevated PMI output price indexes, along with other factors, suggest sticky inflation in the near term.

Inflation timing shows continued but slower disinflation



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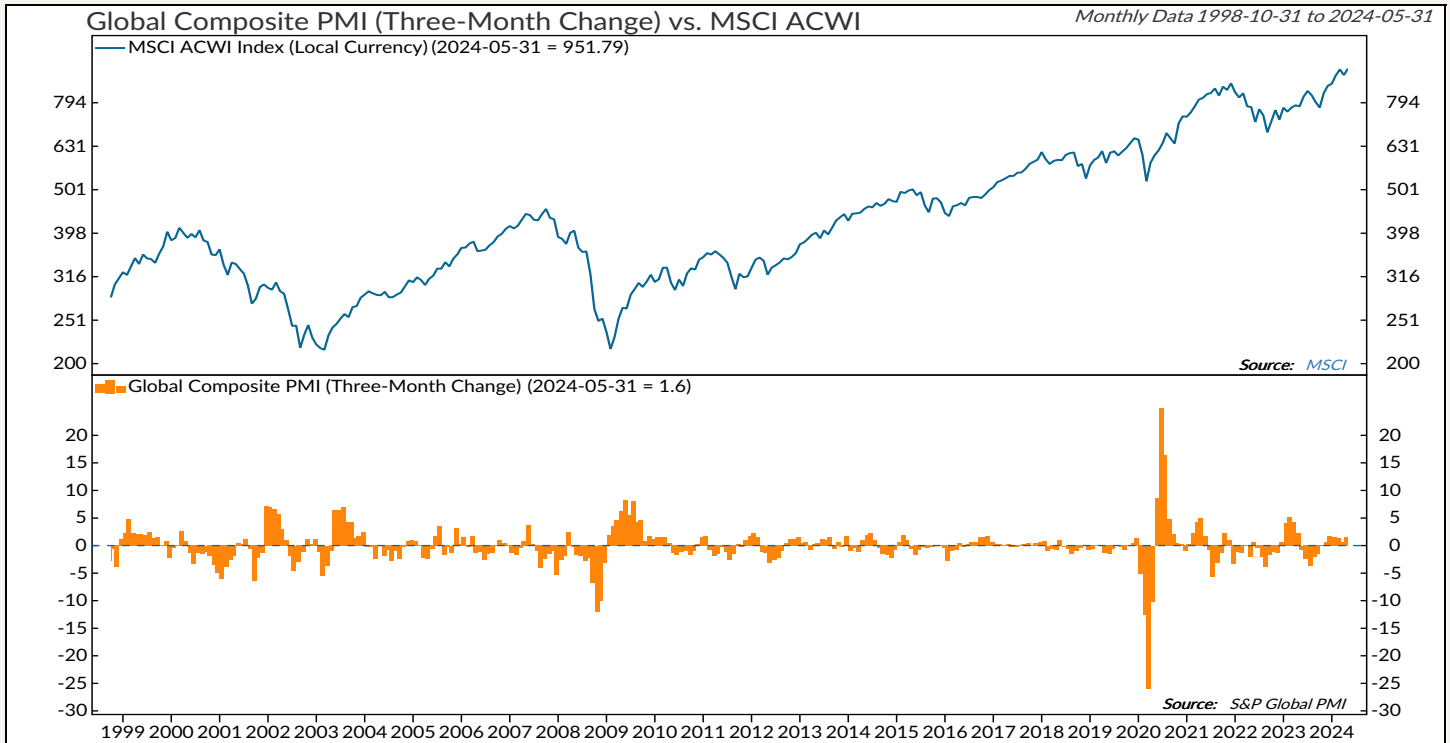
International economy: Still running strong

In May, the global economy maintained its robust pace, with the composite PMI (services and manufacturing) surging by 1.3 points to 53.7, reaching its highest level in a year. This acceleration in economic momentum historically correlates with strong performance in equity markets (chart below). The positive trend in the composite PMI is supported by various global macroeconomic indicators, such as the Global Recession Probability Model, which recorded its lowest level since late 2021 in June.

Global employment expanded at its fastest rate in ten months, while new orders reached their highest level in a year, signaling an optimistic near-term outlook. Businesses anticipate robust future output, reflecting increased optimism in the expectation index. Both the manufacturing and services sectors demonstrated stronger expansion, with most of the world's largest economies experiencing growth at the composite level, notably India and the Middle East. However, global prices remained persistent, with both input and output price growth indexes holding above pre-pandemic levels. The global manufacturing PMI depicted continued improvement in May, rising 0.6 points to 50.9. Share of economies with manufacturing PMIs in expansion territory jumped to 65% from just under half in April. This puts our breadth measure at a point historically consistent with sustained global economic expansion and strong global equity market performance.

Accelerating growth positive for equities



MSCI ACWI Performance
Full History: 1998-10-31 to 2024-05-31

Change of PMI	% Gain/ Annum	% of Time
Above 0.0	8.20	48.12
Below 0.0	1.83	51.88
Buy/Hold = 4.85% Gain/Annum		

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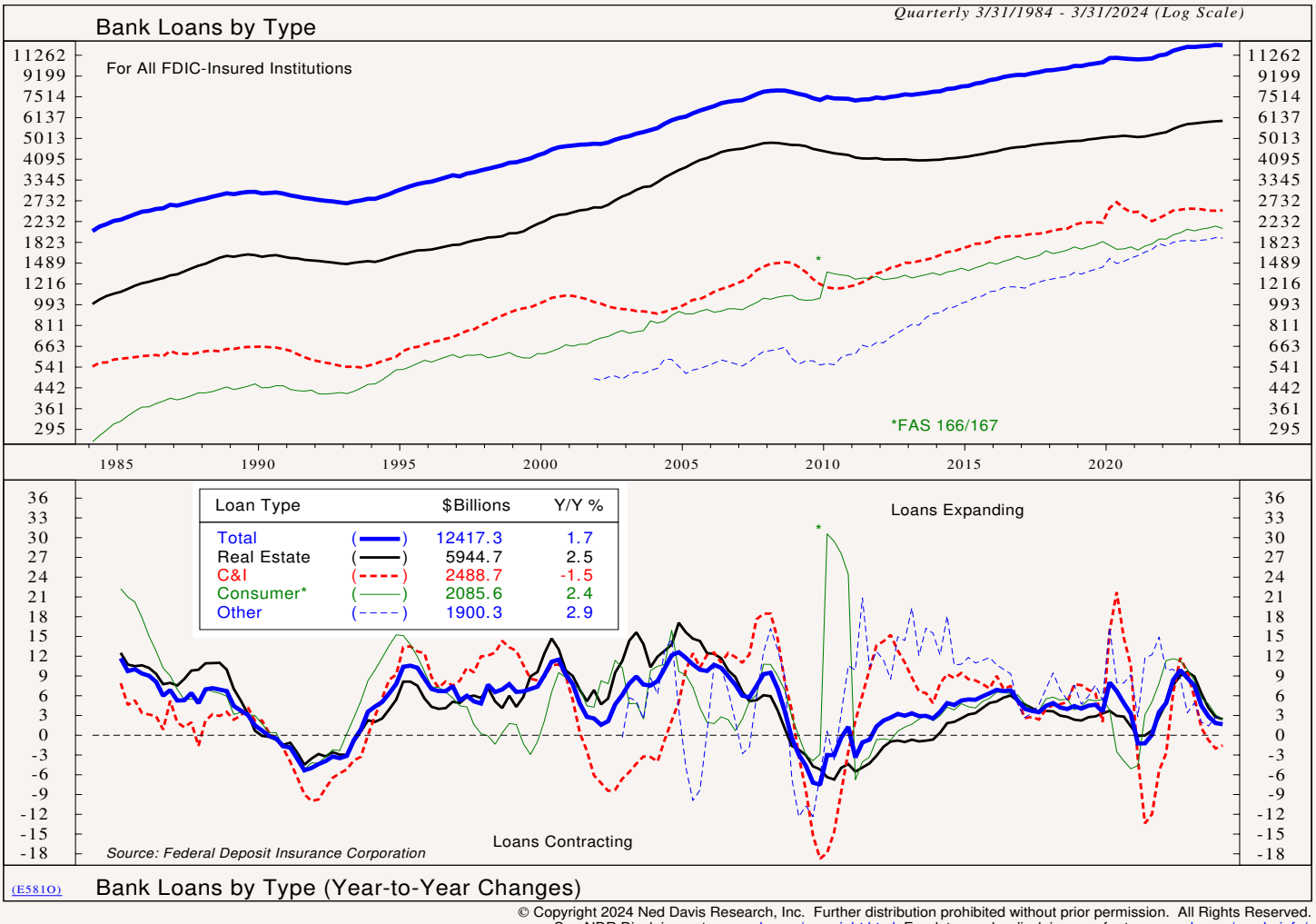
Fixed income: Policy is restrictive

As we march further into election season, there's increasing speculation that a Trump 2.0 could unsettle bond investors by weakening the U.S. Dollar, replacing Chairman Jerome Powell at the Fed, imposing more tariffs, and other potential policy moves. However, obstacles like uncertain congressional control and the need for Senate confirmation for key positions could hinder significant changes. Market comfort relies on potential Treasury Secretary candidates like Bessent and Paulson, but uncertainty prevails amidst these speculations.

Additionally, there's ongoing debate among policymakers and analysts about the restrictiveness of current monetary policy. New York Fed President Williams sees it as sufficient to reach a 2% inflation target, while Dallas Fed President Logan suggests high interest rates may not be curbing economic activity as much as expected. Minneapolis Fed President Kashkari warns of a possible rate hike, while Governor Bowman prefers a slower balance sheet runoff. Evidence from the banking sector, including sluggish loan growth and mounting unrealized losses on securities holdings, adds weight to the perception of policy restrictiveness (chart below). Consumer delinquency rates, particularly in credit cards, have risen, albeit at a slower pace, indicating potential strains on credit portfolios.

Sluggish loan growth



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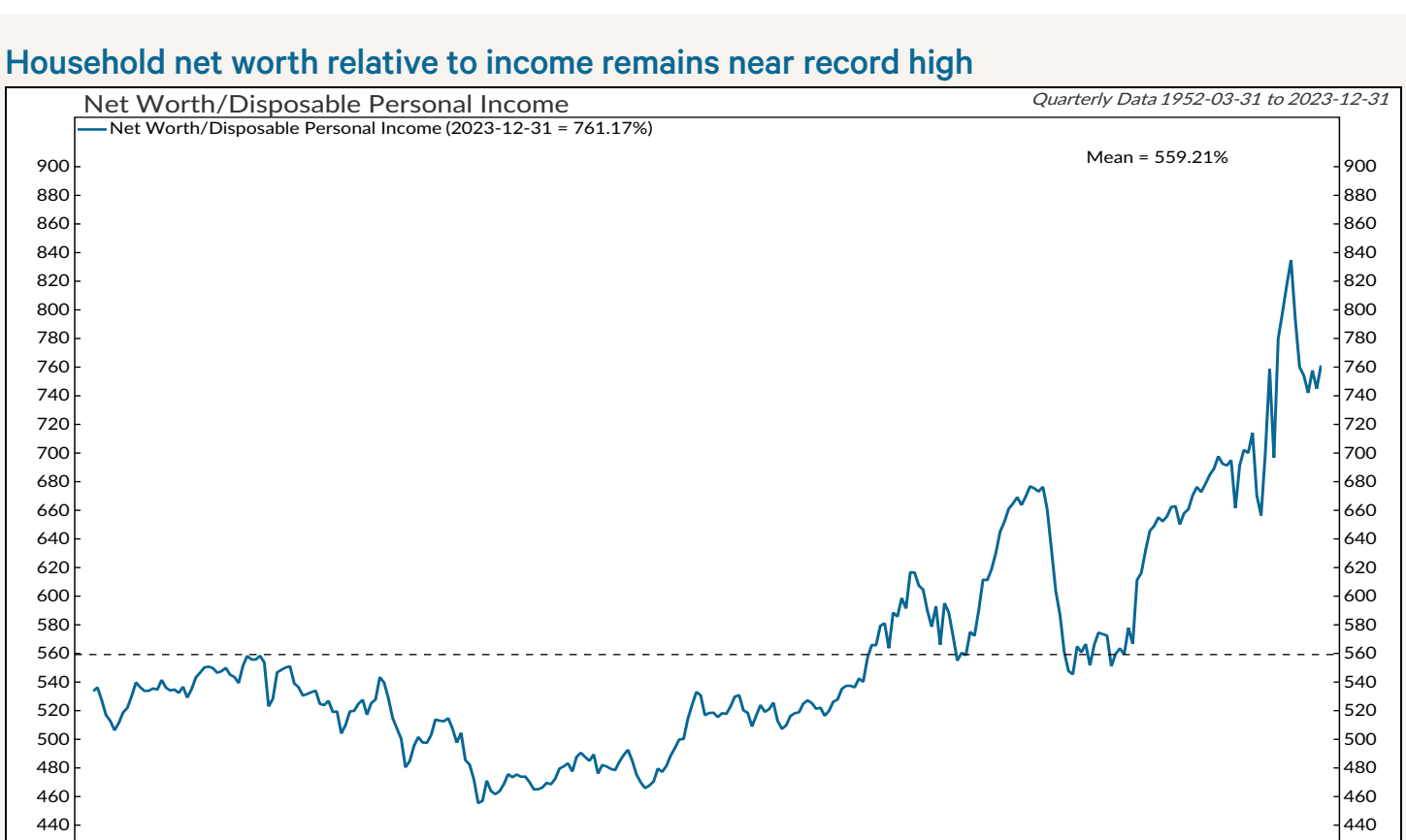
A critical check on consumer sentiment

- The “wealth effect” for consumers is evidenced by the significant increase in consumer wealth, driven primarily by rising stock and real estate values. The value of stocks and household real estate have substantially contributed to the surge in net worth, which stands at a remarkable 7.6 times disposable income (chart below).
- However, recent data show a decline in consumer sentiment, indicating a shift in consumer outlook. The University of Michigan sentiment index recorded an 8.1-point plunge in May to 69.1, while the Conference Board’s consumer confidence index rebounded slightly to 102 in May.
- Ideally, market conditions are favorable when confidence is low but trending upwards, which fosters a more sustainable economic environment.

Household net worth relative to income remains near record high



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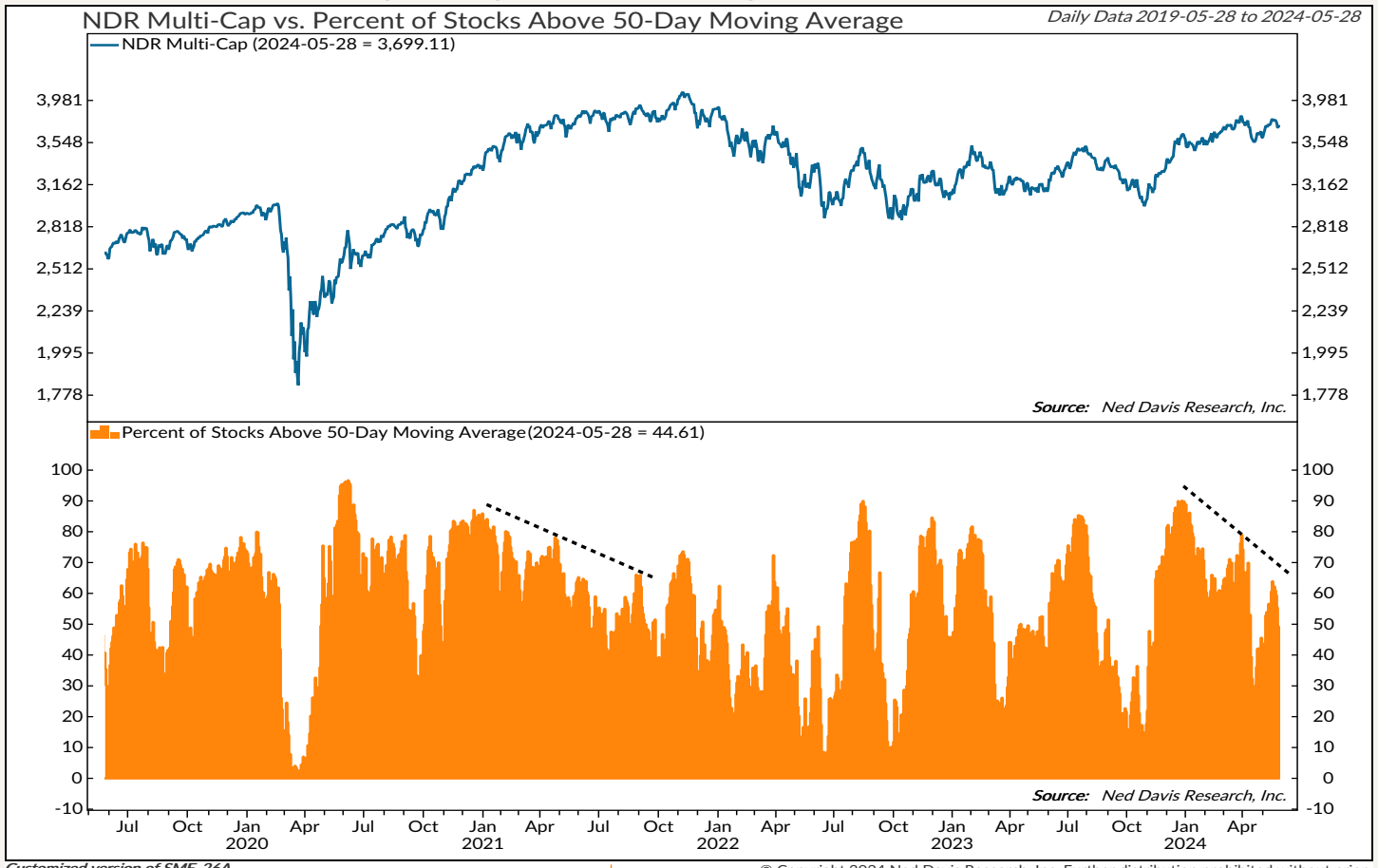
U.S. equities: Evidence is supportive for stocks

The evidence remains supportive for stocks, with earnings showing a broadening recovery into their second year despite the stickier-than-expected inflation noted by the Fed. However, it's crucial to remain vigilant for signs of market tops, often indicated by the early warning signals found in stock price movements. Market peaks usually follow a process, starting with cycle highs, followed by pullbacks and subsequent rallies that may lack broad participation, potentially leading to fewer stocks maintaining upward trends. While most divergences tend to resolve bullishly, recent record highs in major indices like the S&P 500 and Nasdaq have not been confirmed by several breadth indicators, underscoring the importance of evaluating these divergences. Perhaps the most glaring divergence stems from the percentage of stocks in the NDR Multi-Cap universe above their 50-day moving averages (chart below). While some divergences have persisted throughout the year, many have just surfaced, suggesting that if the market is approaching a peak, it's in its early stages. Insufficient evidence warrants altering an overweight recommendation on U.S. stocks currently.

We have been bullish on U.S. stocks all year, both absolutely and relative to bonds and cash. However, in April, we shifted 5% from stocks to cash due to some deterioration in our U.S. asset allocation model, retaining a 10% equity overweight. As the model rebounded in May, we recently moved 5% back into stocks (max overweight), this time taking it from bonds.

% stocks > 50-day moving average made lower highs in March & May



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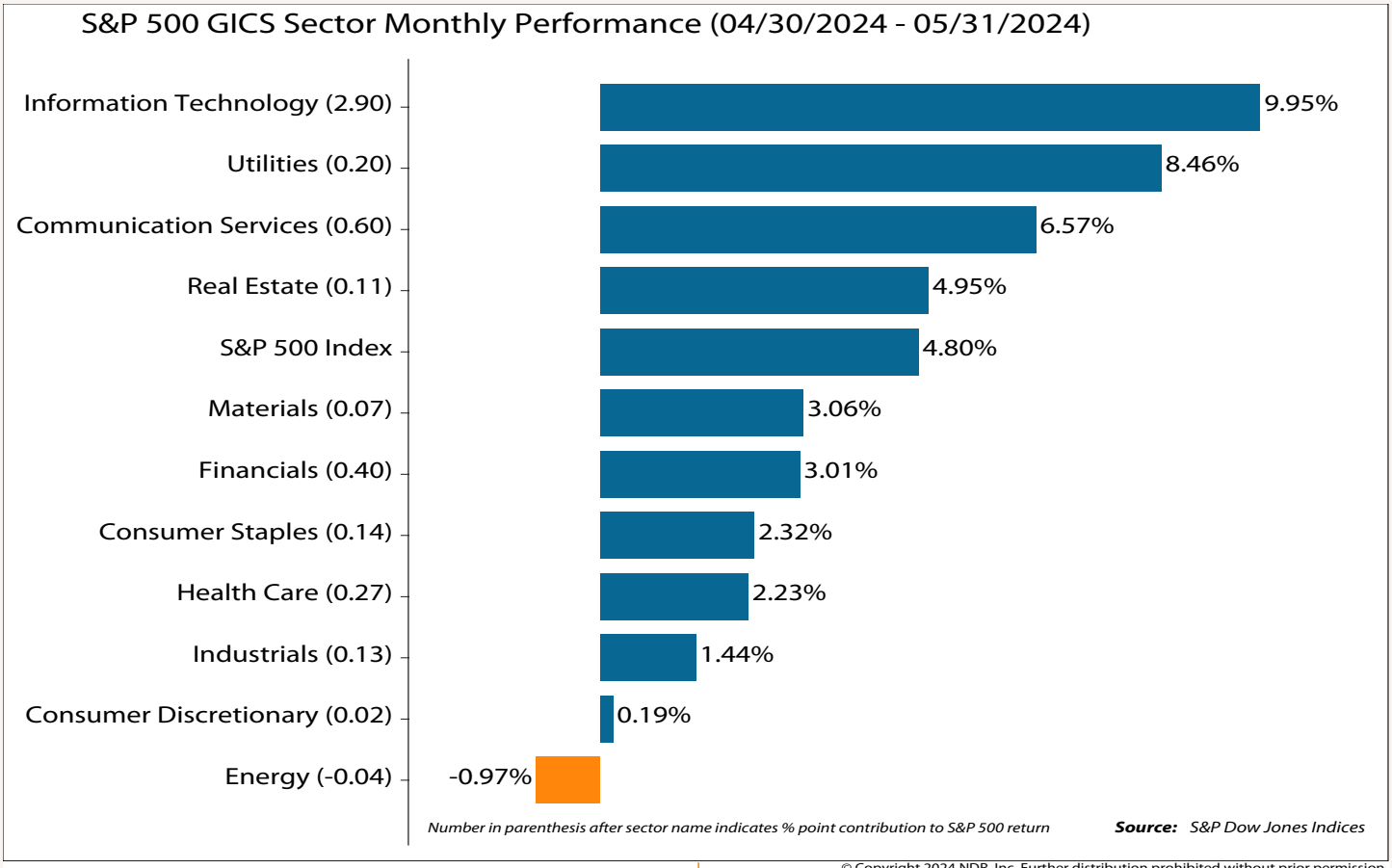
U.S. sectors: Best May for S&P 500 in 15 years

The S&P 500 saw a significant 4.8% increase in May, the highest May return since 2009, driven primarily by strong performances by the Technology and Communication Services sectors, which collectively contributed 3.5% points to the index's return. Apart from Energy, all sectors posted gains, showcasing the market's broad strength (chart below). The Magnificent 7 components, (excluding Tesla), all saw positive returns, with these seven stocks alone contributing over 60% of the index's overall return, leading to a new record concentration for the S&P 500. Notably, Technology's weight in the index surged to 30.6%, the highest level since 2000.

Utilities continued its upward momentum, gaining 8.5% in May, the second-best performance among all sectors. This sustained strength led to an upgrade to overweight status on May 9, with Utilities showcasing broad-based strength and the highest percentage of stocks trading above key moving averages. Q1 earnings results were solid, with the majority of S&P 500 companies beating consensus estimates. Beat rates were notably higher for Growth stocks compared to Value stocks.

The sector model underwent four position changes in May, with Health Care upgraded to overweight, Utilities downgraded to marketweight, and Communication Services and Real Estate downgraded to underweight. The model remains neutral on cyclical versus defensive sectors and favors Value over Growth.

All sectors but Energy were up in May



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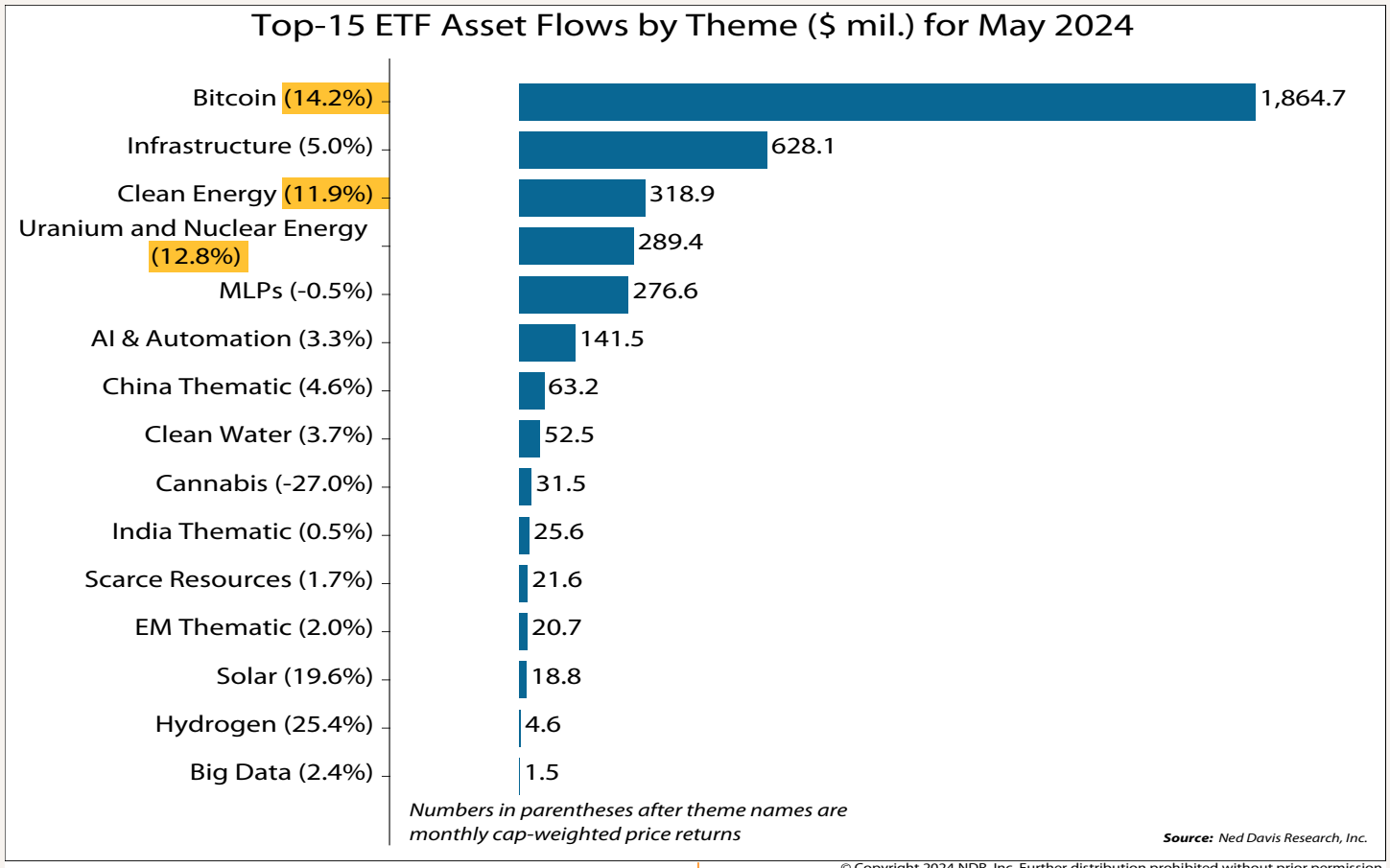
Themes: Physical over Digital

Thematic breadth narrowed for the third straight month with only 16 of 48 (33%) themes outperforming a strong S&P 500 (+4.8%) return in May. Nine of the 16 outperformers were in our Global Shock category..

- Global Shock (+7.7%) saw nine of 15 themes (60%) outperform in May, its third consecutive month with more than 50% of themes outperforming. Clean Energy momentum continued led by Hydrogen (+25.4%), Solar (+19.7%), and Wind (+14.0%). Uranium (+12.8%) was the next-best performer in May and we re-upgraded Uranium & Uranium Production on May 22. A look at the trend in average scorecard ranks shows the momentum is clearly with this category.
- Technology (+2.0%) saw only three of 17 themes (18%) outperform in May—Blockchain, 5G & IOT, and Data Centers. Weak Technology breadth continued in May despite strong performance from Tech Titans (+7.0%). While Semiconductors (+12.3%) was one of the top-performing sub-industries in May, Application Software (-8.3%) was one of the worst. A broader Physical over Digital theme is showing no signs of slowing.
- Demographics (-3.9%) saw only four of 16 themes (38%) outperform in March—Bitcoin, Petcare, Video Games, and Genomics. Bitcoin (BTC) was a bright spot. The crypto rebounded 11.5% in May after a rough April (-14.3%). Importantly, BTC moved back above $61,000, a level we deem critical support, and it did it emphatically with a $1.9 billion in-flow into Bitcoin ETFs (chart below).

Clean Energy and Bitcoin rebounded in May



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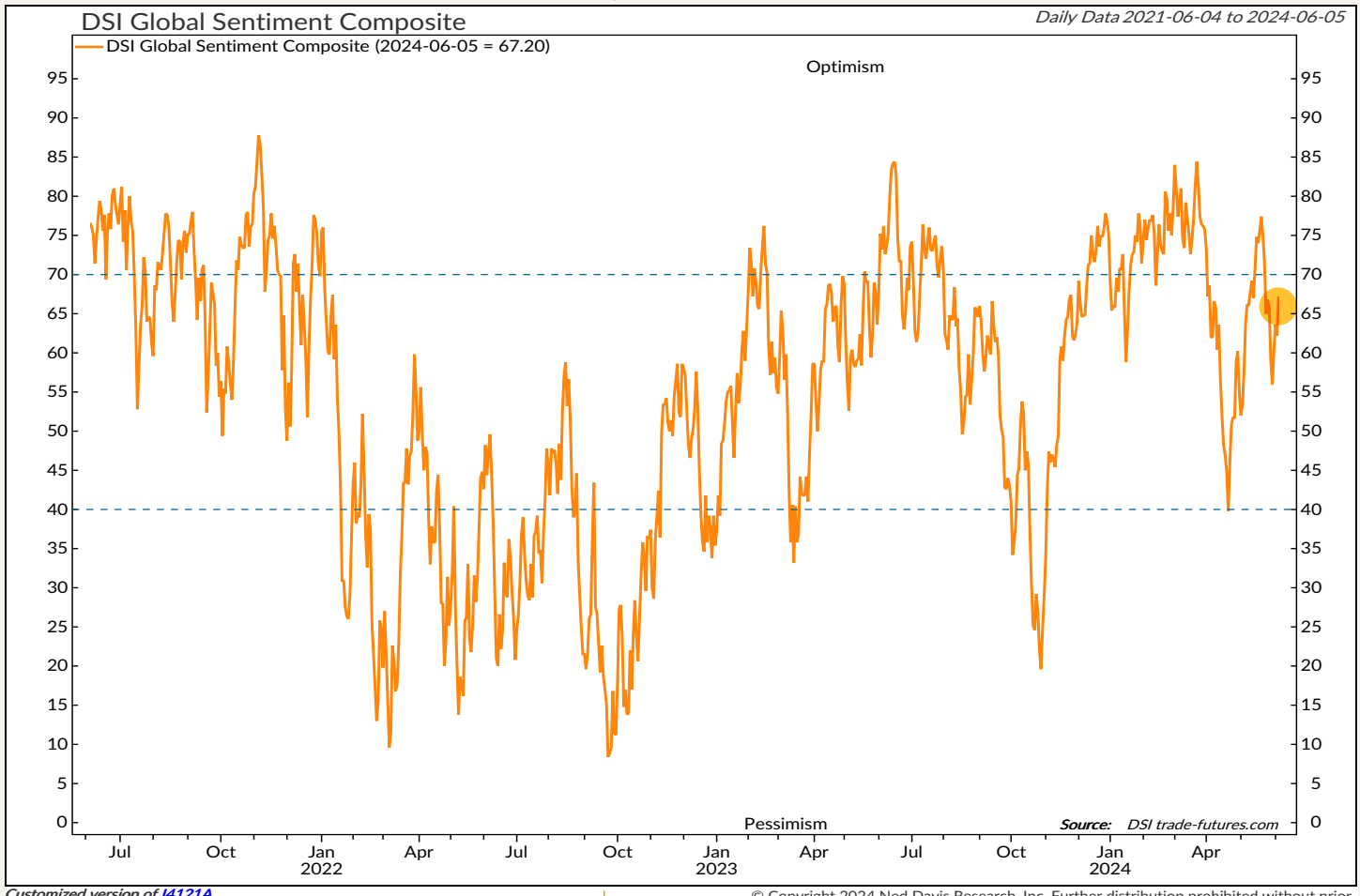
Global equities: All eyes on optimism

After a healthy correction alleviated excessive optimism, the market saw a return to optimism, with the DSI Global Sentiment Composite reaching levels last seen in March (chart below). Unlike March, the current optimism isn't a cause for concern; initial high optimism often signals renewed investor demand rather than complacency. This contrasts with periods when all positive news has been priced in, leaving the market vulnerable to unexpected negatives, like the bond yield upturn in March-April and Fed policy worries. Selling based on initial excessive optimism is usually not advisable, as historical data shows that the market tends to rise during such periods. Market weakness is typically expected when sentiment shifts from high optimism to neutral, as observed in April. Additionally, a new buy signal from the slower and broader sentiment indicator in the Global Balanced Account Model suggests a positive trend.

Market conditions are being monitored by the Stock/Bond Composite, which has recently reached a level last seen 21 months ago, and is used in the Global Balanced Account Model. Historical trends show that a bullish market tends to follow higher highs and higher lows, while a bearish market exhibits lower highs and lower lows. With buy signals generated by sentiment and earnings estimate revisions, allocations are expected to align closely with our recommended weightings. Monitoring for warning signs like deteriorating breadth will continue to be crucial.

Global Sentiment Composite indicates high optimism



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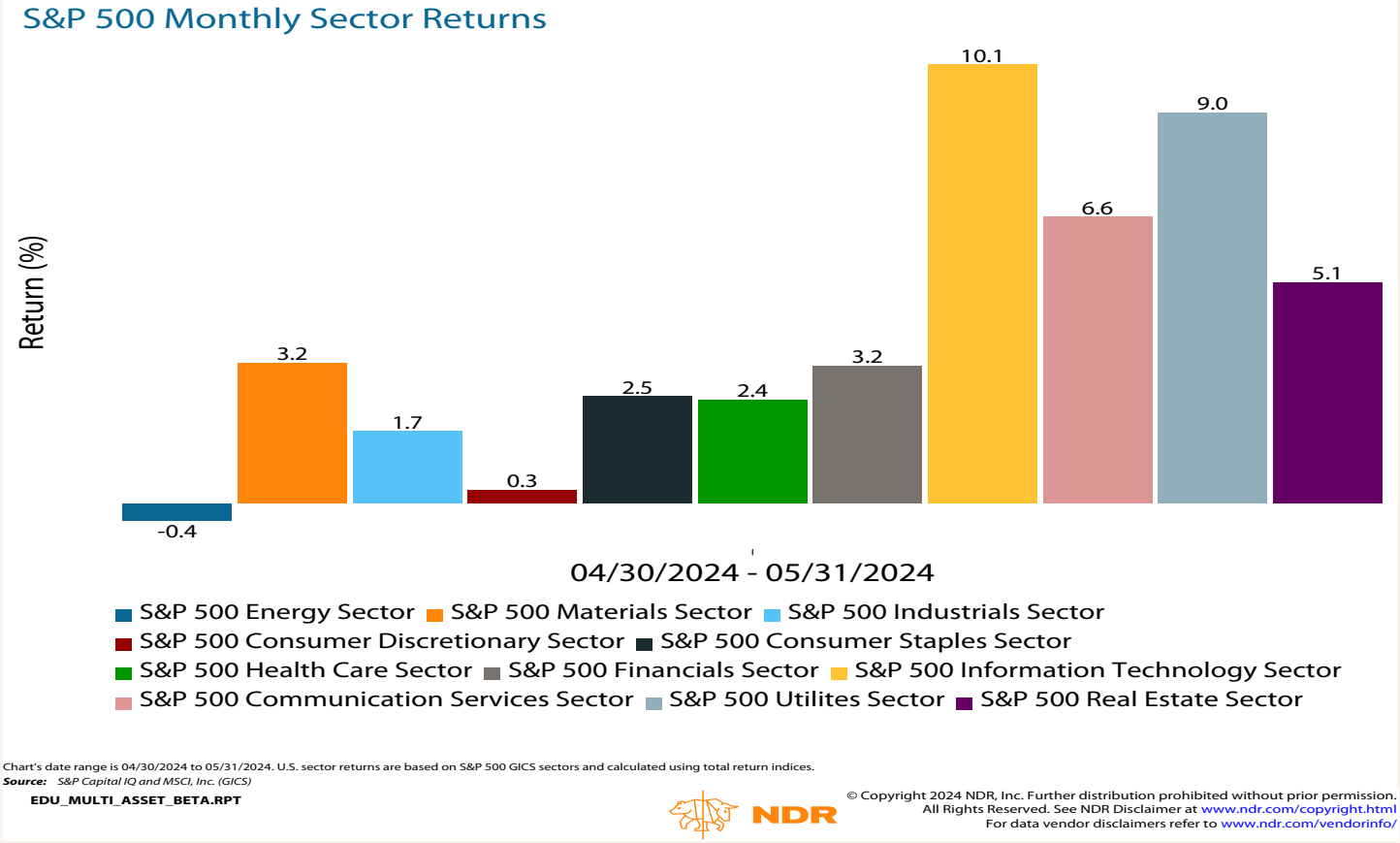
May Returns



Chart's date range is 04/30/2024 to 05/31/2024. U.S. sector returns are based on S&P 500 GICS sectors and calculated using total return indices.
Source: *S&P Capital IQ and MSCI, Inc. (GICS)*
EDU_MULTI_ASSET_BETA.RPT

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Asset Class Benchmark Returns

2024 Q1	2024 March	2024 April	2024 May	Year-to-Date	Rolling 1-Year Through 04/30/2024
S&P 500 TR 10.56	Gold 8.35	Gold 3.40	NASDAQ 6.88	Gold 12.71	NASDAQ 29.37
S&P 500 10.16	S&P GSCI 4.40	Dollar 1.71	S&P 500 TR 4.96	EAFE 11.67	S&P 500 TR 28.19
EAFE 9.96	EAFE 4.00	EM 1.40	S&P 500 4.80	NASDAQ 11.48	S&P 500 26.26
NASDAQ 9.11	S&P 500 TR 3.22	S&P GSCI 0.63	T-Bonds 2.86	S&P 500 TR 11.30	EAFE 19.89
S&P GSCI 8.74	S&P 500 3.10	T-Bills 0.44	EAFE 2.46	S&P 500 10.64	Gold 18.33
Gold 7.50	EM 3.02	EAFE -0.87	DJIA 2.30	S&P GSCI 7.03	DJIA 17.56
DJIA 5.62	DJIA 2.08	Bond Agg -2.53	Bond Agg 1.70	EM 6.46	EM 14.62
EM 4.49	NASDAQ 1.79	S&P 500 TR -4.08	Gold 1.39	Dollar 3.20	S&P GSCI 8.53
Dollar 3.12	T-Bonds 1.23	S&P 500 -4.16	EM 0.48	DJIA 2.64	T-Bills 5.39
T-Bills 1.32	Bond Agg 0.92	NASDAQ -4.41	T-Bills 0.44	T-Bills 2.21	Bond Agg 1.31
Bond Agg -0.78	T-Bills 0.44	DJIA -5.00	Dollar -1.60	Bond Agg -1.64	Dollar 0.39
T-Bonds -3.26	Dollar 0.39	T-Bonds -6.09	S&P GSCI -2.20	T-Bonds -6.55	T-Bonds -7.16

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Citations

Excerpts from the following NDR publications:

"Inflation to remain sticky in 2H 2024" by Veneta Dimitrova, May 28, 2024

"Upgrading our U.S. growth outlook for 2024" by Veneta Dimitrova, May 9, 2024

"Q1 GDP revised down, led by softer consumer spending" by Veneta Dimitrova, May 30, 2024

"Plenty of evidence policy is restrictive" by Joe Kalish, June 4, 2024

"Is Trump 2.0 a risk for bond investors?" by Joe Kalish, May 30, 2024

"Eyeing breadth divergences" by Ed Clissold, May 29, 2024

"Positive resolution" by Ed Clissold, May 22, 2024

"Mega-caps propelled S&P 500 to best May in 15 years" by Rob Anderson, June 5, 2024

"Can we trust the Utilities turnaround?" by Rob Anderson, May 9, 2024

"A check on consumer sentiment" by Pat Tschosik, May 29, 2024

"Thematic update June 2024" by Pat Tschosik, June 5, 2024

"Rising optimism and the EM recovery" by Tim Hayes, May 23, 2024

"More bullish evidence and the Growth/Value message" by Tim Hayes, May 30, 2024

"Global economy unstoppable" by Alejandra Grindal, June 5, 2024

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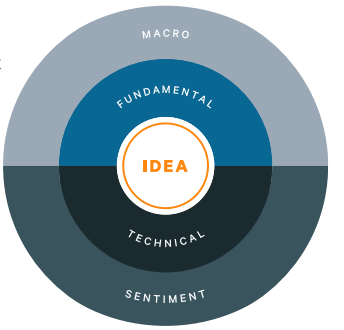

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