The Weekly Market Update – 7/29/24: Second Quarter GDP Beats Estimates

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	5,459.10	-0.83%	-0.03%	14.45%	22.67%	5,667.20	3.8%
Dow Jones Industrial Average	40,589.34	0.75%	3.76%	7.69%	17.97%	41,198.08	1.5%
NASDAQ Composite	17,357.88	-2.08%	-2.11%	15.63%	25.89%	18,647.45	7.4%
Russell 2000	2,260.07	3.47%	10.37%	11.49%	19.66%	2,442.74	8.1%
MSCI EAFE (USD)	2,337.59	-0.97%	0.99%	4.54%	9.66%	2,418.31	3.5%
MSCI Emerging Markets (USD)	1,072.28	-1.59%	-1.29%	4.74%	8.37%	1,444.93	34.8%
Bloomberg Commodity Index	95.96	-1.56%	-4.98%	-2.72%	-5.44%	237.95	148.0%
Barclays U.S. Aggregate Bond	91.14	0.22%	1.32%	-0.61%	1.51%	112.07	23.0%

Source: FactSet

U.S. economic growth surged above estimates in the second quarter (2Q24) but is likely to slow in the second half. The Bureau of Economic Analysis (BEA) reported 2Q24 U.S. real (inflation-adjusted) gross domestic product (GDP) growth of +2.8% annualized, exceeding the +1.9% FactSet consensus estimate. We recently discussed potential for an upside surprise in the GDP report as the Federal Reserve Bank of Atlanta's real-time GDPNow model showed +2.7% growth. The largest GDP component, consumer spending, increased +2.3% annualized and accelerated from +1.5% growth in 1Q24 as solid services spending growth coupled a rebound in spending on goods, which had declined in 1Q24. Both business investment and government spending delivered growth compared to the first quarter as well. Business investment upside was driven by technology spending (that we believe supported generative AI) and transportation equipment (including trucks and buses), while government spending included stable spending growth from state and local entities, as well as a surge in federal expenditures. GDP growth also benefitted from a +0.9-point inventory adjustment, which could reverse GDP gains in future periods. The GDP contribution from consumer, business and housing, which we view as the core of the private economy, contributed 2.2% to the GDP total, matching the 1Q24 contribution. The contribution of 2.2% from the private economy was below both quarters in the second half of 2023 (3Q23 and 4Q23) and consumer spending growth was lower in 2Q24 than late 2023 as well. We believe this confirms that U.S. economic growth is slowing, but the strength for the second quarter vs. the first quarter also supports the "soft landing" (no recession) expectation that has driven investor optimism in recent months. Despite the 2Q24 positive surprise, GDP growth is likely to moderate in the second half of the year due to mixed consumer data. While retail sales in May and June beat estimates, June personal consumption expenditures were weaker than May, monthly jobs growth has moderated, and the June unemployment rate was 4.1%. This should allow the Federal Reserve Bank (Fed) to reduce interest rates this year and we are watching consumer trends closely.

We expect the Fed to again hold its interest rate target unchanged at its July meeting, but the U.S. Treasury market has prepared for eventual rate cuts. Since July 2023, the Fed's overnight bank lending fed funds interest rate target range has been 5.25% to 5.50%, a high level to address inflation pressure by keeping monetary policy restrictive. Over the past year, the Fed's preferred measure of consumer inflation, the core personal consumption expenditure price index, has moderated to +2.6% from +4.3% (June 2024 vs. June 2023) but remains above the Fed's +2% target. While the Fed waits for more data, the U.S. 2-year Treasury yield, as of 7/26/24, was 4.38%, a full 100 basis points below the midpoint of the fed funds target range. In our view, the 2-year Treasury yield can reflect expectations for future fed funds policy and suggests to us that investors see a runway for multiple Fed rate cuts in 2024 and 2025.

Earnings reports will garner headlines this week, although the Wednesday Fed meeting and Friday employment report are potential market-moving events. Through 7/26/24, 41% of S&P 500 had reported 2Q24 financial results, with Y/Y earnings growth of +8.7% matching the pre-report consensus estimates. This week, 34% of index constituents will report, including four of the "Magnificent 7" companies. Friday's labor report is expected to show that nonfarm payrolls (jobs) increased by +177 thousand in July.

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Market Indices: The information on indices is presented for illustrative purposes only and is not intended to imply the potential performance of any fund or investment. Indices provide a general source of information on how various market segments and types of investments have performed in the past. Index performance assumes the reinvestment of all distributions, but does not assume any transaction costs, taxes, management fees, or other expenses. You may not invest directly in an index. Past performance is not an indicator of future results. The Russell 2000® Index is a market cap weighted index that measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The S&P 400 Index is a market cap weighted index comprised of U.S. stocks in the middle capitalization range, generally considered to be between $200 million and $5 billion in market value. The S&P 500 Index is a market cap weighted index that is designed to measure the US large-cap equity performance. The index is composed of the 500 leading publicly traded US companies based on size, liquidity, industry, and profitability criteria. The Dow Jones Industrial Average is a price weighted index that tracks 30 large, publicly-owned companies trading on the New York Stock Exchange (NYSE) and the NASDAQ. The MSCI EAFE® Index (Europe, Austral, Asia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US and Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. The S&P 500 Equal Weight Index is compiled by S&P Dow Jones. It is an equal-weight version of the widely used S&P 500. The index includes the same constituents as the capitalization-weighted S&P 500, but each company is allocated a fixed weight, or 0.2%, of the index total at each quarterly rebalance.

The Global Industry Classification Standard (GICS) is a four-tiered, hierarchical industry classification system. Companies are classified quantitatively and qualitatively. Each company is assigned a single GICS classification at the Sub-Industry level according to its principal business activity. MSCI and S&P Dow Jones Indices use revenues as a key factor in determining a firm's principal business activity. The 11 sectors are: Communication Services, Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Real Estate, and Utilities.

U.S. economic growth: Gross domestic product (GDP) refers to the monetary measure of the market value of all final goods and services produced within a country's borders within a specific time period. Real GDP is adjusted for the impact of inflation. The most recent GDP report can be found at www.bea.gov. It is reported by the U.S. Bureau of Economic Analysis (BEA). Personal consumption expenditures (PCE) measure consumer spending on goods and services during the period, and is a component of GDP.

Earnings growth. We refer to the weighted average (based upon equity market capitalization) of the earnings per shares (EPS) of all S&P 500 companies compared to the prior period (generally year-over-year). We use data as reported in FactSet.

FactSet is a data aggregation software utilized by D.A. Davidson's Wealth Management Research. The FactSet consensus refers to the aggregate of all analysts' estimates from firms that submit estimates to FactSet for a given financial metric.

The Federal Reserve Bank's Open Market Committee (FOMC) consists of twelve members – the seven members of the Board of Governors of the Federal Reserve System, the president of the Federal Reserve Bank of New York, and four of the remaining eleven Federal Reserve Bank presidents, who serve one-year terms on a rotating basis. The FOMC holds eight regularly scheduled meetings per year. At these meetings, the Committee reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth. The minutes from the most recent FOMC meeting is here.

The term "monetary policy" refers to the actions undertaken by a central bank, such as the Federal Reserve, to influence the availability and cost of money and credit to help promote national economic goals. The Board of Governors of the Federal Reserve System is responsible for the discount rate and reserve requirements, and the Federal Open Market Committee is responsible for open market operations. The Federal Reserve influences the demand for, and supply of, balances that depository institutions hold at Federal Reserve Banks and, in this way, alters the federal funds rate. The federal funds rate is the interest rate at which depository institutions lend balances at the Federal Reserve to other depository institutions overnight.

The U.S. Personal Consumption Expenditures (PCE) Price Index is an indicator of the growth in consumer spending and measures the value of goods and services purchased by persons who reside in the U.S. It is reported monthly by the Bureau of Economic Analysis.

PCE inflation is the percentage rates of change in the price index for personal consumption expenditures (PCE).The Treasury yield curve displays the market interest rate across different contract lengths for U.S. Treasury securities, indicating the relationship between the interest rate and the time ("term") to maturity. The yields of the 2-year and 10-year U.S. Treasury notes are widely followed barometers of the current U.S. interest rate environment. Treasury security data used in calculating interest rate spreads is obtained directly from the U.S. Treasury Department, through FactSet.

The National Bureau of Economic Research (NBER) is a private non-profit research organization. The NBER is widely used as an organization that analyzes U.S. economic data and the business cycle and determines the start dates and end dates of economic recessions. The NBER defines recession as "a significant decline in economic activity that is spread across the economy and that lasts more than a few months;" and also looks at the depth, diffusion, and duration of the downturn.

The Bureau of Labor Statistics (BLS) compiles U.S. labor statistics from two monthly surveys. The household survey measures labor force status by demographics, while the establishment survey measures nonfarm employment and data by industry. The nonfarm payrolls component of the establishment survey is drawn from private businesses and government entities. The nonfarm payrolls number is among the most widely used data points to assess U.S. employment trends. The unemployment rate is the percentage of the labor force that is jobless and actively willing and available to work.

Generative Artificial Intelligence (GenAI): We think of artificial intelligence as using advanced computers to process large amounts of data to ultimately approach human problem solving and decision making. Early versions were often called “machine learning” and could sift through large data sets and accurately predict single outcomes. Now, generative AI goes further to utilize all forms of inputs. While still predictive models, generative AI can give detailed responses, much better than a search engine, which does a good job of telling the user where to go to find additional information. As generative AI systems access more data, they become larger and learn to make better decisions. At each iteration, the system gains knowledge, enhancing its predictive (reliable) capabilities and ability to produce original content. Generative AI systems become more robust as they are used as all new data can be trained into the system, creating new cha5llenges and opportunities.

The term Magnificent 7 has been used by investors to describe a group of high-performing, technology-centric growth stocks that, through most of 2023, were the highest valued companies by equity market capitalization in the S&P 500 index. The seven stocks are Microsoft (MSFT), Apple (AAPL), Alphabet (GOOG & GOOGL), Nvidia (NVDA), Amazon (AMZN), Meta (META), and Tesla (TSLA). According to the Wall Street Journal, the term “Magnificent 7” was first used by investment strategist Michael Hartnett.

Personal Income and Outlays is reported monthly by the BEA. Personal income is the income received by, or on behalf of, all persons from all sources: from participation as laborers in production, from owning a home or business, from the ownership of financial assets, and from government and business in the form of transfers.

We define a “soft landing” economy as U.S GDP growth that trends below the average growth of 2.3% from 2014 to 2019. This could be as low as 1.0% annually but would stay positive and not fall into a recession.

The Federal Reserve Bank of Atlanta updates a current quarter GDPNow estimate. This gives a running estimate of GDP in the current quarter as data is reported, so updates frequently. It is not an official forecast, and is viewed as a running estimate of real(net of inflation) GDP growth.