Quarterly Insights:

JULY 2024

By Matthew Gaude & Shawn McGuire

Expected Rate Cuts, AI Enthusiasm, and Falling Inflation Push the S&P 500 to New All-Time Highs

The S&P 500 experienced its first real dose of volatility early in the second quarter, but expectations for interest rate cuts by the Federal Reserve, solid economic growth, and continued strong financial performance from artificial intelligence-related tech companies ultimately pushed the S&P 500 to new all-time highs and the index finished the quarter with strong gains.

While the S&P 500 hit new highs in the second quarter, the month of April was decidedly negative for markets as fears of no rate cuts in 2024 (or even a rate hike) pressured stocks. The catalyst for these concerns was the March Consumer Price Index (CPI), which rose 3.5% year over year, higher than inflation estimates. That hotter-than-expected reading reversed several months of declines in inflation and ignited fears that inflation could be "sticky" and, if so, delay expected Fed rate cuts. Those higher rate concerns were then compounded by comments by New York Fed President John Williams, who stated rate hikes (which investors assumed were over) were possible if inflation showed signs of re-accelerating. The practical impact of the higher-than-expected inflation report and Williams' commentary was to push rate cut expectations out from June to September, which caused the 10-year Treasury yield to rise sharply, from 4.20% at the start of the quarter to a high of 4.72%. Those higher yields pressured the S&P 500 in April, which fell 4.08% and completed its worst month since September.

On the first day of May, however, the Fed largely dispelled concerns about potential rate hikes and ignited a rebound that ultimately carried the S&P 500 to new highs. At the May 1st FOMC decision, Fed Chair Powell essentially shut the proverbial door on the possibility of rate hikes, stating that if the Fed was concerned about inflation, it would likely just keep interest rates at current levels for a longer period instead of raising them. That comment provided immediate relief for investors and both stocks and bonds rallied early in May as rate hike fears subsided. Then, later in the month, the April Consumer Price Index report (released in mid-May) rose 3.4% year over year, slightly lower than the 3.5% in March, and that resumption of disinflation (the decline in inflation) further increased expectations for rate cuts in 2024. Additionally, employment data moderated in May, with the April jobs report coming in below expectations (but still at healthy levels). The practical result of the resumption of disinflation, the supportive Fed commentary, and moderating labor market data was to increase September rate cut expectations, push the 10-year Treasury yield back down below 4.50% and spark a 4.96% rally in the S&P 500 in May.

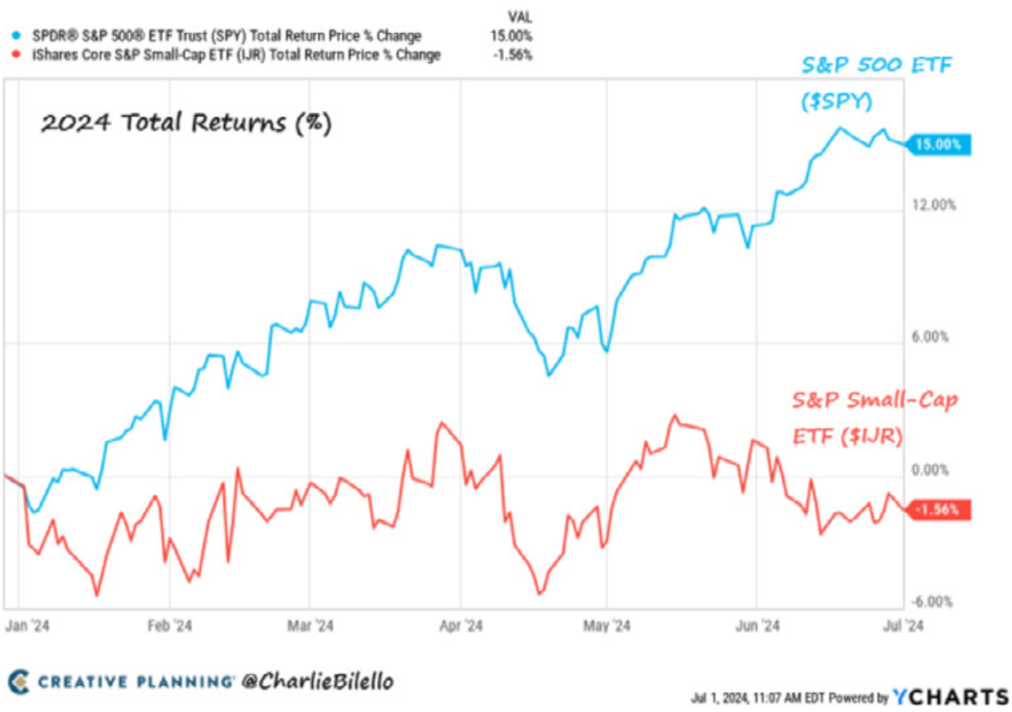
The upward momentum continued in June thanks to more positive news on inflation, additional reassuring commentary from the Fed, and strong AI-linked tech earnings. First, the May CPI (released in mid-June) declined to 3.3% year over year, the lowest level since February. Core CPI, which excludes food and energy prices, dropped to the lowest level since April 2021, further confirming ongoing disinflation. Then, at the June Federal Reserve meeting, Fed Chair Powell reassured investors two rate cuts are entirely possible in 2024, reinforcing market expectations for a September rate cut. Economic data, meanwhile, showed continued moderation of activity, and that slowing growth and falling inflation helped to push the 10-year Treasury yield close to 4.20%, a multi-month low. Finally, investor excitement for AI remained extreme in June, as strong AI-driven earnings from Oracle (ORCL) and Broadcom (AVGO) along with the news that Apple (AAPL) was integrating AI technology into future iPhones pushed tech stocks higher. That, combined with falling Treasury yields and rising rate cut expectations, sent the S&P 500 to new all-time highs above 5,500.

In sum, markets impressively rebounded from April declines and the S&P 500 hit a new high thanks to increased rate cut expectations, falling Treasury yields, and continued robust earnings growth from AI-linked tech companies.

Second Quarter Performance Review: A Tale of Two Markets

The second quarter produced a more mixed performance across various markets than the strong return in the S&P 500 might imply, as AI-driven tech-stock enthusiasm again powered the Nasdaq and S&P 500 higher while other major indices lagged. The S&P 500 made 34 new highs as of July 8, 2024. The Nasdaq was, by far, the best performing major index in the second quarter while the S&P 500, where tech is the largest sector weighting, also logged a solidly positive gain. Less tech-focused indices didn't fare as well, however, as the Dow Jones Industrial Average and small-cap focused Russell 2000 posted negative quarterly returns.

A rising stock market has not lifted the performance of all sectors. Small-cap stocks are down 2% on the year while the S&P 500 is up 15%. This is the biggest outperformance of large caps over small caps since 1998.



By market capitalization, large caps outperformed small caps in Q2, as they did in the first quarter of 2024. Initially, higher Treasury yields in April weighed on small caps, while late in the second quarter economic growth concerns pressured the Russell 2000. Big Tech keeps driving returns. Amazon, Apple, Meta, Microsoft, and Nvidia were responsible for 46% of the returns of the S&P 500 index. 25% of the returns came from Nvidia alone.

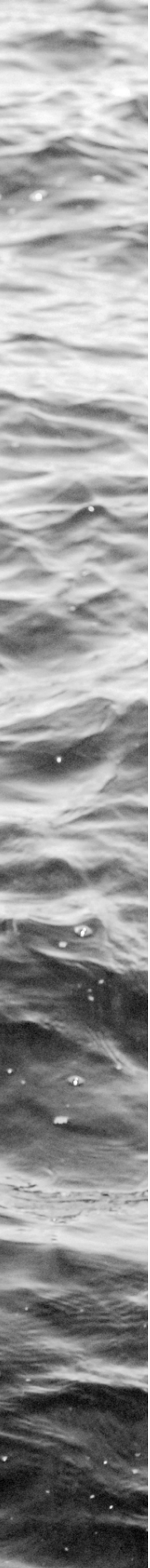
Stock Index Performance

Index	Week	YTD	12-mo.	2023	5-yr.
Dow Jones Industrial Avg. (39,119)	-0.08%	4.79%	16.02%	16.18%	10.31%
S&P 500 (5,460)	-0.06%	15.29%	24.54%	26.26%	15.01%
NASDAQ 100 (19,683)	-0.07%	17.47%	30.77%	55.13%	21.74%
S&P 500 Growth	0.17%	23.56%	32.51%	30.02%	16.84%
S&P 500 Value	-0.36%	5.79%	15.27%	22.19%	11.85%
S&P MidCap 400 Growth	-0.30%	11.69%	18.81%	17.44%	10.45%
S&P MidCap 400 Value	0.32%	0.42%	8.13%	15.35%	9.48%
S&P SmallCap 600 Growth	1.34%	3.28%	12.91%	16.93%	8.26%
S&P SmallCap 600 Value	1.07%	-4.73%	4.17%	14.84%	7.35%
Russell 2000	1.33%	1.73%	10.03%	16.88%	6.90%
MSCI EAFE	0.36%	5.34%	11.54%	18.24%	6.46%
MSCI World (ex US)	0.38%	5.69%	11.62%	15.62%	5.54%
MSCI World	0.14%	11.75%	20.19%	23.79%	11.76%
MSCI Emerging Markets	0.06%	7.49%	12.55%	9.83%	3.09%
S&P GSCI	-0.01%	11.08%	15.01%	-4.27%	8.27%

Source: Bloomberg. Returns are total returns. *5-yr. return is an average annual.* One-week, YTD, 12-mo. and 5-yr. performance returns calculated through 6/28/24. An index cannot be purchased directly by investors. Past performance is no guarantee of future results.

From an investment style standpoint, growth massively outperformed value in the second quarter, as tech-heavy growth funds once again benefited from continued AI enthusiasm. Value funds, which have larger weightings toward financials and industrials, posted a slightly negative quarterly return as the performance of non-tech sectors more reflected growing concerns about economic growth.

Also underperforming were Value stocks, International stocks, and Regional Bank stocks. Within the fixed-income space, long duration underperformed cash equivalents as interest rates have moved higher on the year. Within the currency markets, the U.S. dollar remains king while the Japanese Yen has plummeted. The following chart shows the best performing market or sector compared to the worst performing market or sector. The far right-hand column under “Spread” shows the difference in performance between the two.



A Tale of Two Markets (2024 Total Returns as of 6/30/24)		
US Large Caps ($SPY)	US Small Caps ($IJR)	Spread
15.2%	-0.8%	16.0%
US Growth ($IWF)	US Value ($IWD)	Spread
20.5%	6.5%	14.1%
US ($SPY)	International ($ACWX)	Spread
15.2%	5.6%	9.6%
Semis ($SMH)	Regional Banks ($KRE)	Spread
49.1%	-4.8%	53.9%
Short Duration ($BIL)	Long Duration ($ZROZ)	Spread
2.6%	-11.1%	13.7%
US Dollar ($UUP)	Japanese Yen ($FXY)	Spread
7.5%	-12.6%	20.1%
CREATIVE PLANNING	@CharlieBilello	

On a sector level, performance was decidedly mixed as only 4 of the 11 S&P 500 sectors finished the second quarter with positive returns. The best performing sectors in the second quarter were the AI-linked technology and communications services sectors. They posted strong returns, aided by better-than-expected earnings results from Nvidia, Oracle, Broadcom, Taiwan Semi, Microsoft, Amazon, and others as artificial intelligence enthusiasm continued to push the broad tech sector and S&P 500 higher. Utilities also logged a modestly positive quarterly return, as the high yields and resilient business models were attractive to investors given rising concerns about future economic growth, while declining Treasury yields made higher dividend sectors such as utilities more attractive to income investors.

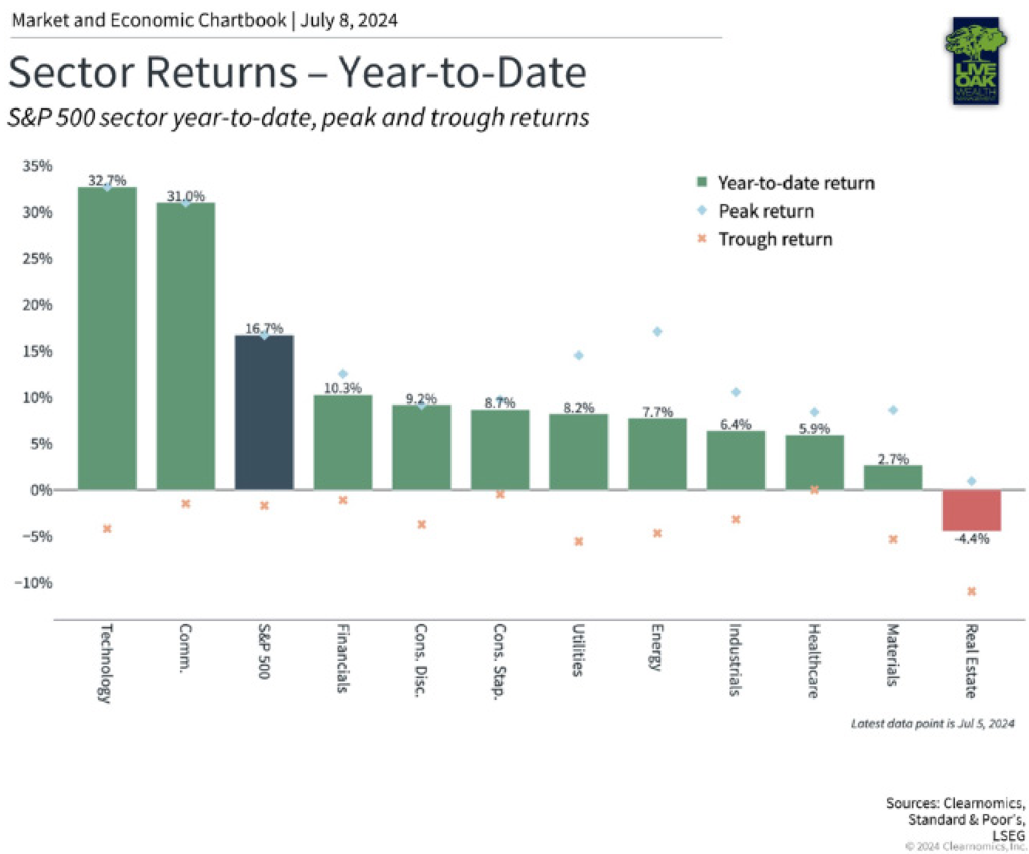
Another notable during the quarter is that we saw Nvidia become the largest company traded on the S&P 500, overtaking both Apple and Microsoft.

Stock Market News, June 18, 2024: Nvidia Powers S&P 500 to Fresh Record

Nvidia surpasses Microsoft to close as the most valuable listed U.S. company

How long will Nvidia remain the most valuable company? That largely depends on whether it can continue to grow at a rapid pace while maintaining its record profit margins. With net income of $43 billion vs. $86 billion for Microsoft and $100 billion for Apple, investors are clearly expecting significant growth in the years to come. And with profit margins of 53% vs. 36% for Microsoft and 26% for Apple, investors are also betting that Nvidia will stay far ahead of the competition.

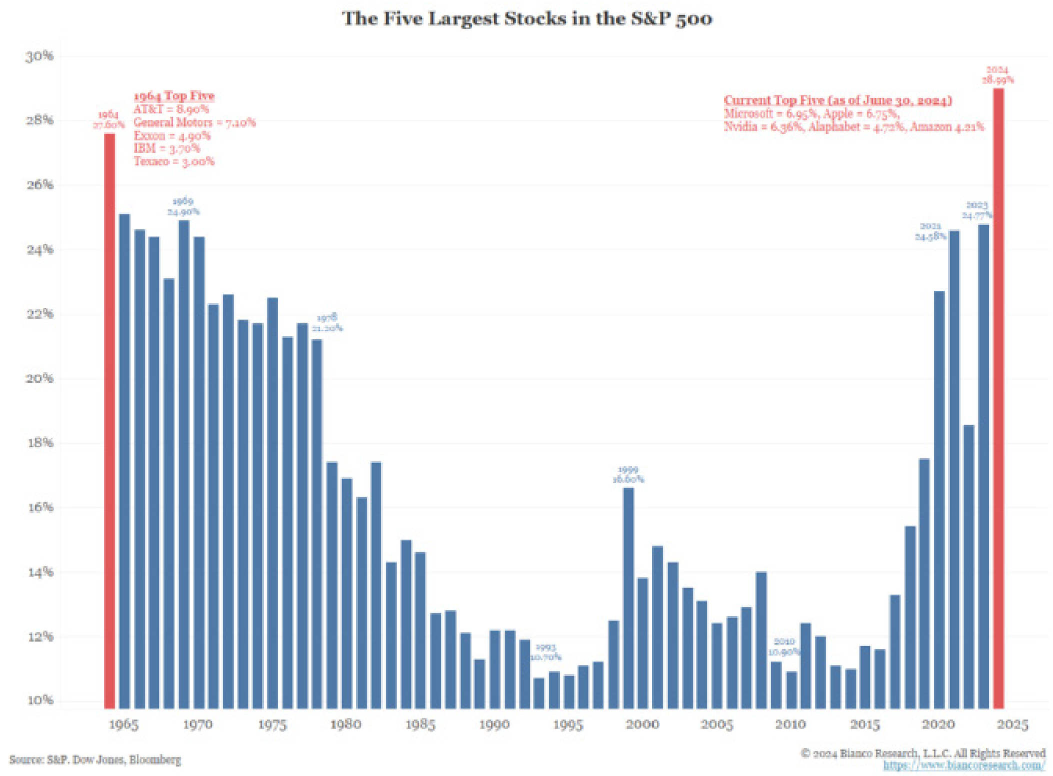
Turning to the sector laggards, the energy, materials, and industrials sectors closed the quarter with modestly negative returns. Their declines reflected growing anxiety about future economic growth as those sectors, along with small-cap stocks, are more sensitive to changes in U.S. and global growth.



While the dominance of technology isn't anything new or surprising, in past quarters it's been that technology and technology-related sectors simply rose more than other sectors, but the vast majority of S&P 500 sectors traded higher, just not as high as technology. The second quarter is different, not just because this time half the S&P 500 sectors are negative for the second quarter, but also because the other sectors that have posted positive returns are largely defensive in nature. Point being, the market in the second quarter seems to be underscoring the fact that economic growth is slowing. Consider that the four best performing sectors in Q2 are Utilities, Technology, Communication Services, and Consumer Staples. Two of those sectors are defensive in nature (Utilities and Consumer Staples) and the other two are direct artificial intelligence investments. Conversely, the quarter-to-date laggards are Energy, Materials, and Industrials. Those are the typical cyclical sectors we'd expect to underperform if, under the surface, growth concerns are bubbling up.

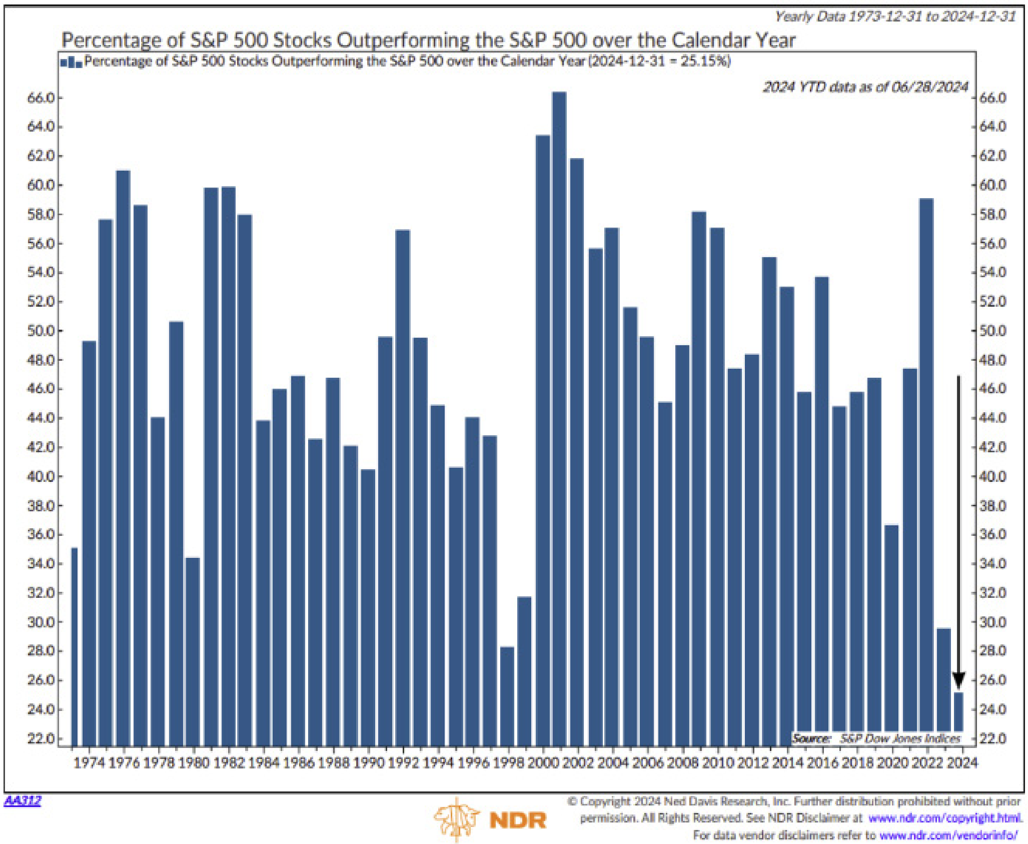
Bottom line, if we just focus on the performance of the S&P 500, the second quarter was a fantastic one for markets and many investors saw positive returns. But if we look past the S&P 500, market technicals are confirming our concerns about future growth. We are not declaring a growth collapse is imminent, but we will be focusing on growth concerns that may become a more dominant market topic in the third quarter, and the quarterly performance of most sectors further reinforces that belief.

As Microsoft, Nvidia, Apple, Google, and Amazon continue to get bigger, they now make up 28.99% of the S&P 500 Index. When you buy the S&P 500, you are buying 5 companies that make up almost 1/3 of the index.

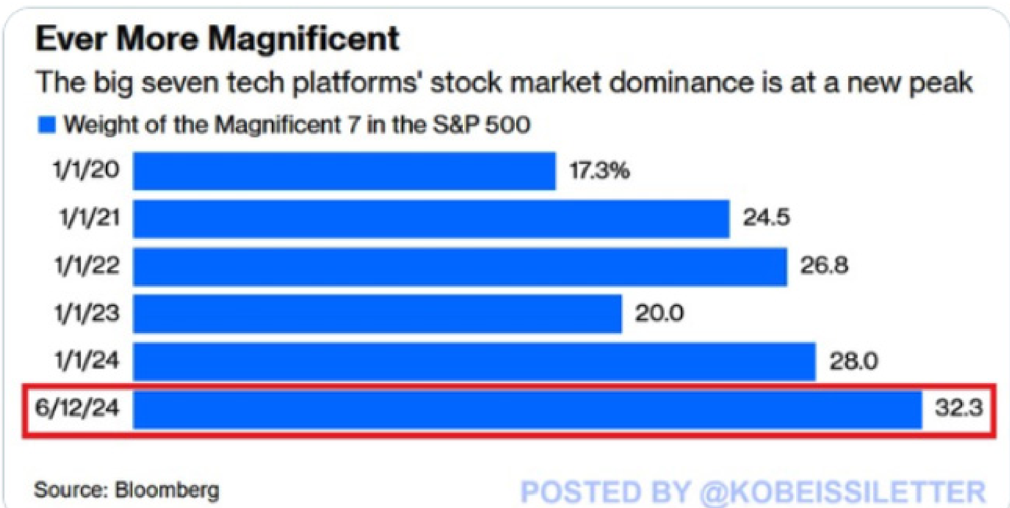


Last year, we saw that only 28% of companies in the S&P 500 beat the return of the index. As of June 28, 2024, only 24% of stocks in the S&P 500 outperformed the S&P 500 index, marking the third narrowest 6-month period in history since 1986 (was narrower in July 2023 at 23% and in Feb. 2020 at 21%). Nvidia contributed 4.6% of the S&P 500's 15.3% return, while the Magnificent 7 stocks (Apple, Amazon, Microsoft, Nvidia, Tesla, Alphabet, and Meta) contributed 9.1%. Does this present opportunity in other sectors? Possibly. We continue to favor energy and precious metals.

On pace for record low % of stocks beating S&P 500



The Magnificent 7's share of the S&P 500 just hit another all-time high of 32%. This is 12 percentage points higher than at the beginning of 2023. The weight of these 7 stocks in the index has almost DOUBLED in just over 4 years. This comes as the 3 largest stocks (Apple, Microsoft, and Nvidia) are all officially worth over $3 trillion. Meanwhile, the technology sector just hit another all-time high relative to the S&P 500. Tech is becoming even more dominant.



U.S. Stocks Continue to Outperform International and Emerging Markets

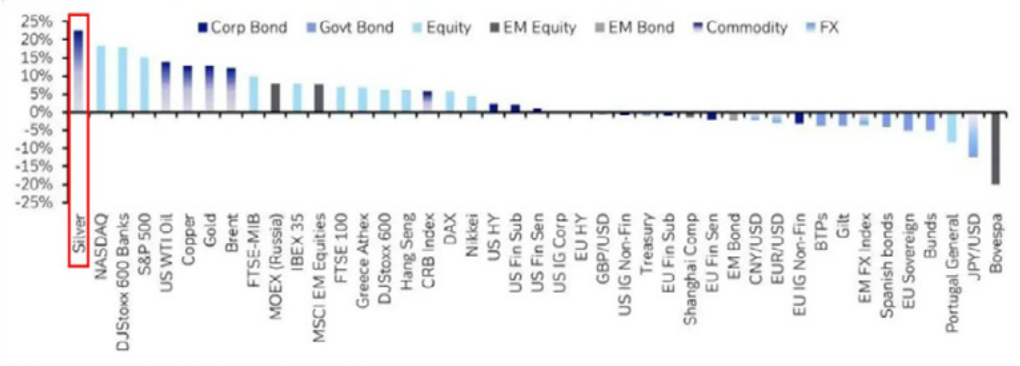
Internationally, U.S. stocks continue to dramatically outperform international and emerging markets, not only on a YTD basis, but over the last 21 years, as shown in the chart below. There really is no reason to believe this will change anytime soon, which is a reason why we have not allocated any funds to international or emerging markets investments.

Gold & Silver

Gold and silver have been standout performers in the commodities markets this year. Silver is hitting new decade highs, with gold making another new all-time high.

In addition, silver has had the best performance of any major global financial asset during the first half of 2024, as shown in the chart below.

Figure 6: Total Return Performance of Major Global Financial Assets in YTD (in USD)



Source: Deutsche Bank, Bloomberg Finance LP
Note: Equities, credit and bonds shown on total return basis, FX and commodities shown on spot return basis

Third Quarter Market Outlook

Stocks begin the third quarter of 2024 riding a wave of optimism and positive news as inflation is declining in earnest, the Fed may deliver the first rate cut in over four years this September, economic growth remains generally solid, and substantial earnings growth from AI-linked tech companies has shown no signs of slowing down.

Those positives and optimism are reflected in the fact that the S&P 500 has made more than 30 new highs so far in 2024 and is trading at levels that, historically speaking, are richly valued. That said, if inflation continues to decline, economic growth stays solid, and the Fed delivers on a September cut, absent any other major surprises, it's reasonable to expect this strong 2024 rally to continue in Q3.

However, while the outlook for stocks is undoubtedly positive right now, market history has shown us that nothing is guaranteed. As such, we must be constantly aware of events that can change the market dynamic, as we do not want to get blindsided by sudden volatility.

To that point, the market does face risks as we start the third quarter. Slowing economic growth, disappointment if the Fed doesn't cut rates in September, underwhelming Q2 earnings results (out in July), a rebound in inflation, and geopolitical surprises (including the looming U.S. elections) are all potential negatives. And, given high levels of investor optimism and current market valuations, any of those events could cause a pullback in markets similar to what was experienced in April (or worse).

Numerous earnings updates from consumer-related companies have cited reduced consumer demand and spending (Nike and Walgreens the most recent examples). Additionally, while the unemployment number reported on July 5th was fine, unemployment now is at 4.1%. That's a near-three-year high. It's not a disastrous number, but it's not going in a good direction. In addition, the growth of the U.S. economy, or the Gross Domestic Product (GDP) has slowed to an estimated growth rate of 1.5% as of July 3rd, not much better than the 1.4% GDP growth in the first quarter of 2024.

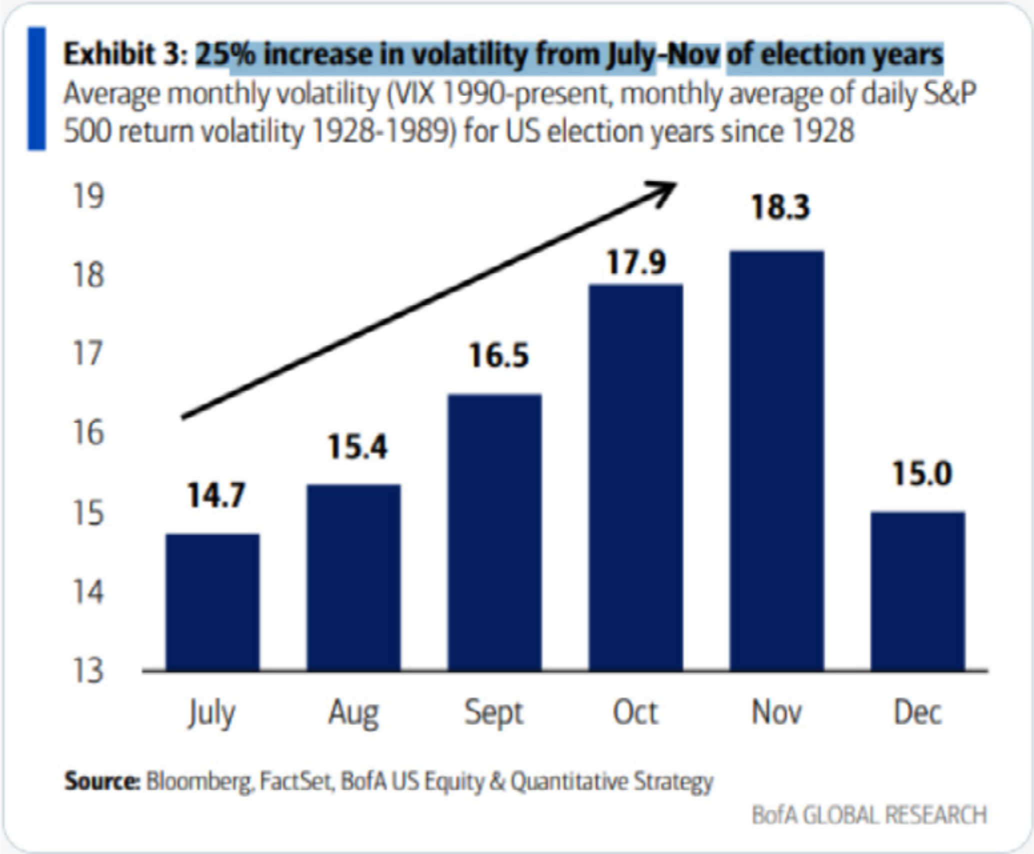
While any of those risks (either by themselves or in combination with one another) could result in a drop in stocks or bond prices, the risk of slowing economic growth is perhaps the most substantial threat to this incredible 2024 rally. To that point, for the first time in years, economic data is pointing to a clear loss of economic momentum. So far, the market has welcomed that moderation in growth because it has increased the chances of a September rate cut. However, if growth begins to slow more than expected and concerns about an economic contraction increase, that would be a new, material negative for markets. Because of that risk, we will be monitoring economic data very closely in the coming months.

The Bottom Line

I want to make sure all of us are aware that the economic plane has started its descent, and while sentiment and spirits are running high (along with the S&P 500), we are entering perhaps the most important several months for this bull market. And while a sudden drop in growth of the economy is not the most likely outcome, it is possible and we will be watching economic data very closely in the coming months to make sure we are not blindsided by sudden weakness.

We believe the outlook for stocks remains positive, but that should not be confused with a risk-free environment. There are real risks to this historic rally and we will continue to monitor them closely in the coming quarter.

Be prepared for volatility as we proceed into the last half of 2024, especially in an election year. The chart below shows the potential for increased volatility starting in August as we go into the November election time period. In the meantime, our portfolios continue to perform well with Large-Cap Growth, Energy, Precious Metals, our core bond funds, and short-term bond ETFs.



We’re Committed to You

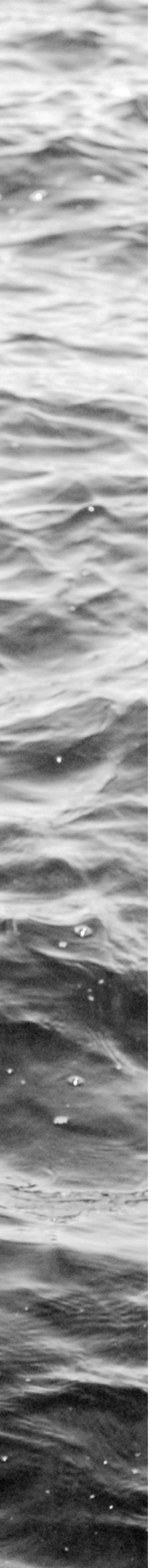
As a side note, feedback we have received is that you would rather read shorter, more focused reports rather than our longer quarterly reports. That was one reason why we broke out our quarterly equity updates and our fixed-income strategy updates. We will be writing an election report in August as well as more focused reports such as the energy and precious metals update we have previously issued.

To that point, at Live Oak Wealth Management, we are committed to helping you effectively navigate this investment environment. Successful investing is a marathon, not a sprint, and even intense volatility is unlikely to alter a diversified approach set up to meet your long-term investment goals.

Therefore, it’s critical to stick to your plan as we’ve worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.

We remain focused on both opportunities and risks in the markets, and we thank you for your ongoing confidence and trust. Please rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review by clicking here.



About Matthew

Matthew Gaude is an *investment advisor representative and the co-founder of Live Oak Wealth Management, a financial services firm in Roswell, Georgia. He serves the planning and investment needs of corporate employees, those approaching or in retirement, and 401(k) plan sponsors. Working first as a commodity broker and then as a Business Development Manager for a national broker-dealer in previous jobs, he has the insight and experience to help clients understand the complexities of the market and implement strategies to minimize risk. To learn more about Matthew, connect with him on LinkedIn or visit www.liveoakwm.com.

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