GLOBEINVEST
CAPITAL MANAGEMENT INC.

INVESTMENT NOTES

JUNE 2024

UPCOMING 2024 BNN SHOWS

Christine: July 15, 2024

Alexander: August 12, 2024

Christine: August 20, 2024

The second quarter performance for the major stock market indices was mixed. The S&P/TSX Composite Total Return Index was down 0.5%, weighed down by economically sensitive sectors including energy producers, banks, and industrial companies. On the flip side, the frenzied exuberance surrounding artificial intelligence-related investments continued during the quarter with the NASDAQ Composite Price Index up 8.3% and the S&P 500 Total Return Index up 4.3%. In contrast, the DIJA Total Return Index was down 1.3%, which highlighted narrowing market breadth within U.S. equities.

Chart 1 illustrates how historic this narrowing market breadth has been. Not since the mid-1960s has the weight of the 10 largest stocks in the S&P 500 Index been this high. Additionally, it has been almost 30 years since the weight of the 11th to 50th largest stocks has been this low. The specific driving force behind this bifurcation has been the so-called “Magnificent Seven” stocks: Meta, Apple, Tesla, Microsoft, Amazon, Alphabet, and – of course – Nvidia. Interestingly, though, only three of these stocks significantly outperformed the S&P 500 in the second quarter: Apple, Alphabet, and Nvidia, which were up 23%, 21%, and 37%, respectively. While we are happy to continue to own Apple and Alphabet in client portfolios, we believe the risk/reward outlook for Nvidia skews to the downside as increased competition is bound to come. If Nvidia’s shares were to give back some of the previous gains, this would result in a significant decline for major indices, given the company’s historic weighting (all else equal).

Looking at this concentration in a slightly different manner, Chart 2 shows the performance of two slightly different indices so far in 2024. The blue line shows the price return of the S&P 500 Index, where each of the 500 stocks are weighted by market capitalization. The black line shows the S&P 500 Equal Weight Index, where each of the same 500 stocks are weighted equally. You can see that when the Magnificent Seven are weighted the same as the other 493 stocks in the index, performance is more than 10% weaker.

While not a surprise announcement, the Bank of Canada (BoC) cut its overnight rate on June 5, the first reduction in four years. Other central banks in developed countries have also begun to lower interest rates, including Switzerland, Sweden, and the European Central Bank. The U.S. Federal Reserve has yet to make its first cut, maintaining a circumspect approach toward lowering rates. A relatively healthy labour market means the U.S. central bank has more time to ensure inflation is on a sustainable downward path before cutting rates.

The Staying Power of the U.S. Consumer

The U.S. consumer is the main driver of the economy, accounting for almost 70% of nominal GDP. The resilience of the U.S. economy is attributable to the staying power of the U.S. consumer, despite higher interest rates. Personal spending has risen steadily, up 5% year-over-year in May, anchored by a 4.6% increase in personal income. The challenge for the Fed in this cycle has been getting the consumer to respond to a higher interest rate environment. Pandemic era savings and an increase in consumer credit extended the timing of the expected impact of monetary policy changes. But the period of increased liquidity and cheap credit is now largely behind us. Whilst still rising, the growth in personal spending is moderating. With the savings rate now below historical standards, income growth has once again become the primary source of purchasing power for households. This suggests future spending patterns by consumers will exhibit elevated sensitivity to labour market conditions.

Rosenberg Research describes the U.S. consumer as a conglomerate made up of three distinct groups, each with a different relationship to the economic cycle. Defined as a percentage of total household income, the three groups consist of the top 20% (high-income), 20% to 80% (bulge bracket middle-income) and bottom 20% (low-income). The distribution of wealth amongst the groups is very concentrated: the top 20% own 68% of household financial assets, with a sizable proportion allocated to equities and debt securities. High-income households rely very little on credit (only 35% carry a credit card balance) and their leverage and debt service ratios are the lowest across income groups. As a result, their spending and saving behaviour is more influenced by asset prices and financial returns. The bottom 20% also have low leverage and credit card ownership rates, but that is due to their inability to gain access to credit. Spending patterns for these low-income households are dictated by employment and wages. Thus, borrowing is dominated by middle-income households, so their spending behaviour is sensitive to a gamut of economic conditions, such as interest rates, lending environment, and labour market conditions.

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The bifurcation between the top 20% and everyone else is widening. Healthy equity market returns are driving a powerful wealth effect that is keeping high-income consumers spending. Low-income households have been under pressure because of the initial inflation spike post-pandemic depressing their purchasing power. More importantly, middle-income households are now feeling the impact of high interest rates and a softening labour market. The rising fragility of the U.S. consumer is evidenced by numerous consumer-facing companies flagging a growing cohort of cost-conscious, value seeking consumers. Rosenberg Research concludes that while it is the bulge bracket of consumers that drives the consumption cycle and moderate spending ahead of a recession, it is a pullback in spending by high-income households that pushes the economy into a recession. Historically, this is triggered by a significant correction in asset prices, which sparks a simultaneous loss of confidence and negative wealth effect.

Employment

The Canadian labour market has been cooling over the past two years. The unemployment rate dropped to a low of 4.9% in June 2022 and has since edged up to 6.4% in June. The deteriorating employment situation reflects the cumulative negative impact of rising interest rates translating into fewer job openings and population growth resulting in more job seekers. Surging population growth has also put downward pressure on many per-capital productivity figures. For the seventh consecutive quarter, domestic demand grew at a slower pace than population growth, attesting to the significant slowdown in the economy over this period. Combined with persistently lower inflation readings, the BoC opted to lower its policy rate in early June. Further signs of softening in labour markets would help to reassure the BoC that inflation pressures are more likely to drift lower and set the path for additional rate cuts to follow.

The employment situation in the United States has been much more resilient, even though the unemployment rate has moved up to 4.1% from a recent trough of 3.4% in April 2023. Population growth in the U.S. has been more muted than in Canada, barely 0.5% higher than a year ago compared to Canada's 3.2%. Fed officials are cognizant of the delicate balance between taming inflation and avoiding a significant deterioration of the labour market. Chair Jerome Powell has acknowledged that the labour market is cooling off and has reiterated his view that a sudden deterioration in employment growth could spur faster rate cuts. For now, consensus expectations are for the first policy rate cut to happen in the fall.

Leading Economic Indicators

The leading indicators that we track continue to raise a red flag for the U.S. economy.

The May Conference Board Leading Economic Index (LEI) continued its long descent, having been flat or down in each of the past 27 months (Chart 3). The LEI is now just a touch above its pandemic low, at odds with an economy that continues to expand.

While the ISM manufacturing index briefly turned positive in March, economic activity has contracted in the manufacturing sector since then. Manufacturing activity has remained in contraction territory for 19 of the last 20 months (Chart 4). One encouraging reading from June's report was the large drop in prices paid signaling that price pressures are abating.

Economic activity in the services sector has been consistently expanding post-pandemic; however, the ISM services index contracted for the first time in April, ending a period of 15 consecutive months of growth. The index had reported expansion in 45 of the previous 47 months. Services sector activity is cooling with the June reading also in contraction territory (Chart 5). After a long run of growth, the services sector looks to be running up against the weight of restrictive monetary policy and slowing consumer spending. For the Fed, this is another welcome signal that monetary policy is proving effective in cooling consumer demand beyond the interest-rate sensitive goods sector.

The U.S. Treasury yield curve has been inverted since July 2022. The spread between the 10-year and 2-year treasury bonds is negative 35 basis points (bps) compared to negative 77 bps a year ago and negative 33 bps last quarter.

Outlook

The global economy is slowing, not stalling. That is the desired outcome of restrictive monetary policy as central banks navigate to a soft landing. Inflation is on a downward trend, moving towards the target ranges, providing central banks leeway to start lowering policy rates. So long as slower inflation readings continue, rate cuts should continue.

Narrowing breadth in equity markets is concerning and a broadening in price gains across more sectors would a healthy development. Upside to consensus corporate profit expectations and visibility to future profit growth is necessary to support equity prices.

Our focus is to build wealth for our clients over the long term through owning a diversified portfolio of financially sound, well-managed and reasonably priced companies. We remain steadfast in adhering to this philosophy.

Christine Poole, MBA, CFA
Alexander MacDonald, CFA, P.Eng., MBA

CHART 1: Historic bifurcation of S&P 500 weight
- J.P. Morgan

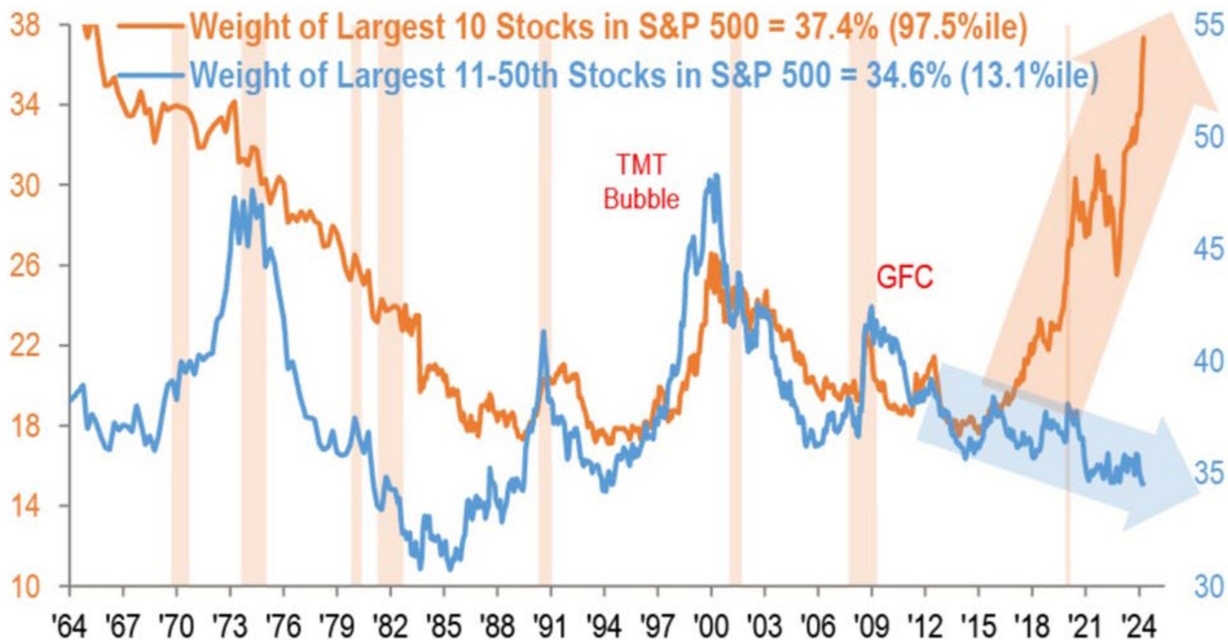


CHART 2: S&P 500 Index vs. S&P 500 Equal Weight Index
- Bloomberg Finance L.P.

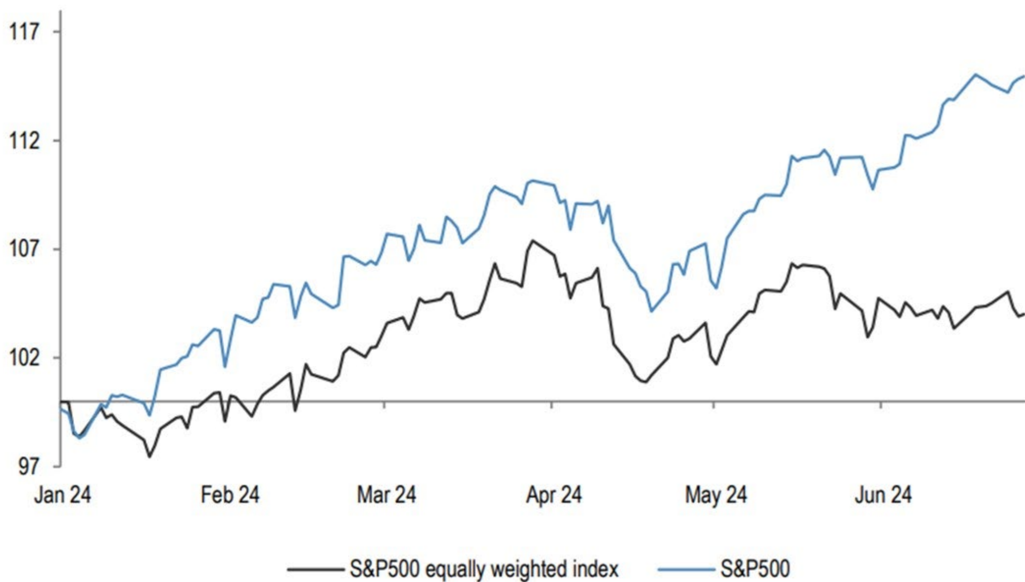


CHART 3: Composite Index of 10 Leading Indicators |
United States: Conference Board Business Cycle Indicators (index)
- Haver Analytics, Conference Board, Rosenberg Research

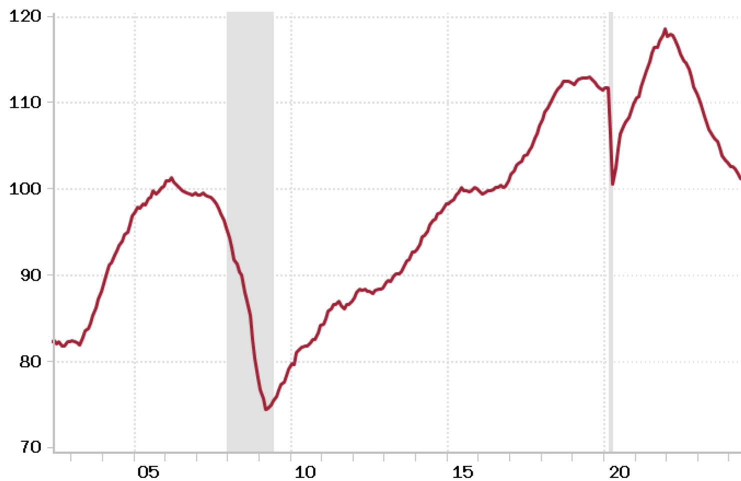


CHART 4: ISM Manufacturing & Prices Paid Diffusion Index
- Insitute for Supply Management and Wells Fargo Economics

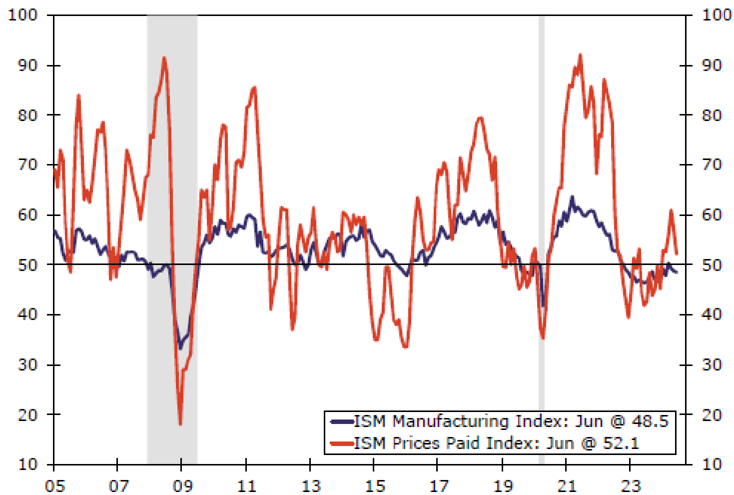
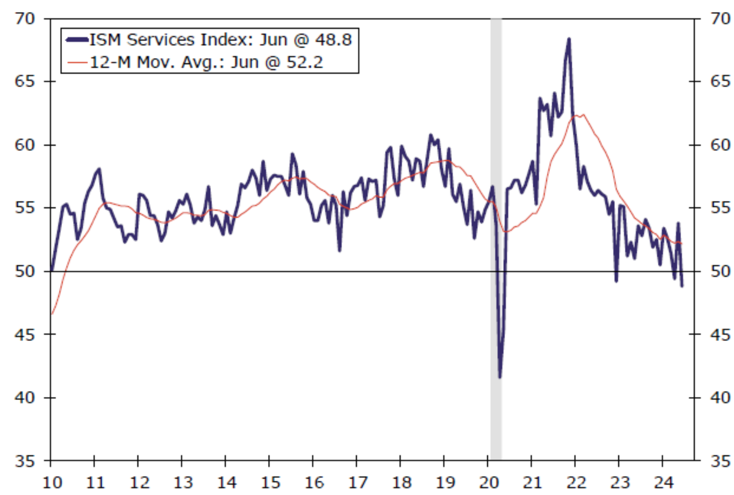


CHART 5: ISM Services Composite Diffusion Index
- Institute for Supply Management and Wells Fargo Economics



RECENT BNN SHOWS

Christine: June 13, 2024

Alexander: May 8, 2024

Christine: March 21, 2024

Christine: January 22, 2024

Christine: December 21, 2023

Christine: November 23, 2023

Alexander: October 30, 2023

Christine: October 23, 2023

Christine: September 21, 2023

JUNE 30, 2024 STATISTICAL SUMMARY

STOCK MARKETS	QTD	YTD	1 YEAR
S&P TSX COMPOSITE TOTAL RETURN (CAD)	-0.5 %	6.1 %	12.1 %
S&P 500 TOTAL RETURN (CAD)	5.4 %	19.1 %	28.7 %
S&P 500 TOTAL RETURN (USD)	4.3 %	15.3 %	24.6 %
DJIA TOTAL RETURN (USD)	-1.3 %	4.8 %	16.0 %
NASDAQ COMPOSITE PRICE RETURN (USD)	8.3 %	18.1 %	28.6 %
MSCI WORLD INDEX PRICE RETURN (CAD)	3.2 %	14.4 %	22.3 %
MSCI WORLD INDEX PRICE RETURN (USD)	2.2 %	10.8 %	18.4 %
CANADIAN UNIVERSE BOND INDEX	0.9 %	-0.4 %	3.7 %

COMMODITIES	QTD	YTD	1 YEAR
GOLD	5.5 %	12.9	21.9 %
SILVER	18.1 %	20.8	28.2 %
COPPER	7.9 %	11.7	14.5 %
NATURAL GAS (NYMEX)	47.5 %	3.5	-0.1 %
WTI	-2.0 %	13.8	17.2 %
BRENT	-1.4 %	11.8	17.2 %

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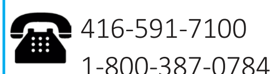
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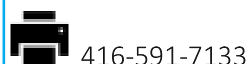
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TREASURY BONDS	06/30/24	12/31/23	06/30/23
2 YEAR (CAD)	3.99 %	3.88 %	4.58 %
2 YEAR (US)	4.71 %	4.23 %	4.87 %
5 YEAR (CAD)	3.51 %	3.17 %	3.68 %
5 YEAR (US)	4.33 %	3.84 %	4.13 %
10 YEAR (CAD)	3.50 %	3.10 %	3.26 %
10 YEAR (US)	4.36 %	3.88 %	3.81 %
30 YEAR (CAD)	3.39 %	3.02 %	3.09 %
30 YEAR (US)	4.51 %	4.03 %	3.85 %
CPI (CAD)	2.90 %	3.10 %	3.40 %
CORE CPI (CAD)	2.90 %	3.50 %	4.40 %
CPI (US)	3.30 %	3.10 %	4.00 %
CORE CPI (US)	3.40 %	4.00 %	5.30 %
PCE (US)	2.60%	2.60 %	3.00 %
CORE PCE (US)	2.60 %	2.90 %	4.10 %

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