SIGMA
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Q2 2024 MARKET REVIEW AND OUTLOOK

MARKET REVIEW & OUTLOOK

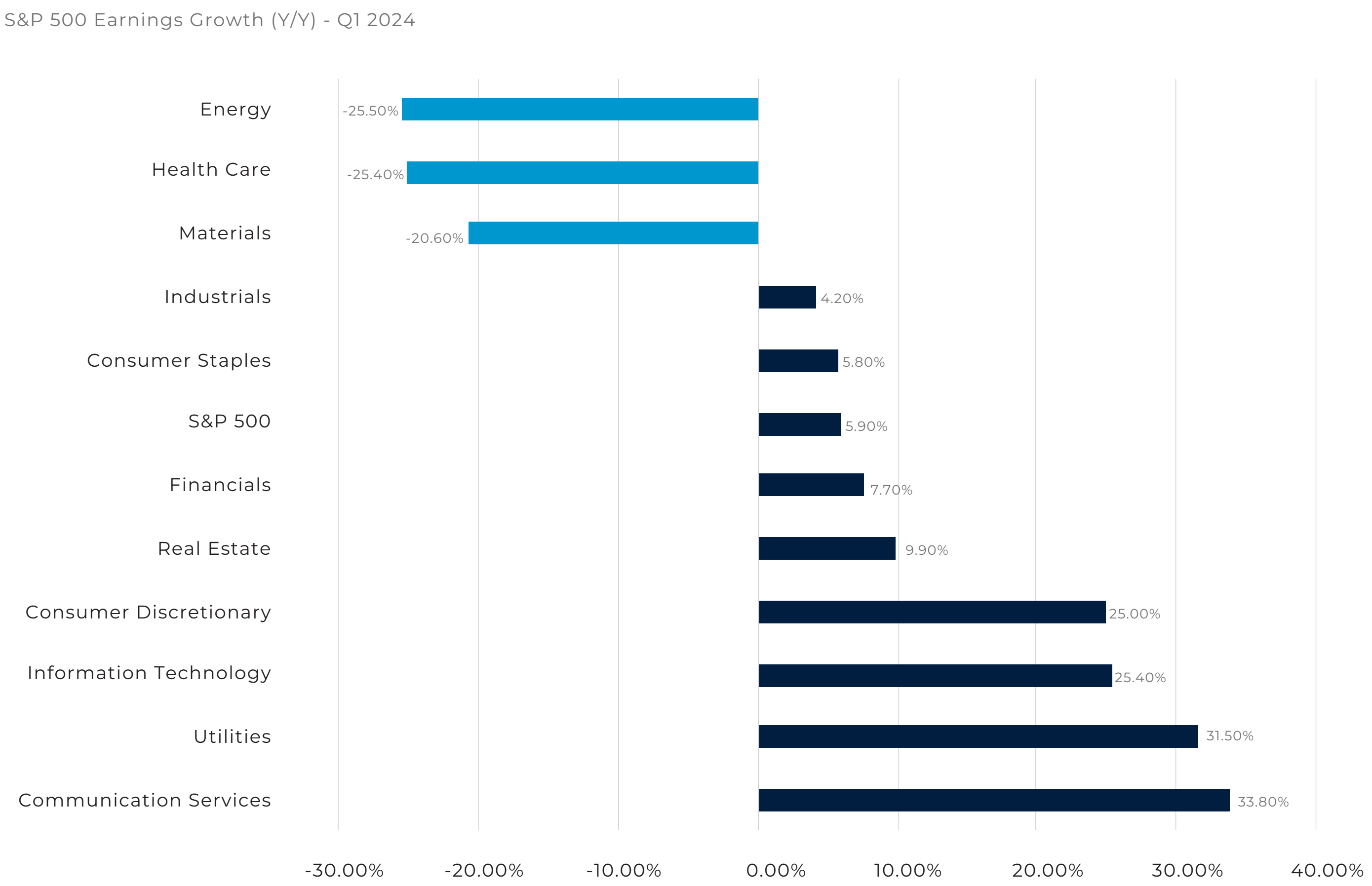
Just halfway through the year and the S&P 500 is up 14.48%, well above its historical average for any full year, and multiple record highs have been notched. The strong start has left some investors wondering if stocks have risen too far, too quickly. History would suggest not, and we'll explain why later, but for now we'll start with a brief review of the developments this quarter.

Global equity markets continued to climb the wall of worry, with the MSCI World up 2.18% for the quarter and 10.81% year to date. European equity markets lagged the US, as the Nasdaq 100 reclaimed its position as the top-performing developed market index, rising 7.82% over the quarter. Strong earnings reports propelled mega-cap technology stocks higher, with Nvidia becoming the third company ever to exceed a $3 trillion market cap, temporarily surpassing Apple and Microsoft as the world's largest publicly traded company. AI's transformative and productivity-boosting potential continued to gain traction. Apple previewed their "Apple Intelligence," reaffirming their place in the Magnificent 7 and climbing to new all-time highs. However, this resulted in some of the first quarter's increased market breadth, defined as the ratio of the number of advancing stocks to declining stocks, being undone in Q2.

The reacceleration in earnings growth has been the main driver of equity market strength year to date, and while the tech giants have led the way, earnings have been impressive across the board. The S&P 500 had its best earnings season in almost 2 years, with all 11 sectors exceeding analyst expectations and 8 sectors posting year-over-year earnings growth as seen in Chart 1. Continued strength in earnings should be supportive for equity markets over the remainder of the year and is encouraging for a broader contribution to returns.

CHART 1

THE S&P 500 HAD ITS BEST EARNINGS SEASON IN TWO YEARS



Source: FactSet. Data as of June 14, 2024.

Once again, the global economy has shown remarkable resilience, defying many expectations. In the US, despite mixed data over the quarter, the latest ISM Services PMI (Purchasing Managers Index) exceeded consensus forecasts as business activity and exports accelerated. Similarly, the most recent jobs report revealed US employers added 272,000 nonfarm payrolls, significantly surpassing the 180,000 expected, leading to upward revisions in Q2 GDP forecasts. Following a slight uptick in inflation in Q1, May's CPI release confirmed that inflation continues to cool, with both headline and core CPI at their lowest levels in years.

Overall, the data painted a picture of a robust economy with moderating inflation. The Federal Reserve echoed this sentiment at the June FOMC meeting, suggesting the US economy could handle higher rates for a bit longer, with the next move likely being a rate cut. However, they reduced their projection from three cuts to just one in 2024. This is a stark contrast to the seven rate cuts markets anticipated at the beginning of the year. As we've noted over the past few quarters, there doesn't seem to be an urgency for the Fed to cut rates when the macroeconomic backdrop remains strong, and corporate earnings growth is driving markets. However, with rates at these elevated levels and proof that inflation is subsiding, the Fed has the flexibility to act swiftly if economic data worsens unexpectedly.

Elsewhere, June marked the beginning of rate-cutting cycle for the European Central Bank (ECB) and Bank of Canada, each opting for a 25-basis point reduction in their deposit rates. Now, 20 of the 37 central banks tracked by JPMorgan are in easing mode; this is the first time in over two years that more central banks are cutting rather than hiking rates. Despite this, European government bond yields spiked immediately after the ECB's move, as the hawkish tone and refusal to promise further rate cuts caught many off guard.

Given the ongoing uncertainty surrounding the timing and magnitude of rate cuts, bond yields globally have remained volatile, fluctuating with each economic data release. Consequently, the Bloomberg Global Aggregate Bond Index (USD), the benchmark for investment grade fixed income, is down -3.16% year to date, disappointing those who hoped for a strong bond rally amid a global rate-cutting cycle.

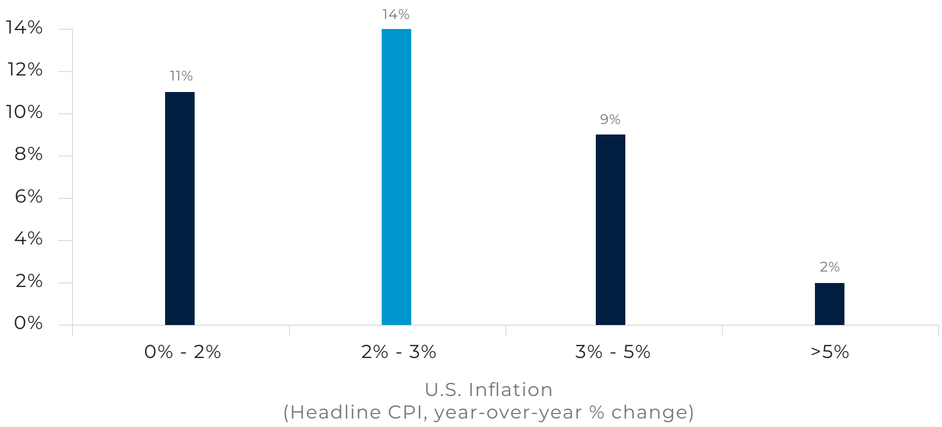
Despite this, the role of fixed income in portfolios remains crucial. High-quality, investment-grade issuers offer attractive yields and act as a buffer against potential equity market volatility. Moreover, investment-grade fixed income has rarely looked healthier, with corporate net interest paid as a percentage of cash flow at historically low levels and credit ratings at all-time highs; with over 50% of the US investment-grade bond index is rated A or above.

Modest price appreciation in bonds could still occur when interest rates begin to decline, likely in the second half of this year. However we believe, a higher growth and inflationary environment should favour stocks. Equities have historically acted as a natural inflation hedge, as companies can raise prices while keeping costs under control. Chart 2 highlights this dynamic, showing how equities have historically fared well with inflation between 2%-3%. As such, we continue to favour mega-cap growth stocks with business models that can pass on the elevated costs and higher interest rates to customers, driving their profit margins to some of the widest levels in history.

CHART 2

STOCKS TEND TO DO WELL WITH INFLATION BETWEEN 2%-3%

S&P 500 One-year returns in U.S. inflation regimes, % (1950-2024).



Source: Bureau of Labor Statistics, J.P. Morgan, Bloomberg Finance L.P. Data as of April 30, 2024.

HAVE EQUITIES RISEN TOO FAR, TOO FAST?

Twenty-one months into this new bull market, both the MSCI World (+48.32%) and S&P 500 (+52.65%) indices have surged from their October 2022 bear market lows. This significant ascent has generated scepticism among investors and headlines alike, particularly given the looming fears of recession. However, examining the performance of young bull markets provides some perspective.

CHART 3
STRONG RETURNS TEND TO SIGNAL MORE STRENGTH AHEAD

S&P 500 returns after a 10% rally 100 trading days into the year

Year	Day 100, YTD Return	Rest of year return	Full year return
1950	11%	9%	22%
1954	17%	24%	45%
1961	14%	8%	23%
1963	11%	7%	19%
1967	12%	7%	20%
1975	32%	0%	32%
1976	10%	8%	19%
1983	18%	0%	17%
1985	12%	13%	26%
1986	14%	0%	15%
1987	19%	-15%	2%
1989	15%	11%	27%
1991	14%	11%	26%
1995	15%	17%	34%
1996	10%	9%	20%
1997	14%	15%	31%
1998	13%	13%	27%
2013	16%	12%	30%
2019	13%	14%	29%
2021	12%	14%	27
2024	11%	0%	11%
Average		8%	24%
Median		9%	26%
% higher		81%	100%

Source: Bloomberg Finance L.P., J.P. Morgan. Data as of May 23, 2024.

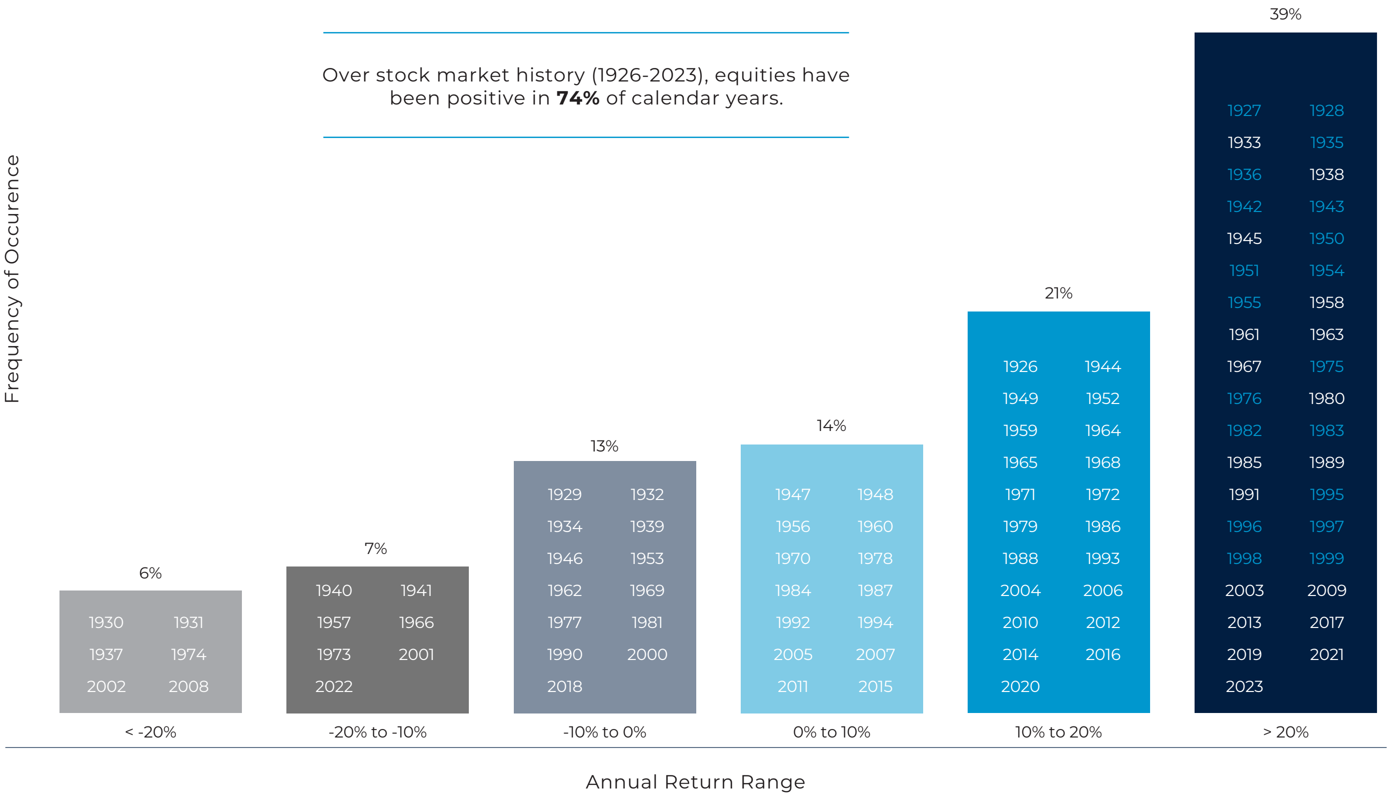
The strength of 2023's young bull market rally surprised many (but not us – check out our video here). Last year, the S&P 500 climbed over 8% in the first 100 trading days: this year, it's up more than 10%. 2023 closed with a gain of nearly 25%, leading many pessimists to doubt the sustainability of such gains. Yet history tells a different story. Since 1950, whenever the S&P 500 has gained at least 10% in the first 100 trading days, it has typically closed the year with an average return of about 25%.

Moreover, this year's rally has driven the S&P 500 to 30 new all-time highs after a two-year lull. Historically, in years where the S&P 500 sets a new high, it averages around 30 new highs. This raises the question: do we have more all-time highs in store for us this year? When stocks have hit this many all-time highs early in the year, they typically surpass 50 new records by year end.

While these historical insights are encouraging, they don't guarantee the future. Yet, understanding the context can help investors appreciate the power of positive momentum.

Contrary to popular belief, average returns aren't the norm. The long-term average annual return for stocks, around 10%, is derived from widely varying yearly returns. As shown in Chart 4, double-digit returns occurred in 60% of calendar years. Embracing this perspective can help investors recognise the potential for continued growth. And big (20%+) back-to-back years aren't uncommon in bull markets as economic expansion and earnings growth propel equities forward, as we see today.

CHART 4
AVERAGE RETURNS AREN'T NORMAL



Source: S&P 500 Total Return Index data, annual, 1926 – 2023, FactSet. Data as of January 4, 2024.

However, as diligent investors, we must remember that global equities can experience sentiment-driven corrections (a 10%-20% decline) for any or no real reason. Such bouts of volatility occur roughly once a year, reminding us of the inherent unpredictability of markets. It remains to be seen what the second half of the year has in store for us, but as always it is important to be prepared. Market corrections can be unsettling, but they are also natural parts of market cycles and can provide buying opportunities for long-term investors.

Furthermore, maintaining a diversified portfolio and a committed investment strategy through market ups and downs has consistently proven to be the best way to achieve long-term growth. Diversification helps manage risk by spreading investments across different asset classes, sectors, and geographies, thereby dampening volatility. Resisting the urge to react to short-term fluctuations and embracing the strength of a bull market requires discipline and a clear understanding of how investment goals are best achieved. By focusing on the long-term and avoiding hasty decisions based on market noise or emotional responses, investors can navigate uncertainties and work towards their desired financial objectives more effectively.

As we move forward, we will continue to closely monitor the evolving economic environment, heightened geopolitical risks, and various political developments. These factors can influence market conditions and investor sentiment, and our team is committed to staying informed and proactive. We look forward to updating you again next quarter with more insights and analysis.

Thank you for taking the time to read our Market Review.

Sigma Investment Committee