# Research Review

July 2024

*The first month of the third quarter presented global asset allocators with several important thematic market shifts, including a pullback across the "Magnificent 7" (Mag 7) stocks, a rotation into the more economically sensitive corners of the equity market—notably value and small cap—and the sharpest monthly decline in interest rates since December 2023. An emerging theme of U.S. labor market weakness also garnered attention during the month as the headline unemployment rate increased to 4.3%, a level 90 bps above its cyclical low in early 2023 and 50 bps above the three-year moving average. Performance across real assets continued to be mixed with the interest rate-sensitive real estate investment trust (REIT) and global listed infrastructure sectors generating significantly positive total returns while commodity futures posted a monthly loss due to declines across energy prices—a key headwind to the sector during the month.*

INSIDE THIS ISSUE



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# Economic Update

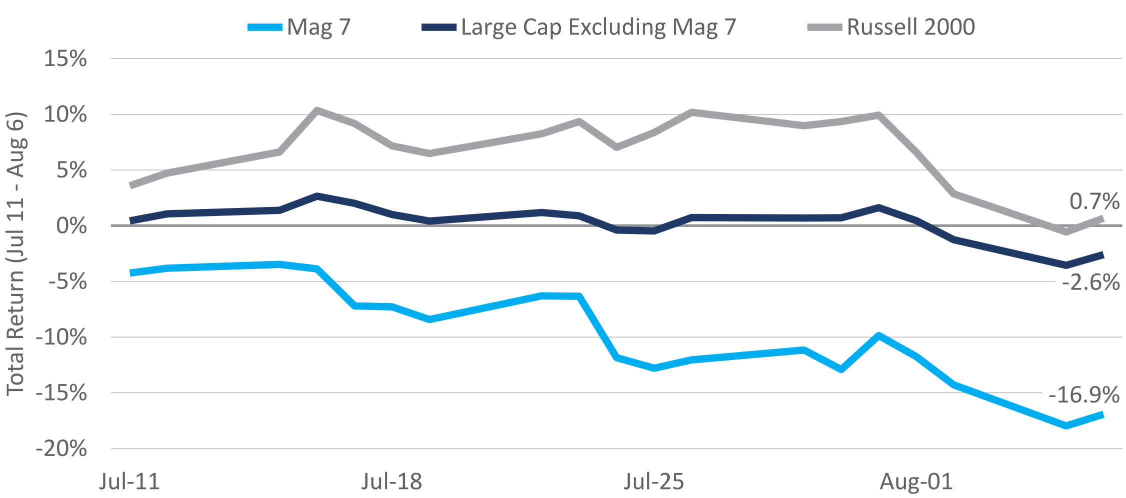
## Magnificent 7 Pullback Approaches Bear Market Threshold

"There was little to complain about when reviewing the performance posted by the major asset classes in July while, under the surface, notable thematic changes began to emerge." – Mike O'Conner, CFA

There was little to complain about when reviewing the performance posted by the major asset classes and sub-asset class categories in July, although some subtle thematic changes have begun to emerge under the surface. First and foremost was the significant pullback across the Mag 7 which, as of August 6, has suffered a nearly 17% drawdown from its July 10 peak, placing the Bloomberg Magnificent 7 Index within three percentage points of a bear market decline.

Dragging the Mag 7 down over the month includes approximately 20% price declines from Nvidia, Tesla, Google, and Amazon, in addition to less dramatic losses from Apple, Microsoft, and Meta. Importantly, the price action since July 10 across the broader market has favored—at least on a relative basis—the rest of the large cap market, which has experienced only a modest decline, as well as smaller cap stocks, which have eked out a slightly positive return during this period.

**MAG 7 HAS SIGNIFICANTLY UNDERPERFORMED REST-OF-THE-MARKET SINCE JULY 10TH PEAK**




*Data source: Bloomberg, L.P.; Data as of August 6, 2024*

In addition to the thematic shift from both a capitalization and style perspective across the equity market since July 10, the bond market has displayed its own signs of change. In July, the yield on the benchmark 10-year Treasury note fell 37 bps to 4.03%, the largest monthly decline of 2024 thus far, and the downward pressure of the move spilled over into August. Furthermore, the slope of the Treasury yield curve, as proxied by the spread between 2- and 10-year Treasury notes, briefly peaked into positive territory on Monday August 5 after maintaining an inverted posture since March 2022.

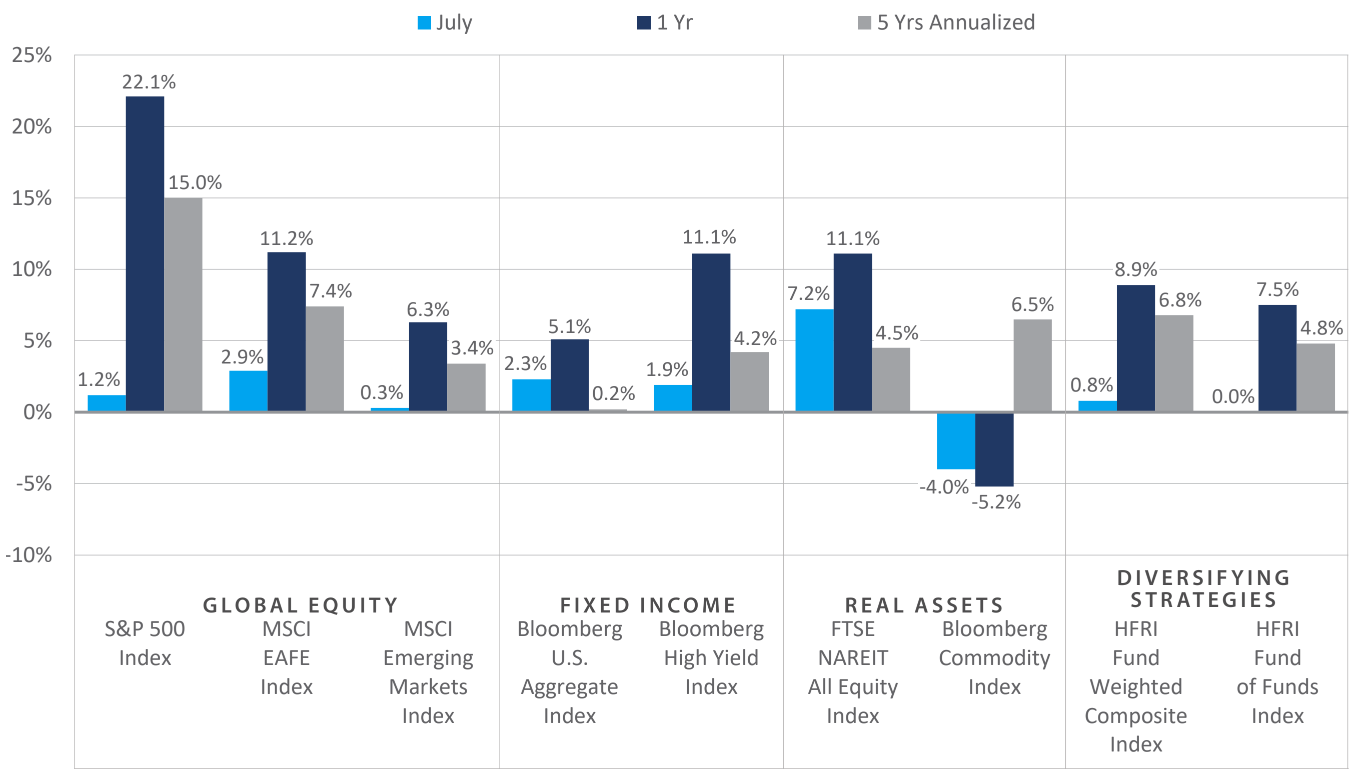
Fundamentally, a key driver behind the recent thematic changes across the equity and fixed income market has included growing speculation the U.S. economy may be cooling and on the verge of a potential cyclical inflection, with labor market weakness coming into focus in recent months. Through July, the headline unemployment rate stood at 4.3%, a level 90 bps above the cyclical low from March 2023 and 30 bps above the Federal Reserve's (Fed) year-end 2024 median projection as suggested in the June Summary of Economic Projections (SEP).

Relatedly, the possibility that the Fed may have once again found itself behind the curve has entered the equation. Much like how the Fed was somewhat slow in tightening policy once inflation pushed above their 2% target following the global pandemic, concerns the Fed will be too slow to ease policy have grown. The Fed's June SEP "dot plot" pointed to the expectation of just one 25 basis point rate cut by the end of 2024; however, Fed funds futures currently imply four 25 basis point cuts by the end of the year, once again raising the specter of a Fed policy mistake, this time in the opposite direction.

To conclude, the financial markets witnessed meaningful thematic shifts in July across both the stock and bond markets, as market participants continued to position for a shift in Fed policy, the looming changing of the guard in the White House, and a potential business cycle inflection from expansion to contraction.

# Market Summary

July 2024




*Data source: Lipper, HedgeFund Research*

# Global Equity

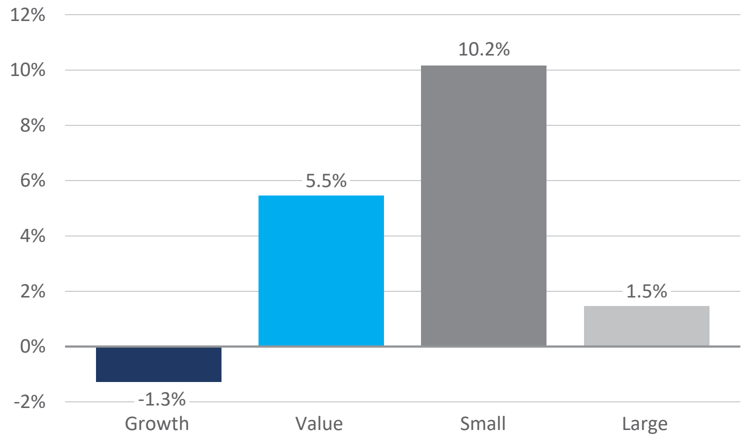
Equity markets underwent a style shift as the third quarter began, with investor demand waning for technology-related growth names, with performance favoring other areas of the market. As the market positioned itself for a potential rate cut at the July Fed meeting, interest-rate sensitive investments such as small cap stocks and REITs outperformed. Geographically, UK-based equities outperformed both U.S. and emerging markets as investors took advantage of the valuation discount.

In July, the Russell 2000 Index outperformed large cap domestic equities. The reversal was influenced in part by many institutional investors rebalancing out of information technology and covering small cap short positions. This sharp reversal caused the largest monthly outperformance of the Russell 2000 over the Nasdaq 100 Index since the internet bubble. This rally was short-lived, however, because the market sold off in early August, erasing July's modest gains. The sell-off was triggered by unfavorable economic announcements and partly caused by margin calls on carry traders who borrowed Japanese yen.

Like the U.S., Japanese equities also experienced extreme volatility in July, which carried over into August with back-to-back trading days of double-digit returns. The Japanese yen appreciated rather sharply after the Bank of Japan (BOJ) unexpectedly increased interest rates in the third quarter. This affected a large carry trade, when traders borrow a currency at a low interest rate—in this case the yen—and purchase assets in another country. A weakening yen benefits this strategy due to the currency conversion, so as the yen began to strengthen, many traders were faced with margin calls or risk complications, resulting in the need to sell equity securities.

**U.S. GROWTH DECLINES ON MEGA-CAP EARNINGS MISS**

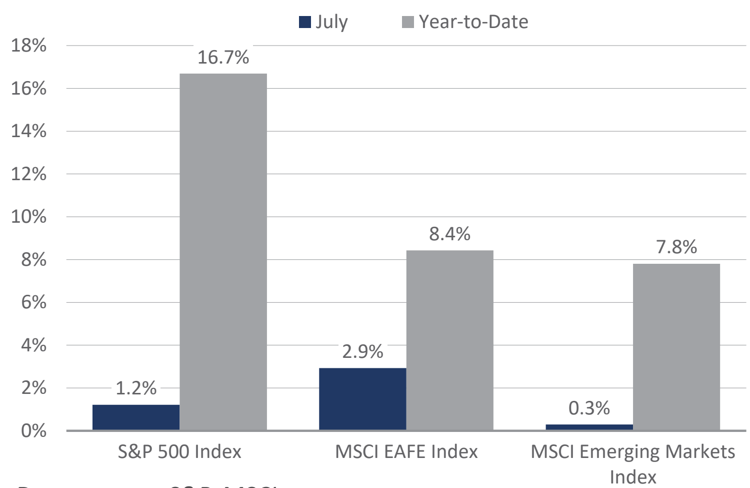
U.S. Style Returns




*Data source: FTSE Russell*

**U.S. TAKES SILVER**

Equity Indices Performance Returns (U.S. Dollars)




*Data sources: S&P, MSCI*

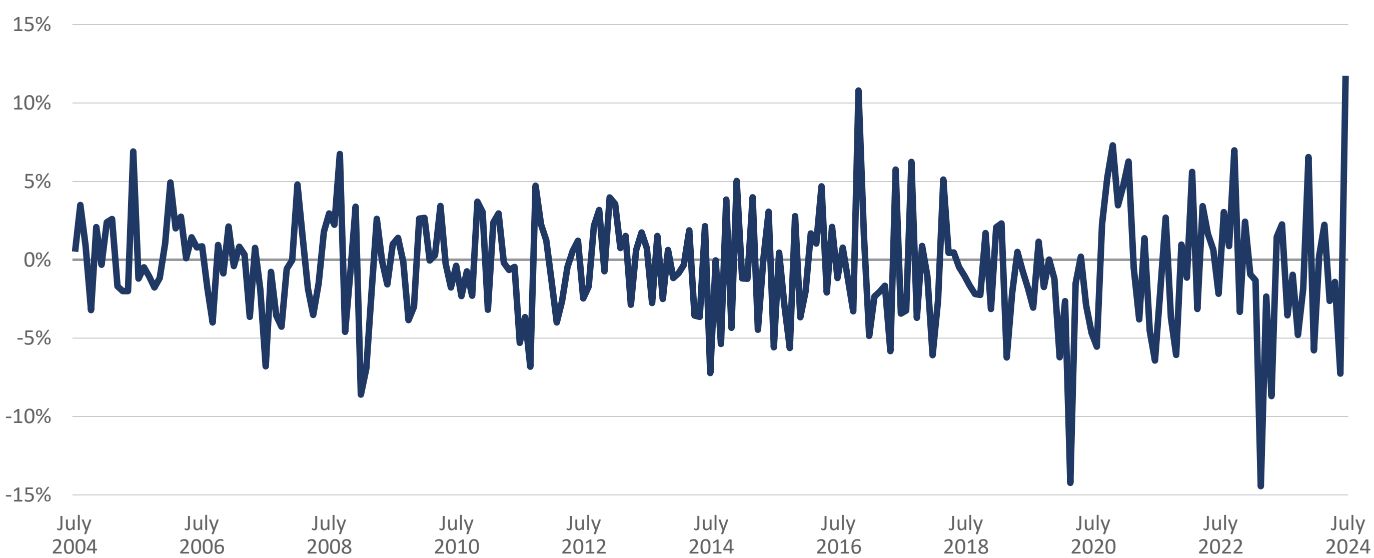
Europe ex-UK equities underperformed their U.S. and UK counterparts. Specifically, consumer discretionary and information technology lagged. Consumer demand has continued to decline in Europe and abroad, driving large market contributors such as Burberry and Yves Saint Laurent to slash prices indefinitely in an effort to win back upper-middle-class consumers. Conversely, health care, utilities, and real estate performed well after strong quarterly earnings results.

UK-based equities outperformed both U.S. and emerging markets for the month. Expectations materialized for a Labour Party victory, as well as an interest rate cut by the Bank of England, supporting a stable backdrop for equity markets. Additionally, the PMI increased to its highest reading in two years, providing more confidence to investors. The recent surge in bid activity for UK-listed companies continued during the month as investment firms took advantage of the relatively low valuations in the UK markets.

The MSCI Emerging Markets (EM) Index was largely held back by underperformance in China as consumer sentiment and property activity continue to be depressed. Concerns about significant artificial intelligence spending reverberated throughout emerging markets, causing the information technology sector to decline. Notably, Latin America remained relatively flat despite several elections this year.

**LARGEST OUTPERFORMANCE OF SMALL-CAP STOCKS SINCE THE INTERNET BUBBLE**

Monthly Returns of the Russell 2000 in Excess of the NASDAQ 100




*Data source: FactSet*

# Fixed Income

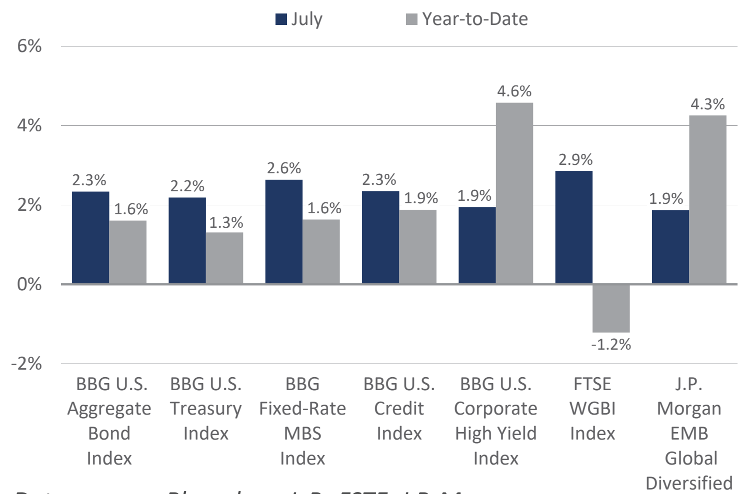
During July, the 10-year Treasury fell 27 basis points to 4.09% and the 2-year Treasury fell 42 basis points to 4.29%. Subsequently, Treasuries staged a large rally in early August following weaker economic data and renewed expectations of rate cuts, with the 10-year Treasury yield temporarily falling below 3.75%. Additionally, the yield curve steepened 15 basis points in July and temporarily de-inverted in August for the first time since July of 2022.

At its July meeting, the Fed opted to hold its benchmark rate steady, emphasizing the need for further evidence that inflation is approaching its target. However, Chair Powell did acknowledge the gradual weakening of labor data. The final week of July saw lower than expected job gains in non-farm payrolls, a modest uptick in initial and continuing unemployment claims, and an increase in the unemployment rate, which rose to 4.3% from 4.1%. The Sahm Rule—a popular recession predictor in which the three-month moving average of the U.S. unemployment rate is at least a half percentage point higher than the 12-month low—was also widely discussed at the meeting. The Fed's dual mandate is back in focus as it attempts to orchestrate a soft landing, though it may be behind the curve.

The BOJ raised its policy rate 15 bps to 0.25% and announced a gradual taper bond purchasing program. This policy change rippled through global markets and allowed the yen to rally against the dollar, ending the month at ¥149. The BOJ also emphasized that it is monitoring inflation risk and rates could rise further. However, following the volatility in August, the BOJ will likely push back on its rate increase plans and wait for markets to settle before making its next move.

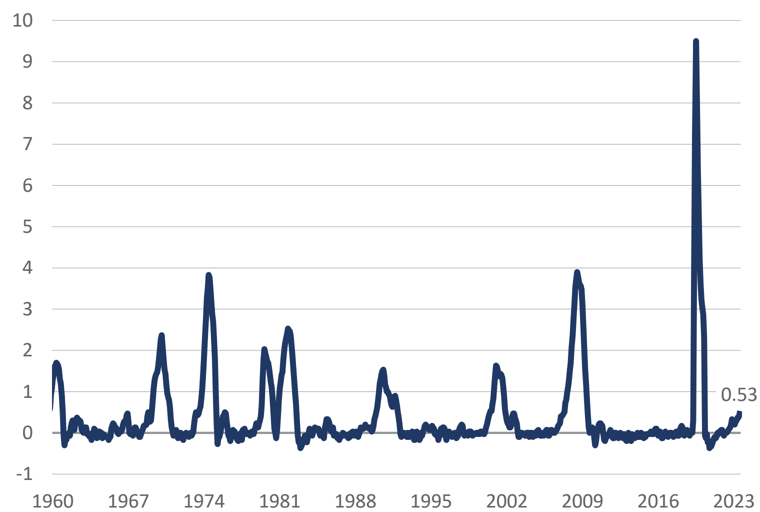
**BONDS RALLY WITH FALLING RATES**

Fixed Income Index Returns




*Data sources: Bloomberg L.P., FSTE, J.P. Morgan*

**SAHM RULE PREDICTS RECESSION**




*Data source: FRED*

# Real Assets

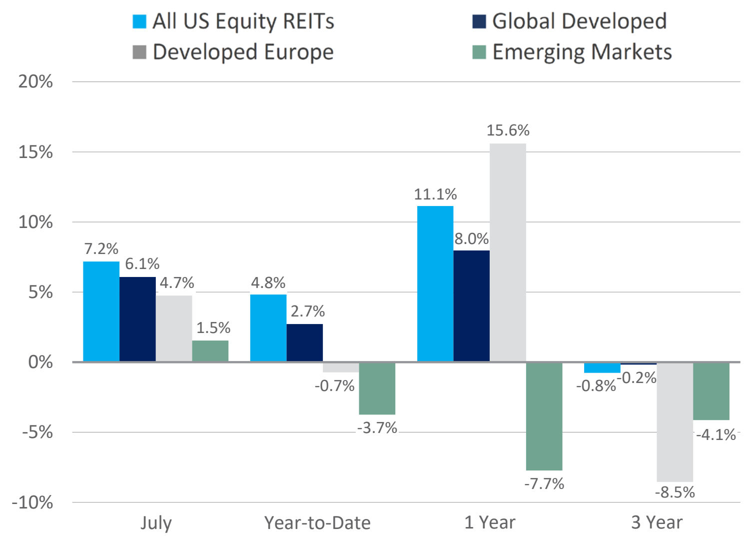
## Real Estate

In July, U.S. REITs rose 7.2%, as measured by the performance of the FTSE Nareit All Equity REITs Index. Speculation of rate cuts revived in July, lifting the listed real estate sector after its continued fight against the effects of higher interest rates. Global developed REITs were up 6.0%, held back by milder performance from developed Europe, as measured by the FTSE EPRA/Nareit Developed Index.

Surprisingly, office was a top-performing U.S. REIT sector in July, up 17.0%. The sector faced slightly improving leasing conditions, with overall demand still challenged. At the end of the month, Lineage went public in the largest initial public offering of 2024 and is now considered the world's largest cold storage REIT.

**REITs RALLY IN JULY ON RATE CUT SPECULATION**

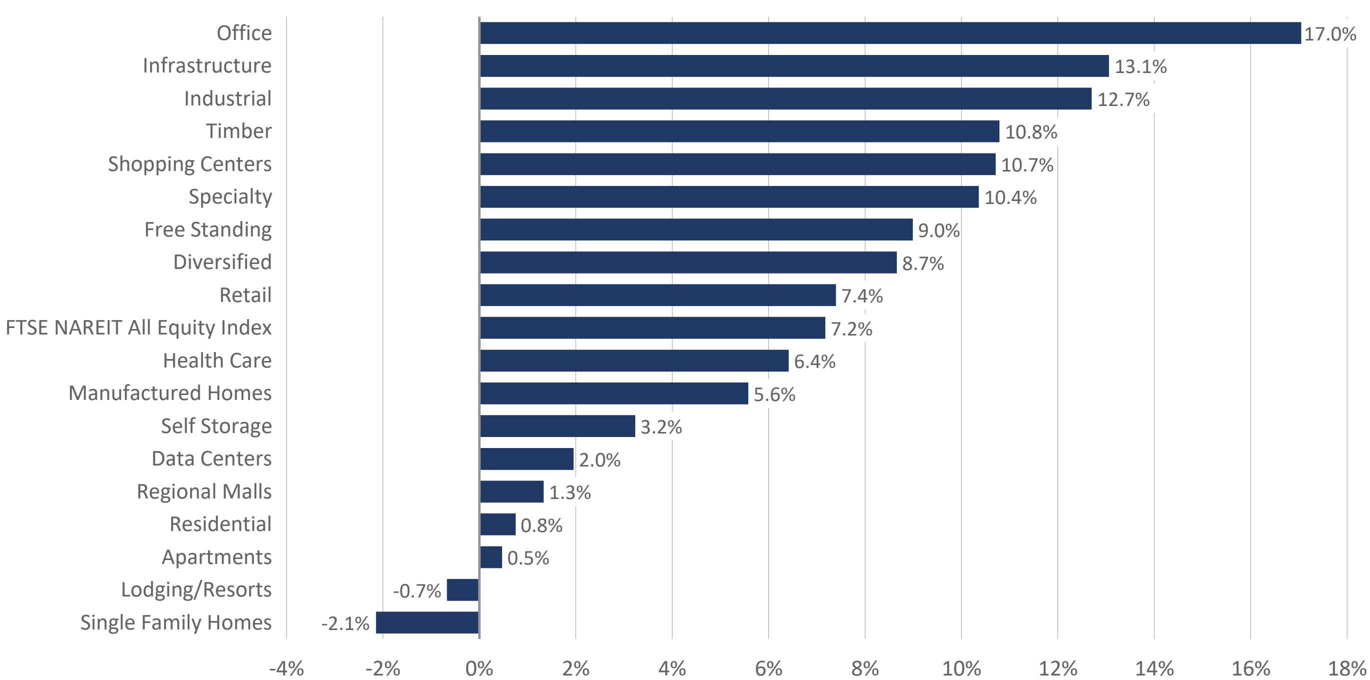
Trailing REIT Performance by Geography




*Data source: FactSet*

**LEASING IMPROVEMENTS BOOST BRUISED OFFICE SECTOR**

REIT Trailing Performance by Property Type



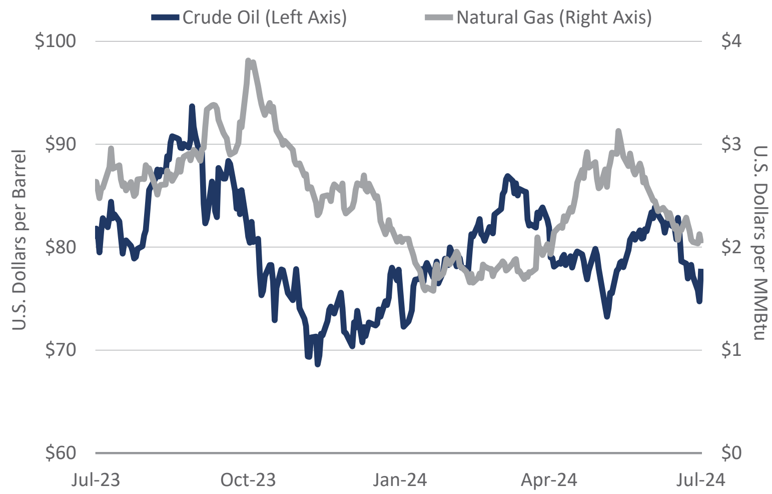

*Data source: FactSet*

## Natural Resources

Crude oil prices declined 9.8% in July, as measured by the West Texas Intermediate (WTI) spot contract. Crude prices have remained range bound in 2024, with downward pressure due to lackluster demand from China, concerns of OPEC+ voluntary cuts lifting in the fall, and continued U.S. production growth. Conversely, U.S. crude inventories reached the lowest level since February on the back of record U.S. gasoline consumption this summer and further driven by continued conflict in the Middle East. Natural gas price volatility continued, with pricing falling 21.7%, as measured by the Henry Hub natural gas spot contract.

**THE PRICE TRAJECTORY OF ENERGY HAS BEEN DOWNWARD**

Price of West Texas Intermediate (WTI) Crude and U.S. Natural Gas



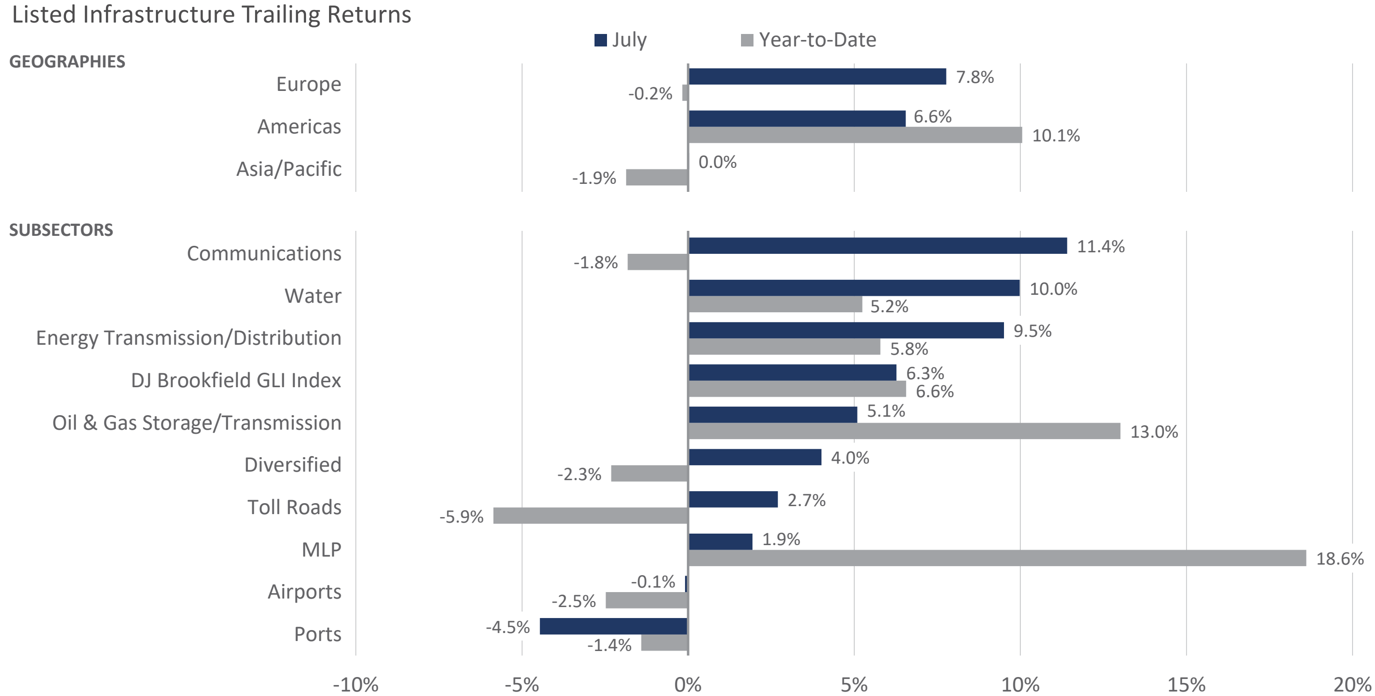

*Data source: FactSet*

## Infrastructure

Global listed infrastructure stocks rallied in line with REITs in July, up 6.3% as measured by the Dow Jones Brookfield Global Infrastructure Index. Communications—predominately cell tower stocks—led subsector performance on rate cut speculation. At the end of the month, the PJM power market region saw a 9.3x increase in capacity prices for 2025 and 2026. The price spike was driven by coal power plant retirements, load growth, and new pricing rules to better reflect the impact of extreme weather events. Publicly traded utility and independent power producer stocks rallied on the pricing increase.

**JULY BOOSTS INFRASTRUCTURE EQUITIES**

Listed Infrastructure Trailing Returns




*Data source: FactSet*

# Diversifying Strategies

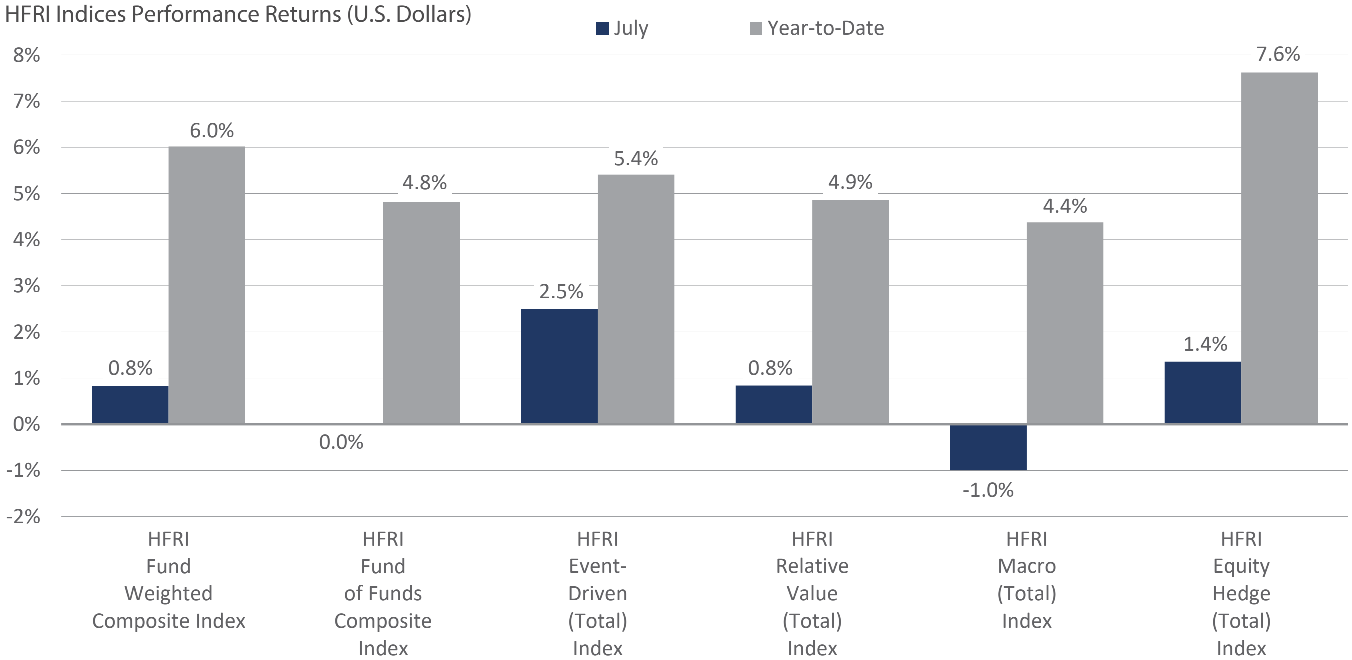
Hedge fund performance in July was positive across most underlying strategies, led by equity hedge and event-driven approaches. Within event-driven strategies, activist strategies were the biggest drivers of return. Merger arbitrage and distressed/restructuring were also significant outperformers during the month.

Discretionary macro managers were able to pivot allocations throughout the month to take advantage of the market volatility. Discretionary portfolio managers tend to be more reactive than systematic-oriented strategies, allowing them to outperform in choppy market environments.

Systematic trend-following managers faced headwinds in July as several recent trends reversed course across multiple sectors and heightened volatility in equity markets. The strategy's losses were concentrated in currencies, with fixed income and equities also resulting in losses. Given the sharp, quick reversals, longer-term models were especially challenged.

**HEDGE FUNDS GENERATED WIDESPREAD GAINS**

HFRI Indices Performance Returns (U.S. Dollars)




*Data source: HedgeFund Research*

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