Mag 7 Market

Danny Robushi, APEX MACRO Founder

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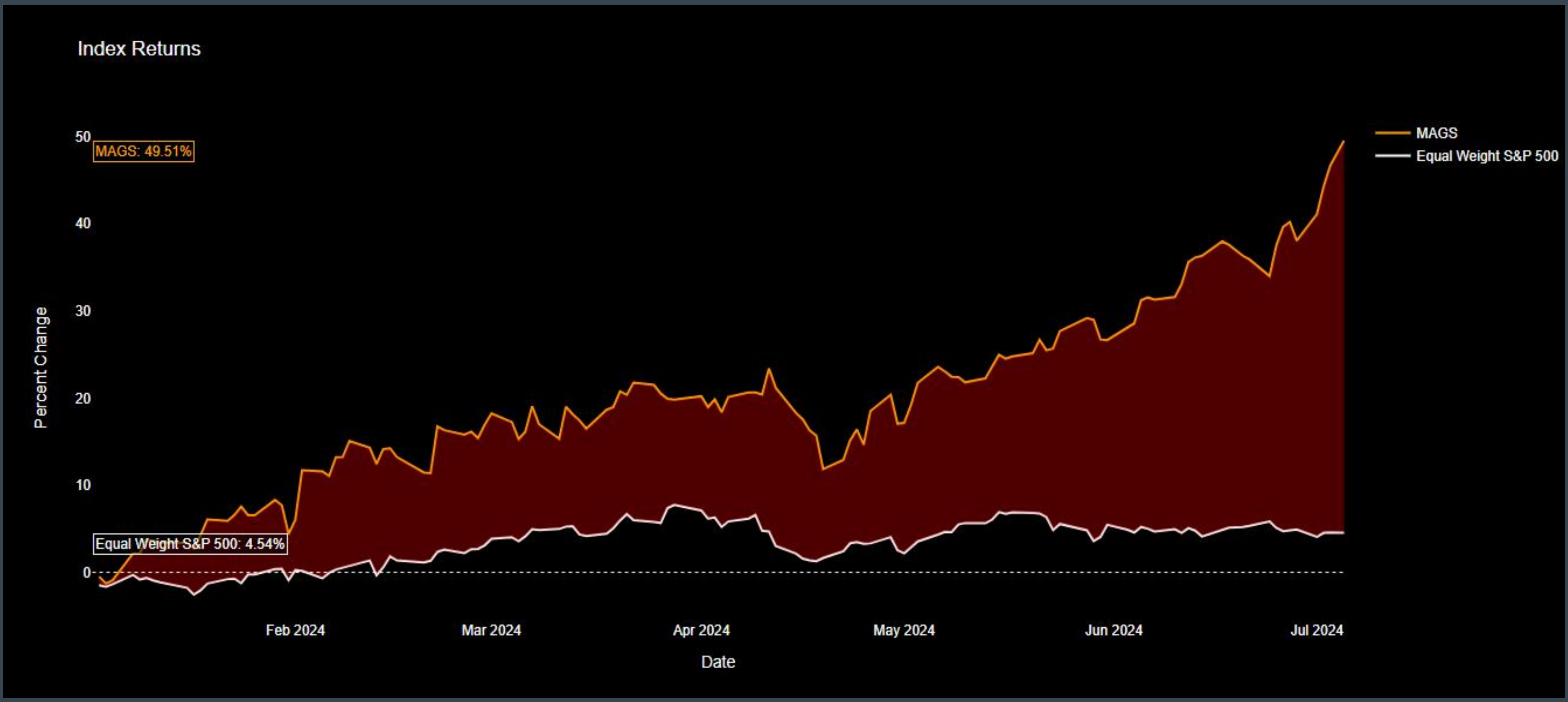
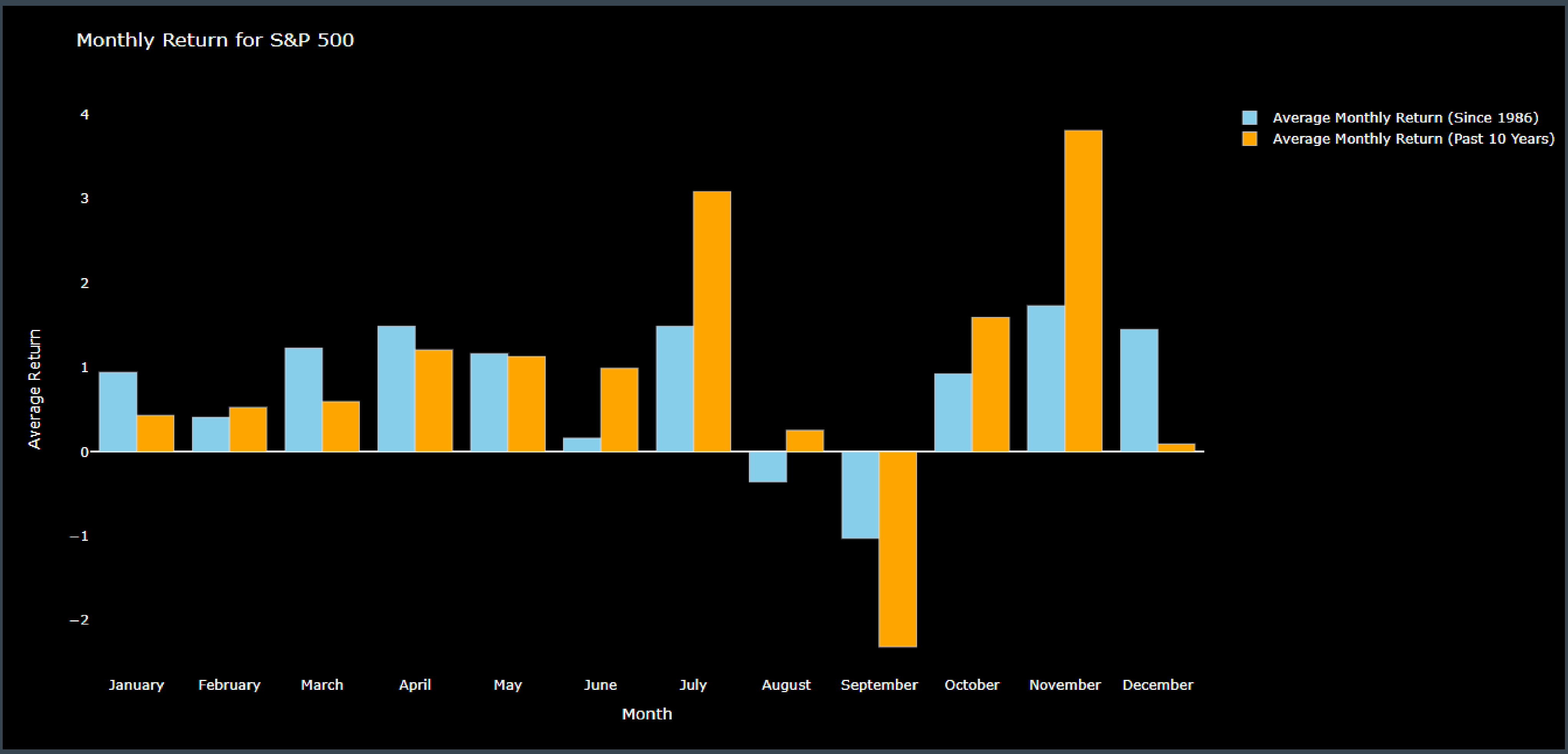
The S&P 500 grinded higher during this shortened trading week, breaking above the 5,500 mark for the first time. Despite lighter-than-usual trading volume and a market that was only open for 3 ½ days, we observed a strong bid for the Mag 7 stocks. This group of stocks has continued to outperform the broader market by a considerable margin. The deviation between the performance of the Mag 7 stocks and the average stock, represented by the RSP (Equal Weight S&P 500 ETF), has widened dramatically. Year-to-date, the Mag 7 stocks have surged nearly 50%, while the RSP has barely increased by 5%.



It has become increasingly challenging to predict what might resolve the significant market bifurcation observed over the past year. As we and many others have noted, the more concentrated the markets become, the greater the risk of heightened volatility and substantial downturns. The larger indexes are increasingly influenced by the performance of a very small number of stocks. The Mag 7 stocks, in particular, benefit from passive flows, such as 401K contributions, which likely contributed to their upward movement despite light trading volume this week. Over 30 cents of every dollar invested in the market goes into one of these seven stocks. This creates a tailwind that is unlikely to reverse unless there is a significant rise in unemployment. In such a scenario, fewer people would contribute, and there would be a higher propensity to withdraw money from 401Ks for general living expenses. Moreover, the current market structure has created career risk for money managers. The only thing people hate more than losing money is underperforming in an up market. As a result, they are compelled to participate and allocate funds to these stocks, regardless of valuations, because they cannot match market performance without them. Additionally, these stocks are now perceived as safe havens, boasting the best balance sheets, the most cash, and the strongest pricing power. In a downturn, it is expected that the largest companies would fare the best, falling less than the overall market. Barring any significant technical deterioration within the Mag 7, which might cause some consolidation or pullback, it is difficult to envision this group experiencing a material decline as we approach year-end. In recent weeks, there has even been turnover within the Mag 7, with Nvidia correcting but being offset by rallies in Apple, Google, Amazon, and Tesla. At some point, this deviation will resolve, and going long the equal weight index is likely to be a trade that outperforms. However, predicting the catalyst and timing remains impossible. For now, the Mag 7 are driving both technicals and earnings growth, which is why they continue to attract most of the investment flows.

As we enter July, let's take a look at seasonality and how the S&P 500 has performed on average each month over the last 10 years, as well as extending back to the 1980s

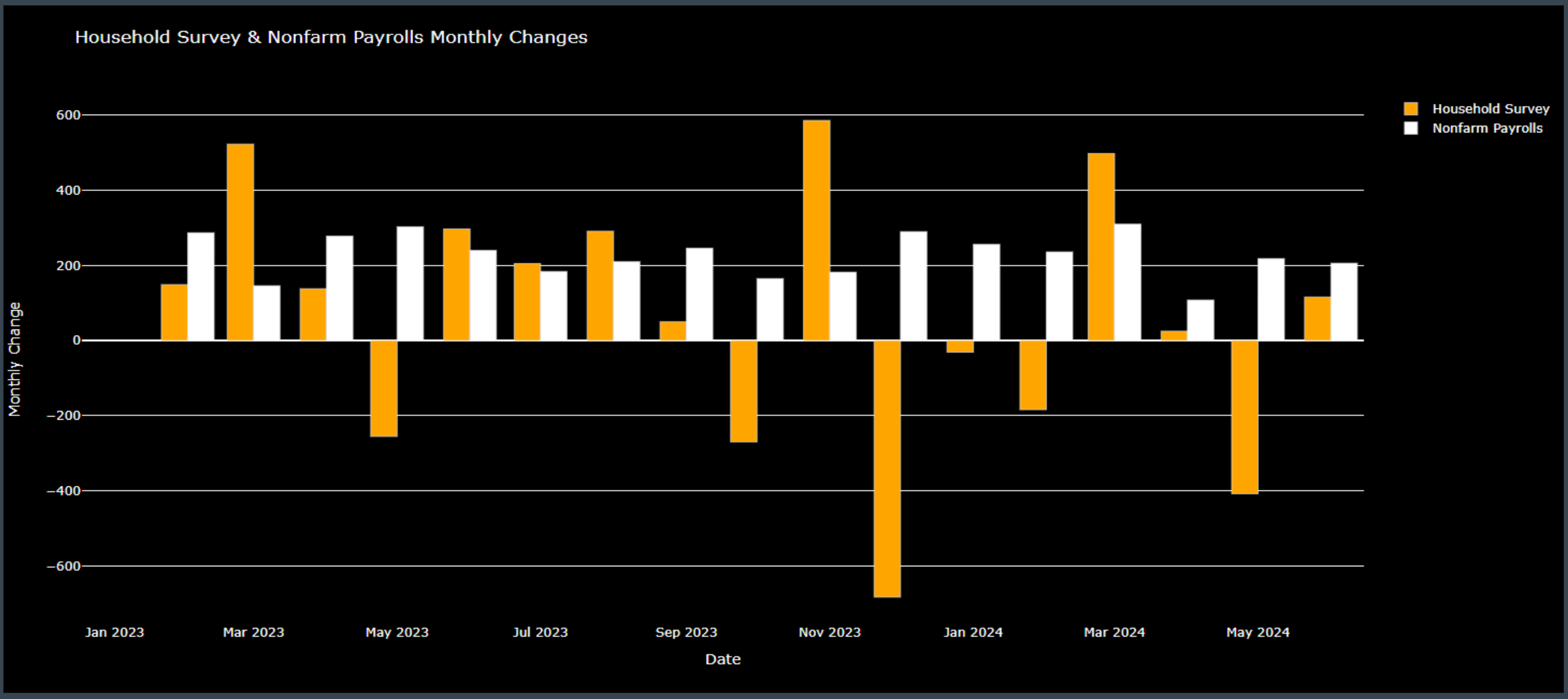


Stocks going back to 1986 have, on average, returned over 1% in July and over 3% in the past 10 years during this month. July tends to be a favorable month for the market, and historically, 10 months of the year tend to show positive returns. However, August and September are typically challenging months for the market. Comparing this year's market trajectory with 2023 supports this pattern. In 2023, the stock market peaked at the end of July, followed by a correction lasting until the end of October. The market path in 2024 so far appears eerily similar to last year

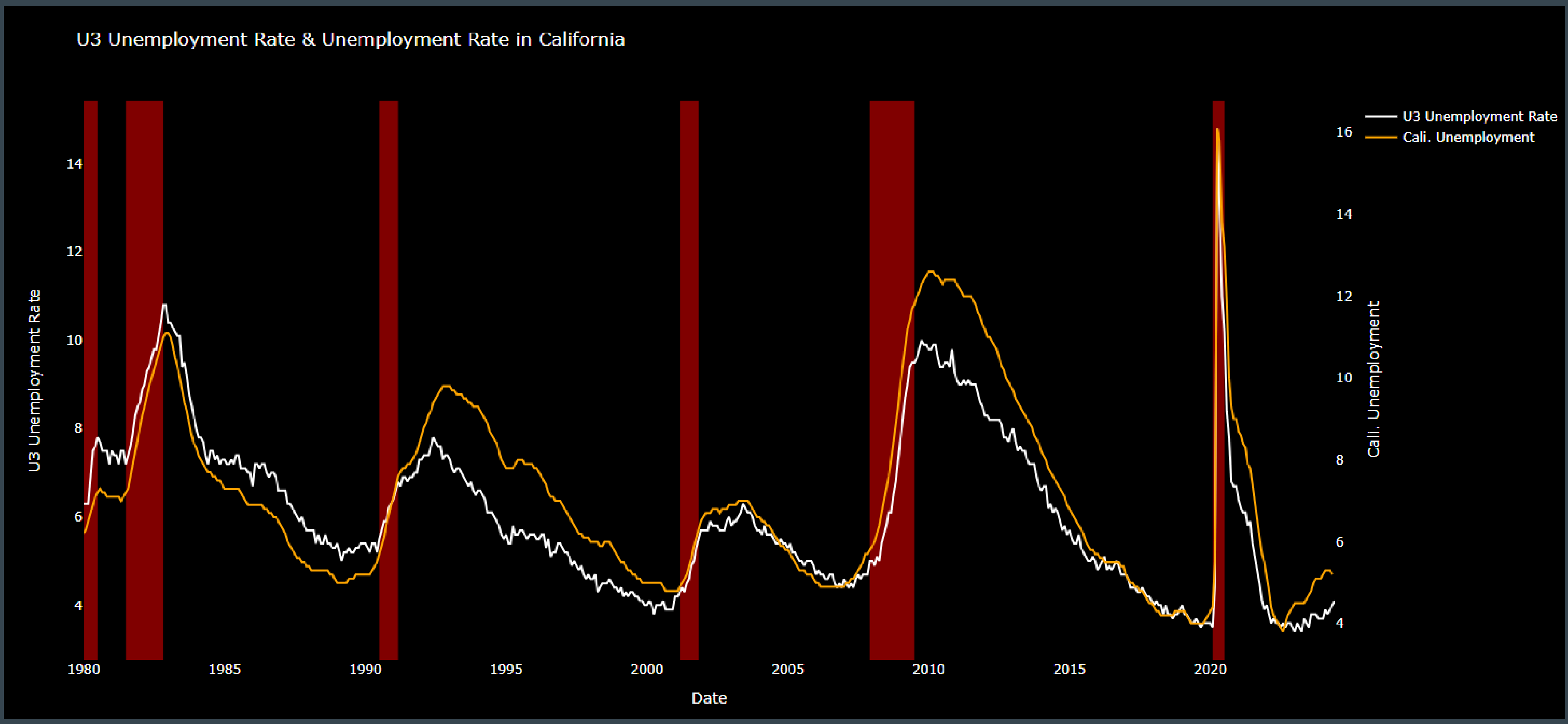
Another aspect we examined was the seasonality of the VIX. We analyzed data from all years since 2000, excluding 2008 and 2020 due to the extreme volatility caused by the Great Financial Crisis and COVID-19, which would have skewed the results. Our findings indicate that September through October typically experiences heightened volatility before it subsides heading into the year-end. Considering all these factors, after a 16% return in the first half of the year with the top 7 stocks up 50%, it suggests that a correction could be due in the fall, coinciding with the election season. Markets generally dislike uncertainty, and with plenty of it in the political landscape right now, we place a high probability on seeing a pullback come September and October.

Another month, another Nonfarm Payroll report that beat expectations, along with more downward revisions to previous data. This pattern has been consistent for the better part of the last year. Nonfarm payrolls came in at 206,000 versus the expectations of 185,000. Last month's number was revised down from 272,000 to 218,000, and April's figure was revised from 165,000 to 108,000. So, jobs just over the last 2 months were overstated by 111,000. Over the past 15 months, 10 have seen downward revisions, which often serve as a recession indicator. While a headline of 206,000 does not yet signal a significant slowdown in the job market, the revisions suggest that the initial data, which the market reacts to, is overestimated. As usual, a deeper look into the data reveals that the payrolls added do not reflect what we would consider a healthy economy.

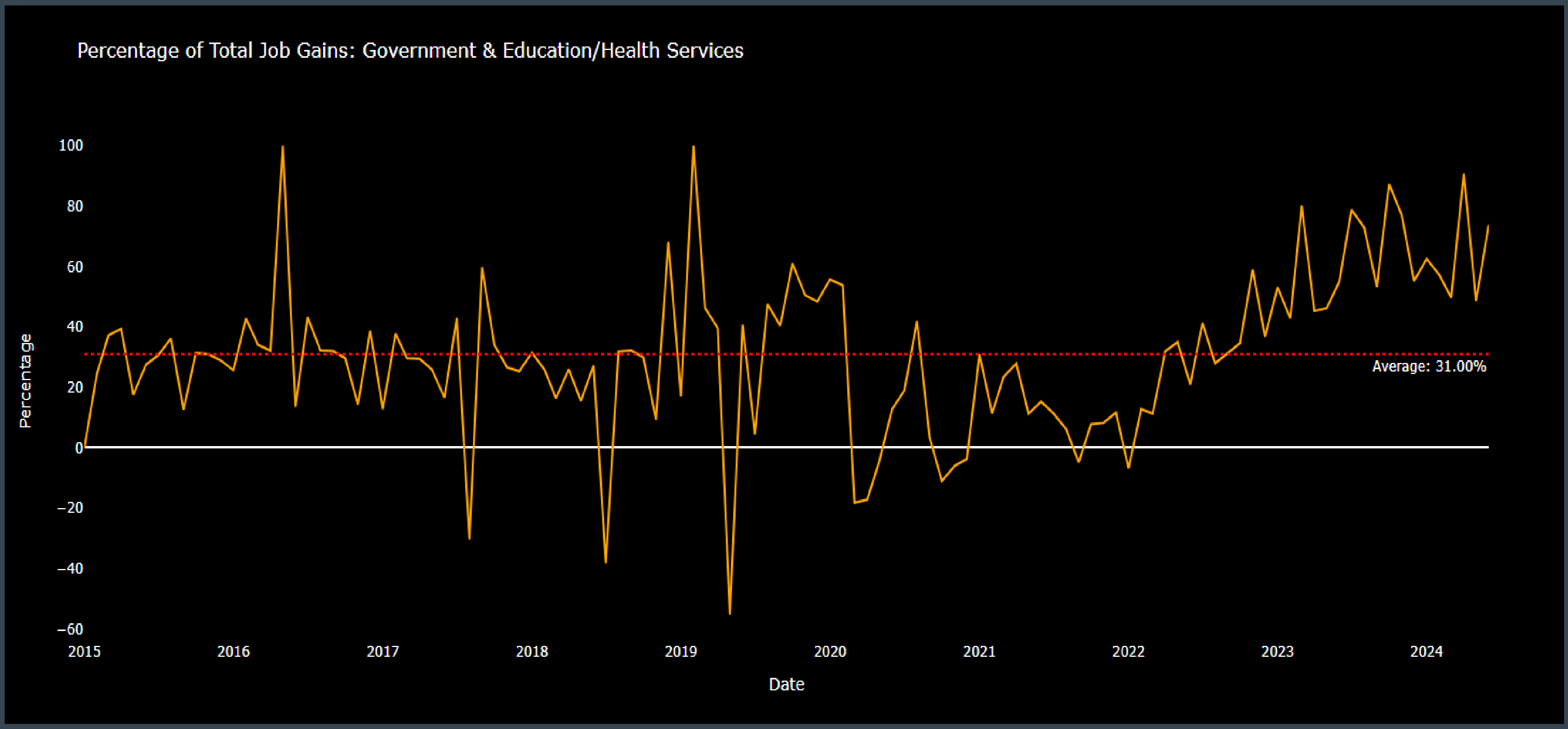
The Household Survey rebounded from the -408,000 print last month to 116,000 this month.



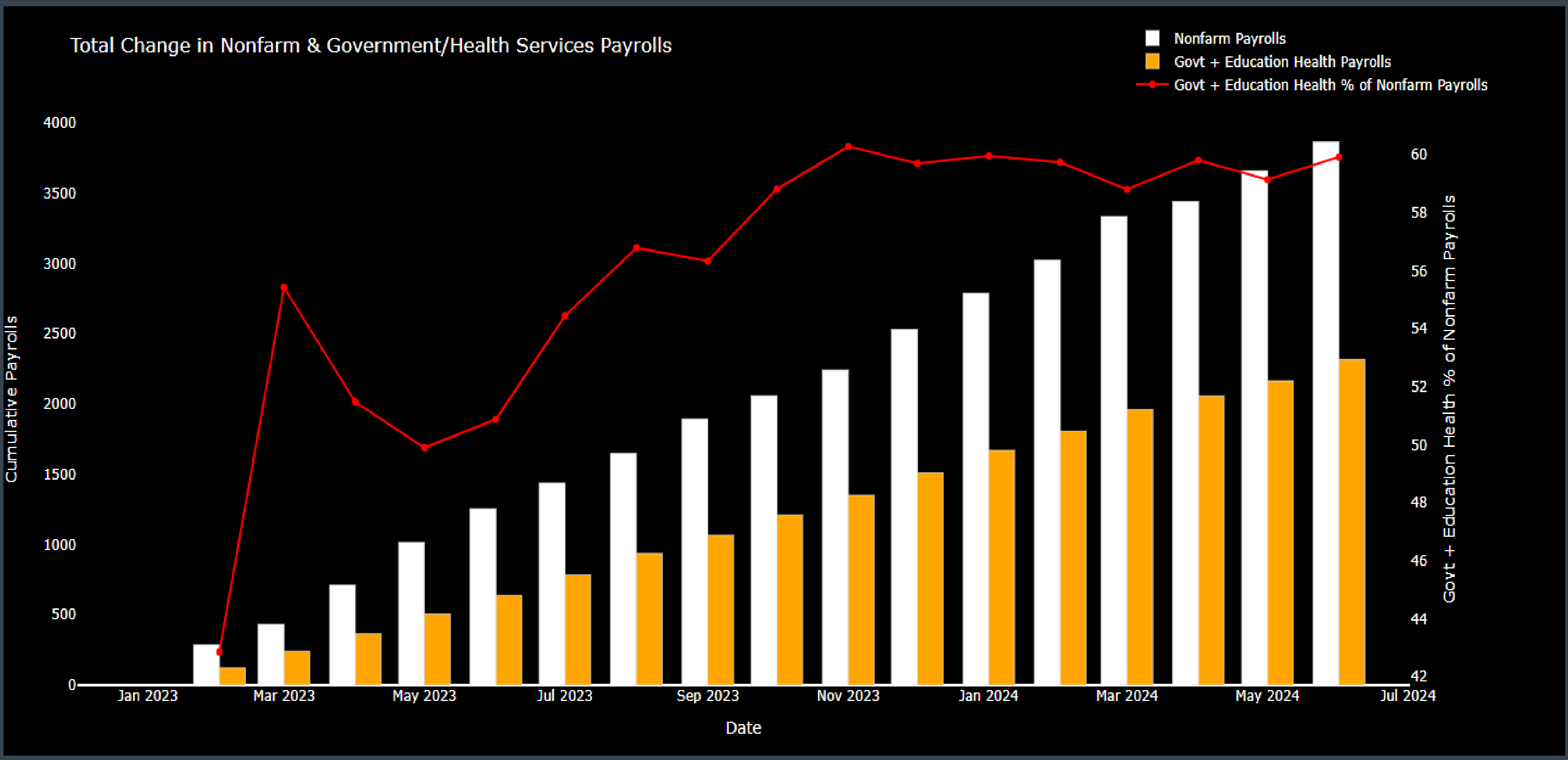
The unemployment rate ticked up 10 basis points to 4.1%. It has a 90%+ correlation to the unemployment rate in California which is at 5.2%. This tells us unemployment is likely to head higher. At 4.1% the unemployment rate is already above the Fed SEP Projection put out last month that predicted a peak of 4% at year end. We also want to point out that if unemployment moves higher by another 10 basis points to 4.2% in July, it will trigger the Sahm Rule (3 month moving average rises 50 basis points above the 12-month low). Headlines in the media will likely begin to focus on this indicator as we get close to July's report and especially if the indicator is triggered in the first week of August.



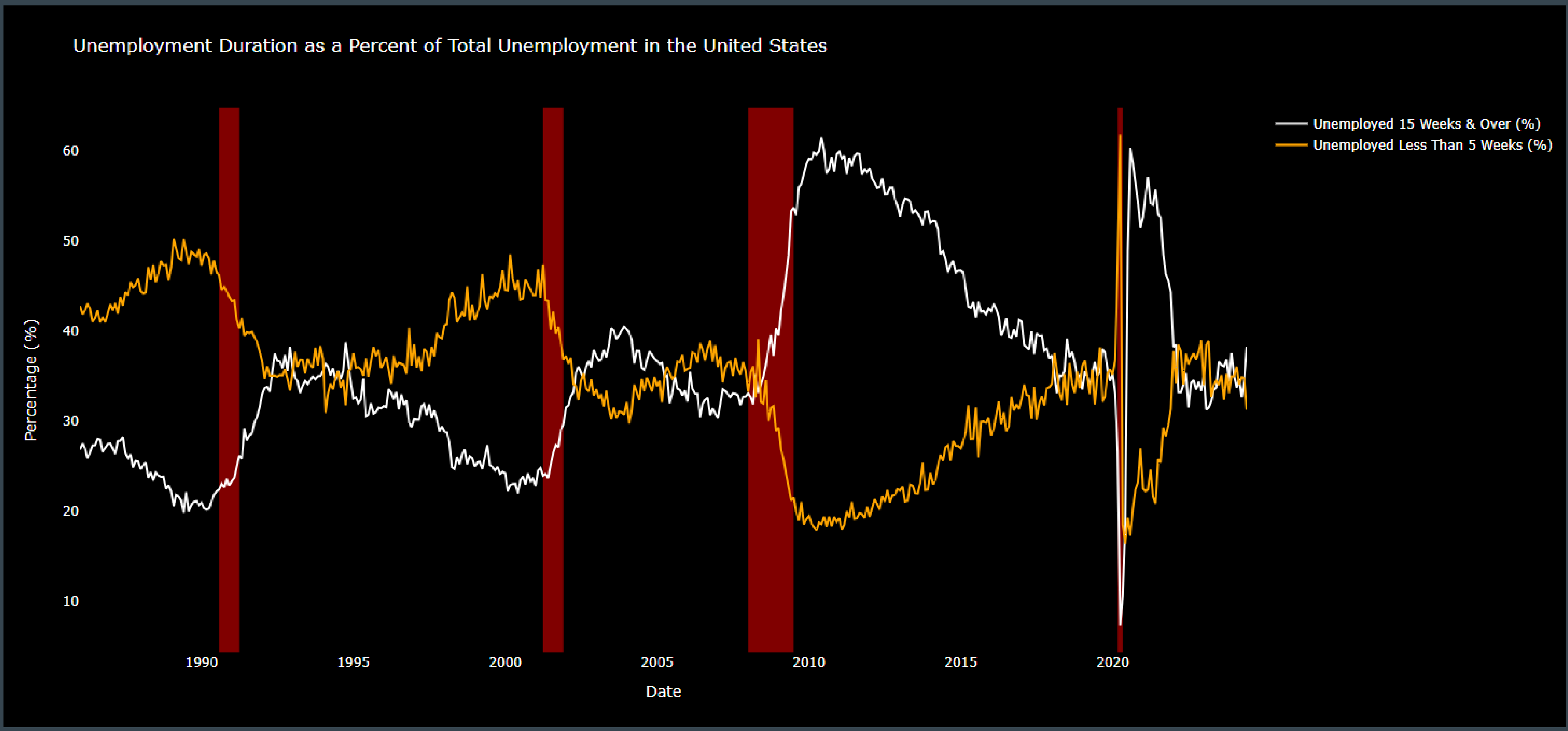
In June, 73% of payroll gains were from government or government-related jobs in education and health services. This continues the hiring trend by the government that has been ongoing since late 2022. Historically, the average percentage of payroll gains in these sectors has been 31% going back to 2015. However, since August 2022, there has not been a single month where the percentage of payroll gains has been at or below this 31% average.



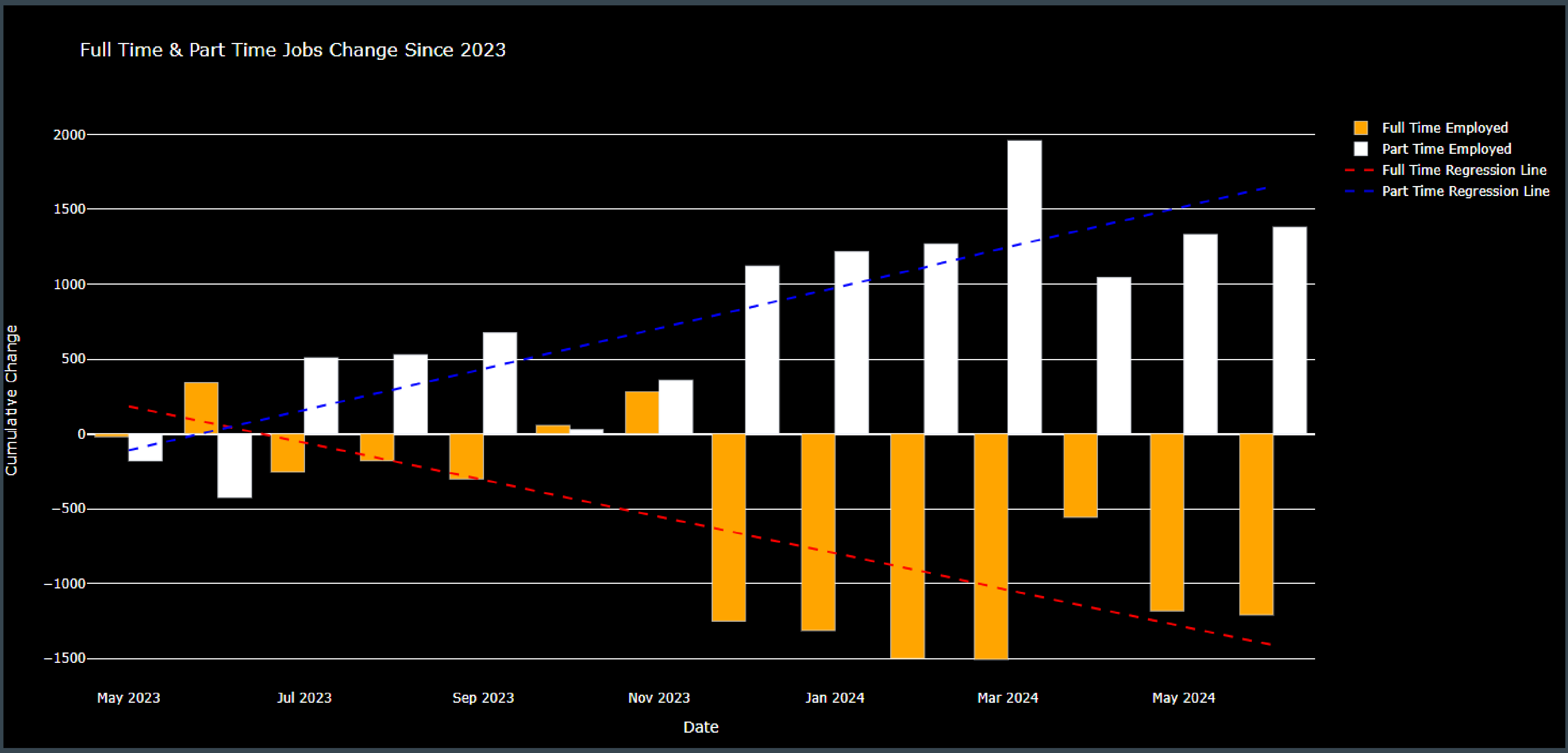
If we look at the cumulative change in government and education/health services payrolls starting back in 2023 they have made up 60% of the total job gains. As stated in pervious articles we do not think this represents a healthy economy as it takes private sector jobs and taxes to pay the salaries of Government workers which is a headwind to economic growth.



We took a deeper look into not only the unemployment rate but also the duration of unemployment and the percentage of workers struggling to find new jobs. The speed at which unemployed individuals find work is a strong indicator of the labor market's health and can signal whether hiring is picking up or slowing down. Our analysis revealed that the percentage of people unemployed for over 15 weeks now exceeds the percentage of those unemployed for less than 5 weeks. Historically, these lines tend to cross well into a recession, going back to 1990.



The most glaring trend that indicates an unhealthy labor market is the deviation between full-time and part-time jobs. This month, full-time jobs declined by 28,000, while part-time jobs increased by 50,000. More concerningly, cumulatively since April 2023, full-time jobs have decreased by over 1.2 million, while part-time jobs have risen by 1.38 million.


Full Time & Part Time Jobs Change Since 2023
Full Time Employed
Part Time Employed
Full Time Regression Line
Part Time Regression Line
2000
1500
1000
500
0
−500
−1000
−1500
Cumulative Change
May 2023
Jul 2023
Sep 2023
Nov 2023
Jan 2024
Mar 2024
May 2024
Date

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