Market Update

Danny Robushi, APEX MACRO Founder

July 27, 2024

- The Mag 7 have been dominant year to date and created a market with narrow leadership
- A rotation has been sparked by short covering and followed up by profit taking in the Megacaps. This has led to the start of a broadening out of performance to other sectors of the S&P 500
- To support their optimistic earnings projections of 36% growth for 2025, Small-Cap companies will require accelerated GDP growth and lower yields.
- For the overall rotation to be sustained the broadening out of earnings within the S&P 500 has to come to fruition this year
- Lower yields and a weaker Dollar would be a setup for an environment where Foreign stocks begin to outperform
- PCE this past week came in at expectations and the Feds SEP released in June revised PCE for 2024 higher while keeping unemployment flat at 4%. This gives them the cover to justify cuts

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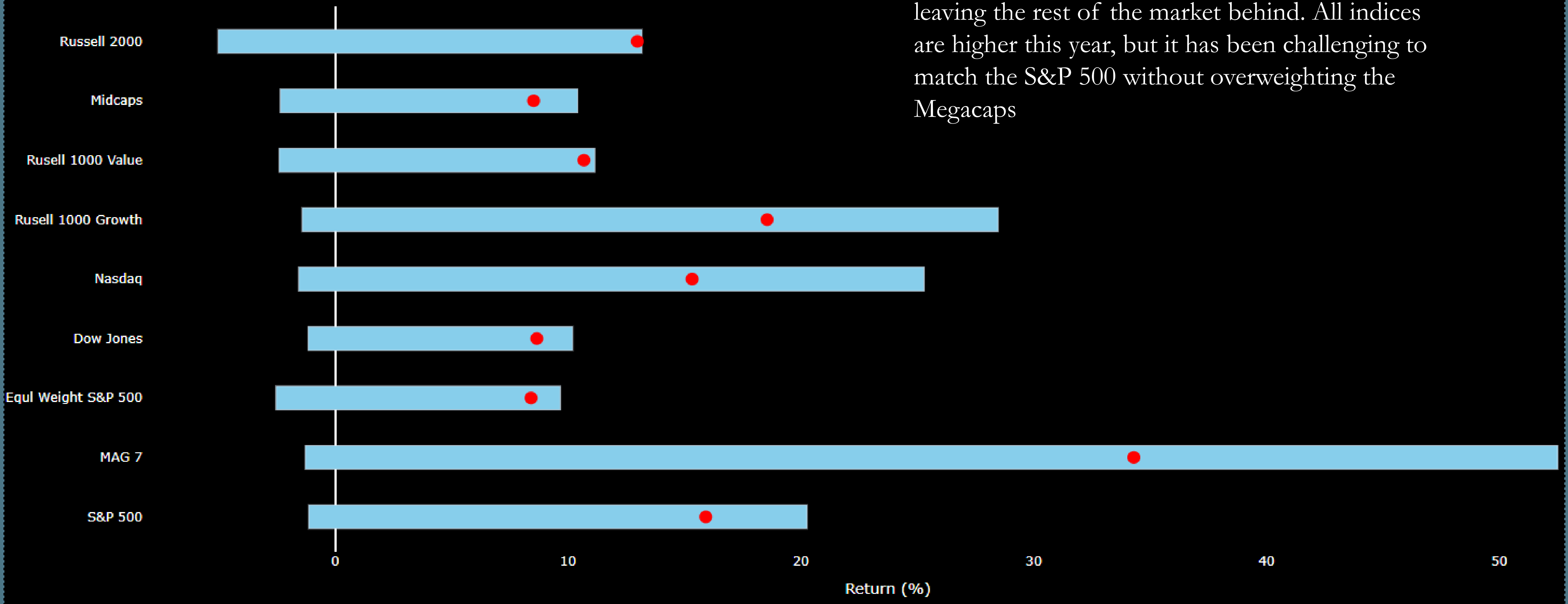
Year To Date Returns



Mag 7 dominance has created narrow leadership leaving the rest of the market behind. All indices are higher this year, but it has been challenging to match the S&P 500 without overweighting the Megacaps

The Russell 2000 was on a straight line down and to the right vs. the S&P 500 for the last 3 years until the recent rally. Even with the 10% move we are still in a drawdown from the late 2021 peak

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Russell 2000

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Traders are still underweight. The rally sparked some covering with a move to lower short positioning but this past week some of those shorts have been put back on

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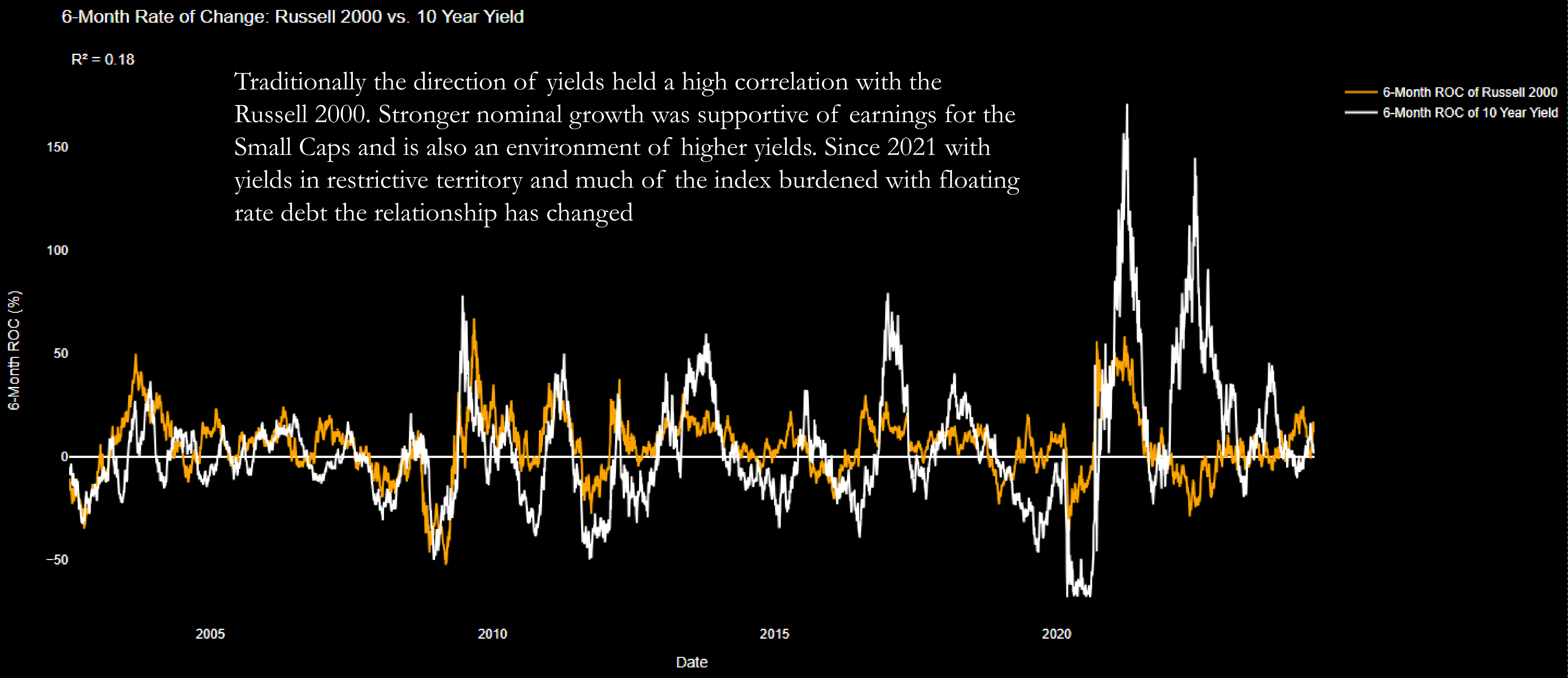

Traditionally the direction of yields held a high correlation with the Russell 2000. Stronger nominal growth was supportive of earnings for the Small Caps and is also an environment of higher yields. Since 2021 with yields in restrictive territory and much of the index burdened with floating rate debt the relationship has changed

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Since 2020 there is a clear relationship between the relative performance of the S&P 500 and Russell 2000 with the 10 Year Yield. Lower yields have meant Small Caps beat the broader index while the S&P 500 has absorbed the impact of higher rates better

In looking at the Mag 7 all the way down to Microcaps relative to the 10 Year Yield, since November of 2023 the impact of higher yields is greater as you move down the Market Cap spectrum

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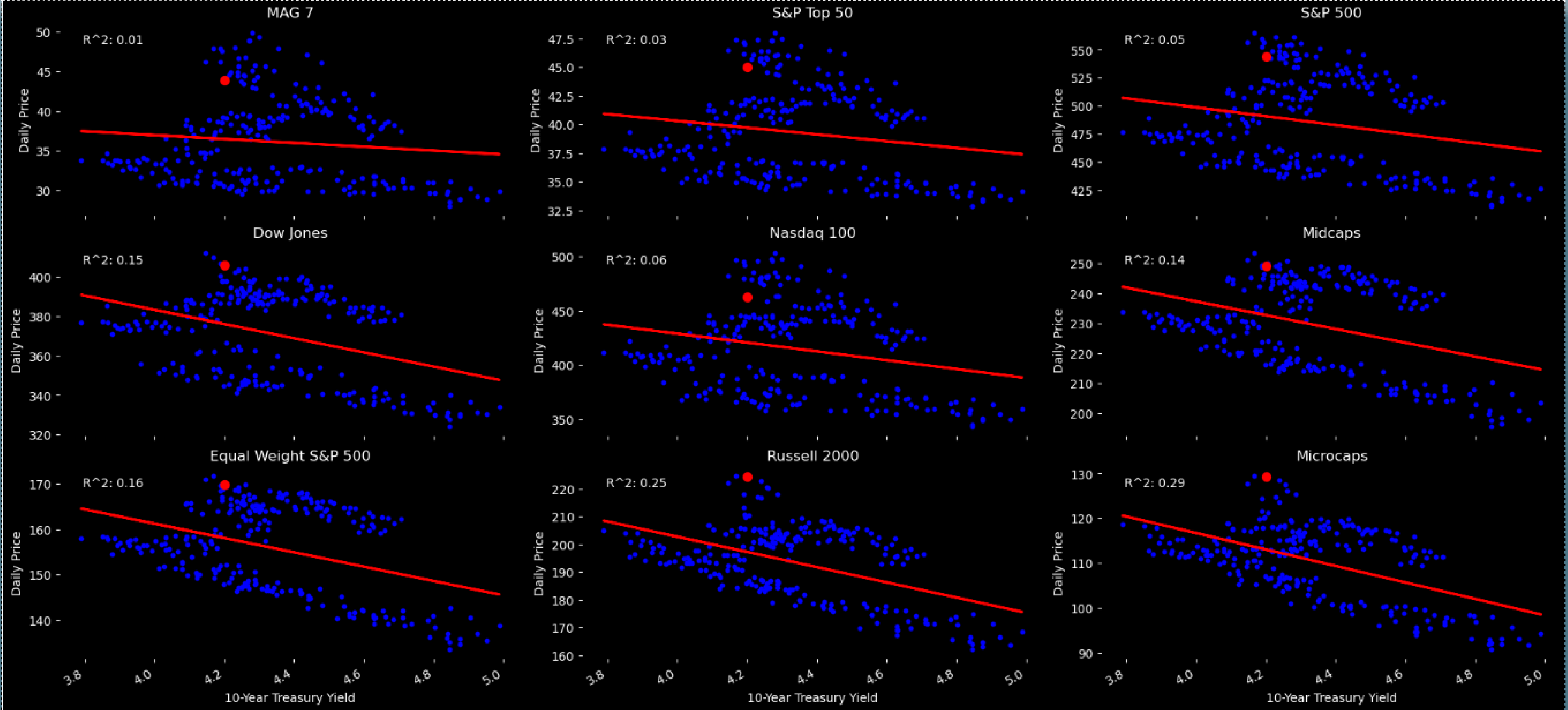

Value stocks beat growth post Dotcom bubble and through the GFC. Starting in 2014 we have had a historic run up in Growth outperformance driven by big tech

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The strength/weakness of the Dollar has played a key role in the relative performance of Growth/Value. Stronger Dollar has led to Value beating Growth and vice versa for a weaker Dollar

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Growth ETF (IWF) / Value ETF (IWD) Ratio & USD (Dollar Index)

International Markets have struggled to go anywhere the last few years. There was some outperformance coming out of the 2022 bottom but that did not last long as U.S. equities reclaimed dominance

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International Developed Markets (EFA)

The Dollar plays a key role in the performance of International Markets. Strength in the USD has contributed to the S&P 500 beating Foreign markets for the last 15+ years. Foreign markets will need to see weakness to outperform

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APEX MACRO

The Equal Weight S&P 500 finally rallied against the Market Cap Weight S&P 500 over the past 2 weeks after its underperformance this year. The broadening out in EPS growth that's expected will allow the rally to continue

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S&P 500 Equal Weight ETF (RSP)

The correlation between stocks and bonds converged with the correlation between the Equal Weight S&P 500 and Market Cap Weight index for the first time in recent history. This has meant you were more diversified within the S&P 500 than you were holding a 60/40 portfolio. It creates risks within the broader market though as correlations head toward 1 in market selloffs and they could not go much lower

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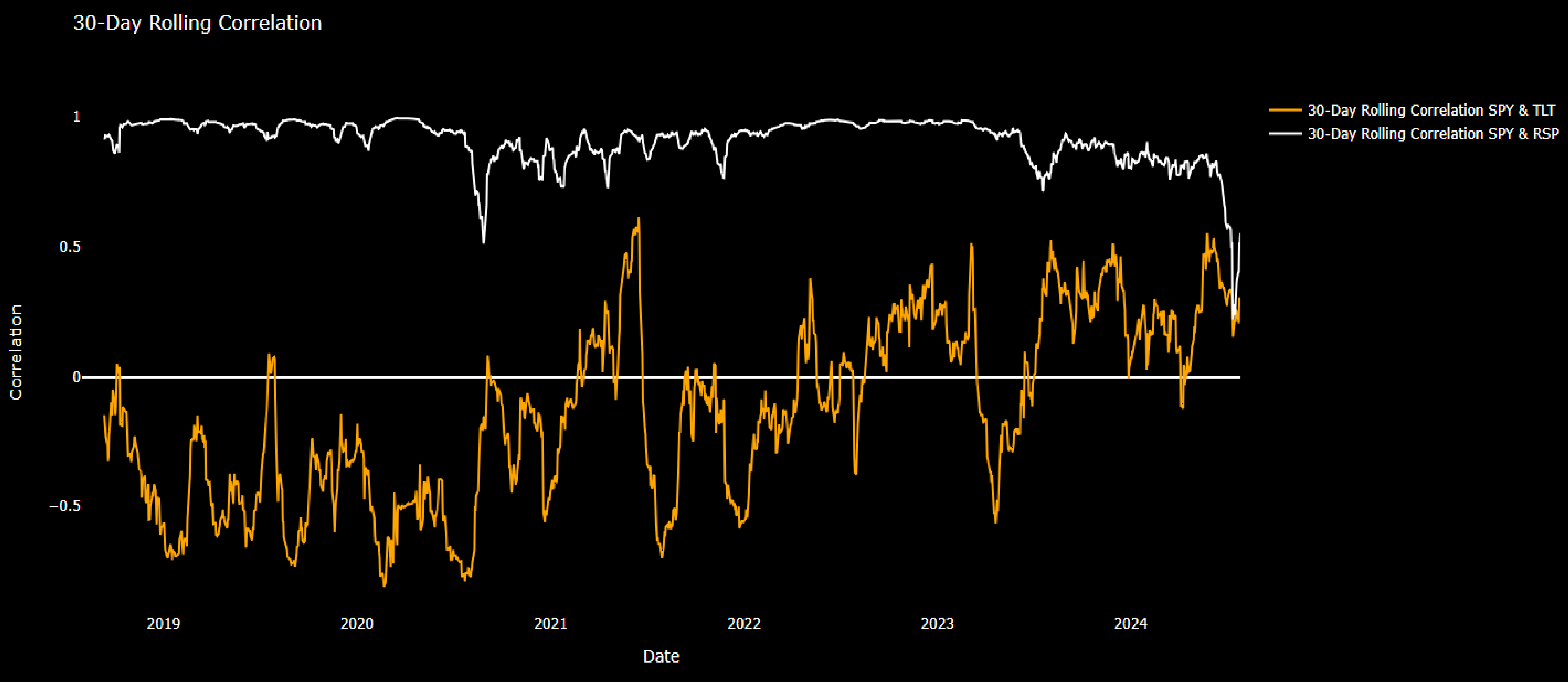

Mag 7 dominance finally broke to the downside both on a technical basis and relative the broader index. These stocks now sit below their 50-day moving average with some still to report earnings for Q2 in the coming weeks. Earnings will be less important than the guidance they provide

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The average correlation between each of the Mag 7 stocks was nonexistent to start the month. As they sold off their correlations snapped back. Here lies the risk in high levels of concentration within the index. As those stocks pull back and become more correlated, they pull the market with them

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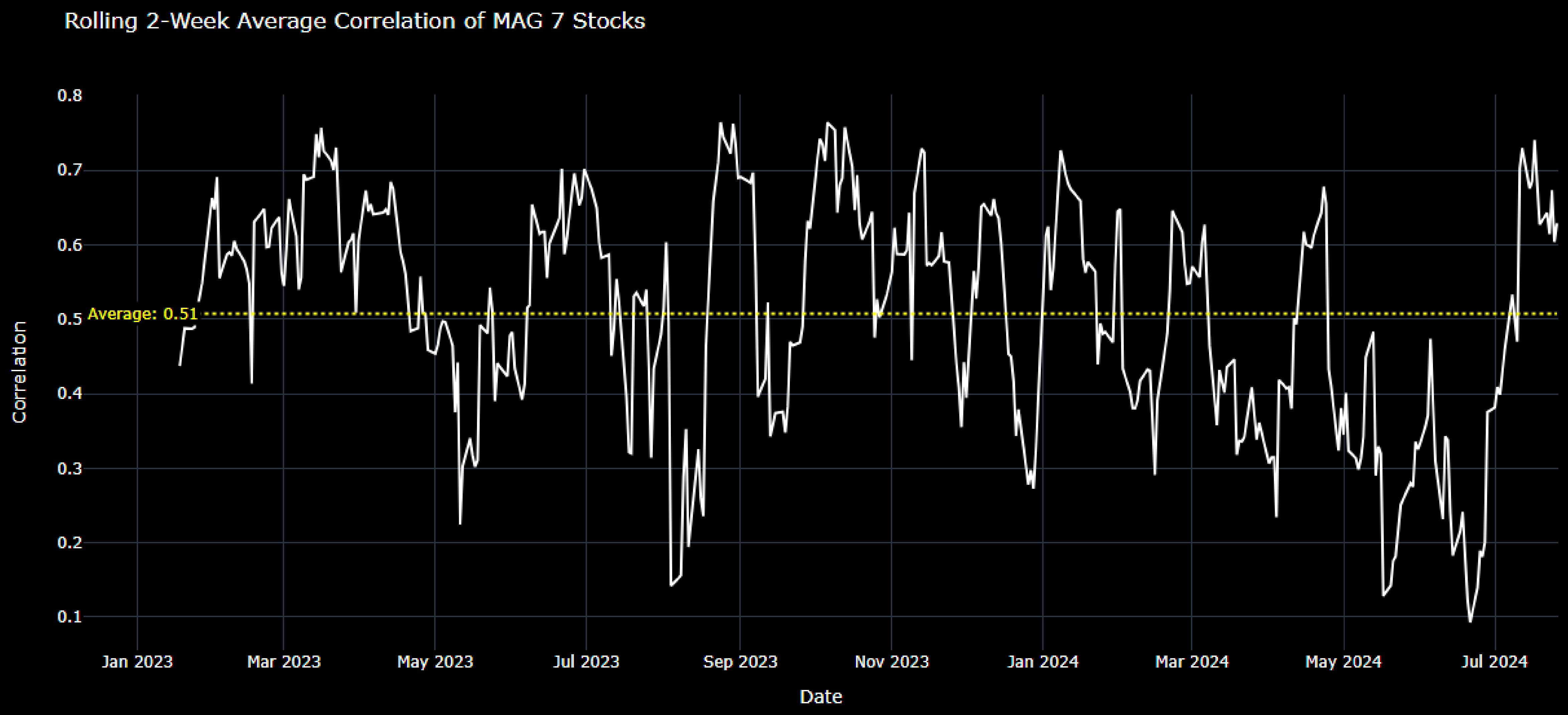

With this selloff we saw volatility come back into the market. However, many of them were at such low levels of volatility that it only caused them to move toward their averages

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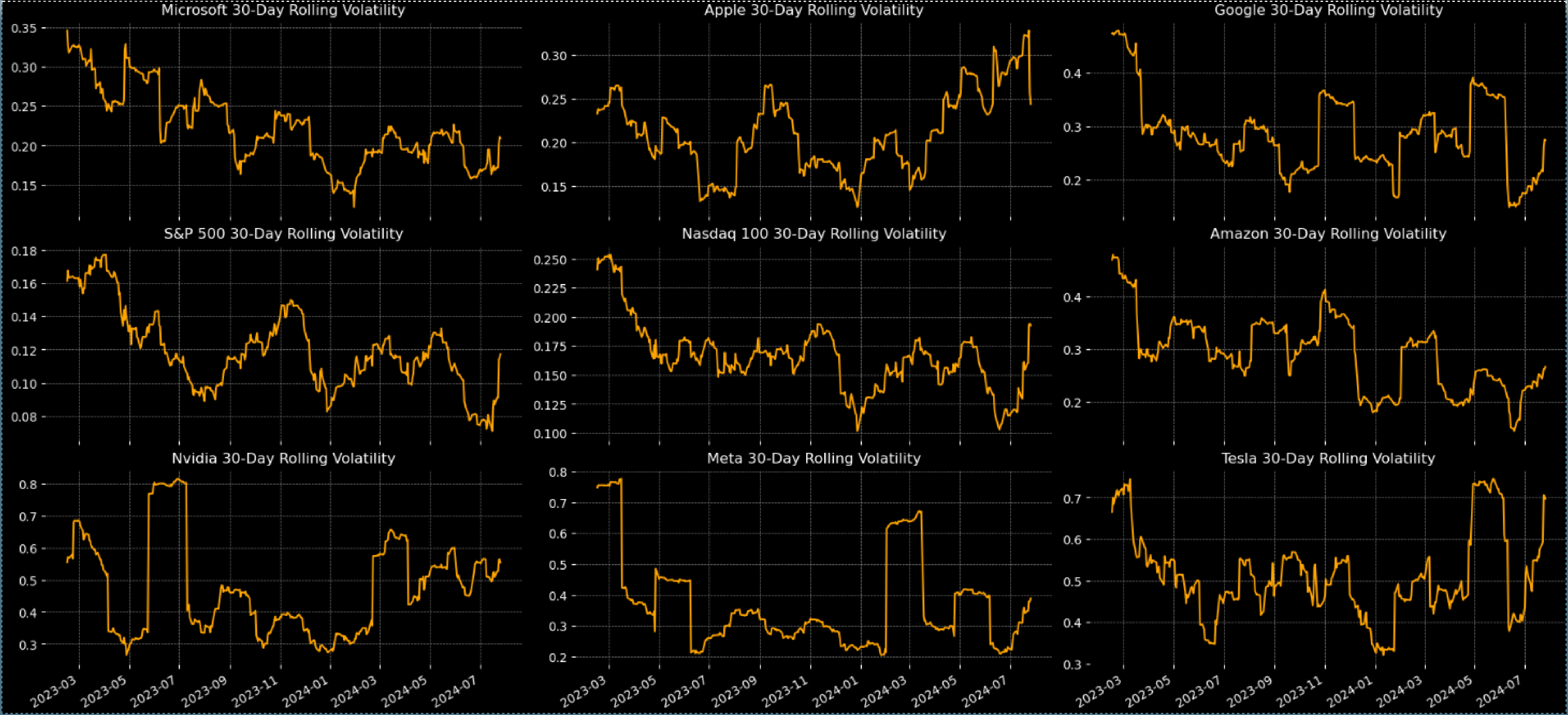

The R2 between the MAGS ETF which equal weights the Mag 7 and the S&P 500 has been 0.71 this year. These stocks have an overwhelming grip on overall market performance

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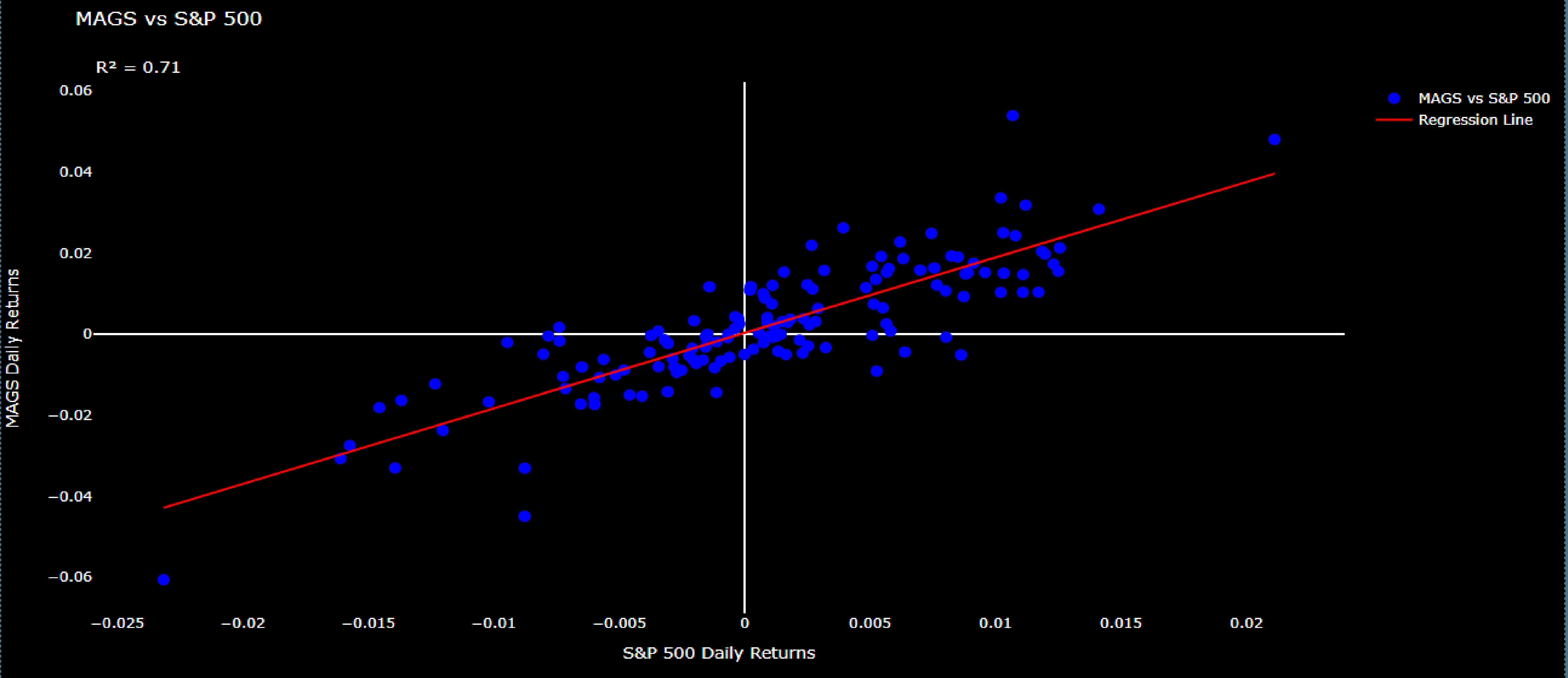

The 5-year Treasury Yield has broken below both the 50 DMA and 200 DMA. It sits just above 4% and the move lower across the curve has taken pressure off stocks. With only 1-2 rate cuts expected this year we could be nearing a bottom on yields barring a forced cutting cycle from the Fed due to economic weakness

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The 10 Year Yield has more influence over asset prices but has the same price action as the 5 Year. We are 20 basis points away from a 3 handle for the first time in 7 months

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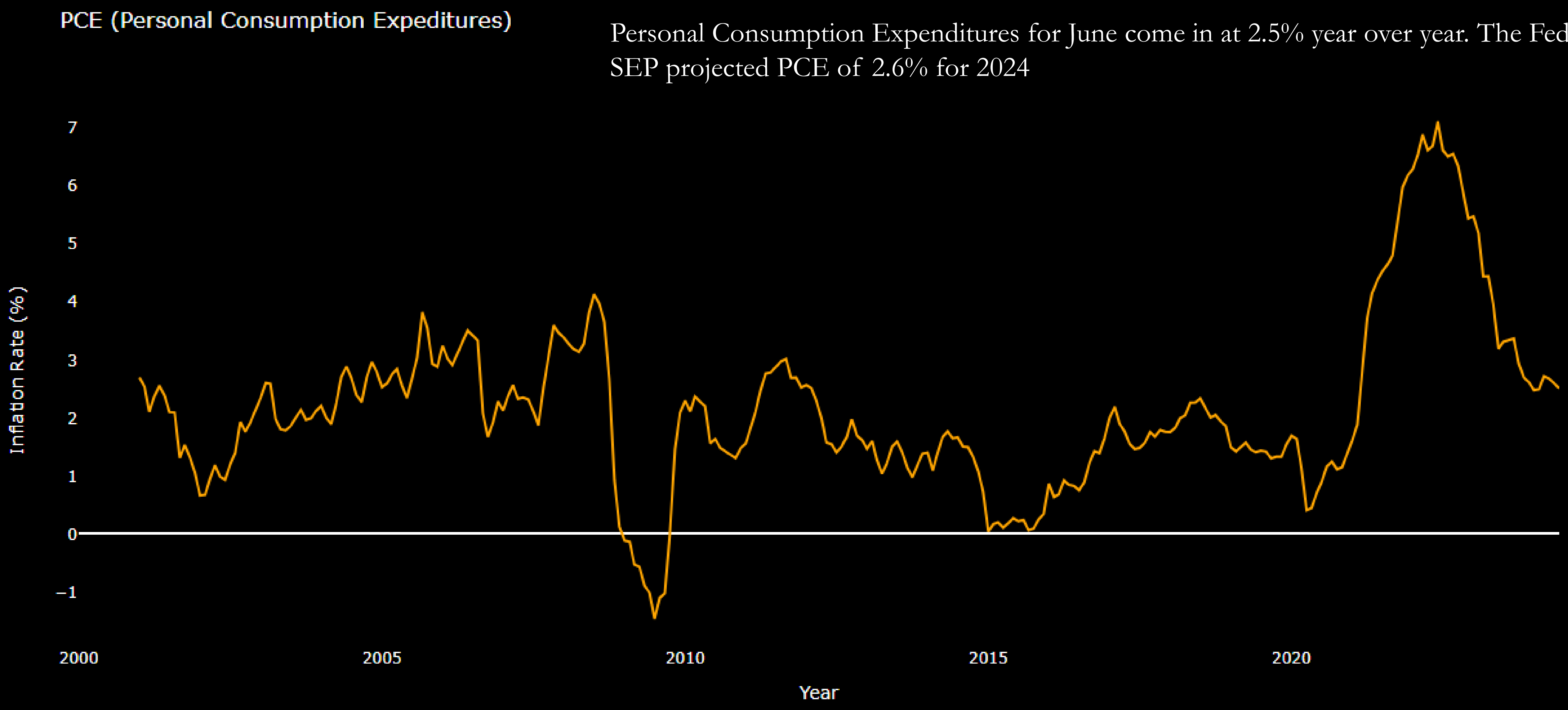
Personal Consumption Expenditures for June come in at 2.5% year over year. The Feds SEP projected PCE of 2.6% for 2024



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If you forecast out what PCE would look like if it averaged 0.10, 0.15 and 0.20 for the rest of the year we end below the Feds projection as long as it stays below 0.20

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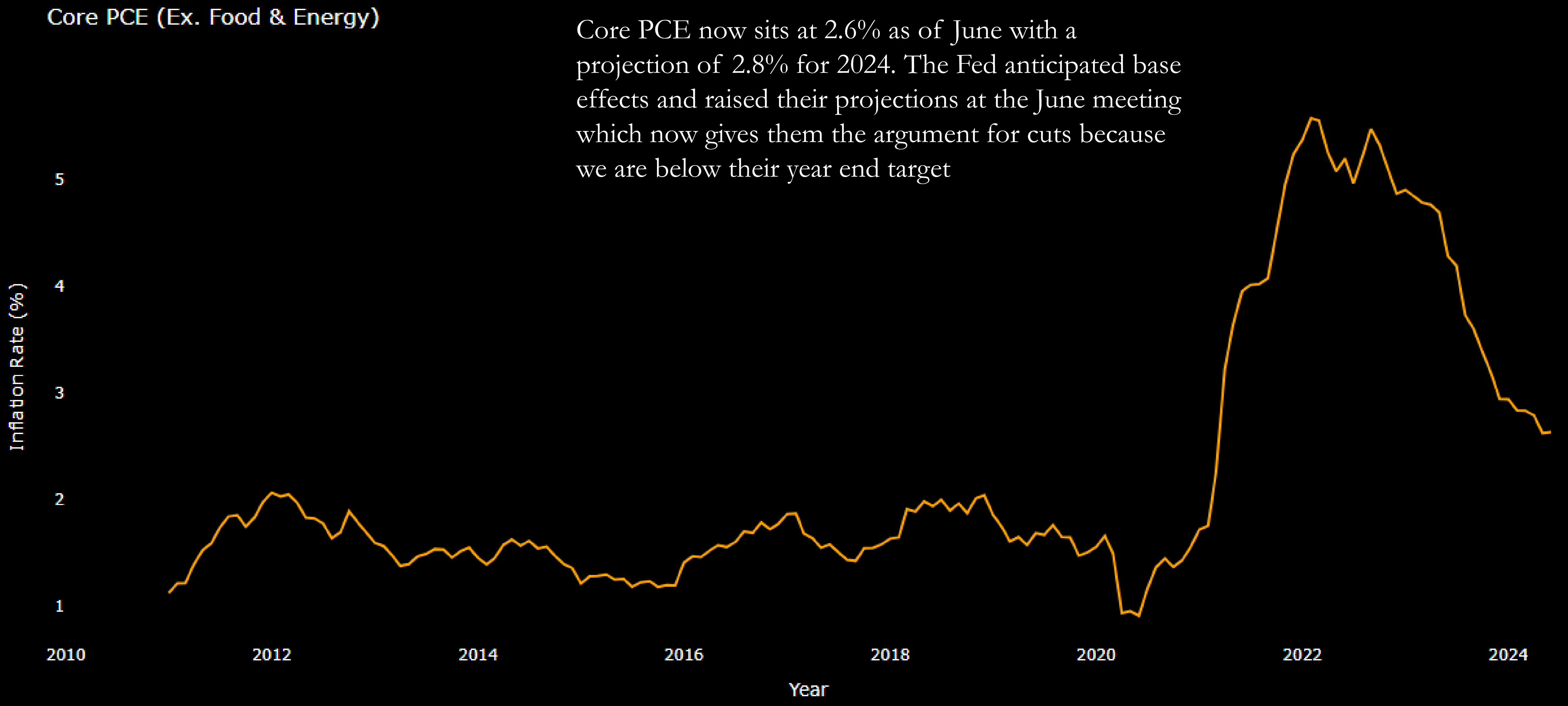
Core PCE now sits at 2.6% as of June with a projection of 2.8% for 2024. The Fed anticipated base effects and raised their projections at the June meeting which now gives them the argument for cuts because we are below their year end target



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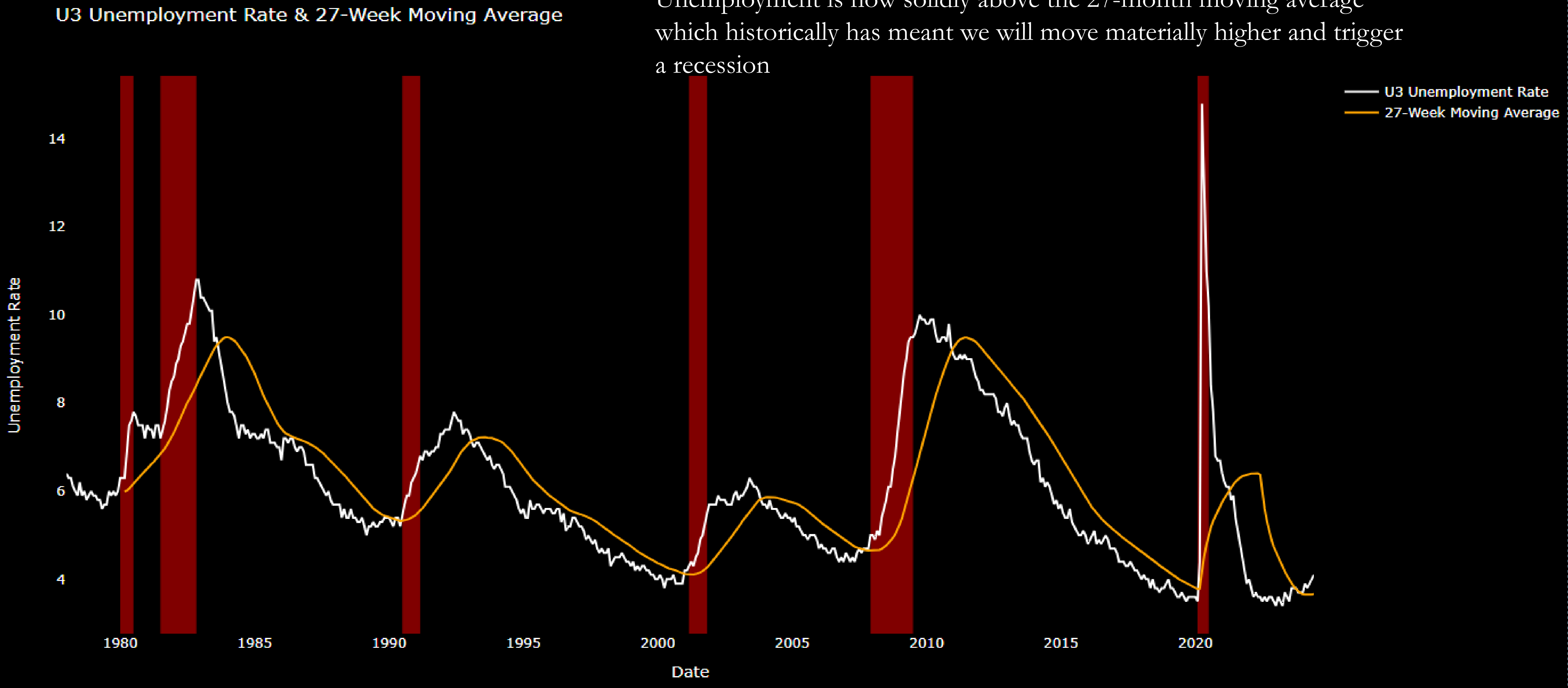
Unemployment is now solidly above the 27-month moving average which historically has meant we will move materially higher and trigger a recession



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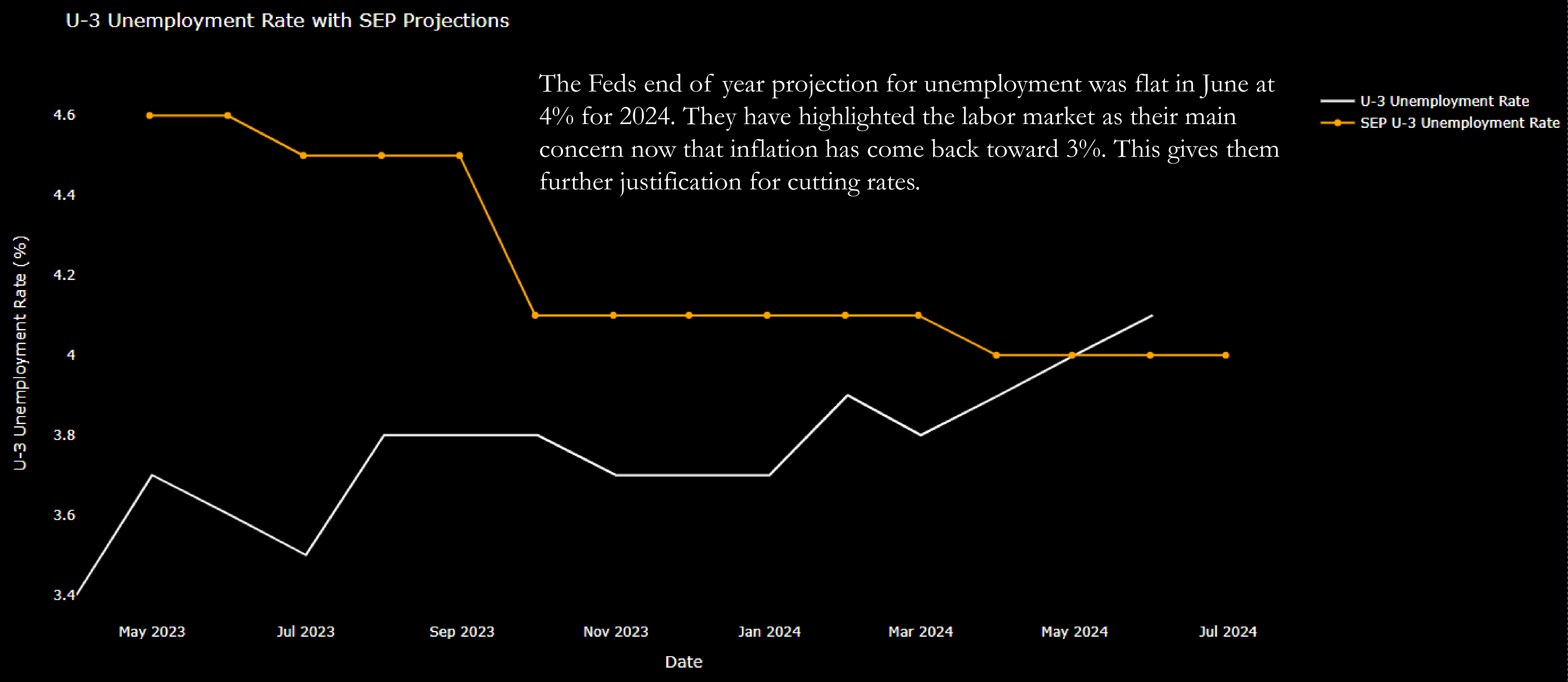
The Feds end of year projection for unemployment was flat in June at 4% for 2024. They have highlighted the labor market as their main concern now that inflation has come back toward 3%. This gives them further justification for cutting rates.



The 2 Year Yield has been a good indicator for Fed cutting cycles in the past. It is currently telling the Fed to cut as the spread sits at -47 bps. The average spread is 44 bps. In previous instances going back to 1985 the spread going negative has been a consistent recession indicator telling the Fed they have tightened too much

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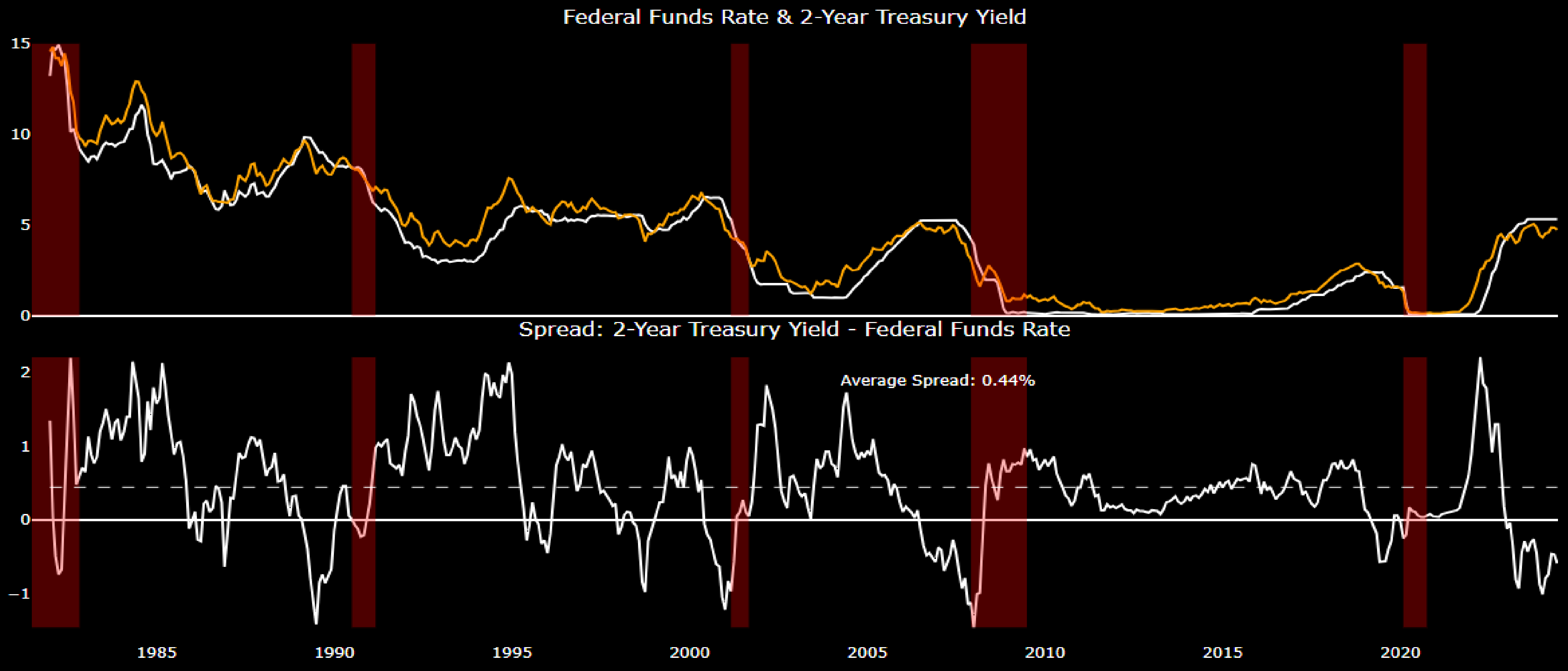

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