

STOCK MARKET ROTATION CONTINUES; US GROWTH PICKS BACK UP

Market Review:

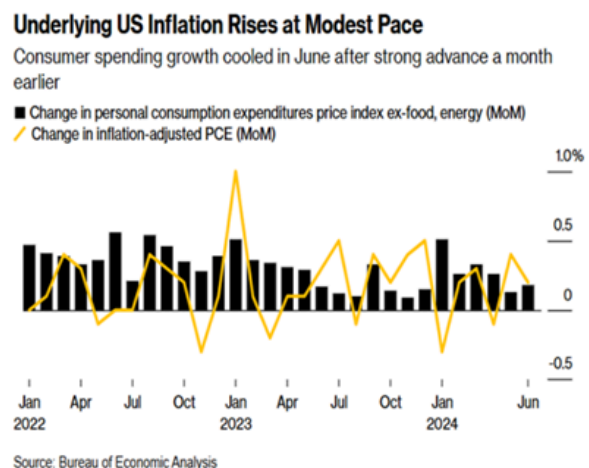
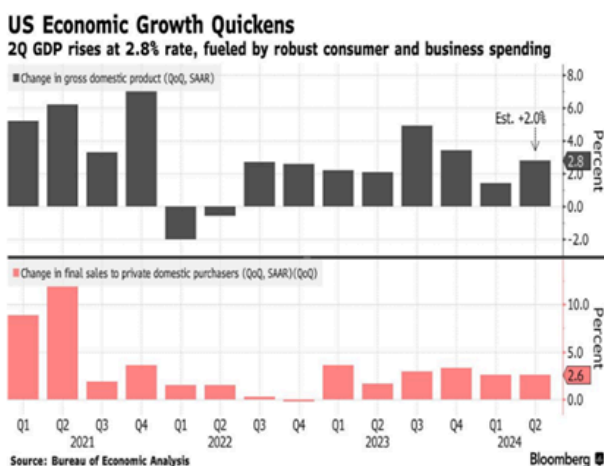
It was another volatile week for the equity markets despite some encouraging economic data out of the US and UK. The rotation trade out of the US mega caps and into small cap and sector laggards continued, as the Russell 2000 topped the table for the second week. Other regions were whipsawed to some extent by the US gyrations. There were also signs of an unwinding of the Yen 'carry trade', with the currency moving back from 162 against the USD to finish around 154. The currency appreciation hit Japanese equities hard. Even another rate cut in China failed to ease the sell off in Asian markets and both the Hang Seng and MSCI China are now showing losses over a 1 year period. Oil dropped sharply at the beginning of the week, staged a muted recovery on the back of the strong US GDP numbers, before heading down to week lows. Bonds traded sideways despite all the macro noise and Gold, having set new highs intra week settled back down below \$2400.

Equity Indices		1 wk %	
Russell 2000 TR in US		3.47	
MSCI India TR		1.91	
FTSE 100 TR in GB		1.59	
FTSE 250 TR in GB		1.37	
MSCI Europe ex UK TR		0.17	
S&P 500 TR in US		-0.83	
MSCI Emerging Markets TR		-1.41	
MSCI AC Asia ex Japan TR		-1.63	
Nasdaq Comp		-2.09	
MSCI China TR		-2.40	
Nikkei 225 in JP		-5.98	
Bonds/Currency/Commod		19.07.2024	26.07.2024
Bond: UK 10 Year Yield		4.126	4.103
Bond: US 10 Year Yield		4.242	4.193
Currency : GBP/USD		1.2919	1.2919
OIL: WTI \$		80.25	76.44
Gold \$		2402.80	2385.70

Encouraging US Data

Before taking a closer look at the sector rotation under way in the American market, it is worth highlighting that we did get some really good economic data releases last week, exactly the type that support the Goldilocks narrative. First off, we got confirmation that the US economy is in good health, with Q2 real GDP jumping 2.8% q/q and 3.1% y/y. Business investment boomed 8.4% q/q, up from 4.4%, driven by spending on capital equipment and intellectual property. Personal consumption expenditures rose 2.3% q/q, up from 1.5%, as goods spending rebounded. And then on Friday we got the Fed's preferred measure of underlying US inflation. Here the core personal consumption expenditures (PCE) price index, rose by 0.2% in June from the previous month and 2.6% year-over-year.

Source - Bureau of Economic Analysis



This moderate increase, along with healthy consumer spending, suggests inflation is cooling without significantly impacting the economy and increases the likelihood of a September rate cut. Had investor's been in a different mood, I would have expected both these releases to have been greeted by a much stronger positive reaction by the markets, but we appear to be in a twilight zone at the moment. Essentially, the old narrative of Big Tech dominance and passive inflows driving the winners higher - at the expense of smaller, cheaper and unloved stocks - seems to be reversing. Investors are now grappling with the conundrum; will the rotation continue or reverse?

Great Rotation could confirm the Bull Market

I have been arguing for quite some time that, for this upward market movement in equities since Oct 22 to be confirmed as a proper, healthy, sustainable bull market, then we would expect to see increased market breadth. For it to continue we would then need a pickup in economic growth and confirmation of corporate health with a steady increase in corporate earnings across different industries and not just tech. Well, we just might be able to tick all those boxes.

Source - FEFund Info



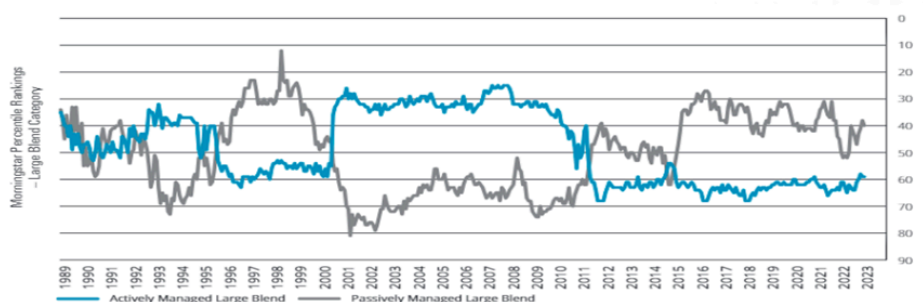
Despite the S&P 500's 0.8% drop last week, over 300 of its stocks ended the week positively and small cap recorded another week of strong gains. That's the sign of a healthy market, remember in normal market cycles over time, you would expect small cap and the median cap to outperform large.

The shift had already begun at the beginning of the month, but the earnings miss from Tesla and worries over Alphabet's planned spending on AI, triggered concern that Big Tech is spending too much money on AI infrastructure. To be fair to Alphabet, it did still beat earnings expectations even with the high spend and as their CEO explained why they are pumping so much in to AI, 'the risk of underinvesting is dramatically greater than the risk of overinvesting for us here. Even in scenarios where if it turns out we are overinvesting, these are infrastructure which are widely useful for us, they have long useful lives, and we can apply it across and we can work through that'.

The share price reaction was painful, nearly a 10% fall last week from Google as it was known, an excessive amount, given their results were actually still a beat. But I guess the pressure on big tech to deliver has never been greater and if they are spending so much on AI, that might hamper the earnings growth investors want to see to justify the valuations. Perhaps the blind love affair investors have had with the Mag 7 is coming to an end? Extending that argument one step further, this might even herald a new period where we see passive trackers (that blindly follow capitalisation-weighted indexes) underperform. It would appear that there is finally appetite from retail and institutional investors to invest into the next wave of market winners and they have begun hunting in areas such as small cap, consumer stocks, real estate, industrials, financials and health care. Maybe it's the turn of Active managers to start outperforming again, after all it would appear to be cyclical as the following chart argues ...

Source - Morningstar

Active and passive outperformances are cyclical (rolling monthly 3-year periods, 1989-2023)

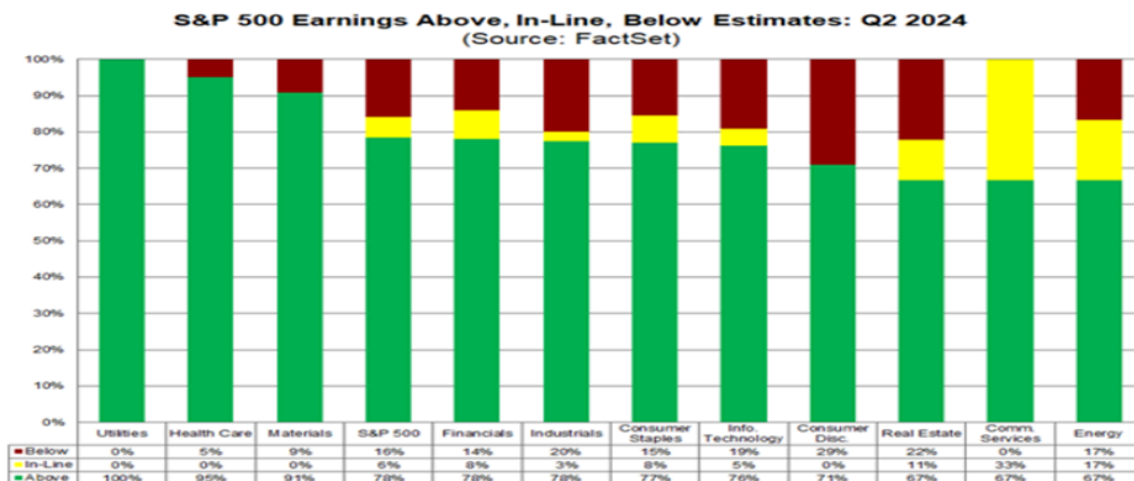


But before we right off big tech, let's remember that their earnings growth is still likely to be significantly above that of the average company in this results season and for the foreseeable future. Yes, they are expensive, but time and again this premium has proved to be justified. In the next six months, if we were to see a slowdown in the growth rates of the US economy, investors will go back to what was working, the perceived safety trade - the Magnificent Seven and other growth-oriented companies that are tied to the AI theme. That's not my base case. I expect economic growth to prove resilient, but don't forget that would also be good news for big tech, so I don't see so much of a correction from this segment, more likely a period of consolidation. However, for the first time in a long time, there are arguably better opportunities elsewhere and the beginnings of an appetite from investors.

Q2 Earnings are on the rise

Another of my pillars for a sustainable bull market, corporate earnings growth, seems to be in place. With 41% of the companies in the S&P 500 having now reported for Q2 2024, 78% have come in with Earnings Per Share above estimates. The blended (combines actual results for companies that have reported and estimated results for companies that have yet to report) earnings growth rate for the second quarter is 9.8% which is on course to mark the highest year-over-year earnings growth rate reported by the index since Q4 2021

Source - FactSet



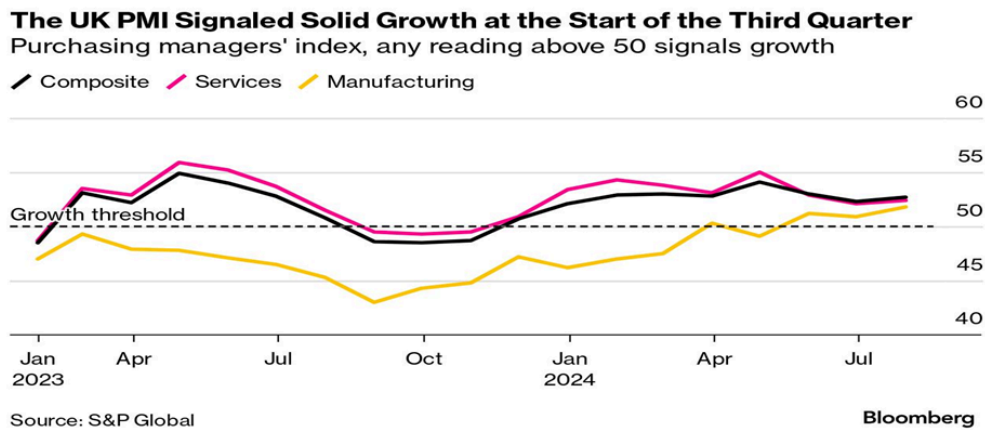
Looking ahead, analysts expect (year-over-year) earnings growth rates of 6.8% and 16.7% for Q3 2024, and Q4 2024, respectively. The wobble in markets has also brought valuations down a little to a forward 12-month P/E ratio of 20.6, which is still expensive when viewed against a 5-year average (19.3), although arguably justified with the prospect of rate cuts on the horizon.

UK

Almost lost in all the drama in the US, we got some good PMI data out of the UK last week and companies reported a surge in confidence, hiring and new orders after Labour's landslide election victory. New business grew at the fastest rate in 15 months, while hiring was the strongest in more than a year. After stumbling last month, confidence rebounded in July and is now close to a two-year high reached earlier in the year. That's unequivocally good news for the economy, but might it inadvertently cause the BOE to stay their hand when it comes to rate cuts? We shall find out next week...

But, the first post-election business survey paints a welcoming picture for the new government, with companies operating across manufacturing and services having gained optimism about the future, reporting a renewed surge in demand and taking on staff in greater numbers. Perhaps, the domestic rotation in the US will also lead to their institutional investors to start looking further afield for value opportunities and perhaps the UK, with its shiny new pro-European Govt, will finally start featuring, we live in hope! Certainly the surge in UK M&A suggests that companies can see the value, we just need the money managers to follow suit.

Source - FEFund Info



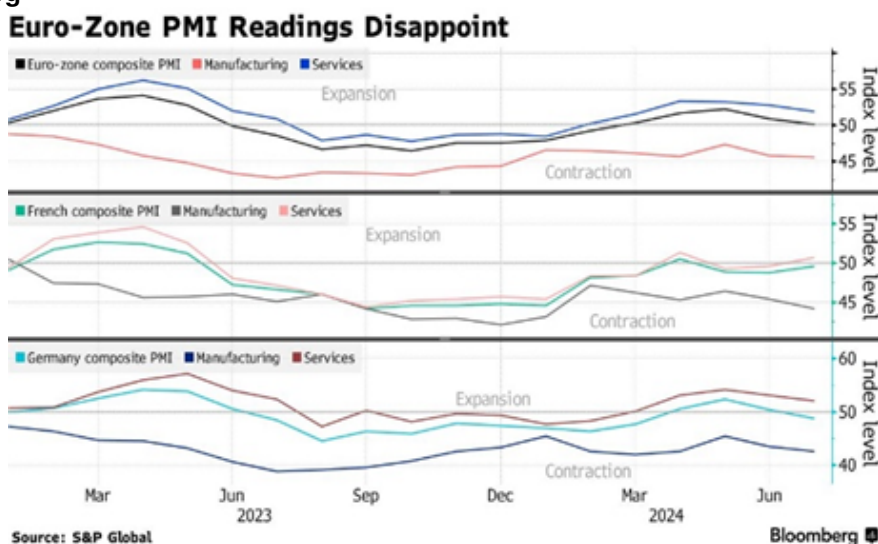
All eyes will be on the BOE next week as we not only get their decision on interest rates , but also get to hear from Andrew Bailey and the BOE on their economic outlook. Will they or won't they cut? At the moment, market expectations are they won't cut (60%), but that's a slim margin and reading the tea leaves, I think they may well cut which could be a pleasant surprise for both bonds and equities, we shall see. My logic could be flawed, but given that we only get a press conference and hear from Andrew Bailey every 3 months, I think he would want to coincide a rate cut with the chance to talk about it and they probably don't want to wait till November when we will be lost in US electioneering.

Europe

In contrast to the UK, Euro-area private-sector activity barely grew this month as its top economy unexpectedly slumped. S&P Global's composite Purchasing Managers' Index fell to 50.1 in July, according to data published Wednesday. While that's above the 50 level that signals growth, it's the worst reading since February and worse than economists had predicted in a Bloomberg survey, which saw the measure holding steady at last month's 50.9.

That shortfall can be attributed to Germany, which surprisingly contracted, dropping below the vital threshold for the first time since March. France also failed to grow, though its 49.5 reading outpaced all but one estimate in a survey of 11 economists.

Source - Bloomberg



Next Week

Lots more happening next week , which I will keep a distant eye on as I am off on holiday to Turkey and will not be around to produce the market matters , but I am sure Ash and the gang will assemble something, probably a lot shorter you will be pleased to hear. We get U.S. Federal Reserve Interest Rate Decision: U.S. Non-Farm Payrolls and Unemployment Rate : Eurozone CPI Data: Bank of Japan (BoJ) Interest Rate Decision: China PMI Data: UK Bank of England (BoE) Interest Rate Decision. And also hear from Apple, Amazon, Meta, Microsoft. It is also worth keeping an eye on Kamala Harris who continues to build momentum ahead of the Democrat convention, she really is engaging the 'youth' with her new 'brat' persona.



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