The Weekly Market Update – 9/3/24: Sector Rotation Drives Summer Gains

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	5,648.40	0.24%	3.44%	18.42%	25.31%	5,667.20	0.3%
Dow Jones Industrial Average	41,563.08	0.94%	6.25%	10.28%	19.70%	41,563.08	0.0%
NASDAQ Composite	17,713.62	-0.92%	-0.11%	18.00%	26.21%	18,647.45	5.3%
Russell 2000	2,217.63	-0.05%	8.30%	9.40%	16.74%	2,442.74	10.2%
MSCI EAFE (USD)	2,453.44	0.57%	6.00%	9.72%	16.32%	2,453.44	0.0%
MSCI Emerging Markets (USD)	1,099.92	-0.07%	1.26%	7.44%	12.20%	1,444.93	31.4%
Bloomberg Commodity Index	96.09	-0.38%	-4.86%	-2.59%	-9.38%	237.95	147.6%
Barclays U.S. Aggregate Bond	93.00	-0.60%	3.38%	1.42%	4.75%	112.07	20.5%

Source: FactSet

Equity market gains broadened in August after recovering from a sharp decline to begin the month, and extended a third quarter (3Q24) rally. The S&P 500 increased +2.3% (not including dividends) in August, and the two-month gain (July and August) was +3.4%. But unlike the first half of 2024 where the S&P 500 Technology (Tech) sector (one of eleven GICS sectors) led the market rally (+27.8% from 12/31/23 to 6/30/24), other sectors delivered gains to drive the broader market higher over the past two months (Tech declined -1.0% in July and August). In 3Q24, through August, Real Estate +13.2%, Utilities +11.3%, and Financials +11.0% were the top-performing sectors. Because Technology is the dominant sector weight in the S&P 500, investors question whether the broader index can sustain gains without contribution from large tech stocks. As of 8/30/24, Technology comprised 31% of the index's total equity market capitalization, while the next two largest sectors, Financials and Health Care, represented 13.3% and 12.2%, respectively. At least over the past two months, the answer to that question was "yes." The S&P 500 rally from the early August low (up +8.9% from 8/5/24 to 8/30/24) reflected a quick turnaround from a sell-off that began in mid-July, but the index, which closed at 5,648 on Friday, remained a shade below its all-time closing high of 5,667 (on 7/16/24). Several S&P 500 sectors moved to all-time highs, however, including Financials, Industrials, Materials, Utilities, Health Care, and Real Estate, while Technology and Communication Services were still -6.9% and -6.6% below all-time highs, respectively. The broad rotation into the "value" sectors, away from technology and "growth" sectors, was not unexpected as growth has led market returns for much of the past two years, but continued relative underperformance of Tech and other growth sectors could limit broad market gains in the weeks ahead. In addition, recent strong performance of more defensive sectors (such as Utilities and Health Care) and interest-rate sensitive sectors (Real Estate and Financials) suggests potential investor caution regarding U.S. economic growth, which could contribute to renewed market volatility as investors return from the Labor Day holiday.

In recent years, September has been a weak month for equities. Over the past 25 years (1999 to 2023), the S&P 500's average annual price return (price change of the index, no dividends) was +7.2%, but the month of September has averaged a decline of -1.7% (February, -1.1%, is the only other month that is down on average since 1999). The index was lower in each of the past four Septembers (averaging down -5.7%) including -4.9% in September 2023. Despite the August rally in equities, we believe that equity markets remain on edge this September as investors await economic data (the U.S. economy is slowing), an important Federal Reserve Bank (Fed) policy meeting on 9/18 (discussing the path of short-term interest rates), and the ramp-up of a contentious and unpredictable national election (including a presidential debate scheduled for September 10th). We expect increased volatility in the weeks ahead.

Friday's (9/6/24) August jobs report is the last monthly labor data that will be released prior to the next Fed meeting in late September. The Bureau of Labor Statistics (BLS) is expected (FactSet consensus) to report August nonfarm payrolls up +162 thousand (K) and an unemployment rate of 4.2%. Both would be an improvement from the July report of +114K and 4.3%, respectively. In our view, an in-line jobs report supports the market expectation for a -0.25% reduction in the overnight fed funds target on 9/18, while weaker-than-expected data would increase the chances of a more aggressive -0.50% cut.

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The Global Industry Classification Standard (GICS) is a four-tiered, hierarchical industry classification system. Companies are classified quantitatively and qualitatively. Each company is assigned a single GICS classification at the Sub-Industry level according to its principal business activity. MSCI and S&P Dow Jones Indices use revenues as a key factor in determining a firm's principal business activity. The 11 sectors are: Communication Services, Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Real Estate, and Utilities.

U.S. economic growth: Gross domestic product (GDP) refers to the monetary measure of the market value of all final goods and services produced within a country's borders within a specific time period. Real GDP is adjusted for the impact of inflation. The most recent GDP report can be found at www.bea.gov. It is reported by the U.S. Bureau of Economic Analysis (BEA). Personal consumption expenditures (PCE) measure consumer spending on goods and services during the period, and is a component of GDP.

FactSet is a data aggregation software utilized by D.A. Davidson's Wealth Management Research. The FactSet consensus refers to the aggregate of all analysts' estimates from firms that submit estimates to FactSet for a given financial metric.

The Federal Reserve Bank's Open Market Committee (FOMC) consists of twelve members – the seven members of the Board of Governors of the Federal Reserve System, the president of the Federal Reserve Bank of New York, and four of the remaining eleven Federal Reserve Bank presidents, who serve one-year terms on a rotating basis. The FOMC holds eight regularly scheduled meetings per year. At these meetings, the Committee reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth. The minutes from the most recent FOMC meeting is here. The Federal Reserve influences the demand for, and supply of, balances that depository institutions hold at Federal Reserve Banks and, in this way, alters the federal funds rate. The federal funds rate is the interest rate at which depository institutions lend balances at the Federal Reserve to other depository institutions overnight.

The Bureau of Labor Statistics (BLS) compiles U.S. labor statistics from two monthly surveys. The household survey measures labor force status by demographics, while the establishment survey measures nonfarm employment and data by industry. The nonfarm payrolls component of the establishment survey is drawn from private businesses and government entities. The nonfarm payrolls number is among the most widely used data points to assess U.S. employment trends. The unemployment rate is the percentage of the labor force that is jobless and actively willing and available to work.

"Defensive Sectors" are sectors whose constituents are companies that are generally less exposed to changes in the business cycle, and thus have less volatility in revenue and earnings. Traditionally we view Consumer Staples, Utilities, and Health Care as defensive sectors, although some companies in these sectors are less defensive than others, and some companies in other sectors have defensive qualities as well.

"Growth" sectors are loosely defined as sectors that predominantly comprise companies that can grow sales and earnings at a faster rate than the market, or index, as a whole, while "value" sectors comprise sectors that include companies trading at lower than average valuation multiples, and generally have a more stable expected revenue and earnings trajectory. Interest rate sensitive sectors generally pay dividends, which can factor in to investor demand for those securities.