

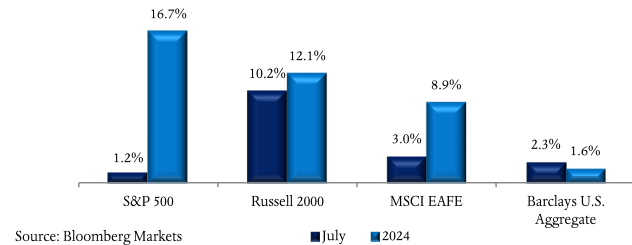


MARKETS

July featured notable economic and geopolitical developments. Steady growth, cooling inflation, and a slowing US labor market cemented expectations that the Federal Reserve (Fed) will begin cutting interest rates in September. Against this backdrop, investors orchestrated a massive rotational shift from crowded mega-tech and AI related equities to small-cap stocks which stand to benefit from broader economic growth stemming from lower interest rates. The Russell 1000 Growth index lost -1.7% in July (+18.6% ytd), while the small cap stocks in the Russell 2000 gained +10.2% (+12.1% ytd), the largest such divergence in over 20 years. Meanwhile, the S&P 500 pulled-back from its mid-month record level, ending the period +1.2% higher (+16.7% ytd). From a factor rotation perspective, value outperformed growth by a sizeable 7.3% in July. Overseas stocks in the MSCI EAFE index achieved a mid-month all-time high (eclipsing the prior September 2021 peak) ending July +3.0% ahead (+8.9% ytd).

Softening inflation and labor market data improved investor expectations for Fed rate cuts. Economists brought-forward their forecasts for the first loosening of US monetary policy to September, pricing approximately 150 basis points worth of cuts by June 2025. This optimism boosted US Treasuries, which led the US Aggregate bond index higher by +2.3% in July (+1.6% ytd).

Natural resources lost ground during the month, with the Bloomberg Commodity Index decreasing by -4.0% (-1.6% ytd). Crude oil prices (WTI -4.5% in July; +8.7% ytd) contributed to the downdraft, as the market weighed the impact of weaker demand from China against supply issues arising from rising tensions in the Middle East. Meanwhile, gold achieved a record monthly closing high of \$2,448/oz, +5.3% (+18.7% ytd) acting as a safe haven buoyed by declining bond yields.



GEOPOLITICS

July was quite an eventful month in US politics. Republicans attended the 2024 National Convention. Former President Trump was shot. Senator JD Vance (R-OH) was selected as the Republican nominee for Vice President. President Joe Biden dropped out of the 2024 election, and Vice President Kamala Harris became the presumed Democrat nominee. Finally, as we go to press, Harris picked Minnesota Governor Tim Walz as her vice presidential running mate. In what is expected to be a very tight election, Harris is estimated to lead Trump by one point overall in the seven battleground states likely to decide the election, according to a July 24-28 Bloomberg/Morning Consult poll. Harris is indicated to be ahead in Michigan, Wisconsin, Arizona and Nevada; Trump in the lead in Pennsylvania and North Carolina; and the two tied in Georgia.

The ongoing Israel-Gaza war in the Middle East expanded its scope in July. A rocket, which Israel says was launched by Hezbollah from Shebaa in southern Lebanon, impacted onto a soccer pitch in the Druze town of Majdal Shams in the Israeli-occupied Golan Heights. It was reported that twelve children, ranging in age from 10 to 16, were killed while practicing. Hezbollah denied responsibility for the strike. In response, Israel sought retribution by killing Hezbollah's most senior military commander in Beirut. Ultimately, whether the regional conflict escalates very much depends on if, and how, Hezbollah retaliates.

UNITED STATES

The initial reading of second quarter US GDP indicated that the economy grew by 2.8% annually, ahead of expectations of 2.0% and double the 1.4% seen in the first quarter. Retail sales showed solid levels of discretionary spending on goods (ex-autos and gas +0.8% sequentially, well ahead of consensus +0.2%). This was corroborated by the Consumer Confidence Index which improved to 100.3 in July from 97.8 in June.

However, there are emerging signs that the economy is on the verge of slowing. A measure of manufacturing data, reported by ISM, dropped to an 8-month low amid a slump in new orders. Headline inflation decelerated in June as CPI fell -0.1% sequentially (consensus +0.1%), and decelerated to +3.0% year-over-year, compared to May's +3.3%. On the labor front, July saw 114,000 job additions, which was below expectations and far short of the 12-month average of 215,000. In turn, the unemployment rate rose to 4.3% from 4.1% the previous month, the highest level in nearly three years. These data points have seemingly increased the potential of a recession and caught the Fed's attention. Notably, Fed Chair Powell acknowledged that higher unemployment outweighs risk of higher inflation. As a result, volatile markets are now pricing in four quarter-point interest rate cuts for the remainder of this year, starting no later than September, and 150 basis points of reductions over the next twelve months.

EUROPE

The eurozone's economy grew a mere +0.6% year-over-year in Q2, while Germany's GDP unexpectedly contracted -0.1%. Headline inflation surprisingly rose to 2.6% in July, while the services component ticked down to a still-elevated 4.0%. A disappointing Purchasing Managers' Index (PMI) print confirmed the tempering of eurozone economic growth over the summer.

In the UK, a robust service sector PMI, coupled with stronger than expected economic growth for the second quarter, both pointed to improving economic mo-

July 2024 Economic Statistics

	Jul-24	Dec-23	Dec-22
Federal Funds Target Rate	5.25 - 5.50%	5.25 - 5.50%	4.25 - 4.50%
Consumer Confidence Index	100.3	110.7	108.3
Manufacturing PMI Index	46.8%	47.4%	48.4%
Unemployment Rate	4.3%	3.7%	3.5%
JPY / USD	149.98	141.06	131.11
USD / EUR	1.0825	1.1036	1.0702
Gold / oz.	\$2,448.10	\$2,062.59	\$1,824.40
Oil (WTI) / bbl	\$77.91	\$71.65	\$80.26

Sources: see disclosure *

mentum. The economy, is however, still contending with persistent services inflation. Nevertheless, the Bank of England cut interest rates by 25 basis points for the first time since the pandemic, and indicated it will proceed cautiously.

ASIA

In Japan, the central bank continued to normalize monetary policy in July, raising its benchmark overnight rate by 15 basis points to 0.25% and stating that it will slightly reduce the pace of Japanese Government Bond purchases by 400 billion yen (\$2.8 billion) per quarter starting in August, with a pledge to consider further moves. In local currency markets, expectations of earlier Fed interest rate cuts, coupled with the BoJ's interest rate hike led to the yen appreciating by 6.5% versus the US dollar, the strongest monthly move since June 2016. These actions triggered an unwind in the "yen carry trade" (borrowing Japanese yen at extremely low interest rates and using the proceeds to acquire an assortment of other assets), forcing levered speculators to reduce their global holdings. While the amounts involved in the yen carry trade are unknown, it is believed to be enormous, measured in trillions of dollars.

The Chinese economy remains hampered by continued challenges in the real estate sector and the spillover effects. As a result, Chinese authorities implemented measures to provide liquidity support to the financial system, including cutting the reverse repo rate, a key short-term policy rate, and lowering the benchmark loan prime rate. These stimulus efforts will be directed

at consumers, a deviation from policymakers' prior playbook of pouring funds into infrastructure projects. Regarding the crisis-hit property sector, the Politburo reiterated that China will continue to support the delivery of unfinished projects and convert unsold apartments into affordable housing. By implementing these countercyclical adjustments the central planners seek to increase the odds of achieving 5% economic growth in 2024.

OUTLOOK

Global markets are undergoing a rough patch of volatility. Sequential data has pointed to a cooling economy, initially spurring investors to rotate away from mega-cap and AI-related technology stocks into small-cap equities and other interest-rate sensitive asset classes. This has transitioned into a "correction" (defined as a decline greater than 10%) for semiconductor and growth-oriented stocks. Financial market liquidity was already drying-up, as seen by the Federal Reserve's Reverse Repurchase Account having dwindled to \$338 billion from \$2.5 trillion at the start of last year. In addition, the Fed has reduced its balance sheet by \$1.7 trillion via its Quantitative Tightening program, which continues at a pace of \$50-60 billion per month. Monetary policy tightening typically works with a lag of 12-18 months, having recently annualized nearly 5.5% of interest rate increases, with the full impact now starting to be felt by the economy. As a result, we expect the Federal Reserve to swiftly deliver deep cuts over the coming months and quarters.

Second quarter S&P 500 corporate earnings are off to a good start with 60% of constituents having reported. According to FactSet data, nearly 80% of those corporate reports have produced a positive surprise, averaging about +4% above consensus, with a blended growth rate of +10.2% (versus the +8.9% consensus expectation prior to the start of reporting season). Given the earnings acceleration, a further broadening of equity markets is possible, which would be a positive and healthy development. Overseas markets, which offer lower valuations, could also benefit from the ongoing rotation of capital, while providing additional diversification benefits. Thus, we

recommend that investors remain invested in a combination of quality-growth and value oriented stocks, where expected earnings growth rates are able to support valuations.

Fixed income markets are also in the midst of a significant re-rating, featuring large drops in yield. Further, the 10-year Treasury Note's yield recently topped that of the 2-year, marking the first time the yield curve has uninverted since July 2022 (the longest period of inversion on record). Recent economic data has shaken confidence in the economy's ability to orchestrate a soft landing, revived recession fears, and worries that the Fed maintained a tight monetary policy for too long. Traders are now pricing an overwhelming chance of a 50-basis point interest rate cut at the September FOMC meeting, with more to follow. Over the next year, we forecast that Treasury yields will settle in the 3.5%-4.0% range, relatively flat across the yield curve. As such, investments in short duration bonds appear optimal. Looking ahead to the end of August, investors will be keenly focused on commentary from the Jackson Hole Economic Symposium which this year is titled "Reassessing the Effectiveness and Transmission of Monetary Policy."

The "healthy bout of fear" we referenced last month recently came to pass, with the equity volatility index (VIX) rocketing from 12 to over 60, indicating extreme fear. Our research infers this resulted from a cocktail of technical market factors, extreme investor optimism and leveraged positioning. Active hedge funds and non-market correlated investments, that we recommend as an antidote to such volatility, are intended to defend investor capital while producing solid risk adjusted returns over time. Our forecast of a capital rotation into small capitalization stocks also materialized in a dramatic way, a trend that our research indicates should continue. Elsewhere, we are seeing opportunities in select software equities, with an activist element. We have also identified compelling private equity investments, revolving around European growth, healthcare, and education-technology.

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*Sources: Reuters, Bloomberg, Bureau of Labor Statistics, Conference Board, Federal Reserve, Institute for Supply Management, MSCI, Russell, Standard & Poor's, Financial Times and the Wall Street Journal.