HIGHLAND

Multi-Asset Solutions Weekly Commentary

July 1, 2024

What We're Watching:

- Eurozone Consumer Price Index (CPI) for June is released Tuesday and is expected to have risen 0.1% month over month and 2.4% year over year, below the 0.2% and 2.6% readings from May. Inflationary pressures continuing to subside across the euro area could allow the European Central Bank to ease monetary policy more aggressively over the coming months/quarters than is currently anticipated, which would be supportive of upward revisions to economic growth.

- The Institute for Supply Management (ISM) Services Purchasing Managers Index (PMI) for June is released Wednesday and is expected to fall to 52.5 from 53.8 the month prior. A reading above 50 indicates expansion or growth, while a reading below 50 indicates contraction.

- The June Nonfarm Payrolls report is released Friday and is expected to show 190k jobs were created during the month, a sharp drop from the initial reading of 272k jobs that were believed to have been created in May, but still evidence of a relatively tight labor market. Average hourly earnings are expected to have risen 0.3% month over month and 3.9% year over year versus 0.3% and 4.1% readings in May, and the unemployment rate is expected to remain static month over month at 4.0%.

Key Observations:

- Large-cap U.S. stocks closed out a profitable quarter with a modest weekly decline as some of the biggest artificial intelligence (AI) beneficiaries took a breather.

- Japanese equities were strong performers as weakness in the yen drove upside, but gains could prove short-lived as the Bank of Japan faces increased pressure to intervene and stem the fall in the country's currency.

- Treasury yields ended the week higher, despite the Fed's preferred inflation gauge falling month over month and coming in in-line with the consensus estimate, as personal income surpassed expectations, spurring concerns that disinflationary readings could reverse course in the coming months.

	Price/Yield	Total Return %					
	6/28/2024	1 Week Ago	1 Month Ago	Year to Date	1 Year	3 Years	5 Years
S&P 500	5460.48	-0.06	3.82	15.29	26.09	10.06	15.05
NASDAQ	17732.60	0.26	4.88	18.57	31.49	7.72	18.21
S&P Mid Cap 400	2930.09	0.00	0.57	6.17	15.73	4.50	10.27
S&P Small Cap 600	1296.98	1.21	0.00	-0.72	10.64	-0.14	8.06
MSCI World ex US	329.38	0.13	2.43	11.30	20.91	5.35	10.76
MSCI EM	1086.25	0.06	1.73	7.49	12.40	-5.12	3.10
Bloomberg U.S. Aggregate	5.00	-0.65	1.73	-0.71	2.13	-2.99	-0.23
Bloomberg Corporate	5.48	-0.65	1.51	-0.49	4.46	-2.99	0.62
Bloomberg U.S.High Yield	7.91	0.04	1.19	2.58	10.72	1.68	3.92
Bloomberg EM USD Aggregate	7.17	-0.35	1.08	2.22	7.72	-2.22	0.47
Bloomberg Global Aggregate	3.90	-0.41	0.72	-3.16	0.63	-5.51	-2.02
Bloomberg Municipal Bond	3.72	-0.22	1.58	-0.40	3.06	-0.86	1.16

	Price / Yield						
	6/28/2024	1 Week Ago	1 Month Ago	12/31/2023	1 Year Ago	3 Years Ago	5 Years Ago
Secured Overnight Financing Rate (yie	5.34	5.31	5.32	5.38	5.06	0.05	2.50
30 Year Mortgage (average rate)	7.26	7.27	7.35	6.99	7.10	3.13	3.80
2 Year Treasury (yield)	4.75	4.73	4.98	4.25	4.71	0.25	1.75
10 Year Treasury (yield)	4.40	4.26	4.55	3.88	3.71	1.48	2.01
30 Year Treasury (yield)	4.56	4.40	4.67	4.03	3.81	2.09	2.53
WTI Crude (closing price)	81.54	80.73	79.83	71.65	69.56	72.91	58.47
Gold (NYM $/oz)	2339.60	2316.40	2356.50	2071.80	1912.30	1779.60	1413.70

Source: Bloomberg (*3-and 5-Year Returns Annualized)

What Happened Last Week:

Stocks: Seasaw Price Action As The S&P 500 Consolidates To Close Out A Strong Quarter; Political Risk Weighs On Euro Area Stocks While Japan Rallies; India Remains A Standout Within Emerging Markets.

- **AI Beneficiaries Take A Breather But The S&P 500 Barely Notices.** Profit-taking hit some of the artificial intelligence (AI) theme's biggest beneficiaries last week but the broader market barely flinched, evidenced by the S&P 500 falling less than 0.1% on the week. Capital appeared to be rotating between sectors as opposed to moving out of stocks entirely over the balance of the week as communication services, consumer discretionary, energy, and real estate all posted gains while information technology, materials, and utilities were the biggest detractors, with materials and utilities falling 1% on the week. Semiconductors, which have been one of the strongest industry groups year-to-date, experienced profit taking and the Van Eck Semiconductor ETF (SMH) fell 1.5% on the week, but it's notable that SMH still ended the quarter with a 15.8% gain, well ahead of the S&P 500's still respectable 4.3% quarterly return.

- **Heightened Political Risk Drags Down Eurozone Equities.** The 0.5% weekly gain out of the MSCI EAFE Index last week doesn't fully capture the negative political undercurrents present abroad, as only half the of top-10 country exposures ended the week in positive territory. Political concerns continue to cloud the backdrop for eurozone equities with the French CAC 40 Index ending lower by 1.7% and U.K. FTSE 100 down by 0.8%, both in U.S. dollar terms, giving back much of their prior week's bounce. Uncertainty surrounding snap elections and potential regime change in France, specifically, and potentially across the euro area broadly could weigh on risk appetite and sentiment surrounding euro area stocks over the coming months/quarters. German and Japanese equities were standout performers within the international developed index, as the former benefited from improved consumer sentiment surrounding the inflation outlook and Japan's currency weakened, improving conditions for Japanese exports.

- **Japanese Stocks Rally On Yen Weakness, Strong Economic Data.** The Japanese yen fell versus the U.S. dollar over the balance of last week, closing above 160¥ per $1 on Wednesday for the first time since 1986, a move that contributed to a 1.7% weekly gain for Japan's Nikkei 225 index. The Nikkei was also boosted by strong industrial production numbers from May, which rose 2.8% month over month, well ahead of the 1.9% consensus estimate. Japan's economic momentum appears to be intact, but with the yen continuing to weaken versus the U.S. dollar, the Bank of Japan (BoJ) will likely remain under pressure to step in and support the currency, which could lead to a reversal of some of the Nikkei's recent gains.

- **Indian Equities Have Recovered Post-Election Losses And Have Resumed Their Leadership Position Within Emerging Markets.** After seeing a steep decline on the heels of surprising election results in early June, Indian equities have rebounded nicely, with the MSCI India index gaining 2% last week on its way to a 6.5% return since June 5, the day after India's elections. India's popular Prime Minister Narendra Modi managed to win a 3rd term in office, but in a somewhat surprising turn of events his party lost parliamentary seats and he now has a narrower majority or alliance, which could make it harder for Modi's party to pass legislation moving forward. Investors appear to be warming to the idea that the ruling party may experience modest lags in its ongoing expansionary plans, potentially preventing an overspend by the government that could result in higher inflation or an elevated debt burden.

Bonds: Treasury Yields Rise To Close Out The Week As Cooler Inflation Readings, Solid Auction Results Are Offset By Higher Income Data; European Central Bank Talks Up Flexibility, Points To Additional Policy Easing.

- **Treasury Bonds Sell Off As Investors Focus On Higher Income Reading, Leading To Disinflationary Doubts.** Fixed income investors dealt with choppy trading environment last week amid a low-volume backdrop that saw Treasuries give back recent gains, but core investment-grade bonds still posted a strong monthly advance. Price declines occurred across most debt markets as only the shortest duration instruments were spared, with the Bloomberg Aggregate Bond Index falling 0.6%. Credit sensitive assets faced more modest declines on tighter below investment grade spreads that allowed the Bloomberg High Yield index to close out the week where it began it. Personal income from May which came in above expectations was partially, if not primarily, to blame for the back-up in Treasury yields, but the run-up in yields on Friday also was likely driven by Thursday night's presidential debate. The yield curve steepened with the 10-year treasury rising 11 basis points on Friday to end the week at 4.36% as markets appeared to run with the idea that a less restrictive interest rate and tax regime were in the offing, providing a glimpse of how markets will attempt to price in election-related risks as the race unfolds.

- **Heavy Slate Of Treasury Auctions Sees Still Strong Demand Despite Looming Data.** In all, the US Treasury floated over $180B across 2-year, 5-year, and 7-year notes over the balance of last week with relative ease compared to auctions earlier in the quarter and year as indirect bidders returned in force. The 7-year note auction, often a less desirable tenor/maturity, even managed to see its percentage taken down by primary dealers reach levels last seen in October of last year. Treasury issuance wasn't solely in notes as over $205B in short-term bills (1 year or less) were also sold to both fund the government over the near-term as well as to maintain market liquidity into quarter end. While demand is unlikely to be as strong going forward with uncertainty around fiscal policy and the presidential election on the horizon, it's tough to ignore strong auction results, particularly with ever important PCE data on the docket last week as well.

- **ECB Speakers Telegraphing Flexibility With Additional Easing Likely.** Members of the European Central Bank voiced opinions last week on the future path of monetary policy for the euro bloc, with centrist Olli Rehn's thoughts catching press attention for the comment that futures markets had "reasonable expectations" of two quarter-point rate cuts by year end. Traditionally hawkish speakers also emerged to voice more data dependent views, but echoed the sentiment that sustained positive inflation readings would necessitate further easing. Euro area inflation is due out this coming week and could temper public commentary on the pace of easing but one datapoint likely won't be enough to stamp out confidence to the contrary. Another narrative worth considering this week is how the ECB will react to political uncertainty out France as the country goes to the polls for snap elections as members of the ECB governing council suggested there has been few dislocations thus far but stand ready to act as needed.

- **FOMC's Preferred Inflation Gauge Cools In May As Expected, But Personal Spending Calls Into Question The Durability Of Disinflation.** Last Friday, Personal Consumption Expenditure (PCE) Deflator for May was released. This closely watched inflation gauge largely came in as expected, with headline PCE flat month over month and rising 2.6% year over year. Core PCE which tends to be more impactful for FOMC policy making, rose 0.08% month over month, a touch below the 0.1% estimate, and 2.6% year over year, in-line with the consensus estimate, but encouragingly below the 2.8% year over year reading in April. While PCE, broadly speaking, was as expected, we were struck by the market's reaction to the data as yields on long-term U.S. Treasuries rose sharply into the weekend as market participants appeared to key off personal income rising 0.5% month over month, slightly above the 0.4% estimate. PCE cooling will be well received by the FOMC, but the growth in personal spending has led to doubts as to whether the disinflation seen in May can be sustained. The Committee continues to voice concerns regarding a resurgence of inflationary pressures in the coming months, and the higher personal income data point will do little to ease those fears and could be cited as cause for the FOMC to stand pat on rates in July. We still expect a 25-basis point rate cut in September, but May PCE provided something for both the hawks and doves on the FOMC to latch onto, contributing to monetary policy uncertainty.

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