

7/12/2024

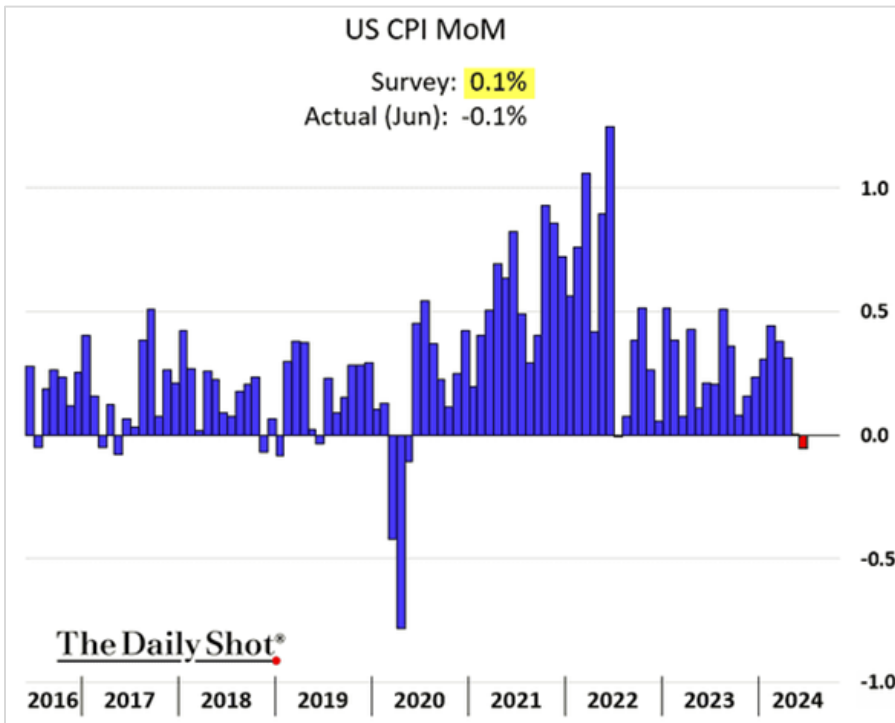
## Summary:

**Intriguing Shift:** Following a long period of rising inflation, the June CPI report unveiled a surprise decline on July 11th, 2024, the first actual drop in prices over the past four years. The market response was immediate with U.S. equities undergoing a massive rotation from mega-cap technology growth stocks to small cap and value stocks. Rate sensitive sectors such as utilities and real estate led the broader market as the bond traders began pricing more cuts in the Federal Reserve Funds rate beginning in September. U.S. Treasury yields dropped across the maturity curve while the U.S. dollar weakened, notably against the Japanese yen.

Although we cannot predict whether Thursday's rotation will sustain itself as the Fed has yet to confirm monetary easing, the dispersion in earnings growth expectations between the so-called Mag7 hyper-scalers and the rest of the U.S. market has become extreme. If U.S. economic activity slows enough to ease labor market and supply/demand imbalances without falling into recession, then the earnings landscape could improve dramatically outside of the technology sector.

## Moderation in U.S. Inflation Opens the Door for 2-3 Federal Funds Rate Cuts in 2024

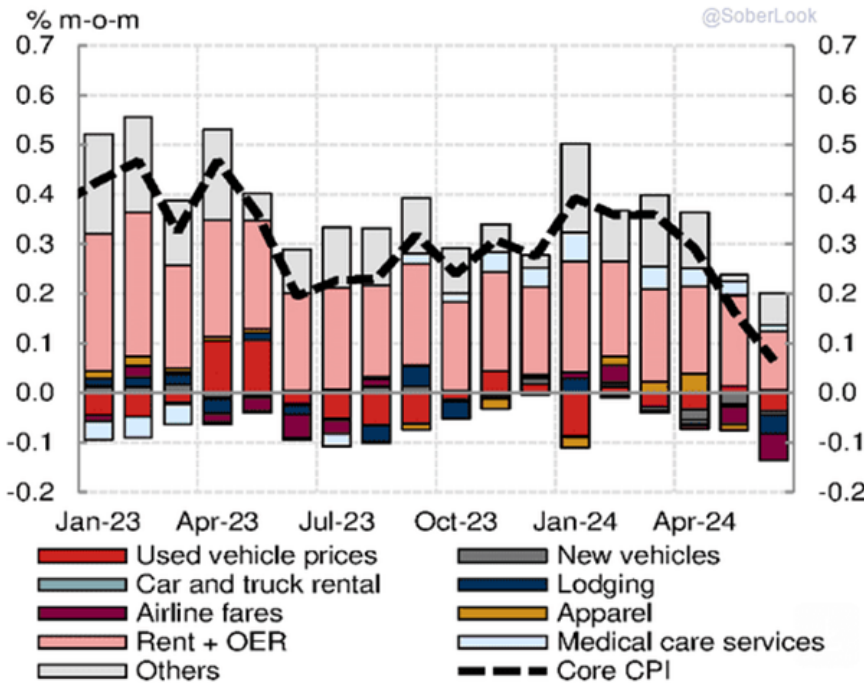
The Bureau of Labor Statistics release of the June U.S. Consumer Price Index showed the lower inflation rate was led by declines in motor vehicles, lodging, and airline travel. In addition, the core component that strips out food and energy also slowed down, led by a moderation in the shelter component which has proven to be sticky up over the post-pandemic period.



**Fig. 1: Core CPI inflation slowed sharply to 0.065% in June**

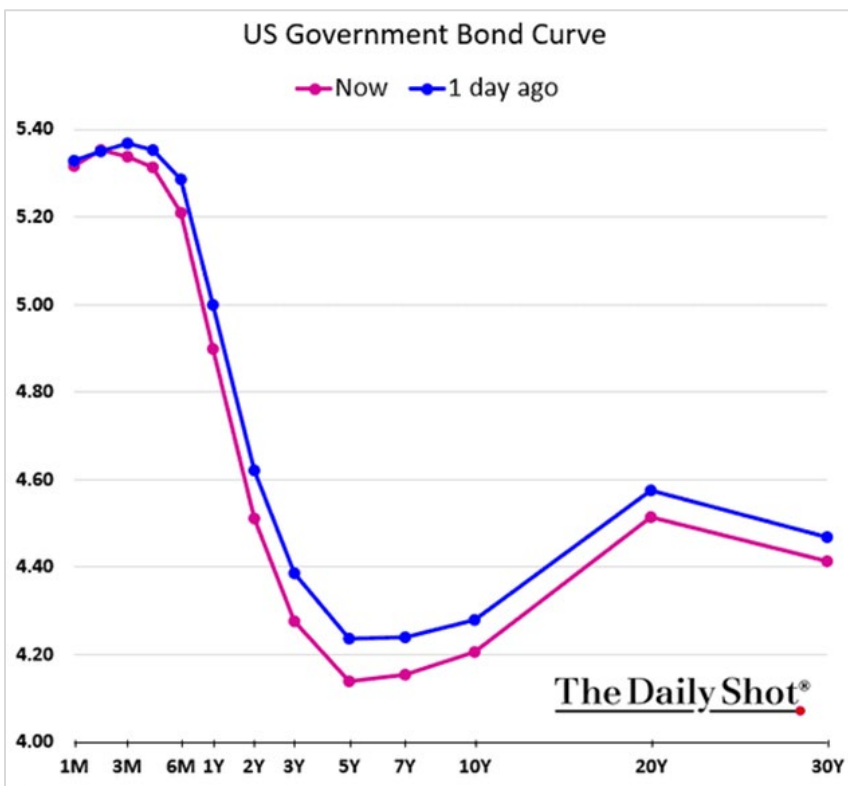
The Daily Shot  
12-Jul-2024

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Source: BLS, Haver, Nomura

Additionally, The U.S. bond market reacted strongly to the release, bringing down U.S. Treasury yields and confirming expectations for the U.S. Federal Reserve to start cutting rates as early in the coming meetings.

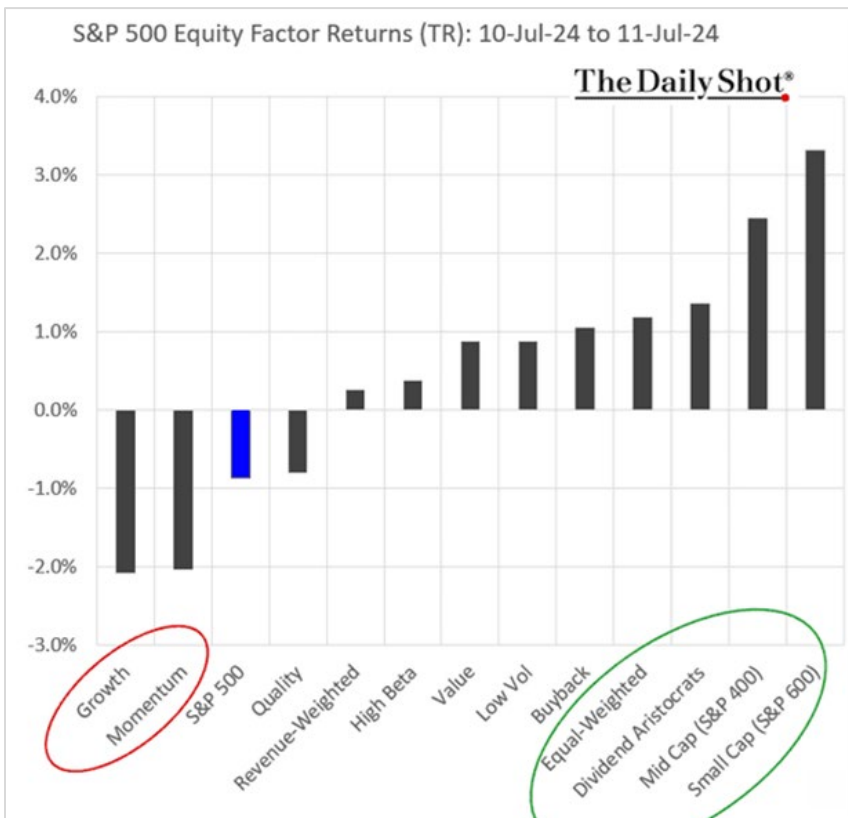
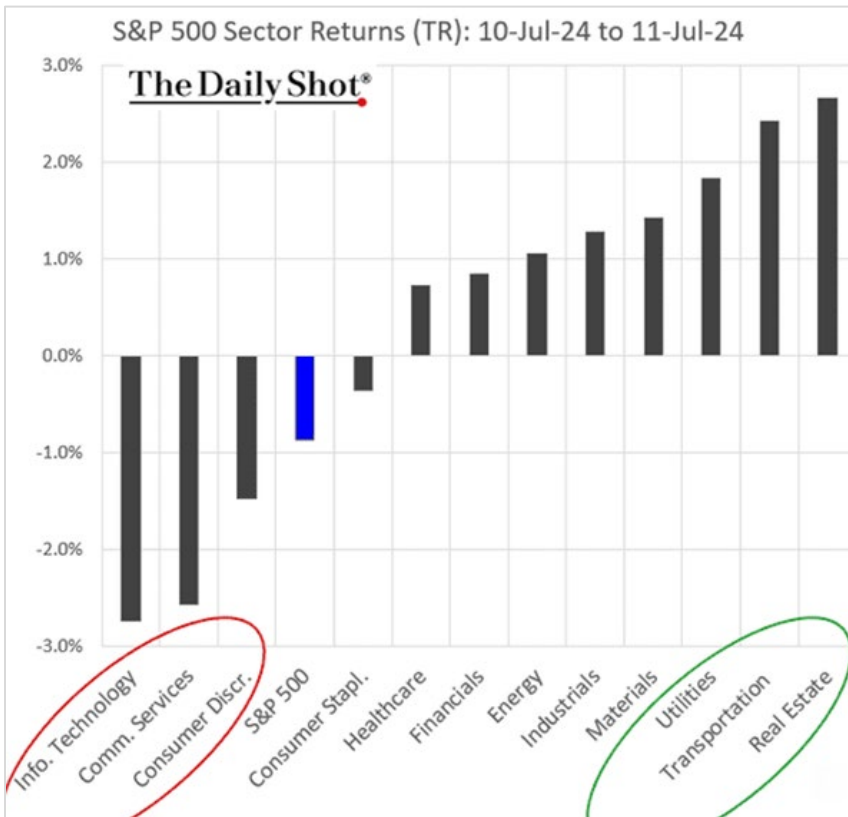


## Massive Reversal in Stock Market Leadership Following CPI Release

Following the CPI release, U.S. equities experienced a massive rotation as investors bid up this year's 'losers' while selling the 'winners.' The capitalization-weighted S&P 500 declined 0.85% driven by a sell-off in the Mag7 megacap growth stocks while both U.S. small caps and the equal-weighted S&P 500 surged, returning 3.57% and 1.17%, respectively. Rate-sensitive sectors (beneficiaries of lower interest rates), such as Utilities and Real Estate, led the overall market as did rate-sensitive risk factors such as dividend-focused factors along with small and mid-caps.

Presumably, this year's market laggards would benefit the most from lower rates and an easing of borrowing conditions should the Fed easing cycle begin. The key will be whether the slowdown in economic conditions, especially in the labor market, would affirm market expectations of rate cuts for 2024.





## Seek Opportunities But Be Cautious On Timing

We continue to guide advisors to seek opportunities beyond the top-heavy U.S. market even if Thursday's reversal proves to be short-lived. However, should the growth environment slow enough for the Fed to ease policy but remain strong enough to support loan growth, market breadth should broaden beyond the Mag7. The elusive "no landing" scenario could benefit financials and traditional cyclicals in a lower rate environment.

We reiterate to those parked in cash vehicles to consider extending maturity profiles as today's high interest rates are expected to decline and now may be the beginning of that decline.

## Actions for Advisors to Consider Taking Today:

- Broaden market breadth and diversification by allocating to 1) U.S. mid and small caps, 2) traditional cyclicals and rate-sensitive sectors, and 3) international markets, which could benefit from a weaker U.S. dollar.
- In fixed income portfolios, increase duration (rate-sensitivity) and credit risk as a soft landing is conducive for both lower inflation-adjusted (real) rates and corporate profitability.

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Except as otherwise specifically stated, all information is as of July 12, 2024.