



Weekly Focus – Think About It

“It’s not what you look at that matters, it’s what you see.”

—Henry David Thoreau, author

THE MARKETS

THE RATE CUT STARS ARE ALIGNING

For the last year, borrowing costs in the United States have remained relatively high as the U.S. Federal Reserve (Fed) waited for economic data to show that inflation was on track to reach the Fed’s two percent target. Now, we may finally be on the cusp of lower rates.

“The Fed’s preferred inflation gauge has eased to 2.6 [percent], not far off its 2 [percent] target, and the once overheated labor market has cooled to pre-pandemic levels. The rebalancing has been accompanied by moderation in consumer spending, as high prices and borrowing costs tamp demand and thus price pressures,” reported Victoria Cavaliere of *Bloomberg*.

Last week, Fed Chair Jerome Powell told the Economic Club of Washington D.C., “...if you wait until inflation gets all the way down to 2 [percent], you probably waited too long...Our test has been that we wanted to have greater confidence that inflation was moving sustainably down toward our 2 percent target. What increases that confidence is more good inflation data and, lately here, we have been getting some of that.”

Few anticipate the Fed will lower the federal funds rate at its July meeting, but the outlook for September is good. The probability of a September rate cut was above 90 percent last week, according to the CME FedWatch.

Changing rate expectations disrupted stock markets, last week. Investors moved from big technology firms into smaller companies that tend to perform better when rates are lower. Rita Nazareth of *Bloomberg* explained that the market experienced, “a ‘rotation’ that saw investors trimming positions on this year’s winners in favor of laggards. Underpinning that trade were bets the 2024 rally would broaden out of megacaps as the Federal Reserve cuts rates.”

By the end of the week, the Standard & Poor’s 500 Index was down about 2.0 percent and the Nasdaq Composite had fallen about 3.7 percent. The Dow Jones Industrial Average fared better, finishing the week in positive territory, reported Alex Harring and Jesse Pound of CNBC. Yields on U.S. Treasuries were mixed over the week.

| Data as of 7-19-24 | 1-Week | Y-T-D | 1-Year | 3-Year | 5-Year | 10-Year |
|---|--------|-------|--------|--------|--------|---------|
| Standard & Poor's 500 (Domestic Stocks) | -2.0% | 15.4% | 20.6% | 8.9% | 13.1% | 10.8% |
| Dow Jones Global ex-U.S. | -2.3 | 5.6 | 7.6 | -1.0 | 3.4 | 1.7 |
| 10-year Treasury Note (Yield Only) | 4.2 | N/A | 3.7 | 1.2 | 2.1 | 2.5 |
| Gold (per ounce) | -0.1 | 15.6 | 21.7 | 9.8 | 10.8 | 6.2 |
| Bloomberg Commodity Index | -3.2 | -1.2 | -7.6 | 1.9 | 4.2 | -2.8 |

S&P 500, Dow Jones Global ex-US, Gold, Bloomberg Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT Total Return Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods. Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association. Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable.

MICROCHIP COMPANIES STUMBLER OVER GOVERNMENT POLICY

In general, one aim of governments in democratic countries is to implement policies that promote solid and sustainable economic growth. Sometimes, a policy change—or the possibility of one—will ripple through financial markets. Last week, we saw two examples of this as companies that have benefited from enthusiasm around artificial intelligence saw their share prices drop sharply when it appeared that U.S. government policy might change.

1. **Stricter limits could be imposed on some exports to China.** In one case, a potential change in government policy caused the share price of a Dutch company to drop, reported Adam Clark of *Barron's*. The company produces lithography machines that are necessary for semiconductor manufacturing. The company's solid second quarter earnings report was overshadowed by news that President Biden may impose new restrictions on exports to China. Clark reported that the administration:

"...is considering more severe trade restrictions on exports to China if companies...continue selling chip-making machinery to the country. While the [lithography machinery] company is already restricted from selling its most advanced machines to Chinese customers, [the company] still generated 49% of its revenue from China in the second quarter, as buyers looked to stock up on older machinery."

2. **The United States' relationship with Taiwan may change.** In an interview with *Bloomberg Businessweek*, presidential candidate Donald Trump was asked about the United States' relationship with Taiwan. He answered, "They did take about 100 [percent] of our chip business. I think, Taiwan should pay us for defense."

After the remarks became public, the share price of Taiwan's largest company—the world's largest maker of advanced chips—tumbled, reported George Glover of *Barron's*. The share

price fell even though the company had beaten quarterly estimates and lifted 2024 revenue projections, reported Jane Lanhee Lee of *Bloomberg*.

Other chip companies' stocks moved lower, too, on concerns that a change in U.S. policy could result in new supply chain disruptions. "China's ruling Communist Party has vowed to 'reunify' with Taiwan and has refused to rule out using military force to take back control of the country," reported Glover.

It can be dismaying when the value of a stock or stock market index moves lower. However, falling share prices sometimes have silver linings. They sometimes create opportunities to invest in companies with solid fundamentals at attractive prices.

Best regards,

Andrew Zittell
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Sources:

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* Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features.

* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. You cannot invest directly in this index.

* All indexes referenced are unmanaged. The volatility of indexes could be materially different from that of a client's portfolio. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. You cannot invest directly in an index.

* The Dow Jones Global ex-U.S. Index covers approximately 95% of the market capitalization of the 45 developed and emerging countries included in the Index.

* The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.

* Gold represents the 3:00 p.m. (London time) gold price as reported by the London Bullion Market Association and is expressed in U.S. Dollars per fine troy ounce. The source for gold data is Federal Reserve Bank of St. Louis (FRED), <https://fred.stlouisfed.org/series/GOLDPMGBD228NLBM>.

- * The Bloomberg Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998.
- * The DJ Equity All REIT Total Return Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones.
- * The Dow Jones Industrial Average (DJIA), commonly known as “The Dow,” is an index representing 30 stock of companies maintained and reviewed by the editors of The Wall Street Journal.
- * The NASDAQ Composite is an unmanaged index of securities traded on the NASDAQ system.
- * International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.
- * Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.
- * The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage is often obtainable in commodity trading and can work against you as well as for you. The use of leverage can lead to large losses as well as gains.
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