"Bull markets are born on pessimism, grown on skepticism, mature on optimism and die on euphoria."

~ Sir John Templeton

As we enter a new quarter in an election year, it seems appropriate to reflect on the dynamic interplay between political events and market behavior, which is very much like the symbiotic relationship between voter participation and election outcomes. Just as every vote counts in shaping the political landscape, every market participant's decision contributes to the overall valuation of the stock market.

Political elections are a quintessential demonstration of collective sentiment. Voter turnout reflects the public's engagement and confidence in the political process, much like investor activity mirrors trust in and outlook on market conditions. High voter participation typically signals a robust democratic process, similar to how increased trading volumes can indicate a healthy, liquid market.

A recent example is the recent political swings observed in the French elections. Initial expectations pointed towards a far-right majority, but a record voter turnout resulted in a left-leaning divided government for the second round. Such political shifts create periods of volatility and adjustment as markets react to new policy directions and economic strategies.

Similarly, recent US election events have thrown a curveball into the election outlook, adding another layer of uncertainty to an already unusual year of worldwide political events. These highlight the intricate connections between political developments and market behavior, as investors adjust their strategies based on anticipated policy changes and economic impacts.

Recently, we've observed a notable decline in the trading volume of SPY (the SPDR S&P 500 ETF), indicating a period of reduced investor activity and engagement. This decrease in volume can be interpreted as a sign of market participants adopting a wait-and-see approach, possibly due to uncertainties in the macroeconomic environment or in anticipation of future political developments.

Moreover, the current US market rally is extremely narrow, dominated by a handful of high-profile stocks and not representative of the overall market health and breadth. This phenomenon is particularly concerning in a slowing late-cycle economy, where broader market participation is crucial for sustained growth and stability. Stocks like NVIDIA (NVDA) have shown remarkable performance, yet their success underscores the disparity between leading stocks and the general market conditions.

As we move into the third quarter, understanding some of these parallels can offer deeper insights into market movements. By appreciating the connections between trading volumes, individual stock performances, and market valuation, we can better anticipate and respond to the multifaceted forces shaping our investment landscape.

Our goal is always to provide you with innovative solutions adapted to the uncertainty of investing, guiding you through an optimal allocation according to your financial goals and risk tolerance. Now for my view on the topics affecting your investments.

A CIO's View

These events are monitored daily by our models. We also regularly cover these topics in our monthly Navigator and quarterly Fixed Income Commentary.

Market Return: A Narrow and Negative Quarter

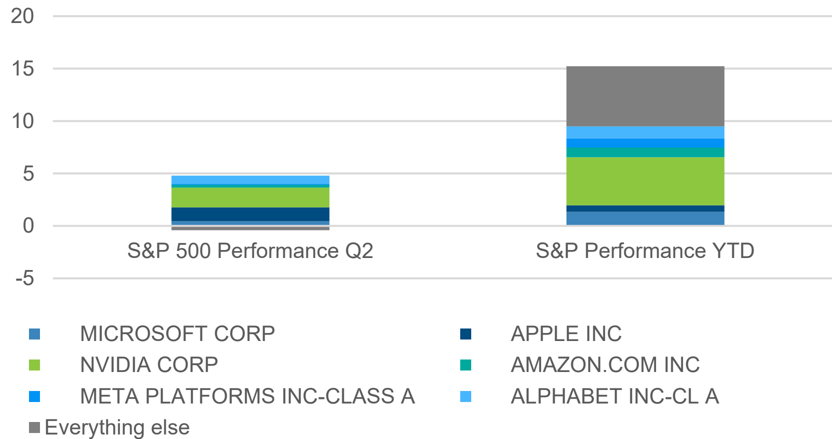
Last quarter we discussed the magnitude of the distortion of index returns caused by the artificial intelligence gold rush and some technology stocks. This quarter is confirming the trend, with potential signs of cooling off.

A few year-to-date statistics: the S&P 500 Index is up 15.05% at the end of second quarter, with 38% of its stocks having negative returns and less than 25% of its stocks beating the index. This is on pace to be a record low when looking at the past 40 years (the next two lowest years are 1998 and 2023). The average stock return is 5.2% while the top six names (Microsoft, Apple,

Nvidia, Amazon, Meta, Alphabet) disproportionately accounted for almost 10% of the 15.05% return YTD (almost two-thirds of the performance).

Now looking at the second quarter the index is up 4.18%, more than entirely attributable to the same six names, while the average stock in the index was down 2.5%, with 58% of the stocks having negative returns (Exhibit 1).

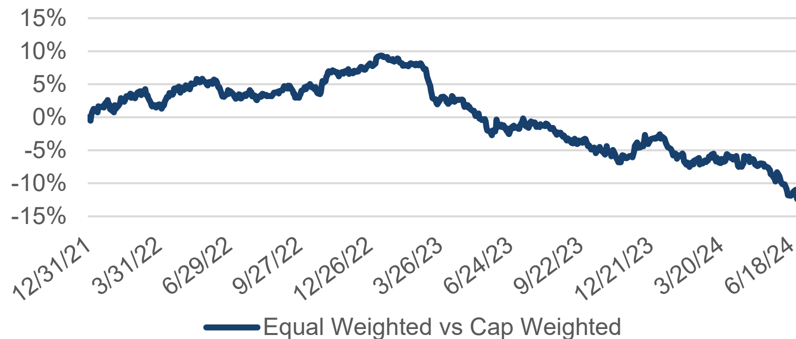
Exhibit 1: S&P Performance Q2 and YTD



Source: Bloomberg.

We like to measure the notion of market breadth by comparing the performance of the equal-weighted S&P 500 Index versus the cap-weighted index performance. You can see below that after a difficult 2023 and Q1 2024, the race between those two indices has gotten even worse over the past few months (Exhibit 2).

Exhibit 2: S&P500 Cap-Weighted vs. Equal-Weighted Performance

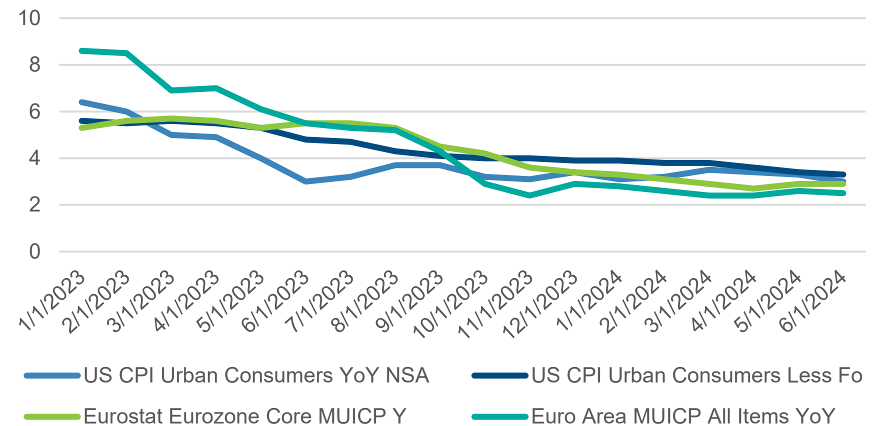


Source: Bloomberg.

Inflation: Improvements so far but resilience ahead

Core inflation has continued to abate but is now doing so slower (Exhibit 3). Core inflation now stands at 3.3%, and headline inflation has now declined to 3%, both declining by 0.5%. While the trend continues to be in the right direction, the pace in inflation moderation is slower than previous quarters and slower than the market anticipated. This quarter the decline was mostly caused by gasoline prices, which tend to be more volatile. We have highlighted in our previous commentaries that possibility and see it becoming the base case for the moment. The markets seem to have integrated this scenario as the new consensus.

Exhibit 3: US/Europe Core Inflation Rates

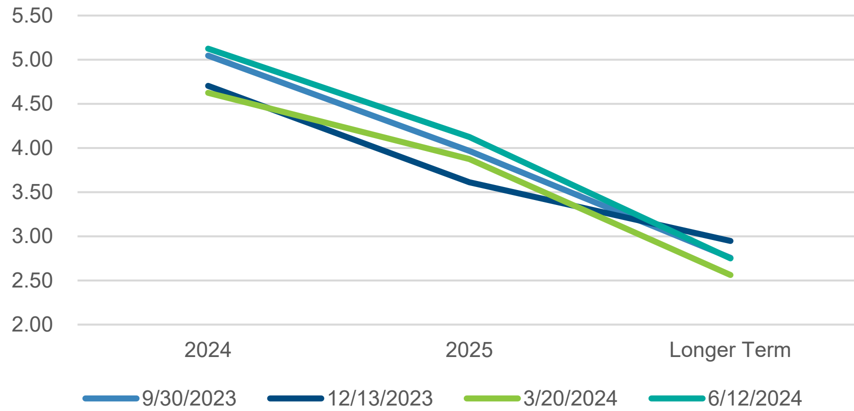


Source: Bloomberg.

Federal Reserve Actions: A First Cut in September?

In May and June, the FOMC continued to pause and maintain its policy rate within 5.25% and 5.5%. While acknowledging the encouraging data, they indicated they're looking for additional data confirmation before taking any action. The tone was to pause, reiterating the 2% inflation target and the need to stay higher for longer, while assessing the strength of the economy and the labor market. The dot plot is now higher than the last one for all horizons (Exhibit 4).

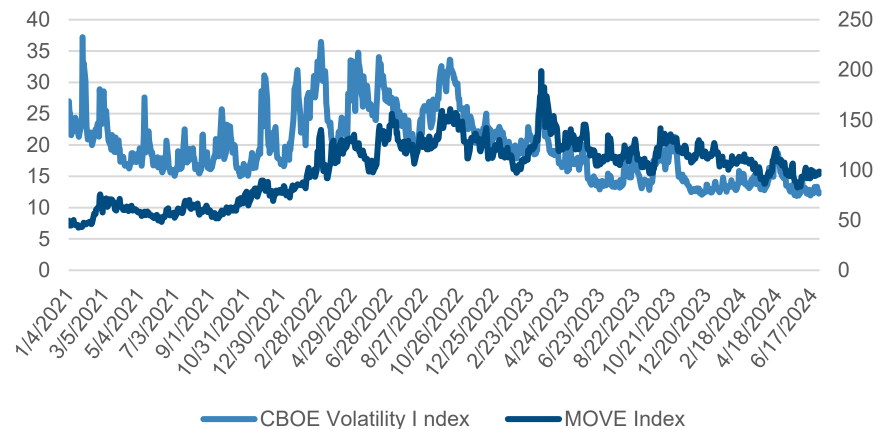
Exhibit 4: FOMC Dot Plots continue to signal high rates for longer



Source: Bloomberg.

Interest rate uncertainty is still high, as can be seen in Exhibit 5. The MOVE Index (implied volatility of a basket of OTC options on US interest rate swaps) illustrates the uncertain environment we are in. With a continuation of the positive trend this quarter, that uncertainty is a little lower than it used to be, indicating that the “higher for longer” scenario might be sinking in. Meanwhile the VIX (Volatility) Index continues at its lows along with tight credit spreads, reflecting the optimism in the economic situation.

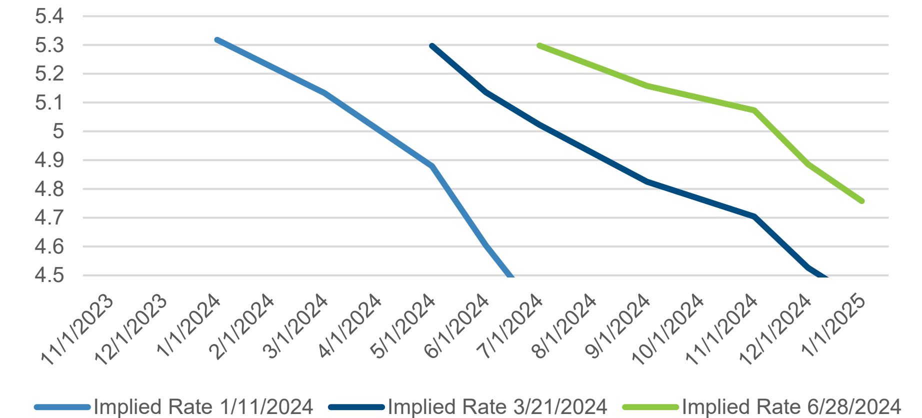
Exhibit 4: The MOVE Index indicate moderating uncertainty in interest rates, while the VIX Index indicates a constructive investment narrative.



Source: Bloomberg.

The rates markets have incorporated this information (Exhibit 6) and are pricing in higher rates for longer, showing an implied rate curve higher than the ones of the last two quarters.

Exhibit 6: Implied Rates have significantly decreased in Q4



Source: Bloomberg.

We continue to see US equities trading at multiples of 24X-27X with some signs of economic slowdown in combination with resilient inflation. The prudent thesis makes risk assets seem overbought, exposing vulnerabilities in US equities. The Shiller CAPE (cyclically adjusted price-earnings ratio) is 36, near the highs of the dotcom bubble. In contrast, the Euro Stoxx 50 is trading at 13X-15X multiples, the FTSE 100 Index trades at 12X-14X, the S&P TSX Index trades at 16-17X, offering viable competing alternatives to US equities. Yield spreads continue to compress and are low by historical standards both in corporate and high yield segments.

Economy: Resilient with a Moderate Slowdown

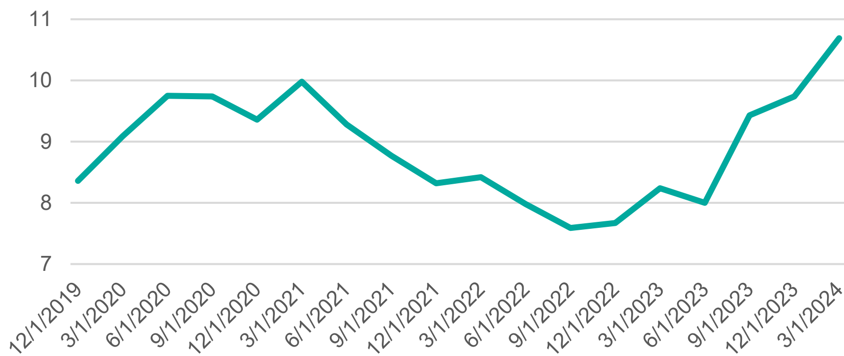
Recession risks have continued to inch lower however more recently recession probability has decreased slightly to a moderate 30%.

For 2024, we are continuing to see some further signs of slowdown which could grow more substantial: personal savings buffers are lower than post-pandemic which could diminish consumer strength, fiscal policy is looking contractionary with the lapsing of past policies, the additional labor participation rate looks more challenging, the delayed impact of variable rate debt is likely to be seen in more corners of the economy, US election

uncertainty, and geopolitical tensions in the Middle East could create additional headwinds.

Credit card delinquencies are rising to levels now higher than the 2020 recession (Exhibit 7).

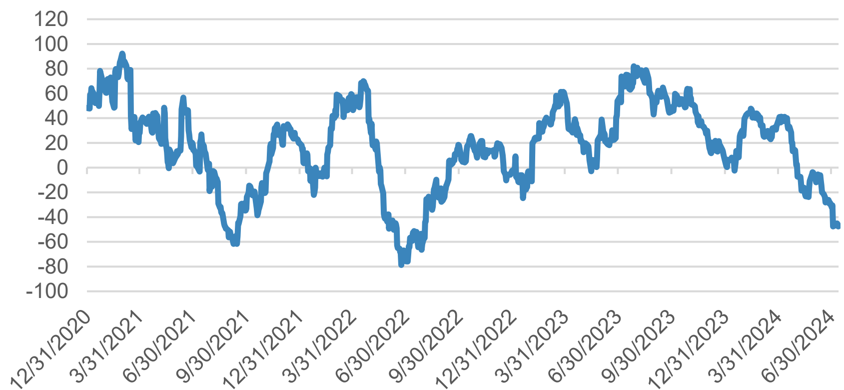
Exhibit 7: Credit Card Delinquencies starting to rise (% of balance delinquent 90+ days)



Source: Bloomberg

Another sign of economic slowdown is the Citigroup Economic Surprise Index which continued to decline over the past quarter, indicating that while still resilient, the US economy is no longer posting as many strong positive surprises as the majority of 2023. This indicator is now firmly in negative territory. (Exhibit 8).

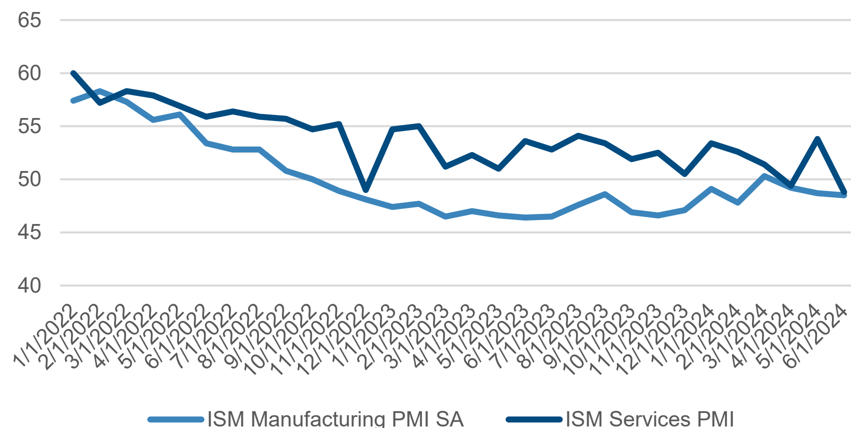
Exhibit 8: The Citigroup Economic Surprise Index indicates how economic data compares with consensus estimates



Source: Bloomberg, Citigroup.

Further signs of a moderate slowdown can be seen in the leading indicators of the PMI ISM surveys (Exhibit 9). Both indices are now at slightly below the neutral 50 level. While the declines seem to have stabilized, they have not shown any clear signs of improvement over the past six months.

Exhibit 9: ISM Manufacturing and Services Indices are in neutral territory



Source: Bloomberg.

US Elections: More uncertainty later in the year

We continue to monitor the election, with some unprecedented developments for both candidates over the past quarter. The outcome of the election could yield significant changes to regulation, fiscal policy, trade policy and foreign policy. Of particular interest are the risks of higher tariffs and increased fiscal spending which could reinvigorate inflation risks. While this aspect is dominating the news, with some uncertainty, we take comfort that it has not yet seemed to impact the markets. We anticipate some volatility as the year progresses and the agendas become more clearly defined between the candidates on fiscal, trade, and regulatory policies.

Investment Implications

Looking forward, it seems that the focus on the Fed and its inflation fight are more of a known-unknown with a reasonable consensus, in the context of a soft landing/higher for longer scenario dominating the narrative. The focus

seems to have started shifting to the magnitude of the economic slowdown and the resilience of the economy amidst political uncertainty and a concentrated bull market fueled by the economic prospects of artificial intelligence. Any evidence of a less than perfect scenario can create vulnerabilities, and some risks of a healthy correction. While we still do not see any major risks to the upside or the downside, the current return/risk environment does not appear the most favorable, thus our cautious stance and willingness to embrace any trading weaknesses to capitalize on future opportunities.

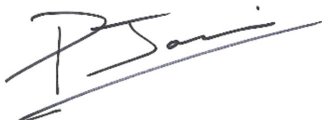
Given the current market conditions we reiterate our recommendations:

- Diversify-Diversify-Diversify: by asset class (bonds, equities, alternatives, options), by investment approach (long, tactical, premium income), by style (active, passive, defined outcome), by benchmark (equal weighted / cap weighted), by geography (US, International …): embrace other scenarios.
- Be realistic and remain cautious and opportunistic in the current environment with active risk management and tactical strategies.
- Follow a systematic and flexible approach and stick with it during episodes of volatility.

As the S&P Index breaks new records this summer and propels certain stocks to very generous levels, keep in mind the recent political gyrations and how quickly a situation which seemed quite certain can evolve.

I hope this letter finds you and your family happy, healthy, and enjoying your summer. If you have any questions about your portfolio or would like to discuss your current positioning, please contact your advisor at any time. Our team always has your interest at heart and stands ready to help meet your goals with the appropriate allocations and proactive financial planning. As always, we thank you for your business.

Warm regards,



Patrick Jamin
President & CIO

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