August 2024

MARKET UPDATE

The second half of July was marked with a period of equity market volatility as a few high-profile earnings reports and future guidance disappointed investors and partially called into question the strength of the AI and cloud tech names that have helped drive the market higher this year. Some of the most watched stocks were down well over 10% at their worst point in July, with NVIDIA shedding over 23% of its market value at one point. However, a rally toward the end of the month helped dampen these drawdowns and allowed the S&P 500 to gain 1.22% in the month. Small caps blew past the S&P 500 in July, with the Russell 2000 gaining 10.16% on the back of a better-than-expected CPI report and solidifying expectations of a Federal Reserve rate cut in September.

As September approaches the yield curve continued to drop across July, with yields on 2-year US government bonds falling 49 basis points, though the 1-month continued to be a bit steadier, ending the month at 5.37%. Beyond the shortest part of the yield curve, the decline in rates further helped bond prices, pushing them out of negative territory on a year-to-date basis.

On the economic front, the economy is performing better than economists had predicted while inflation, at least in the latest report, is improving more than expected. Together with the Federal Reserve’s commentary following their July meeting, the market is fully expecting a September rate cut and asset prices will continue to move in that direction. Overall economic growth in the second quarter showed US GDP grew at an annual rate of 2.8%, doubling the rate of growth from Q1. The June core consumer price index (CPI) increased by 0.1% from May, the smallest rise since 2021, while the overall index fell by 0.1% due to lower gas prices.

ADVISORS’ PERSPECTIVE

Over half of the S&P 500 constituents have reported their earnings so far, with an aggregated surprise and growth of 4.49%, and 11.07%, respectively. The energy sector has seen the largest earnings surprise of 8.44% but has also seen one of the largest declines in earnings growth, decreasing 8.89%. Meanwhile, Health Care has seen the largest earnings growth of 29.56%, with one of the highest aggregated surprise of 6.70%. Earnings and sales of the S&P 500 have seen showing moderate growth over the last several quarters, but so far, earnings surprise is short of the 8.25% seen last quarter.

The US economy grew faster than anticipated in the second quarter, with real GDP accelerating to 2.8% in the second quarter from 1.4% prior, surpassing consensus estimates of 2.0%. Boosts in consumer spending were driven by rebounds in durable goods purchases and moderate increases in services spending. Business investments in inventories, particularly in the auto sector, also grew. Second quarter growth was significantly below the 4.2% average seen in the second half of 2023, due to reduced consumer spending, which fell from 3.2% in the second half of 2023 to just 1.9% in the first half of 2024.

US hiring slowed markedly in July and the unemployment rate rose to 4.3% from 4.1%, an almost three-year high, triggering the Sahm Rule, a recession indicator developed by economist Claudia Sahm. July’s job report fueled fears that the Federal Reserve may be waiting too long to lower interest rates. Consequently, the dollar fell 0.7% on Friday amid heightened concerns about the economic outlook.

July's ISM Services PMI exceeded consensus estimates and remained above contractionary territory, providing the first piece of positive economic news since the July jobs report raised fears of a recession. The services sector was bolstered by gains in employment, orders, and business activity. Notably, the employment component expanded for the first time this year and reached its highest rate since September, providing reassurance amid concerns over declines in the labor market While initial jobless claims saw their largest decline in nearly a year for the week ending August 3, continuing claims have been rising since mid-April. Additionally, with the recipiency rate dropping to 25% in July from 31% earlier in the year, only a quarter of unemployed workers are applying for benefits, diminishing the relevance of initial claims as an indicator of unemployment rate changes.

The VIX (Chicago Board Options Exchange's CBOE Volatility Index) saw its largest intraday jump ever on Monday, increasing by 42 points to over 65. Derivatives analysts attributed the surge to a lack of liquidity and short covering, suggesting the spike might overstate actual market fears, but cautioned against interpreting the lack of liquidity as an all-clear signal for investors.

We remain cautiously optimistic and continue to use a quantitative investing approach. In times of uncertainty, it is more important than ever to follow the data and not make decisions based on emotions. Hilltops partnership with Helios relies on facts and data, which we use during our recalculations on a bi-weekly basis. Our models adjust appropriately to market conditions.

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