

# Quarterly Market Update: Second Quarter 2024

## Executive summary

**THE FOLLOWING IS AN EXECUTIVE SUMMARY FOR THE “QUARTERLY MARKET UPDATE: SECOND QUARTER 2024” REPORT BY FIDELITY’S ASSET ALLOCATION RESEARCH TEAM**



**Dirk Hofschire, CFA**  
Director of Asset Allocation  
Research



**Jake Weinstein, CFA**  
Senior Vice President,  
Asset Allocation Research

**Andrew Garvey**  
Research Analyst,  
Asset Allocation Research

**Azize Engin**  
Research Associate,  
Asset Allocation Research

**Justine Jonathan**  
Research Associate,  
Asset Allocation Research

### Market summary: Stock prices and bond yields rise

Global equity prices posted another quarter of solid gains and added to a stellar one-year performance rebound, aided by signs of improvement across geographies and a solid consumer backdrop in the U.S.

Meanwhile, a rise in U.S. Treasury yields weighed on bond prices amid rising inflation expectations and higher inflation-adjusted borrowing costs. Investors appeared more concerned that the U.S. Federal Reserve may keep interest rates higher than anticipated.

**Global equities advance:** Most global stock categories registered a positive first quarter. Growth stocks, the communication services, sector, and the momentum factor once again powered U.S. equities to the top of the leader board. A rally in gold prices helped push commodity returns into positive territory for the quarter as well.

Non-U.S. stocks outside of Latin America rose, with Japan leading the way. Riskier credit categories, such as leveraged loans and high yield bonds, posted Q1 gains, but more interest-rate sensitive fixed-income categories registered modest losses.

**Large caps led the way:** A continued rally in the stock prices of the largest U.S. companies by market capitalization—concentrated in the technology and communications sectors—once again drove the U.S. equity market’s gain.

After a steep downturn in 2022, the share prices of the largest seven companies have more than doubled since the beginning of 2023. Expanding valuation multiples propelled the bulk of the large-stock gains, as well as the overall market return.

### Economy/macro: A less synchronized expansion

Many major economies, including the U.S., remained in the late-cycle expansion phase and registered hints of stabilization and even reacceleration in some areas.

Expectations of monetary easing have contributed to improving global financial conditions, and worldwide manufacturing activity has firmed. China remained an outlier, as it continued to ease policy in hopes of reaccelerating from its growth slump.

Global cyclical momentum gained steam in Q1 and appeared to broaden across a greater swath of regions and countries. Leading economic indicators improved across a majority of the world's largest economies and an increasing number of countries moved into expansionary manufacturing PMI territory.

Manufacturing bullwhips—leading indicators of industrial activity measured by new orders minus inventories—finished Q1 in positive territory in the U.S. and emerging markets.

**Uneven progress on disinflation:** We believe returning to the stable, low core-inflation backdrop of the past 20 years will be challenging.

Global disinflation trends continued, but progress remained uneven across different geographies. In several developed countries, including the UK, U.S., and Eurozone, persistent core inflation pressures contributed to overall inflation rates remaining above central bank targets.

In contrast, core inflation rates moderated in several emerging market (EM) countries. After leading the monetary cycle by hiking rates first, many EM central banks, particularly in large Latin American economies, have been the first to cut rates.

China's policymakers increased the pace of monetary, fiscal, and regulatory easing measures to support growth. These efforts have contributed to some cyclical stabilization, but it remains uncertain whether they will translate into a full-blown economic reacceleration.

**Fewer Fed cuts are expected:** The Fed continued to signal it would begin easing this year while forecasting higher growth and inflation for 2024. The market's expectations for rate cuts dropped during Q1 to be in line with the Fed's outlook for three cuts (4.6%) by the end of this year.

Historically, stocks and bonds rallied during the period between the last hike and the first cut. So far this time,

stocks and bonds have posted positive returns since the last Fed hike, with stock performance at the upper end of its historical range.

**U.S. consumer strength:** Consumer spending was again supported by solid real wage growth, which continued amid a strong labor market backdrop and ebbing inflation. The long-term, fixed-rate structure of most mortgage borrowing has helped to insulate many households from higher interest rates.

**What about jobs?** Labor markets continued to enjoy a relatively benign softening trend without a major rise in unemployment. Job openings continued to drop from their peak and labor-force participation rates remained high, providing a hint of disinflationary mid-cycle dynamics.

However, labor force growth stagnated in Q1, suggesting that the rapid recovery in participation rates may be nearing its limits. Our demographically adjusted estimates indicate a labor supply recovery that has already overshot the typical late-cycle upswing.

**Investment growth continues:** The growth in business investment and labor-market productivity remained in an upswing. Capital expenditures likely received a boost from AI projects as well as domestic manufacturing reshoring, with new factory construction boosting investment in structures.

If sustained, growth in capital expenditures and productivity could provide a disinflationary path for increased wages and profits that may raise the odds of returning to mid cycle. However, new investments often take multiple years to sustainably raise productivity rates.

**Looking ahead to November:** The November elections will determine who makes the decision on the roughly \$3.5 trillion of 2017 personal income tax cuts that are scheduled to expire at the end of 2025.

Based on CBO projections, the fiscal deficit is expected to remain relatively large over the next several years (5%–6% of GDP), in part due to rising interest-rate payments on federal debt. Politically, spending cuts have become difficult as mandatory outlays on entitlement programs assume a larger share of fiscal expenses.

## Asset markets: Q1 2024 starts strong

Most major U.S. and non-U.S. equity styles and sectors gained in the first quarter. Other than Latin America, non-U.S. global assets advanced as well. Fixed income categories showed mixed results.

**Stock prices:** For the full year, all U.S. stock sectors other than real estate advanced, led by communication services (15.8%) and energy (13.7%). All major stock styles gained as well, led by growth (11.2%) and large caps (10.6%). Outside the U.S., Japan led the way (11.2%), followed by the EAFE region (5.8%).

Valuations became somewhat more expensive amid the Q1 stock rally, especially for the U.S. The trailing one-year price-to-earnings (PE) ratio for U.S. stocks remained well above its long-term average. Emerging markets trailing valuations are slightly above their long-term average, while DM finished below the long-term average.

The expected earnings recovery in the next 12 months implies the forward P/E ratios for all regions are substantially lower than their trailing valuations.

**Fixed income:** Riskier fixed-income categories, such as leveraged loans (2.5%) and emerging market debt (2.0%) gained, whereas U.S. Treasuries and mortgage-backed securities each lost about 1% for the period.

Treasury rates rose during Q1, leading most fixed income categories to end the quarter with yields around their long-term historical averages. Strong corporate and economic trends continued to boost the fundamental

outlook for spread sectors, and credit spreads tightened further in most categories, ending the quarter around the lower end of their historical range.

Overall, fixed-income yields suggest valuations that are roughly in line with long-term averages and better than the past decade of low yields.

**Earnings:** Global earnings growth, which had been decelerating since 2021, appeared to show signs of stabilization during the quarter. Earnings revisions generally steadied, with the U.S. and DM expected to report roughly flat Q1 earnings growth, while emerging markets remained in contraction territory. Investors continue to anticipate a broad-based rebound in earnings growth in 2024 across the world.

Investors expect a double-digit rebound for U.S. earnings growth in 2024 and beyond. With margins still at the upper end of their historical range and signs of diminishing pricing power, the ability of companies to maintain or expand margins will be key to the outlook.

**Currencies:** The U.S. dollar ended the quarter broadly higher versus other major currencies, continuing a period of multiyear strength. Relatively strong U.S. economic growth underpinned the dollar, a position that it had enjoyed for most of 2023.

Most major non-U.S. currencies, particularly the Japanese yen, remained undervalued, suggesting they might provide portfolio diversification benefits to U.S. investors.



## Authors

### **Dirk Hofschire, CFA**

Director of Asset Allocation Research

### **Jake Weinstein, CFA**

Senior Vice President, Asset Allocation Research

### **Andrew Garvey**

Research Analyst, Asset Allocation Research

### **Azize Engin**

Research Associate, Asset Allocation Research

### **Justine Jonathan**

Research Associate, Asset Allocation Research

The Asset Allocation Research Team (AART) conducts economic, fundamental, and quantitative research to develop asset allocation recommendations for Fidelity's portfolio managers and investment teams. AART is responsible for analyzing and synthesizing investment perspectives across Fidelity's asset management unit to generate insights on macroeconomic and financial market trends and their implications for asset allocation.

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*Fidelity Thought Leadership Vice President Mike Tarsala provided editorial direction for this article.*

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