Johnstone Wealth Management
Market Commentary

June 30, 2024

Looking at various key indicators, the global macroeconomic environment has not changed dramatically in the quarter. The service sectors are still enjoying good demand, while the goods sectors have, by and large, normalized after the boom and bust since the pandemic. Inflation is also continuing its bumpy, slow-paced decline, much to the frustration of the bond markets and central bankers. Consequently, with inflation generally still running close to 3%, consumer sentiment remains pessimistic as strong nominal wage gains have been eaten away by cost-of-living increases. While the job market has weakened, it has done so from very strong levels. From a longer-term perspective, we would still characterize today's job market as "tight", given that the unemployment rate is tracking below its natural rate since about 2018.

Global bond markets recorded mixed performance during the second quarter. The Canadian bond market return was 0.9%, with yields under five years declining in response to the widely anticipated interest rate cut of 0.25% (to 4.75%) by the Bank of Canada, while long-term yields rose slightly as they were more influenced by the rise in global interest rates. Corporate bonds underperformed their government bond equivalents after a strong performance in recent quarters. The US bond market posted a negative return with more resilient growth prospects forcing the bond market to price out previously expected interest rate cuts from the Federal Reserve.

Equity markets continued to march higher in the second quarter, driven primarily by a fairly select grouping of Technology securities exposed to growth in Artificial Intelligence (AI) related technologies and applications. This was seen most directly in the ongoing ascent of NVIDIA, the key chip maker for all things AI. Significant evidence of the breadth of this rally (or lack thereof) is the fact that NVIDIA accounted for over 30% of the increase in the S&P 500 this quarter alone. Conversely, the more defensive sectors tended to lag, with Consumer Staples and Healthcare generally among the weaker sectors.

From a geographic standpoint, Technology was a leading driver in most geographies, particularly those more exposed to semiconductors, such as the US. This also supported renewed strength in emerging markets, which was a key theme in the quarter.

In Asia, we saw both Taiwan and China move off their lows, while India also performed well post-election. US markets were also positive, continuing their strong run on the back of ongoing technology strength. In other developed markets, performance was mixed. Japan gave back some gains in the quarter as the yen weakened, while France was also weak due to the snap election gamble enacted by President Macron. The UK and Switzerland fared better, while Canada was towards the lower end of other developed markets in the quarter, as most sectors posted negative returns except for Materials.

Economic conditions have been favourable for profits and equity market valuations. This stands in contrast to expectations for economic growth, which have been downbeat for much of the market's strong performance. Expectations for economic growth, however, have shifted higher and, as such, the stock market can no longer rely on the economy beating low expectations. For further gains, the stock market will now lean more heavily on economic momentum, and therefore earnings growth, particularly with valuations already at historically elevated levels.
Expectations for equity markets returns have also shifted from pessimistic to optimistic in the past two years. While valuations are not at optimistic extremes typically seen at market highs, they no longer provide a tailwind for the market. As a result, a more cautious approach is likely to be more appropriate going forward for the longer term.

Bond markets are somewhat more attractive relative to the low yields on offer in recent years. However, the bullish scenario rests on a continued improvement in inflation and some sort of indication that fiscal excesses will be reined in. The positive economic backdrop of declining inflation and growth looks more obvious in Canada than the US; however, much of this continues to be reflected in the lower Canadian yields. Typically, the start of global easing cycles leads to strong equity and bond market returns and we believe that some of those gains are already reflected in current valuations.

Looking forward, we continue to maintain a cautious outlook as valuations have expanded and there remains evidence that consumers have limited appetite to re-ignite spending in the face of higher borrowing costs. Our focus remains on unique investment ideas underpinned by sound research and valuations, which provide an adequate margin of safety to mitigate against a variety of economic scenarios.

Contact our team of experts today!

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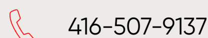

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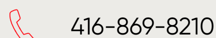

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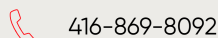

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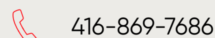

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