Blackshield Capital

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WEEKLY INSIGHTS

A pause in the correction in the financial markets

Dynamics of key assets

Top charts of the week:
- the probability of stagflation is growing
- increase of impact of Magnificent 7
- worsening of low income population's problems

Have a question for the team? CONTACT US

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One of **the most important tasks of an investment firm is** to respond in a timely manner to the challenges of the economy and market conditions. While many risks of a geopolitical and financial nature cannot be predicted, it is worth staying informed to understand what is happening in a meaningful way.

Interest rates, the real estate market, employment and unemployment, inflation and corporate profits are just a few of the variety of factors affecting asset and security pricing.

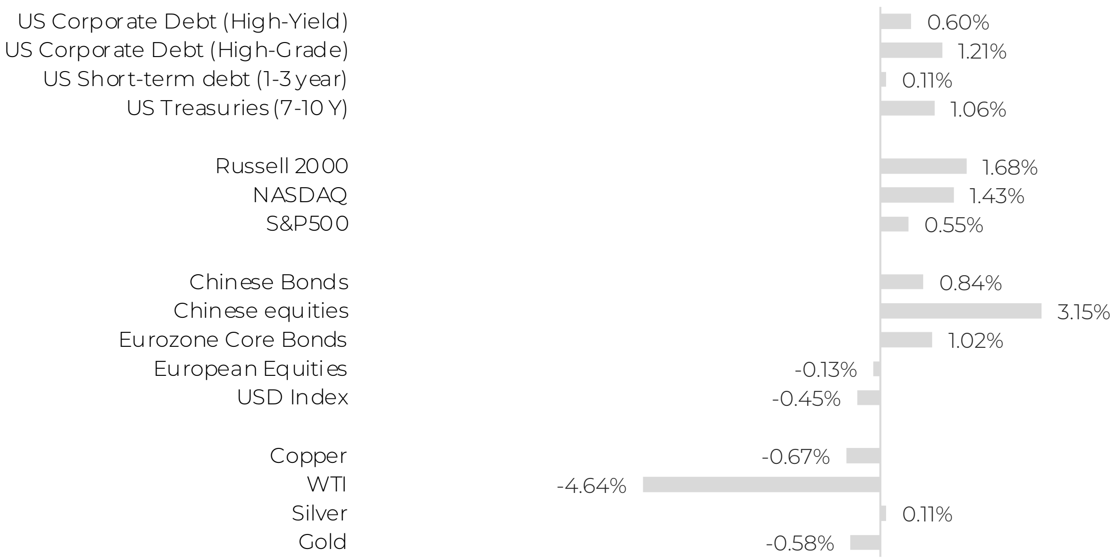
Our goal is to provide a deeper and clearer understanding of what is happening in the markets with an emphasis on illustrations, charts and visuals.

Weekly Insights will provide a more detailed look at industry specifics, delve into the nuances of price mechanics, and provide a more detailed understanding of our strategic vision offered in our quarterly strategic reports.

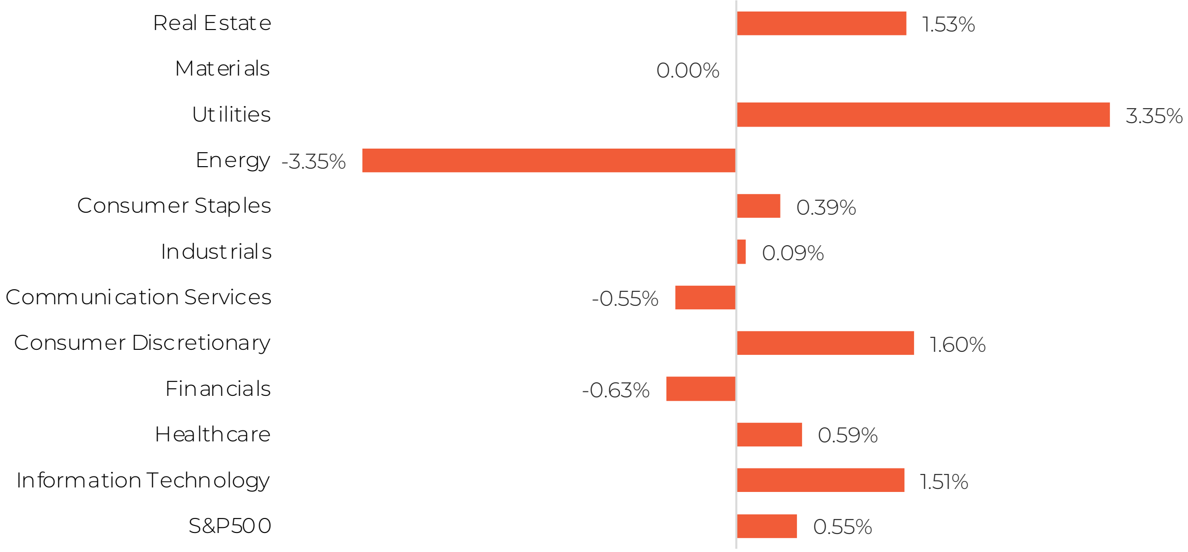
Dynamics of key assets

Last week, positive sentiment continued to prevail regarding the results of earnings reports of the so-called Magnificent 7, partially pushing stock indices to a new wave of growth, which was also boosted by the results of the Fed meeting.

Dynamics by key assets for the week



S&P500 index dynamics for the week



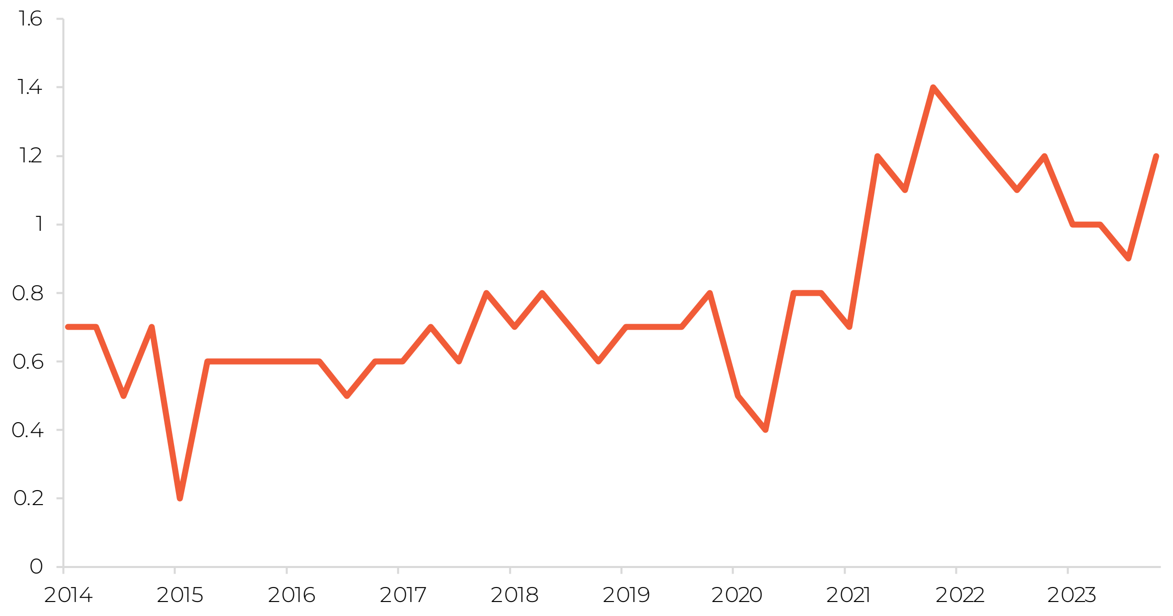
- Both bond and equity markets continued to be somewhat optimistic after the April correction, despite the release of negative macroeconomic data on the labor market, inflation and business activity in the US economy.
- The main reason for this growth was positive earnings season, which was primarily supported last week by the reports of Amazon and Apple.
- On the other hand, oil was the main asset that lagged behind the overall growth of all financial markets. This decline was due to continuing easing of military conflict in the Middle East.

- Looking at the growth of the US stock market by sector, the main driver of the S&P 500 index growth was IT sector, namely Magnificent 7 companies.
- This week we observed a new high level of concentration of Magnificent 7 within the S&P500 index, which has now risen to 34%.
- Looking at the dynamics of other sectors, excluding Consumer Discretionary, which grew mainly due to Amazon and Tesla, the growth of industries was more fragile. This fact indicates a continuation of the trends of previous quarters, which points to a disconnect between the state of financial markets and the real economic situation.

Top charts of the week – the probability of stagflation is growing

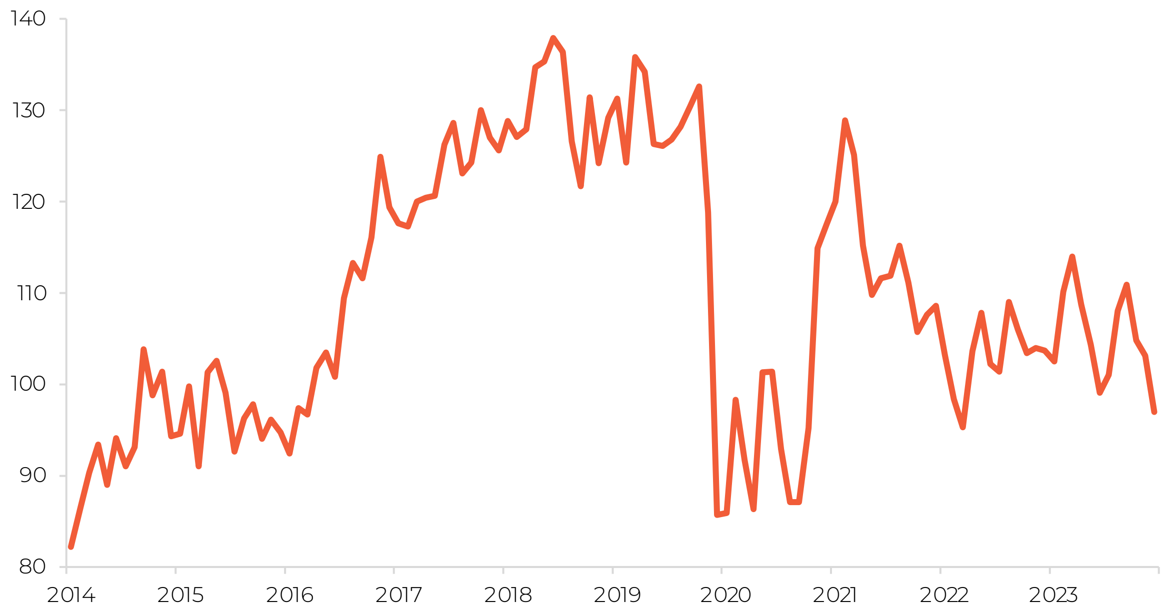
Currently, the economy is facing a controversial situation: on one hand, labor costs are rising, which may push inflation higher, while on the other hand, economic expectations are falling, which suggests a risk of stagflation.

Dynamics of the Employment Cost Index



- Employment Cost Index is one of the main indicators for Fed, as it is the one that the central bank uses to determine the dynamics of wage growth and, accordingly, to forecast the future level of inflation, which is the basis for monetary policy.
- Currently, there is a rapid increase in labor costs (by 1.2% YoY in 1Q 2024), which had one of the largest quarterly increases since 2014 and returned to the level of early 2023.
- This trend, on one hand, indicates economic growth, but on the other hand, it suggests a possible further increase in inflation, which will put pressure on future interest rate cuts.

Dynamics of consumer sentiment in the US

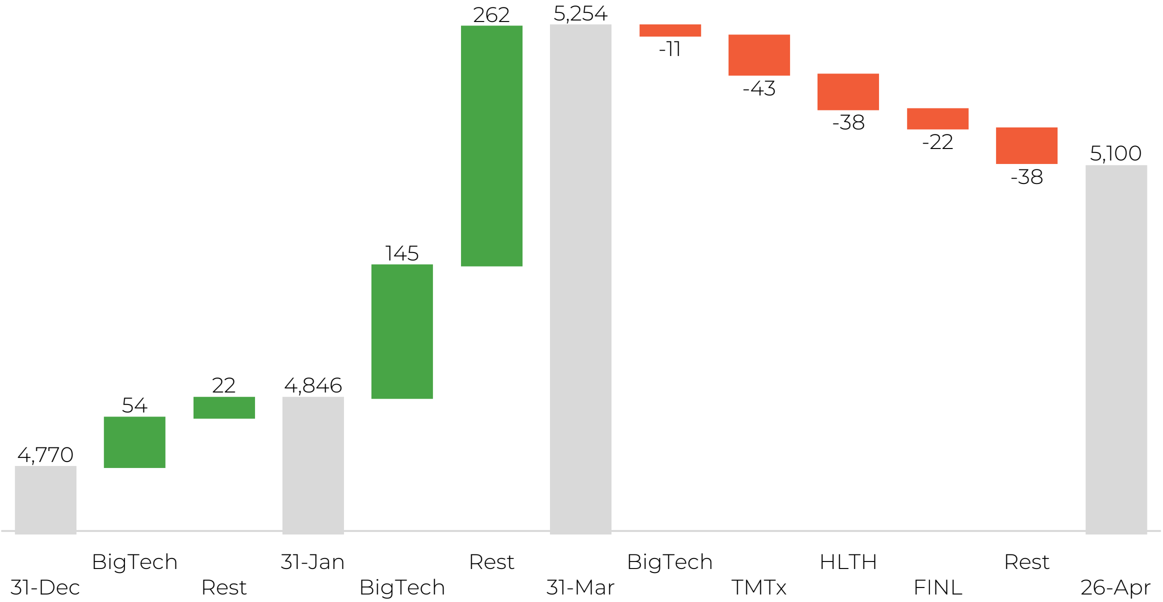


- Despite the increase in wages, consumer confidence has continued to decline since early 2024 and is now almost at the level of 2022. These dynamics also points to a future drop in consumer spending, which is key to maintaining economic activity.
- The main reason for this was a decline in economic expectations among mid and low-income households, whose outlook is deteriorating at a faster pace than other cohorts.
- Therefore, such shifts may point to further stability in inflationary dynamics and rising unemployment, which suggests the risk of stagflation, which is the worst-case scenario for the Fed.

Top charts of the week – Magnificent 7 is gaining attention

Despite April correction, Magnificent 7 remains one of the main market growth leaders, which is currently increasing its concentration within the S&P 500 index to new highs.

S&P 500 Index growth by sector



- Since the beginning of the year, there has been both growth of Magnificent 7 and companies from other sectors of economy (IT, Healthcare and Financials), which significantly influenced market growth in Q1 2024.
- However, despite the market correction in April, Magnificent 7 has maintained its leading growth position since the beginning of the year.
- Indeed, over the past month, most sectors have lost a significant portion of their growth, where the above-mentioned sectors of the economy were among the losers, while the overall Magnificent 7 valuation has been unchanged.

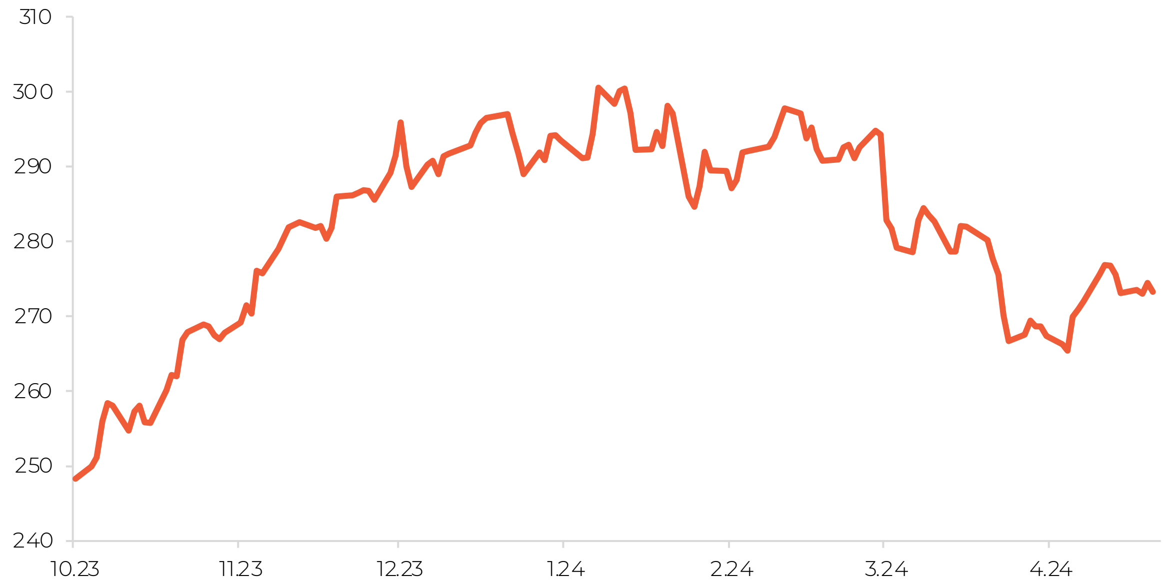
Dynamics of Magnificent 7 relative to S&P493 (excluding Magnificent 7)

- Such dynamics led to a new jump in concentration in the S&P 500 to 34.0% as of the end of April.
- At the moment, given the increase in concentration, the growth of Magnificent 7's valuations is significantly higher than the growth trend of the S&P493 index.
- This trend is rather concerning, as the earnings season, although positive, shows mixed results. On one hand, companies exceed actual expectations, but at the same time demonstrate a slowdown in revenue growth, lower forecasts for the next quarters and focus more on buybacks or increasing dividend payments.

Top charts of the week – negative signals from low-income cohort

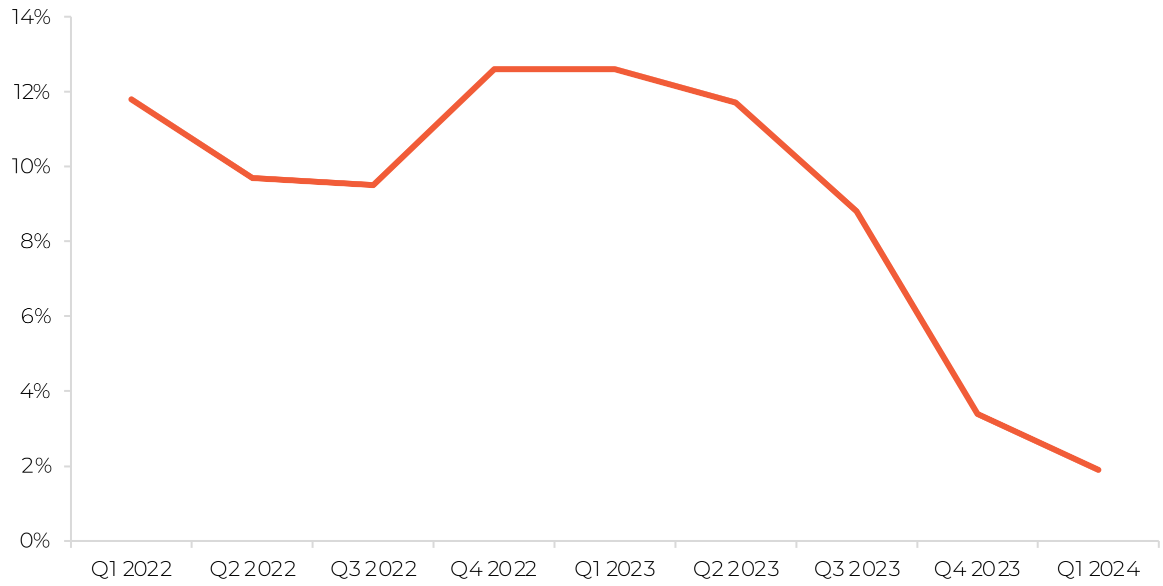
There are reports to which the market reaction may be insignificant, but the fundamental explanation of dynamics of their financial results may indicate the emergence of macroeconomic problems and one of them is McDonald's report for 1Q 2024.

Dynamics of McDonald's share price



- While market's reaction to McDonald's 1Q 2024 report has been quite low, we found management's commentary on sales dynamics as a significant macroeconomic signal.
- The main attention was drawn to comments on the global decline in demand, especially from consumers with average or below-average income level.
- It is worth noting that this group of customers is the most sensitive to changes in income dynamics, inflation and unemployment, so a decline in consumption in this cohort may indicate first negative signals in the economy.

Dynamics of same-store sales growth



- As for the actual results, same-store sales growth in McDonald's restaurants has been declining since 2023 and is currently at 1.9%, which is significantly lower than market expectations.
- In addition, every region where the company operates lagged behind market expectations, including the US market, which is company's main market.
- Population with lower than average income level constitutes main group of McDonald's consumers, so changes in this group trigger negative changes for the company. According to forecasts, this trend may continue, which also reduces expectations for the next quarters.

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