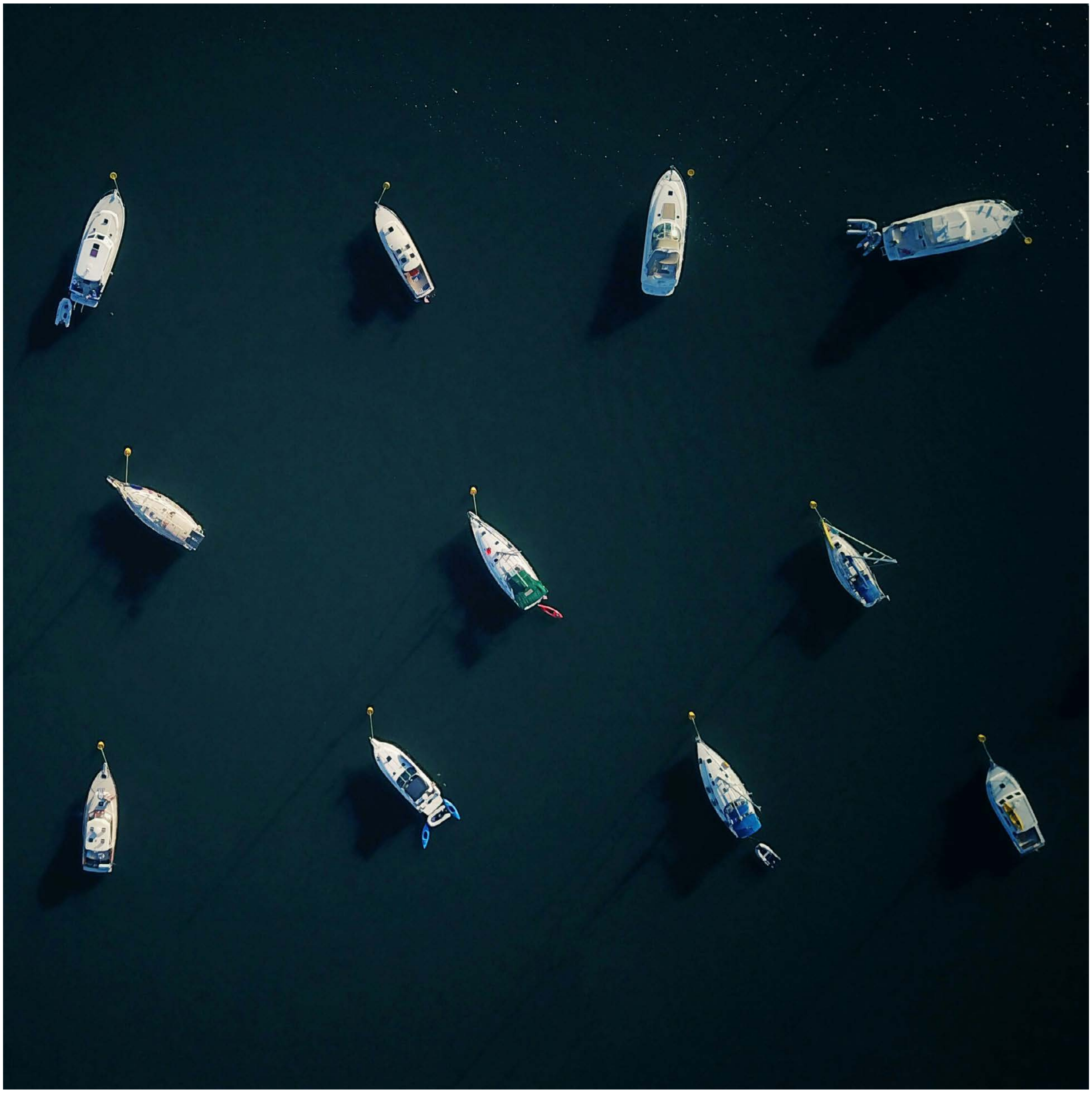
QUARTERLY TRADING REPORT

Q2 2024



RESEARCH

A rising tide doesn't always lift all boats

The second quarter of 2024 was marked by a sharp divergence in U.S. equities, with the Magnificent Seven group of stocks gaining nearly 18% during the April-through-June timeframe, while the other 493 names in the benchmark S&P 500 Index were down a collective 1% on the quarter.

Meanwhile, volatility dominated fixed income markets for the second straight quarter as expectations around U.S. Federal Reserve (Fed) monetary policy shifted, with markets anticipating an initial 25-basis-point (bps) cut in September—a stark reversal from the beginning of the year, when traders were betting that the Fed would begin lowering borrowing costs in March. In foreign exchange markets, the U.S. dollar (USD) held strong and the Japanese yen (JPY) continued its decline, while in derivatives markets, the cost to trade S&P 500 futures in June was the highest in years—even more so than in March.

At Russell Investments, our 35-plus years of experience executing trades for a broad range of institutional clients gives us valuable and differentiated insights into the latest market trends and insights. We trade approximately $2.3 trillion annually through our multi-venue trading platform, and maintain a 24-hour global trading desk with access to over 100 countries across all asset classes. Here are our key observations from the second quarter of 2024.

EQUITIES

Overview

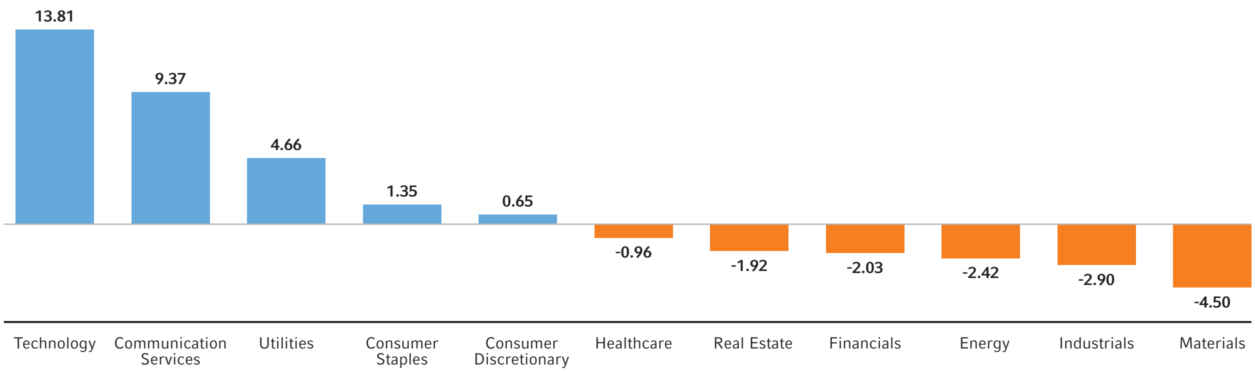
The second quarter of 2024 was marked by both challenges and opportunities. Overall, major global equity indices advanced during the quarter. The euphoria around U.S. tech stocks persisted, while hopes for a soft landing for the U.S. economy were supported by signs of growth in Europe, China, and Japan.

During the second quarter, performance (ex-dividends) for a few of the larger markets included the S&P 500 Index rising by 3.9%, the Hang Seng Index by 7.12%, Japan's TOPIX Index by 1.48%, and the FTSE 100 Index by 2.66%, while the STOXX Europe 600 declined by -0.24%. By the end of June, the S&P 500 had already logged an impressive 31 new closing highs on the year.

Key observations

The artificial intelligence (AI) and tech themes that have been powering markets over the last year-plus remained dominant in the April-through-June timeframe. Case-in-point: Despite six of the 11 sectors in the S&P 500 declining in the second quarter, the U.S. benchmark index reached the halfway point of the year still up 14.5%. The Magnificent Seven group of stocks—consisting of Nvidia, Microsoft, Apple, Amazon, Meta, Alphabet, and Tesla—have turned in strong performances once again, with the group responsible for approximately 60% of the S&P 500's total return in 2024 so far, per the S&P Dow Jones Indices.

S&P 500 TOTAL RETURN IN Q2 2024, BY SECTOR (%)



Source: FactSet

Diving deeper into trading dynamics, global markets saw elevated closing volumes with the MSCI rebalance on May 31, the FTSE rebalance on June 21, and the Russell reconstitution on June 28. The U.S. average daily volume of 11.6 billion shares was down slightly from 11.7 billion shares in the first quarter, as was the average daily turnover of $581.5 billion, versus $619.6 billion in the first quarter. U.S. intraday volatility for both the S&P 500 Index and the Russell 2000 Index remained lower than what was seen from 2020-2023, but this could change during the U.S. elections later this year. Lastly, bid/ask spreads remained relatively unchanged in top global markets.

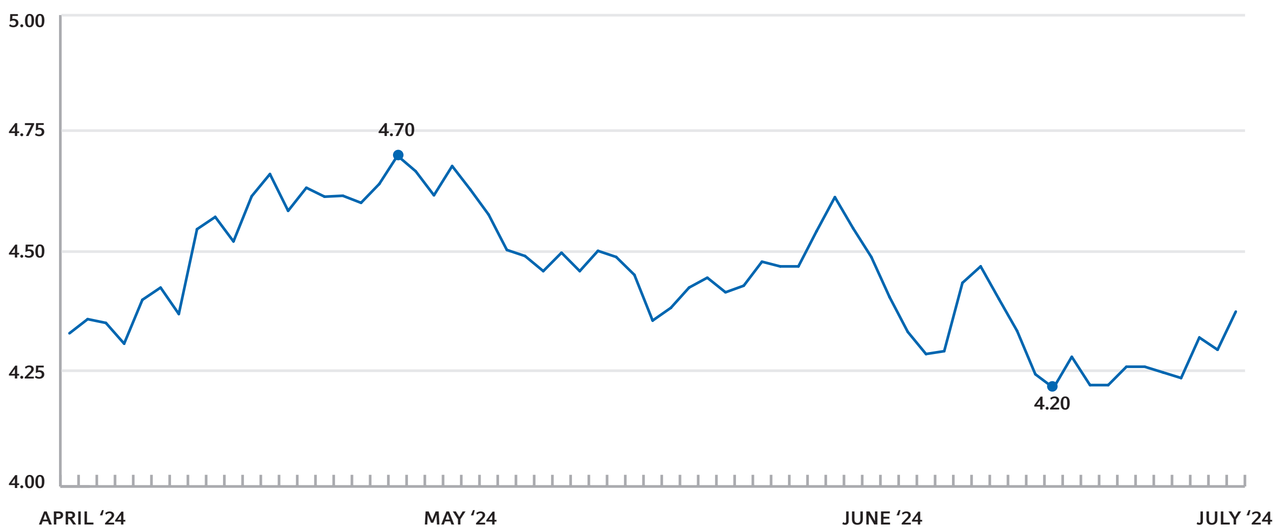
During the third quarter, traders and investors will be keeping a close eye on inflation, interest rates, earnings, global economic growth, and global elections.

FIXED INCOME

The second quarter followed in the footsteps of the first, with continued larger-than-normal volatility in the rates market on the backs of inflation readings and signals about rate cuts from the Fed.

The U.S. 10-year Treasury yield fluctuated sharply during the quarter, at times rising and falling by roughly 50 basis points (bps) in a matter of weeks. The benchmark yield peaked at 4.70% in late April before settling back to 4.20% in mid-June—and 4.18% in mid-July. We continue to see the largest adjustments in the belly of the yield curve—or between Treasury bills with 3- to 7-year maturities. Investors continue to reduce long positions overall, while also buying the dip in larger rate moves to the upside. Duration-wise, firms continue to get shorter, reducing long duration positions and moving into the belly for U.S. Treasuries.

U.S. 10-YEAR TREASURY YIELD (%) DURING Q2



Source: LSEG Datastream

Primary market issuance in credit continues to be on a tear, with $893 billion printed year-to-date, producing the second-largest issuance for the first half of any year after 2020. Additionally, for just the second time on record, every month so far this year has surpassed $100 billion in issuance. Many of these books appear very oversubscribed—in a range of x3 to x5 times over—making allocations very sparse. Primary issuance continues to be the only game in town, with secondary volumes very light over the quarter, with a little pick up in early June. Credit spreads marginally widened over the quarter by 5-10 bps, led by utilities, energy, and materials, with senior unsecured and subordinated debt in financials outperforming.

Overall, investors continue to hold their strategies in place until further guidance emerges from the Fed. The U.S. jobs and consumer price index (CPI) numbers continue to come in muted, with growing expectations for rate cuts in September, as shown by implied rates.

FOREIGN EXCHANGE

The USD remained strong throughout the second quarter, despite lower U.S. yields over the same period. The quarter began with a surge in USD strength, driven by stronger-than-expected economic activity and U.S. inflation data. In light of this, both the *carry* and *momentum* strategies, which were long USD, outperformed. However, both were derailed just a month later when economic activity surprised to the downside instead, leading the USD to broadly retreat in May.

Toward the end of the second quarter, political concerns grew more significant—not just in G10 (Group of Ten) economies, but also in emerging markets, which fuelled demand for the USD as investors searched for a *safe haven* to park their money.

By contrast, the JPY was a notable underperformer among G10 currencies during the second quarter. The ongoing weakening of the JPY was driven by an accumulation of *carry* positions, reflecting not only (1) the Fed's professed reluctance to start cutting rates even though economic data had started to soften, but also (2) a heightened speculation around increased fiscal spending and other more inflationary policies depending on the outcome of the U.S. elections in November.

Meanwhile, the Chinese yuan (CNH) steadily trickled lower as a flurry of policy support measures failed to sufficiently prop up the struggling China consumer and the People's Bank of China (PBOC) allowed the USD/CNY fixing to adjust higher. In Europe, with the trend of European Central Bank (ECB) pricing largely following that of the Fed, rate differentials trended sideways, with the euro (EUR) moving sideways along with it.

DERIVATIVES TRADING

With the S&P 500 posting respectable gains during the April-through-June period, the S&P 500 Index future quarterly roll in June traded at its highest cost in years and was even more expensive than the last quarterly cycle roll in March. CFTC (Commodity Futures Trading Commission) reporting revealed asset managers' net futures positions were at record highs. Robust demand for levered equity exposure (even with the equity market at all-time highs), coupled with the recent common theme of dealer balance sheet constraints, set the stage for these elevated roll costs. The S&P 500 Index future is just one of over 130 different futures products that the Russell Investments derivatives trading desk trades. The desk actively monitors roll periods to discern the optimal roll window.

The CBOE Volatility Index (VIX) is a financial benchmark designed to reflect the market expectation of forward volatility in the S&P 500 Index. It is calculated by using the mid-point of real-time S&P 500 option bid/ask quotes. In our first-quarter report, we noted that the VIX closed the quarter at low levels. At the end of the second quarter, however, the VIX closed even lower.

Why is this index of implied volatility so low? There are, potentially, many reasons. For one, equity markets are rising and yet there has been a distinct lack of hedging activity (other than a brief spurt of activity in mid-April). Realised index volatility has also been low. Large selling flows from burgeoning option-based ETFs (exchange-traded funds) and short-dated options (e.g., 0DTE or the *zero days to expiration* option) are suppressing both implied and realised volatility. Additionally, the increasingly concentrated outperformance of mega-cap tech (i.e., the Magnificent Seven) has caused the correlation between index constituents to drop to multi-decade lows, contributing to the low levels of implied index volatility.

THE BOTTOM LINE

Sometimes, the complete picture of what's really transpiring in markets can be masked by the overall performance numbers. The examples of the S&P 500 Index and the U.S. 10-year Treasury yield during the second quarter demonstrate this all-too clearly, emphasising the need for investor access to a more granular, *under-the-surface* level of detail.

At Russell Investments, we aim to provide exactly this by sharing the latest unique insights and observations from our global trading desk each and every quarter. As an experienced and agile investment solutions provider, we leverage these insights to help deliver scalable solutions that meet the trading and execution needs of asset owners and asset managers alike. Please reach out if you have any questions.

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