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Commerce Trust Market Brief with Scott Colbert
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Scott Colbert: Good morning. It's Monday, November 13th and the markets are open and trending slightly higher. So far this year, the big winner in the financial markets has been the S&P 500 (Index). It's up a total of 16.59% if you include dividends. If we drop down in capitalization to the next 400 largest stocks after those first 500, the so-called Midcap 400 (S&P Midcap 400 Index), returns are only a positive 1.79%. If we go down even further into the Russell 2000 (Index), the 2,000 smaller stocks, after you go through the first 1,000 largest stocks, those returns are actually a negative 1.89% year to date. So, it's been a fairly narrow market, of course driven by S&P 500 returns.

If we drop to the international markets, international returns (as measured by the MSCI EAFE Index) have been positive for larger stocks, up a positive 3.8% so far this year. If we fall down to the smaller emerging market stocks (as measured by the MSCI Emerging Markets Index), those too, like the Russell 2000, have been negative, a negative 84 basis points so far this year. Of course, we all know that bonds haven't been much help at all. The broadest measure of the bond market, the Bloomberg Aggregate (Index), the total return of all the investment grade bonds so far this year is just barely negative 81 basis points, and municipals (as measured by the Bloomberg Municipal Index) have squeaked out a slight positive return, but barely positive 38 basis points.

What explains the narrowness of this stock market return? I think we all have heard, or at least know that it's those largest-cap stocks that have been driving the result. In fact, it's been the so-called "Elite Eight": Meta, which is Facebook, it's Amazon, it's Netflix, it's Microsoft, it's Apple, it's Google, which is now called Alphabet, of course, Tesla, and Nvidia. Those eight stocks on average, this is hard to believe, are up 67% so far this year. If you take the other 492 stocks, they are only up a cumulative 1.7%.

This is the largest differential that we've ever seen between those large eight stocks and the broad market in general. It's important to note this trend has been happening for quite some time. If we go all the way back to 2014, these Elite Eight have driven the returns of the market, in general, higher and higher, and the other 492 have been laggards. Since the end of 2014, the average return per year of those Elite Eight stocks has been a little over 24%. If you take the S&P 500 and you don't include dividends, it's only been up 9%, and the rest of the stock market (S&P 500 ex-Elite Eight) then has only been up about 6% per year.

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Is this narrowness a problem? We don't really think that it's a problem in the sense that you can still have positive stock market returns, but historically, at bottoms in the stock market, you usually get a broadening out of breadth. Most sectors participate, and you get a much broader return. For example, this year, less than a third of stocks are actually up at all. Two-thirds of them are down, where in a typical year, at least half of the stock market is participating, and at bottoms, almost all of the stock market participates in the rally. While the narrowness of the market doesn't suggest the stock market positivity is going to end anytime soon, it does suggest that you ought to be cautious, and it's certainly not indicative of a new start to a bull market.

We're not willing to suggest this is the end of the stock market run, particularly given the seasonals in the year and the fact that we're not in a recession. The economy is clearly cooling, and we are focused on growing unemployment. The three-month moving average of the unemployment rate bottomed at 3.5%. Today, it's about 33 basis points, or a third of a percent higher. Why does that worry us? Because the Sahm Rule, which was crafted by a Federal Reserve bank researcher, suggests that anytime the unemployment rate rises by more than a half a percent, we've ended up in a recession.

This (unemployment) generally is driven from two areas. Number one, a growing increase of newly unemployed, in other words, people that are getting let go, and secondly, an increase in the employment participation rate, or certainly the number of people coming into the employment markets. We have seen a slight increase in unemployment, and we've seen a fairly major increase in those willing to come back to work, including new immigration.

While we're not declaring a recession today or even tomorrow, we do think it's keen to focus on this growing unemployment rate and recognize that even if the unemployment rate rises to about four-tenths or (up to) 4%, that might be enough to tip us into historically what has been considered recessionary territory.

We'll be back in several weeks to dissect some of these employment statistics that we've been talking about and to update you on the financial markets as they work their way towards the end of the year.

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